Ethics Resources
for Accounting Professionals

INTERNAL AUDITORS

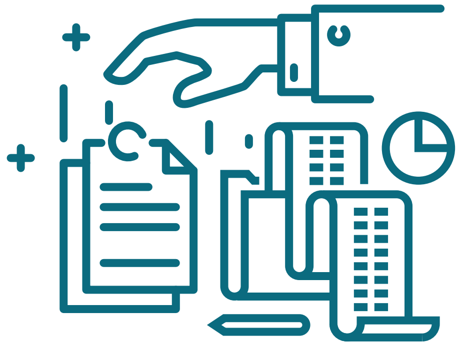
The role of internal auditors is to provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively. They have a professional duty to provide an unbiased and objective view on the operations under evaluation and report to the highest level in an organisation such as the Board of Directors or the Audit Committee. Given their unique roles and duties, internal auditors may face a number of ethical challenges when discharging their duties.

ETHICAL SCENARIOS

Conflicts of interest and personal relationships in workplace

Should I report the non-compliances of my good friends to the management?

Like any members of the company, internal auditors may have developed close friendships with colleagues. They may attend social gatherings with colleagues, e.g. karaoke, dinners, and treat each other with meals and entertainment. How should an internal auditor handle the situation if a number of non-compliances with the laws and the company's policies and procedures by these "good friends" are uncovered during an internal audit?



Interference from management on audit work / findings

Should I follow the instructions of the management to change the audit findings?

Through their work, internal auditors may identify emerging or high risk areas of concern for an organisation. Through their work, internal auditors may make a positive impact on the organisation's operations and generate improvement opportunities. Yet, such opportunities are not always welcome and internal auditors may face pushback from senior management. Some senior management may even instruct internal auditors to put the planned audit work on hold or conduct audit work on other specified areas without any justifications.

Even the most thoroughly researched and fairly presented internal audit reports can generate disagreement. It is not uncommon that internal auditors face pressure from management to suppress or alter the results of audit findings because they reflect poorly on management or some other aspects of the business. When internal auditors resist pressure to change audit findings, they sometimes face consequences, for example, being excluded from meetings for standing their ground on an audit issue, facing budget cuts and even losing their jobs.

Internal auditors should stay alert to the threats as well as understand the requirements under the *Prevention of Bribery Ordinance (POBO) (Cap. 201)* and other relevant legislations. The above situations may create various threats to the *fundamental principles of ethics for professional accountants*.

PREVENTION OF BRIBERY ORDINANCE

According to Section 9 of the Prevention of Bribery Ordinance (POBO), an agent (e.g. an employee, a director), without the permission of his/her principal (e.g. the employer, the company) or any reasonable excuse, solicits or accepts any advantage for doing or forbearing to do any act in relation to his/her principal's affairs or business, shall be guilty of an offence.

Advantage refers to anything that is of value such as money, gift, commission, loan, employment, service or favour, except entertainment. Entertainment refers to the provision of food or drink for consumption on the occasion when it is provided, and any other entertainment connected with such provisions.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

Fundamental principles of ethics for professional accountants

According to the Code of Ethics for Professional Accountants (COE) issued by the HKICPA, there are five fundamental principles of ethics for professional accountants (the fundamental principles):

(a) **Integrity** – to be straightforward and honest in all professional and business relationships.

(b) **Objectivity** – to exercise professional or business judgment without being compromised by:

- (i) Bias;
- (ii) Conflict of interest; or
- (iii) Undue influence of, or undue reliance on, individuals, organizations, technology or other factors.

(c) **Professional Competence and due care** – to:

- (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
- (ii) Act diligently and in accordance with applicable technical and professional standards.

(d) **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships.

(e) **Professional Behaviour** – to:

- (i) Comply with relevant laws and regulations;
- (ii) Behave in a manner consistent with the profession's responsibility to act in the public interest in all professional activities and business relationships; and
- (iii) Avoid any conduct that the professional accountant knows or should know might discredit the profession.

Inducements, including gifts and hospitality

Under section 250 of Chapter A of the COE, an inducement is an object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour. An inducement can take many different forms, for example, gift, hospitality, entertainment, appeals to friendship and loyalty, etc.

A professional accountant shall not accept or encourage others to accept any inducement that is made with the intent to improperly influence the behaviour of the recipient or of another individual. An inducement is considered as "improper" if it causes the individual to act in an unethical manner. The fundamental principles are an appropriate frame of reference for a professional accountant in considering what constitutes unethical behaviour. The determination of whether there is actual or perceived intent to improperly influence behaviour requires the exercise of professional judgment. Relevant factors to consider might include the nature, frequency, value and cumulative effect of the inducement; timing of when the inducement is offered relative to any action or decision that it might influence; the roles and positions of the individuals offering or being offered the inducement, etc.

KEY ISSUES AND TAKEAWAYS

Conflicts of interest and personal relationship in workplace

An internal auditor may commit an offence under the POBO if he/she accepts any advantage (e.g. expensive gift) for not reporting to the management non-compliances with laws or policies committed by colleagues.

Although entertainment is an acceptable form of business and social behaviour, one should avoid accepting lavish or frequent entertainment from persons with whom one has official dealing to avoid placing oneself in a position of obligation. Such situation may create self-interest and intimidation threats to an accountant's fundamental principles. Before accepting an entertainment, an internal auditor should evaluate the level of threats, consider the appropriate actions and safeguards including discussion and/or obtaining approval from the principal. In managing personal relationships at work, an internal auditor should be mindful of any potential or actual conflicts of interest that may call into question his/her professional integrity. For more information about the definition and examples of conflict of interest, ways to handle conflict of interest situations and the possible consequences arising from mishandling of conflict of interest, please refer to the “Topic of Interest” section in the article for “Financial Accountants”.

What’s more, when encountering non-compliance with laws and regulations, an internal auditor shall assess the implications of the matter and the possible courses of action when responding to it. Section 260 of Chapter A of the COE provides a response framework when professional accountants in business encounter or be made aware of non-compliance or suspected non-compliance in carrying out their professional activities.

Interference from management on audit work / findings

Internal pressure is a pervasive threat to the independence and objectivity inherent in internal audit. The interference from senior management on the area of audit work or the pressure exerted on internal auditors to change the results of audit findings create intimidation threat which could compromise the internal auditor’s compliance with the fundamental principles.

In any circumstances, internal auditors shall not allow interference or organisational pressure to compromise their professional ethics or business judgment. They shall be resilient to push through all resistance and work with various parties within the organisation in a constructive manner. To alleviate the pressure, they shall build good working relationship with the Audit Committee as well as the Board to enlist their support. Moreover, they shall always ensure that the audit findings are true and fair in order to build the trust from management and colleagues.

CASE STUDY

WHISTLE-BLOWING

1 Ernest is the Internal Audit Manager of XYZ Co. Ltd., a listed company in Hong Kong.

2 Ernest received an anonymous letter alleging a possible fraud in the company.

3 Following Ernest's diligent investigation, there was evidence showing significant wrongdoing by Margaret, the Purchasing Director who was closely acquainted with the Managing Director.

4 Margaret's malpractices included operating bogus companies to supply materials to XYZ Co. Ltd., accepting secret commissions in awarding contracts and claiming private expenses through the company's accounts.

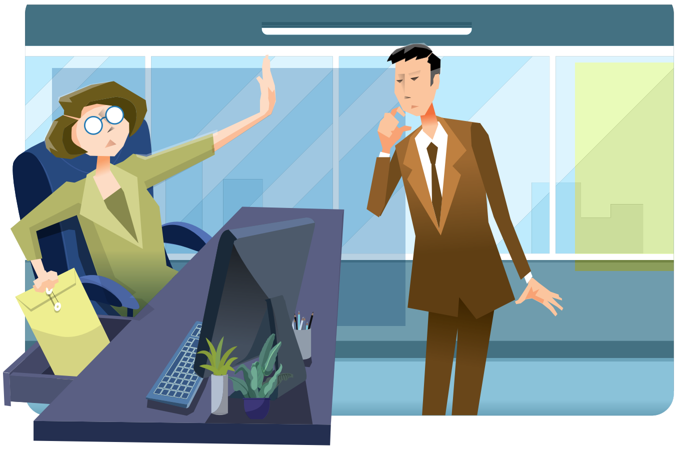
CASE STUDY (CONTINUED)

WHISTLE-BLOWING

5 Ernest presented his findings to the Managing Director and expected appropriate action to be taken by the management.

6 However, the Managing Director criticised Ernest for being over-zealous in the case.

She said that Margaret was a respected senior staff member in the company.



7 The evidence presented by Ernest was questioned in minute details and the accusations were dismissed as minor.

The Managing Director instructed Ernest to stay away from the case.

HOW SHOULD ERNEST REACT?

COMMENTARIES ON THE CASE

Margaret was involved in a conflict of interest situation for operating bogus companies to supply materials to XYZ Co. Ltd. Moreover, she might have breached **Section 9 of the POBO** for accepting secret commissions from other suppliers in awarding contracts for XYZ Co. Ltd. and **Section 9(3) of the POBO** if she intended to deceive her company by using false documents to claim private expenses or to deceive the company in the procurement process.

POBO
According to Section 9(3) of the POBO, it is an offence if an agent intends to deceive his/her principal by using any false or erroneous or defective receipts, accounts or other documents.

In view of the response from the Managing Director, Ernest should **report to the Audit Committee or the Board of Directors** of XYZ Co. Ltd., setting out the details of his findings of Margaret's malpractice.

If the committee or the board does not take appropriate action, then Ernest should consider **reporting the matter to the appropriate authorities** after seeking legal advice. While maintaining confidentiality of company matters is important, Ernest must also consider relevant laws or regulations and weigh the public interest in deciding whether to disclose such matters to the appropriate authorities.

In the worst case scenario, Ernest should be prepared to resign from XYZ Co. Ltd., given that he no longer had confidence in the integrity of those charged with governance of the company.

Audit Committee

According to the Listing Rules, every listed issuer must establish an Audit Committee comprising non-executive directors only and chaired by an independent non-executive director. The Audit Committee must have a majority of independent non-executive directors, a minimum of three members, and at least one of whom is an independent non-executive director with appropriate professional qualifications or accounting or related financial management expertise.

The Audit Committee's tasks include reviewing the company's governance and risk management systems. To achieve this, it should utilise the skills and expertise of the internal audit function, affirming the scope of its work, its priorities and resources. It should also ensure that internal audit is free to work independently and objectively, i.e. free from any influence of those being audited.

COMMENTARIES ON THE CASE (CONTINUED)

Whistle-blowing Policy

According to the **Listing Rules Appendix 14 Corporate Governance Code and Corporate Governance Report** issued by the Hong Kong Exchanges and Clearing Limited, it is a recommended best practice that the Audit Committee establishes a whistle-blowing policy and system for employees and those who deal with the issuer (e.g. customers, suppliers) to raise concerns, in confidence, with the Audit Committee about possible improprieties.

The whistle-blowing policy should include the following and be communicated to all staff:

(a) A statement to encourage reporting of actual or potential misconduct or malpractice by any staff of the company, irrespective of his/her rank, in relation to the company's business;

(b) Examples of misconduct to which the whistle-blowing policy applies, and illustrating the level of substantiation that may justify reporting;

(c) Encouragement of staff to seek guidance from appropriate, designated office(s) in case of doubt about particular situations or practices which may involve or give rise to misconduct or malpractice;

(d) A statement pledging confidentiality of the identity of the whistle-blower and the details of the report, and assurance of fair treatment and protection from retaliation;

(e) A policy against the consequence of knowingly/irresponsibly making false allegations or malicious allegations;

(f) The reporting/consultation channels and reporting mechanisms;

(g) The procedures/mechanism for handling reports; and

(h) A statement pledging timely handling of all reported issues.

TOPIC OF INTEREST

NON-COMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR)

Professional accountants in business may encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out professional activities. Under **section 260 of Chapter A of the COE**, they need to assess the implications of the matter and take the possible courses of action when responding to the non-compliance:

(a) **Understanding the matter -** understand the nature of the act and the circumstances in which non-compliance has occurred or may occur, the relevant laws and regulations, and the potential consequences to the employing organisation, investors, creditors, employees or the public.

(b) **Addressing the matter -** take appropriate steps to have the matter communicated to those charged with governance, comply with applicable laws and regulations, have the consequences of the non-compliance rectified, reduce the risk of re-occurrence, and seek to deter the commission of the non-compliance if it has not yet occurred.

(c) **Determining whether further action is needed -** assess the appropriateness of the response of those charged with governance. In case a professional accountant no longer has confidence in the integrity of those charged with governance, the professional accountant may take further action such as:
- informing the management of the parent entity if the employing organisation is a member of a group;
- disclosing the matter to an appropriate authority to cause the matter to be investigated and action to be taken in the public interest; and
- resigning from the employing organisation.

Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, if the professional accountant determines that disclosure of the matter e.g. bribery, potential harm to public health or safety to an appropriate authority is an appropriate course of action in the circumstances, this **will not be considered a breach of the duty of confidentiality**. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

(d) **Documenting the matter -** document the matter, results of discussions with those charged with governance and their responses to the matter, the courses of action considered, the judgments made and the decisions taken.

A distinguishing mark of the accountancy profession is its responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, professional accountants should always comply with the fundamental principles.

For more details of the above, please refer to section 260 of Chapter A of the COE.

Established under the auspices of the Community Relations Department of the ICAC, Hong Kong Business Ethics Development Centre (HKBEDC) aims to promote business and professional ethics on a long-term basis to sustain a level-playing field in Hong Kong. We offer free ethics training and consultancy services for business organisations and professional bodies.

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