Business Ethics

A Path to Success

September 2007

The Hong Kong Institute of Chartered Secretaries

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GOOD GOVERNANCE COMES WITH MEMBERSHIP

The Hong Kong Institute of Chartered Secretaries is an independent professional body with approximately 4,950 members and 2,700 students. It is dedicated to the promotion of its members’ role in the formulation and effective implementation of good corporate governance policies in Hong Kong and throughout China as well as the development of the profession of Chartered Secretary.

The Institute was first established in 1949 as an association of Hong Kong members of the Institute of Chartered Secretaries and Administrators (ICSA) of London. It became a branch of ICSA in 1990 before gaining local status in 1994.

HKICS issues two sets of post nominals to its Members who qualify locally. One set on behalf of HKICS: FCS for Fellows and ACS for Associates, and one set on behalf of the international body ICSA: FCIS for Fellows and ACIS for Associates.
Hong Kong Shue Yan University was founded in 1971. The idea of an independent liberal arts college was first conceived in the spring of that year when Dr. Henry H.L. Hu, a then Legislative Councillor, and Dr. Chung Chi Yung, a prominent educationist, concerned over the acute shortage of college places for the local Form VI students aspiring after university education, made up their minds to establish an institution of higher learning for the benefit of the youths and in the interests of our society as a whole.

The College was approved to register under the Post Secondary College Ordinance in 1976 and its diploma has since been recognized by the Government as a qualification for appointment to the civil service.

On 19 December 2006, pursuant to the Post Secondary Ordinance (cap.320) approval was given by the Chief Executive in Council for Hong Kong Shue Yan College to change its English and Chinese titles to “Hong Kong Shue Yan University” and “香港樹仁大學” respectively with immediate effect.
FOREWORD

That business ethics is at the core of good corporate governance will come as a surprise to few. That so few Hong Kong companies have a formal and identifiable business ethics code or code of conduct or identify business ethics as a key area when formulating their governance systems, will surprise most people. And so it should.

While much has been made of the recent scandals involving large American companies (proof perhaps that quarterly reporting is not quite the panacea many make it out to be) Hong Kong is no stranger to corporate scandals.

From the 1980s Carrian Group case through to the Peregrine scandal of the 1990s to the 21st century misdeeds of Semi-Tech/Akai Holdings and Euro-Asia, Hong Kong has witnessed some pretty spectacular scandals involving billions of dollars. I do not think that I would be far off the mark when I state that had these companies had a sound code of ethical conduct and a whistle-blowing system in place and embedded into the psyche of the board and management, then such scandals would not, perhaps, have occurred or at least been unearthed at a much earlier stage. That they were not is a sad testimony to what can happen when the ethical compass of a company does not function correctly or is missing altogether.

The recommendations made by The Hong Kong Institute of Chartered Secretaries and our partner, The Enterprise and Social Development Research Centre of Hong Kong Shue Yan University in this research report are clear and well judged. I urge the relevant regulators to give them serious consideration.

Finally I would like to thank all those companies that participated in the survey, our friends and colleagues at Hong Kong Shue Yan University, members of the working group and, as ever, the Institute’s hard working Secretariat.

I hope you enjoy and learn from this report. If just one company formulates a code of conduct or implements a whistle-blowing policy as a result of this report, then it will have been worth the effort producing it. At the very least I would like to think that this report will get those sitting in Hong Kong boardrooms, the regulators and relevant government officials, thinking about the important issue of business ethics.

Natalia Seng
President
HKICS
PREFACE

It is an honour and a pleasure to be invited to write the preface to the Research Report on “Business Ethics, A path to success”.

Corporate governance is a complex, multi-faceted subject involving not only legislation and regulation – although these are essential elements – but also what is usually known as “best practice”, which is very much a matter of corporate culture, mind-set and education. There is an important ethical dimension to running a business. I believe that the standard of governance will depend on the moral values of those in charge, and that a good business ethic must permeate the entire operation from top to bottom and embrace all stakeholders.

As an aftermath of high profile corporate scandals involving giant companies like Enron, WorldCom, the corporate world has started to rethink about their social responsibility and fundamental role in today’s society. An effective business ethics program, apart from providing companies with a marketplace advantage through a set of values and beliefs which help companies to make correct business decisions, can also help to preserve a company’s goodwill, improve its employee morale and add to the competitiveness of the company globally. In this respect Hong Kong has, in the past few years, through the joint effort of various bodies including the Government, the Stock Exchange, the Securities and Futures Commission, etc., introduced new policies and procedures by way of legislation, the Listing Rules or Code of Best Practice to enhance corporate governance and business ethics.

This report contains a clear and well-written introduction to the concept of business ethics, its role and importance, as well as valuable information on the issue from the perspectives of those managing companies listed in Hong Kong. I believe that the report will increase the awareness of business ethics in the business community of Hong Kong and stimulate informed discussion and debate on the various means and ways to enhance business ethics.

For many years, the HKICS has been a strong promoter of good corporate governance and practices. This research report, as I understand it, is the third of a series in the area of corporate governance. I appreciate the continuing effort and dedication of the HKICS to the promotion of good corporate governance in Hong Kong and commend it for the contributions it made in this respect. I also commend Hong Kong Shue Yan University which jointly launches this project with the HKICS for its participation in the promotion of corporate governance in Hong Kong.

Ada Chung
Registrar of Companies
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<td>Acknowledgements</td>
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EXECUTIVE SUMMARY

SURVEY
In April and May 2007, The Hong Kong Institute of Chartered Secretaries and The Enterprise and Social Development Research Centre of Hong Kong Shue Yan University jointly conducted a survey of the 1,150 companies listed in Hong Kong to find out their views on various issues related to business ethics, including drivers for running business in an ethical manner, drivers for and barriers to the issue of a code of ethics, the prevalence of the adoption of a whistle-blowing policy and the provision of ethics training. Sixty-three companies responded to the survey, representing a response rate of 5.48%. The findings of this questionnaire-based survey are summarised as follows.

SUMMARY OF THE FINDINGS
- Ninety-four per cent (94%) of respondents indicate that they have integrated business ethics into their company’s goals, missions and strategies
- Ninety-six per cent (96%) of respondents agree that good business ethics is important and essential for running a successful business
- Ninety-one per cent (91%) of respondents agree that there is a growing concern about business ethics in society
- Eighty-three per cent (83%) of respondents indicate that “enhancement of corporate governance” is a main driver for running business in an ethical manner
- Fifty-nine per cent (59%) of respondents have provided ethics training to their staff
- Fifty-two per cent (52%) of respondents have put a code of ethics in place in their companies
- Of the respondents who have not yet issued a code of ethics, 69% indicate that they have no plan to issue a code in the coming two years
- Eighty-six per cent (86%) of 28 respondents who have not published a code of ethics indicate that making the issue a mandatory legal requirement would be the driver for them to publish one
- Fifty-one per cent (51%) of respondents have put a whistle-blowing policy in place
- Ninety-one per cent (91%) of respondents agree that the issue of a code of ethics should be made a recommended best practice for listed companies
- Seventy-four per cent (74%) of respondents agree that the issue of a code of ethics should be made a code provision for listed companies
- Eighty-seven per cent (87%) of respondents believe that it is necessary for a company to put a whistle-blowing policy in place

SUMMARY OF OUR VIEWS AND RECOMMENDATIONS
It is our view that business ethics is an integral part of a company’s internal controls and risk management system. Not only can it enhance corporate governance; it is essential for running a successful business. Directors and senior management should provide full support and ethical leadership in the promotion of business ethics in a company.

Issuing a code of ethics and a whistle-blowing policy are key tools in promoting business ethics and combating corporate malpractice. However, the survey shows that this good practice is not as widely adopted as it should be in Hong Kong and there is vast room for improvement here.

We also note from our research that Hong Kong seems to have lagged behind other major jurisdictions in providing protection to whistle-blowers. We feel it is time for Hong Kong to assess the need to catch up with international practice.
This research report contains several recommendations and they are summarised as follows:

- The issue of a code of ethics and a whistle-blowing policy should be made a code provision in the Listing Rules for Hong Kong listed companies to “comply or explain”
- In the long run, Hong Kong should enact legislation which provides whistleblowers with statutory protection against retaliation and victimisation
- Ethics training should be provided on a regular basis to all staff, including senior management and directors
- Ethical leadership should be fostered and the directors should actively participate in the promotion of business ethics in the company
BUSINESS ETHICS – AN INTRODUCTION

Business ethics is a set of moral principles, values and standards of conduct for the guidance of business behaviour and is at the core of good governance. The news which hits newspaper headlines almost every day vividly describes the consequences of an absence of or death of business ethics. Corporate fraud by company officers, bribery of procurement managers, food scares, misuse and leaking of customers’ personal data, insider trading, market manipulation, misleading advertisements and all kinds of corporate scandals are the result of many different types of deficiencies in the companies concerned. A lack of business ethics is undoubtedly one such deficiency and most probably the major one. This lack can be manifested in different forms and cover almost every aspect of business. Despite the difference in form and magnitude, corporate scandals do have common features – erosion of public trust and loss of reputation, both of which are very important corporate assets.

SURVEY ON BUSINESS ETHICS

HKICS conducted a survey of 1,150 listed companies in Hong Kong in April and May 2007. The surveyed companies were asked to complete a questionnaire (see Appendix) which sought their views on different issues relating to business ethics. Sixty-three respondents – of which 52 were Main Board issuers and 11 GEM issuers, operating in a wide range of sectors – completed the questionnaire, representing a response rate of 5.48%.

WHAT DO THE RESPONDENTS THINK ABOUT BUSINESS ETHICS?

In order to find out the respondents’ general view on business ethics, they were asked if business ethics has been integrated into their company’s goals, missions and strategies. Ninety-four percent (94%) of the respondents gave an affirmative answer. This shows their belief in the importance of business ethics. This finding echoes another finding of the survey; that 96% of the respondents agree that good business ethics is essential in running a successful business. It is quite clear from the above findings that the Hong Kong business community does acknowledge business ethics as a guiding force to achieve their corporate goals and the success of their business.
Q: Has business ethics (i.e. ethical values based on which a high standard of business behavior is maintained) been integrated into your company’s mission, strategy or corporate goals? (Refer to Question 1 of the questionnaire)

Q: Response to the statement that “Good business ethics is important and essential for running a successful business” (Refer to Part D of the questionnaire)

Far from being ground-breaking, the above findings seem to represent rather than defy common sense. However, instead of taking the findings at face value and concluding that business ethics is necessary when running a successful business, it is worth exploring the benefits of running a business in an ethical manner. The study of the functions and benefits of business ethics is particularly relevant to those who have yet to be convinced of its importance or, for whatever reasons, who do not take business ethics seriously even though they fully appreciate its importance.

WHY IS BUSINESS ETHICS IMPORTANT?
Business ethics is a set of values and beliefs which help companies make the correct business decisions and which help them avoid taking unjustifiable risks and short cuts. In short, business ethics serves as a compass which ensures that the companies stay on the right track. Striving for success within the least possible time is usually one of the objectives of companies operating in a highly competitive market. Under such pressure, it is tempting for companies to cut corners once in a while. If companies have little regard for business ethics and weak internal controls or risk management systems, a market with fierce competition is the perfect breeding-ground for corruption, malpractice and corporate scandals.
The companies surveyed were asked to state the three main drivers (and rank their importance) for running business in an ethical manner.

Fifty-two respondents (83%) chose “enhancement of corporate governance” as one of the three main drivers with 29 of them ranking it as the most important factor. Twenty-nine (46%) chose “minimisation of corruption, fraud and other malpractice” and “strengthening of internal control and risk management” respectively as one of the three main drivers. “To gain loyalty and trust from investors, suppliers and customers” and “to be socially responsible” were chosen by 25 and 23 respondents respectively as one of their three main drivers.

Q: What are the main drivers for running a business in an ethical manner? (Refer to Question 2 of the questionnaire)

1  To enhance corporate governance
2  To be socially responsible
3  To improve financial performance and profitability
4  To minimise corruption, fraud and other malpractice
5  To strengthen the internal control and risk management
6  To gain loyalty and trust from investors, suppliers and customers
7  To address society’s rising concern about business ethics
8  To match competitors’ practice
9  Others

Number of Respondents

Number of Respondents

1st main driver
2nd main driver
3rd main driver

Business Ethics A path to Success
The findings show that an overwhelming majority of the respondents perceive business ethics to be an issue related to corporate governance. There are certain areas in which business ethics and corporate governance coincide. A few concepts embodied by corporate governance – such as transparency, accountability, fairness and integrity – are also principles which business ethics embraces. It is difficult to say whether business ethics is a prerequisite for good corporate governance or vice versa. However, it would be safe to say that the two go hand-in-hand with one reinforcing the other.

The other two most-voted drivers are “minimising corruption, fraud and other malpractice” and “strengthening internal controls and risk management”. A company which has issued a code of ethics and provided regular ethics training to its staff is more likely than not to have honest employees and management who are less prone, if not immune, to corruption and misconduct. The internal controls and risk management system are strengthened by the ethical culture prevailing in the company and by the lower business and reputational risks.

A company with high ethical standards is more likely to gain loyalty and trust from investors, suppliers and customers as the company tends to have a good reputation and better protection against corporate scandals. In 2006, the Institute of Business Ethics in the UK published a synopsis of findings of selected surveys, which had been conducted in 2005, of public and employee perception of ethical conduct within business in the UK and the US. According to a survey of 2,000 members of the UK public during 2005, asking for their opinions on business ethics, 24% of those surveyed indicated that business leaders were among those who are least trusted by the public. Only politicians and journalists ranked below them. While no similar survey can be found in Hong Kong, there is a famous old Chinese saying to the effect that “only those who are cunning can become businessmen” (無奸不成商) which is perhaps an indication that the public perception of businessmen being untrustworthy is also deep-rooted in the Chinese community. This poor image may be attributable to unpleasant experiences which people from all walks of life might have had with businessmen in the past. But it does not mean that the public will continue to accept bad corporate behaviour, especially when the investing public has become more sophisticated and demanding about the ethical standards of the business community. A company which runs its business in an ethical manner tends to have a better reputation; this gives it a competitive edge, enhancing the confidence of its customers, suppliers, lenders and investors.

“To be socially responsible” was chosen by 23 respondents (36.5%) as one of the three main drivers for running a business in an ethical manner. This reflects the public’s increasing belief in good corporate citizenship and corporate social responsibility. The flourishing of socially responsible investments and the assessment of social and environmental risks in project financing by an increasing number of financial institutions in recent years by way of the adoption of the Equator Principles mean that companies which act irresponsibly in their dealings with the public are less likely to obtain support from institutional investors and financiers³.

It is worth noting that 17 respondents (27%) chose “improving financial performance and profitability” as one of their three main drivers. Making profits is perceived universally as one of the prime objectives of commercial corporations. Any value which is not able to further this objective will have little support from the business world as it is divorced from reality. It is therefore significant that some of the respondents (14% chose it as their most important driver) are of the opinion that good business ethics can enhance the profitability of their companies.

³ The Equator Principles is a set of benchmarks for assessing social and environmental risks in project financing. Over 40 financial institutions all over the world have adopted the Equator Principles and they have to ensure that the projects they finance are developed in a manner which is socially responsible and which reflects sound environmental management practices. See http://www.equator-principles.com/index.html
THE PREVALENCE OF MALPRACTICE

Fourteen respondents (23%) confirmed that they have come across misconduct at work during the past 12 months. As the question was not directed at misconduct in their companies, the misconduct that they came across could be either internal or external. In any event, this figure is not particularly high and can be considered to be reasonable.

Q: Have you come across misconduct at work in the past 12 months? (Refer to Question 4 of the questionnaire)

The respondents were also asked to indicate the prevalence of 14 different forms of malpractice in their respective industries/sectors, using a rating system from “1” to “6”. To determine the prevalence of each form of malpractice, “1” (most common), “2” & “3” are collectively interpreted as common whereas “4”, “5” and “6” (least common) are collectively interpreted as uncommon. The findings for all 14 types of malpractice are summarised below.

<table>
<thead>
<tr>
<th>Malpractice</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>N.A.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bribery and corruption</td>
<td>13%</td>
<td>11%</td>
<td>15%</td>
<td>19%</td>
<td>20%</td>
<td>15%</td>
<td>7%</td>
</tr>
<tr>
<td>Conflicts of interest</td>
<td>5%</td>
<td>23%</td>
<td>23%</td>
<td>18%</td>
<td>21%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Abuse of position to obtain personal gain</td>
<td>3%</td>
<td>16%</td>
<td>26%</td>
<td>29%</td>
<td>10%</td>
<td>13%</td>
<td>3%</td>
</tr>
<tr>
<td>Insider dealing</td>
<td>3%</td>
<td>8%</td>
<td>18%</td>
<td>20%</td>
<td>28%</td>
<td>16%</td>
<td>7%</td>
</tr>
<tr>
<td>Unfair competition</td>
<td>2%</td>
<td>5%</td>
<td>30%</td>
<td>18%</td>
<td>20%</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>Improper procurement procedures</td>
<td>3%</td>
<td>15%</td>
<td>24%</td>
<td>25%</td>
<td>18%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Abuse of authority or the use of authority</td>
<td>2%</td>
<td>10%</td>
<td>30%</td>
<td>20%</td>
<td>23%</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>for improper purposes</td>
<td>3%</td>
<td>5%</td>
<td>20%</td>
<td>18%</td>
<td>8%</td>
<td>31%</td>
<td>15%</td>
</tr>
<tr>
<td>Evasion of tax obligation</td>
<td>3%</td>
<td>5%</td>
<td>11%</td>
<td>16%</td>
<td>30%</td>
<td>30%</td>
<td>8%</td>
</tr>
<tr>
<td>Abuse/improper use of IT systems</td>
<td>3%</td>
<td>5%</td>
<td>8%</td>
<td>20%</td>
<td>30%</td>
<td>26%</td>
<td>8%</td>
</tr>
<tr>
<td>False or misleading financial reporting</td>
<td>3%</td>
<td>5%</td>
<td>13%</td>
<td>10%</td>
<td>23%</td>
<td>31%</td>
<td>15%</td>
</tr>
<tr>
<td>Decisions subjected to political influence</td>
<td>2%</td>
<td>3%</td>
<td>10%</td>
<td>25%</td>
<td>15%</td>
<td>30%</td>
<td>15%</td>
</tr>
<tr>
<td>Breach of product safety standards</td>
<td>7%</td>
<td>5%</td>
<td>10%</td>
<td>16%</td>
<td>18%</td>
<td>28%</td>
<td>16%</td>
</tr>
<tr>
<td>Misrepresentation in product or service</td>
<td>2%</td>
<td>3%</td>
<td>16%</td>
<td>16%</td>
<td>21%</td>
<td>29%</td>
<td>13%</td>
</tr>
<tr>
<td>advertisements</td>
<td>7%</td>
<td>5%</td>
<td>10%</td>
<td>16%</td>
<td>18%</td>
<td>28%</td>
<td>16%</td>
</tr>
</tbody>
</table>
The findings in relation to the five most common malpractices are shown by charts below.

**a. Conflicts of interest**
Fifty-one per cent (51%) of respondents chose “conflicts of interest” as a common malpractice (which was ranked “1” by 5%, “2” by 23% and “3” by another 23% of respondents).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>23%</td>
</tr>
<tr>
<td>2</td>
<td>23%</td>
</tr>
<tr>
<td>3</td>
<td>23%</td>
</tr>
<tr>
<td>4</td>
<td>5%</td>
</tr>
<tr>
<td>5</td>
<td>5%</td>
</tr>
<tr>
<td>6 (Least Common)</td>
<td>0%</td>
</tr>
<tr>
<td>N.A.</td>
<td>0%</td>
</tr>
</tbody>
</table>

Usually, conflicts of interest arise when a person has competing interests. As the conflict may compromise a person’s impartiality and ability in discharging duties properly, it will erode the trust placed upon him. Hence, whether it is actual or perceived, conflicts of interest should be avoided and disclosed.

Conflicts of interest arise frequently in a commercial world where individuals commonly play multiple roles. It is usual for a prominent individual to serve on the boards of several companies or organisations at the same time. These multiple roles may increase the chance of conflicts of interest, especially when considering that today’s business deals may involve many parties with complex shareholding structures.

Under common law, a director has the fiduciary duty to avoid conflicts of interest. In the UK, directors will soon face greater challenges than before as the newly enacted Companies Act 2006 has imposed a list of new statutory duties, including a duty to avoid conflicts of interest, on directors. Some practitioners have commented that this is a very wide duty and that it lacks the flexibility of common law. However, the Companies Act does provide a caveat that this duty is not infringed if the situation cannot be reasonably regarded as likely to give rise to a conflict of interest or the matter has been authorised by the directors.

**b. Abuse of position to obtain personal gain**
Forty-five per cent (45%) of respondents chose this as a common malpractice (it was ranked “1” by 3%, “2” by 16% and “3” by 26%).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3%</td>
</tr>
<tr>
<td>2</td>
<td>13%</td>
</tr>
<tr>
<td>3</td>
<td>16%</td>
</tr>
<tr>
<td>4</td>
<td>3%</td>
</tr>
<tr>
<td>5</td>
<td>1%</td>
</tr>
<tr>
<td>6 (Least Common)</td>
<td>0%</td>
</tr>
<tr>
<td>N.A.</td>
<td>0%</td>
</tr>
</tbody>
</table>

Abuse of position to obtain personal gain is also a kind of conflict of interest. For example, the award of a contract by someone in charge of a tender to a related party or even a company owned/controlled by himself without formal disclosure to the company is a blatant abuse of position.

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4 See Section 175 of the Companies Act 2006. The conflicts of interest provisions will come into force in October 2008. The other statutory duties of directors include the duty to act within their powers, to promote the success of the company, to exercise independent judgment and to exercise reasonable care, skill and diligence.
c. **Abuse of authority or the use of authority for improper purposes**

Again, this might also be a product of conflict of interest. Forty-two per cent (42%) of respondents chose this as common malpractice (it was ranked “1” by 2%, “2” by 10% and “3” by 30%).

![Pie chart](image1)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>30%</td>
</tr>
<tr>
<td>2</td>
<td>20%</td>
</tr>
<tr>
<td>3</td>
<td>10%</td>
</tr>
<tr>
<td>4</td>
<td>7%</td>
</tr>
<tr>
<td>5</td>
<td>2%</td>
</tr>
<tr>
<td>6</td>
<td>8%</td>
</tr>
</tbody>
</table>

d. **Improper procurement procedures**

Forty-two per cent (42%) of respondents chose this as common malpractice (it was ranked “1” by 3%, “2” by 15% and “3” by 24%).

Procurement has always been vulnerable to corruption. Excessive purchases, under-the-table deals, leaking tender prices and purchases from connected suppliers are common procurement problems. It is imperative that companies set up checks and balances such as separating the sourcing of suppliers from the assessment of suppliers, and issuing open invitations to tender.

![Pie chart](image2)

<table>
<thead>
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e. **Bribery and corruption**

Thirty-nine per cent (39%) of respondents chose this as a common malpractice (it was ranked “1” by 13%, “2” by 11% and “3” by 15%). This was considered to be the most common form of malpractice; with 13% of respondents choosing it as the most common forms of malpractice (each of the other options was chosen by less than 10% of respondents as the most common form of malpractice).

![Pie chart](image3)

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The business sector in Hong Kong is subject to the Prevention of Bribery Ordinance (PBO) which clearly defines bribery⁵. There is no specific offence called “corruption” in Hong Kong although such an offence exists in the PRC.

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⁵ Section 9 of PBO provides that it is an offence for an agent or an entrusted party, e.g. an employee, to accept an advantage in relation to the business of his principal or entrusting party, e.g. an employer, without his principal’s permission.
As disclosed in the Reports of the Independent Commission Against Corruption (ICAC) Advisory Committees 2006 (ICAC Report 2006), corruption in Hong Kong appears to be under control. The total number of corruption reports fell from 3,685 (2005) to 3,339 (2006) representing a decrease of 9%. The number of corruption reports received in the government sector has also fallen by 8% which is probably due to an increase of outsourcing of work, such as cleaning and security services, to the private sector.

Complaints in the private sector took up a large portion of the corruption reports in 2006, in total 61% or 2,037 cases, a 9% decrease as compared to 2,247 cases in 2005. Building management attracted the largest number of complaints, while the sectors from which the highest number of persons were prosecuted were finance and insurance. A total of 51 persons were prosecuted under s 9 of PBO, representing an increase of 82% as compared to 28 persons in 2005.

According to the ICAC Report 2006, the ICAC has two main concerns. One relates to corruption-facilitated fraud involving directors of listed companies, which undermines the status of Hong Kong as an international financial centre and the confidence of the investing public. The other main concern is cross-jurisdictional investigations with their challenges in terms of the collection of evidence 6.

The other common malpractices are set out below in the order of prevalence:

(i) Unfair competition (37%)
(ii) Insider dealing (29%)
(iii) Evasion of tax obligation (28%)
(iv) Breach of environmental laws or standards (22%)
(v) Breach of product safety standards (22%)
(vi) Decisions subject to political influence (21%)
(vii) Misrepresentation in product or service advertisements (21%)
(viii) Abuse/improper use of IT systems, e.g. leaking of sensitive information (16%)
(ix) False or misleading financial reporting (16%)

Malpractice can take many different forms. Some of those which are not covered above include money laundering, intellectual property fraud and misrepresentation by companies in the IPO stage. Any of these is capable of leading to serious corporate failure or even the collapse of giant corporations, as evidenced in the past by cases such as Enron and WorldCom.

COMBATING MALPRACTICE

There are two ways to combat malpractice: prevention and reporting. All companies should take precautionary measures, such as putting a code of ethics in place and providing training to all levels of staff. It is equally important that any malpractice, once discovered, should be immediately reported to the relevant department or body to ensure that appropriate action, whether legal or disciplinary, is taken.

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6 Refer to the ICAC Report 2006 for further details of the work undertaken by the ICAC during 2006.
a. Reporting of misconduct

When asked whether they would report any misconduct discovered at work to the relevant authorities, 84% of respondents confirmed that they would. Those who said they would not do so gave reasons of “fear of being accused of insufficient evidence” and that misconduct “is not something serious”. Other reasons include “fear of tarnishing the company’s reputation” and “fear of revenge”.

Reporting of misconduct is related to another issue – whistle-blowing – which is examined in greater detail in a subsequent section of this report.

b. Business ethics training

Thirty-seven respondents (59%) indicated that they have provided training on business ethics to staff and management during the past two years. This means that the remaining 41% have not provided any ethics training for at least two years. This seems to be inconsistent with the findings noted earlier in this report, i.e. 94% of respondents indicated that they have integrated business ethics into their goals, missions and strategies and 96% opined that business ethics is important and essential for running a successful business. Clearly there is still a great gap between belief and practice.

Q: Has your company provided any training on business ethics to staff or management in the past two years? (Refer to Question 5 of the questionnaire)

Those who have provided training during the past two years were asked a few additional questions including the target groups for the training, the major areas covered, the frequency of the training and whether they found the training to be effective in cultivating an ethical culture.

When it came to target groups, “senior management” and “general staff” were chosen by 27 respondents (73%) and 24 respondents (65%) respectively. “Procurement managers” and “board of directors” were given training by only 13 (35%) and 11 (30%). While the low rate for the “procurement managers” may partly be explained by the fact that not all respondents employ this category of staff, the lack of ethics training for the board in 70% of respondents that provide regular ethics training is somewhat alarming. This suggests that these companies have not paid sufficient attention to ethical leadership, which is critical for building up an ethical culture and integrating business ethics into their corporate goals and strategies. The importance of ethical leadership is explored in greater detail in a subsequent section of this report.
Q: What is/are the target group(s) of such training? (Refer to Question 5a of the questionnaire)

1. Board of directors
2. Senior management
3. General staff
4. Procurement managers
5. Others

The five major areas covered by the training were “bribery and corruption”, “avoidance of conflicts of interest”, “offer/receipt of gifts or hospitality”, “workplace safety” and “selection of suppliers and transparency in procurement policy”.

It is usual for companies to invite officers from the ICAC to give a briefing on bribery and corruption to their staff. As noted earlier, respondents chose “conflicts of interest” as the most common malpractice and it is also conducive to different kinds of malpractice. “Gifts and hospitality” is also an important area which requires a very clear policy especially on issues such as the appropriateness of the scale, the test for assessing its appropriateness and the value above which disclosure or registration is necessary. “Workplace safety” is closely related to staff well-being and it is important to make sure that no unethical practice exists in this area. Last but not least, tendering and procurement tend to be prone to corruption and appropriate checks and balances should be put in place to avoid abuse of power by the relevant staff. The other areas usually covered in the ethics training are shown in the chart below.

Companies should bear in mind that for the training to be effective, courses should be tailor-made taking into account any type of malpractice which might be more prevalent in their industry. For example, companies which rely heavily on technology should focus on the proper use of IT systems and companies running a retailing business should consider including training on procurement procedures.
Q: What major area(s) is/are addressed in this training? (Refer to Question 5b of the questionnaire)
1. Offer/receipt of gifts or hospitality
2. Bribery and corruption
3. Transparency on tendering procedures
4. Selection of suppliers and transparency in procurement policy
5. Avoidance of conflict of interests
6. Proper use of IT systems
7. Discrimination in the workplace
8. Workplace safety
9. Environmental regulations
10. Others

Turning to the frequency of the training, 14 respondents (38%) provided training on an annual basis. Some provided training twice every year or less than once every year. Seven (19%) only provided training to newly-employed members. This is not a satisfactory arrangement as it means previous training is not updated (especially bearing in mind that some employees might have been with the company for decades).
Out of the 37 respondents which provide ethics training, 32 (86%) stated that they found training effective in cultivating an ethical culture. This positive feedback confirms the usefulness of ethics training and is great reference for companies which have reservations about the effectiveness of this kind of training.

Q: Do you think such training is effective in cultivating an ethical culture? (Refer to Question 5d of the questionnaire)

In combating corporate malpractice, it is also crucial for a company to publish a code of ethics, which is in fact the first step to achieving ethical management and building up an ethical culture. However, only 33 respondents (52%) indicated that they have put a code of ethics in place.

Q: Has your company issued a code on business ethics? (Refer to Question 6 of the questionnaire)
CODE OF ETHICS

A. The 33 respondents which have a code of ethics were asked a few questions relating to its contents and implementation.

a. Contents of the code of ethics

Most of the codes of ethics cover the following major areas:

(i) Accepting/soliciting an advantage (91%)
(ii) Handling confidential information/company property (88%)
(iii) Conflicts of interest (79%)
(iv) Offering an advantage (70%)
(v) Entertainment (64%)
(vi) Reporting channels (58%)
(vii) Observing local laws when working in other countries (48%)

Q: Which of the following areas have your company’s code of ethics provided advice on? (Refer to Question A1 of the questionnaire)

1. Offering an advantage
2. Accepting/soliciting an advantage
3. Entertainment
4. Conflict of interest
5. Handling confidential information/company property
6. Observing local laws when working in other countries
7. Reporting channels
8. Others

While most respondents’ codes dealt with the major topics, it seems that there is not sufficient coverage on “reporting channels” and “observing local laws when working in other countries”.

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If staff are not informed of the reporting channels, they will not know what to do if they discover misconduct. Worse still, they may be led to believe that reporting the misconduct is not important or is an act which they are not encouraged to do. The lack of reporting channels might give staff the impression that the code of ethics is only a guide which is not supposed to be enforced and that no follow-up action has to be taken if any unethical acts are discovered.

The number of companies with overseas operations, especially in the Mainland, is increasing. Staff seconded to other countries should be reminded that they need to observe local laws and maintain high ethical standards while working outside Hong Kong. It is not unusual for expatriate staff to become less wary of the legal pitfalls or forget the importance of business ethics, especially when they are posted to a place where corruption or other malpractice is highly prevalent.

b. Communication channels
Eighteen respondents (55%) have published their code of ethics in public channels such as brochures and corporate websites. Making the code of ethics known to the public including suppliers, contractors and other business partners is a good idea, so that these partners are fully aware of the ethical standard expected of the company’s staff and management. None of the respondents published their code of ethics in their annual report. This is understandable, especially at a time when most annual reports are getting lengthier. However, given the annual report’s role as a major communication channel with the public and the stakeholders, a company may consider putting a brief statement in its annual report on whether it has put a code of ethics in place and if so, whether it has been updated during the relevant period.

Q: Is the code of ethics made public? (Refer to Question A2 of the questionnaire)

![Pie chart showing 45% Yes and 55% No]

Respondents who have not made their codes of ethics public usually circulate them internally through the employees’ handbook (73%), intranet (55%) and internal circulars and memorandums (52%). Briefings on business ethics often occur during staff orientation sessions.

c. Receipt of misconduct reports
As mentioned earlier, reporting misconduct is important in combating malpractice and maintaining high ethical standards in a company. Hence, the reporting line should be clearly stated in the code of ethics. The following chart shows the respondents’ reporting lines.
**Q:** What are the steps which the employees are advised to take if they observe malpractice in your company? (Refer to Question A3 of the questionnaire)

1. Call an ethics or compliance hotline
2. Report to the immediate supervisor or manager
3. Report to the company secretary
4. Report to the legal department
5. Report to the internal audit department
6. Report to the human resources department
7. Report to the board or audit committee
8. Others

"Immediate supervisor or manager" is the most common reporting channel (67%) followed by the "human resources department" (36%). The others include "ethics or compliance hotline" (30%), "internal audit department" (27%), "board or audit committee" (27%), "legal department" (15%) and "company secretary" (9%). Some respondents indicated that their employees are advised to report to the chief executive, operation head, chief financial officer or compliance department.

As seen from the chart, the reporting lines vary from company to company. There is no one single reporting line which can be described as the best. However, there are several criteria which companies should follow in setting their reporting lines: clearness, independence and confidentiality. The reporting lines should be very clear and the individual or department which is delegated with the authority to receive a misconduct report should be impartial and independent. To encourage employees to speak up on the discovery of misconduct, it is extremely important that the details of the misconduct and the identity of the complainants should be kept absolutely confidential. Most importantly, whistle-blowers should be assured that their safety will not be put at stake by making the reports.

d. **Implementation of the code of ethics**

Implementation of the code of ethics involves different processes, i.e. drafting, communication, training, revision, updating and enforcement. Different departments or committees may get involved at different stages. The 33 respondents with codes of ethics were asked to indicate the department or committee which is responsible for implementation of the codes. As no definition of “implementation” was given, they could be very liberal in their interpretation of this question.
Q: Which functional department or independent committee is responsible for the implementation of the code of ethics?  
(Refer to Question A4 of the questionnaire)
1 Legal department
2 Company secretarial department
3 Human resources department
4 Internal audit department
5 Ethics committee
6 Audit committee
7 None
8 Others

The four major departments or committees which are involved in the implementation are the "human resources department" (64%), "internal audit department" (30%), "audit committee" (30%) and "legal department" (24%).

The "human resources department" is primarily responsible for staff training, preparation of the staff handbook and dealing with any other staff related issues. Business ethics is a matter closely associated with the conduct of staff. This probably explains why the majority of the 33 respondents get their "human resources departments" involved in the implementation of their ethics codes.
One of the main duties of the “audit committee” and “internal audit department” is to review and monitor the internal controls and risk management system of a company. While every listed company in Hong Kong must set up an audit committee⁷, they do not have to set up an internal audit department. However, with the increasing importance of internal controls and risk management systems, it seems that more companies have seen the need to establish an internal audit department. A code of ethics which provides staff with a central guide on business ethics is one of the means of strengthening a company’s internal controls and risk management system. This explains the reason why these departments are involved in implementing the company’s ethical code.

It is worth noting that some companies, usually larger ones, have established an ethics committee⁸ to oversee ethical issues, probably alongside other issues related to corporate social responsibility. This is an indication that business ethics has received more attention from the business community in recent years.

The survey’s findings suggest that the “company secretarial department” does not feature prominently in the implementation of codes of ethics. Given the important role of the company secretary in the promotion of corporate governance, which is interwoven with business ethics, the company secretary’s role in the implementation of codes of ethics could be expanded.

When asked whether implementation of codes of ethics involve any senior level participation, all respondents to this part gave an affirmative answer. This shows that this matter has received high level support in their companies. However, the fact that only 45% of the respondents involve their board of directors in implementation of their ethical codes is far from satisfactory. This echoes the earlier finding that only 30% of respondents providing ethics training consider their boards of directors as targets for this training. Both findings, taken together, perhaps indicate that Hong Kong’s business leaders do not participate enough in promoting business ethics. The importance of ethical leadership is further explored in a subsequent section of this report.

Q:  Does the implementation of the code of ethics involve any senior level participation? If yes, it is from... (Refer to Question A5 of the questionnaire)

Participation usually takes the form of “decision making” (82%), “receipt of reports” (42%), “planning” (36%) and “resource allocation” (24%). Reviewing disciplinary measures for misconduct is also a kind of participation, as suggested by one respondent.

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⁷ Rule 3.21 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the Listing Rules) require every listed issuer to set up an audit committee. Code Provision C.3.3 of Appendix 14 to the Listing Rules provides, inter alia, that an audit committee should review the internal controls and risk management system of the listed issuer.

⁸ CLP Holdings has set up a Social, Environmental & Ethics Committee which oversees its positions and practices on issues of corporate social responsibility, principally in relation to social, environmental and ethical matters.
Q: How exactly do they participate? (Refer to Question A5a of the questionnaire)
1 Planning
2 Resource allocation
3 Receipt of report
4 Decision making
5 Others

The key to successful implementation of the code of ethics is to make sure all people within the company fully understand the contents, implications and their responsibilities under the code. Hence, channels should be provided for them to raise queries on ethical issues. Eleven (34%) operate a hotline/helpline for this purpose. Another 11 (34%) provide other channels such as the human resources department, internal audit department, company secretarial department and legal department. However, nine respondents (28%) do not provide any channels for employees to raise queries concerning business ethics. This is a serious loophole which should be rectified.
Q. Does your company provide the following channels to address employees’ queries on business ethics? (Refer to Question A6 of the questionnaire)

1. A hotline/helpline
2. An independent advisor/consultant
3. None
4. Others

Implementation involves enforcement, which is important in establishing the credibility of a code of ethics. Companies should ensure compliance with the code of ethics by all employees and take firm action if any breach is discovered. It is important for companies to adopt a “zero tolerance” approach in respect of any intentional and reckless breach of the code of ethics as any tolerance may be taken to mean that the employer is not serious about enforcement. Companies may also consider taking into account employees’ breach record when they conduct their staff performance appraisal.

Twenty-six respondents (81%) indicated that compliance with the code of ethics is a prerequisite to the commencement or continuation of employment. This policy shows their serious attitude towards their code of ethics and their recognition of the importance of business ethics. Those who gave a negative answer to this question probably do not find compliance with the code of ethics important enough to be a determining factor in any employment. Another possible reason is that they prefer a flexible policy which allows them to take into account the seriousness of any breach before they decide on disciplinary action. While it is a sensible approach to look at the magnitude of the breach and the relevant circumstances before a company dismisses an employee, it is advisable for companies to require any incoming staff to undertake that they will comply with the code of ethics in addition to policies in the staff handbook and elsewhere before employment formally commences.
Q: Is compliance with the code of ethics a prerequisite to the commencement or continuation of employment? (Refer to Question A7 of the questionnaire)

![Pie chart showing 81% Yes and 19% No]

e. Review of the code of ethics and its effectiveness

The effectiveness of implementation of the code of ethics should be reviewed regularly. With the passage of the time and after application for a certain period, weaknesses or even loopholes may become apparent. Upon review, rectification and ways for improvement can be identified. This can strengthen the quality, practicality and enforceability of the code of ethics.

Twenty respondents (61%) measured the effectiveness of the implementation of their codes of ethics through the internal audit function. The other two major measurement procedures were “review by audit committee” (45%) and “staff feedback” (33%). It is rather alarming that five respondents (15%) indicated that they never reviewed the effectiveness of the code of ethics. This is obviously not good practice.

Q: How does your company measure the effectiveness of the implementation of the code of ethics? (Refer to Question A8 of the questionnaire)

1 External audit
2 Internal audit
3 Review by the board
4 Staff feedback
5 Review by audit committee
6 Others
7 None

![Bar chart showing the number of respondents for each method]
A code has to be a “live” document which reflects the changes in the values, priorities and practices of the company. A code of ethics which has lost its currency is simply not relevant and cannot be properly enforced. Ten respondents (30%) conducted yearly reviews. Five (15%) reviewed their codes of ethics either once every two years or more than once every year. Eighteen (55%) indicated that they “review it whenever it is necessary”. This sounds reasonable but is actually not a very reliable or satisfactory policy as it is difficult to decide when the necessity arises. In most cases, since no one has been clearly delegated the duty to decide on this issue, the code may end up not being reviewed for a long time, if at all.

Q: How often is the code of ethics reviewed and updated? (Refer to Question A9 of the questionnaire)

B. A total of 30 respondents (48%) had not put a code of ethics in place at the time of the survey. They were asked if they planned to do so in the coming two years: 29 respondents answered this question, of which 20 (69%) indicated that they had no such plans. This is a rather disappointing finding.

Q: Is your company planning to issue a code of ethics in the coming two years? (Refer to Question B1 of the questionnaire)

Of the nine respondents (31%) which are planning to issue a code of ethics during the next two years, seven (78%) said they would have to get the endorsement of the board of directors. Another seven (78%) indicated that they would instruct an external consultant to help them draft the code and five (56%) said they would conduct a survey of their employees regarding their concerns.
Q: What preparation work do you think is necessary? (Refer to Question B2 of the questionnaire)
1. Get endorsement from the board of directors
2. Seek help from external parties on drafting the code of ethics
3. Conduct a survey of employees to identify the areas of concern or the topics on which specific guidance is required
4. Others

The respondents were asked to give their three main reasons (and rank their importance) for not publishing a code of ethics. Twenty-eight answered this question.

Eighteen (64%) chose “not a legal requirement” as one of the three main reasons with 15 respondents ranking this as the most important reason. This means that these respondents will not issue a code of ethics as long as it remains voluntary practice. In short, they are only willing to comply with the minimum legal requirement.

Nine (32%) indicated that they did not have the in-house expertise. This shows that they felt it would be difficult to put a code of ethics in place and that they would need outside help to achieve this.

Eight (29%) said they doubted the effectiveness of a code of ethics while another eight indicated that they focused on more important matters. Both these findings show that these respondents were not convinced of the benefits and importance of publishing a code of ethics. This is probably a low-priority matter which is not considered to be urgent.
Q: What are the main reasons for your company not having a code of ethics in place? (Refer to Question B3 of the questionnaire)

1. Lack of in-house expertise
2. Implementation is difficult
3. Effectiveness is doubtful
4. Not a legal requirement
5. Budget concerns
6. Our company is small in scale
7. Our staff are honest
8. We focus on more important matters
9. Business ethics is not an issue of concern in our company
10. Others

From the other given reasons, one can see the respondents’ perception (and to a certain extent misconception) of and attitude towards a code of ethics. For example, some believed that having an ethical code is only important for large companies and that publishing such a code is costly. Others indicated that they did not find it necessary because their staff are honest. These reasons probably represent the prevailing beliefs of the business community in Hong Kong.

The respondents were asked to identify the drivers which would encourage them to publish a code of ethics. Twenty-four (86%) chose “mandatory legal requirement”. This is consistent with the above finding that the majority did not publish a code of ethics because it is “not a legal requirement”.

Fifteen (54%) said they need evidence that issuing a code of ethics can enhance the company’s corporate governance. This echoes the earlier finding that 83% of all respondents consider “enhancement of corporate governance” to be one of the main drivers for running business in an ethical manner.

“Evidence of reducing business risks” was chosen by 11 (39%) as the main driver for issuing a code of ethics. This is also an issue closely related to a company’s corporate governance.
The other drivers include “demand from stakeholder group” (32%), “industry norm” (29%) and “supply chain requirement” (7%). The so-called “ethical supply chain management” trend is worth noting. Companies are under increasing pressure from the public and socially responsible investors to make sure their suppliers are also running their businesses in an ethical manner.

Q: What drivers would encourage your company to issue a code of ethics? (Refer to Question B4 of the questionnaire)

1. Evidence that it can enhance the company’s corporate governance
2. Evidence of reducing business risks
3. Mandatory legal requirement
4. Industry norm
5. Demand from stakeholder groups
6. Supply chain requirement
7. Others

WHISTLE-BLOWING POLICY

Whistle-blowing can be defined in a number of ways. In simplest terms, it refers to an act of reporting a wrongdoing within an organisation to internal or external parties. This concept has attracted a great deal of debate in recent years as a result of the infamous corporate scandals, such as Enron and WorldCom, which were brought to light by whistle-blowers.

The respondents were asked if they have a policy (published or unpublished) in handling reported cases of malpractice or whistle-blowing. All except one answered this question. Thirty-seven (60%) indicated that they have such a policy.
Q: Does your company have a policy (published or unpublished) in handling reported cases of malpractice or whistle-blowing? (Refer to Question C1 of the questionnaire)

When asked if they have a whistle-blower protection policy, only 32 out of 63 respondents (51%) gave a positive answer. Coupled with the above finding – that only 60% of respondents have a policy to handle reported misconduct cases and whistle-blowing – it seems that whistle-blowing has yet to receive sufficient serious attention from the Hong Kong business community.

Q: Is there a whistle-blower protection policy in your company (i.e. a policy according to which an employee who has raised concerns about possible malpractice within the company will be protected from retaliation by the concerned party so as to encourage whistle-blowing)? (Refer to Question C2 of the questionnaire)

Twenty-eight respondents (88%) indicated that they would keep the details of the complaints confidential. Twenty-one (66%) would let the whistle-blower remain anonymous. Eighteen (56%) said reported cases would only be “handled by independent personnel with dedicated authority such as independent non-executive directors, the chairman of the audit committee or the internal auditor”. Six (19%) indicated that any retaliation against the whistle-blower would be penalised.
Q: If yes, what are the mechanisms to protect the whistle-blower (i.e. the person who lodges the complaint)? (Refer to Question C2a of the questionnaire)

1. The whistle-blower can remain anonymous if he/she wishes
2. Details of the complaint are kept confidential
3. Reported cases are handled by independent personnel with dedicated authority such as independent non-executive directors, the chairman of the audit committee, or the internal auditor
4. Any retaliation will be penalised with disciplinary action

The concept of whistle-blowing is further explored later in this report.
GENERAL OPINION

Under Part D of the Questionnaire respondents were asked to indicate if they agreed/disagreed (and the extent to which they agreed/disagreed) with several statements. There were six possible answers: “strongly agree”, “agree”, “slightly agree”, “slightly disagree”, “disagree” and “strongly disagree”.

1. **Issuing a code of ethics is effective in ensuring ethical business behaviour in a company**  
Fifty-eight respondents (93%) agreed with this statement to varying degrees (with 12 strongly agreeing, 26 agreeing and 20 slightly agreeing). This result shows that the overwhelming majority of respondents have positive feelings about the usefulness of a code of ethics.

2. **Good business ethics is important and essential for running a successful business**  
Sixty (96%) respondents agreed with this statement (with 27 strongly agreeing, 27 agreeing and 6 slightly agreeing). It is encouraging to note that almost all the respondents recognised the importance of business ethics and regarded it a must for a successful business.

3. **Business misconduct or malpractice is prevalent in our industry or business sector**  
Thirty respondents (49%) agreed with this statement (with two strongly agreeing, 14 agreeing and 14 slightly agreeing). The remaining 32 (51%) disagreed to a different extent (with five strongly disagreeing, 12 disagreeing and 15 slightly disagreeing).

There was no strong correlation between the answers and the sectors in which the respondents operate. Those in the same industry sometimes had very divergent views.
4. Cross-border businesses are particularly vulnerable to potential ethics problems
Fifty-one respondents (82%) agreed with this statement (with six strongly agreeing, 21 agreeing and 24 slightly agreeing). One disagreed and ten slightly disagreed. Nowadays, it is common for companies to have operations outside of Hong Kong, especially in the Mainland. The respondents in agreement with the statement could well have come across ethical problems in connection with their cross-border operations.

5. There is growing concern about business ethics in society
Fifty-six respondents (90%) agreed with this statement (with six strongly agreeing, 31 agreeing and 19 slightly agreeing). Only three disagreed and three slightly disagreed. Hence, it is generally recognised that the public is increasingly concerned about business ethics. Without further analysis, it would be inappropriate to conclude if this is due to the exposure of corporate scandals or malpractice in recent years. However, the power of the media, which places these scandals and malpractice centre stage, cannot be underestimated.

6. Issuing a code of ethics should be a recommended best practice in the Code on Corporate Governance Practices of the Listing Rules (CG Code) for listed companies
This proposal got the support of 55 respondents (91%) (with ten strongly agreeing, 24 agreeing and 21 slightly agreeing). Six respondents did not agree with this proposal (with two strongly disagreeing, two disagreeing and two slightly disagreeing). As recommended best practice is only a guideline, listed companies would have no obligation to adopt the practice. Clearly, all respondents who supported this idea acknowledge the value of a code of ethics and possibly want some guidance from the regulators on this area. However, they probably wish to remain flexible on this issue.

Respondents possibly disagreed for two reasons: because they think it is not necessary to have guidelines from the regulator or because they think a recommended best practice provision would not be sufficient.
7. **Issuing a code of ethics should be a code provision in the CG Code for listed companies**

Forty-five respondents (74%) agreed with this proposal (with seven strongly agreeing, 17 agreeing and 21 slightly agreeing). Sixteen (26%) disagreed (with three strongly disagreeing, five disagreeing and eight slightly disagreeing). The percentage of respondents showing support for this statement is reasonable and probably higher than one would anticipate. It indicates that, for these respondents, this is an important issue which is closely associated with and necessary for the promotion of corporate governance.

According to our earlier finding, only 52% of respondents have put a code of ethics in place and, out of the respondents which do not currently have a code of ethics, about 69% do not intend to publish one in the coming two years. If the issue of a code of ethics is made a code provision, almost half of the respondents would be obliged to issue a code of ethics or else they would have to explain their deviation.

8. **It is necessary for a company to put a whistle-blowing policy in place?**

Fifty-two respondents (87%) showed support for this statement (with 10 strongly agreeing, 22 agreeing and 20 slightly agreeing). Two disagreed and six slightly disagreed. It seems it is generally accepted that it is important for a company to have a whistle-blowing policy.

In this part of the questionnaire, respondents were asked whether they have adopted any other measures to ensure ethical business behaviour in their companies. The following are some of the answers:

a. Established a social, environmental and ethics committee
b. Promote honesty and carefully select senior management
c. Requirement for all staff to acknowledge their understanding and acceptance of the code of ethics
d. Publicising malpractice and disciplinary actions
e. Teaching Confucius’ sayings (論語)
f. Ad hoc training for staff seconded from the PRC
The answers raised some very interesting points which are worth noting.

The establishment of a committee dealing with social, environmental and ethics issues is a new trend. It shows the growing importance of corporate social responsibility and business ethics in the Hong Kong business community.

The suggestion of teaching Confucius’ sayings (論語) as a means of promoting business ethics illustrates the recent trend of reinventing the value and applicability of certain ancient Chinese literature and philosophy to the modern commercial world. This is an interesting phenomenon which seems to be flourishing in Hong Kong. The virtues preached by these ancient literary works are also based on ethics. Concepts such as honesty and loyalty are essentially the same as or highly similar to today’s ethical concepts of integrity and avoidance of conflicts of interest.

Last but not least, ad hoc training for the staff or management seconded from the PRC shows that the possible cultural differences and the lack of understanding of local laws are of concern to some companies which might see fit to organise tailor-made ethics training for seconded staff.

The respondents were also asked if they had any other comments on business ethics issues.

Concerns were raised about the difficulty of implementing and measuring the effectiveness of a code of ethics. One respondent felt that a code of ethics is only produced for junior staff to read. This respondent’s main concern was with enforcement.

Another respondent supported the idea of making a code of ethics and whistle-blowing policy mandatory on grounds that these are already mandatory in the US and there is no reason why Hong Kong should be an exception. This respondent pointed out the importance of having a code of ethics and whistle-blowing policy when operating a business in Hong Kong.

In deciding whether to publish a code of ethics and a whistle-blowing policy, it is necessary for the corporation to have a full understanding of these policy’s functions. In the following sections, the functions of and rationale for putting a code of ethics and a whistle-blowing policy in place are studied.
WHY IS IT NECESSARY TO HAVE A CODE OF ETHICS?
The survey uncovered a dichotomy: while the overwhelming majority of respondents (93%) agreed that issuing a code of ethics is effective in ensuring ethical business behaviour in a company, only slightly more than half (52%) have published a code of ethics.

A code of ethics is the first step to achieving ethical management. It serves several important functions which include the following:

a. A central guide and a road map setting out the ground rules for ethical conduct within the company which provides guidelines for employees’ behaviour and supports management’s day-to-day decision-making
b. A disclosure of values, missions, and principles which the company upholds
c. A tool to encourage discussions of ethics among employees and improve their ability to deal with ethical dilemmas which they come across in their daily work

A well drafted and properly implemented code of ethics can help reduce costs and enhance profits by:

a. Reducing fraud, corruption and other malpractice
b. Enhancing the trust of stakeholders such as shareholders, customers, suppliers, creditors and staff
c. Reducing conflicts of interest
d. Enhancing the company’s reputation

The code’s content may vary substantially across corporations depending on the industry involved. Some industries are governed by certain specific requirements or regulations which may have to be reflected in a code of ethics. Usually, the major topics to be included in a code include conflicts of interest, handling of confidential information, relationships with suppliers/contractors, offer and acceptance of advantages and entertainment.

A clearly drafted code of ethics is not in itself enough. To ensure that its functions can be served and the intended benefits can be obtained, its content needs to be properly communicated to staff of all levels, and it must be regularly revised and updated. Last but not least, regular training should be provided to staff so that they can have a high level of confidence in making decisions which address ethical challenges.

HOW SHOULD A CODE OF ETHICS BE INTRODUCED IN HONG KONG?
Though a code of ethics is perceived as an effective tool in promoting business ethics, many Hong Kong listed companies still have not published one. According to the survey, only a minority (31%) of respondents which currently do not have a code of ethics are planning to issue one in the coming two years. Many of them indicated that “not being a legal requirement” is their reason for not creating an ethics code. If this is the main barrier, should the creation of a code of ethics be made a mandatory requirement in Hong Kong?

Before Hong Kong decides on this issue, it is prudent to make reference to the regulatory frameworks in other major markets. Issuing a code of ethics is voluntary in most jurisdictions including the UK. However, the US and Australia do have different levels of requirements on this area.

9 Refer to the information kit for business organisations entitled “Business Ethics – Your Way to Success” published by the ICAC for a sample code of ethics.
A. The US

In the US, the Securities and Exchange Commission (SEC) adopted final rules implementing s 406 of the Sarbanes Oxley Act (SOX) in January 2003\(^{10}\). Pursuant to the final rules, every public company should disclose whether it has adopted a code of ethics that applies to its key officers, and if not, why not.

The SEC final rules define “code of ethics” as written standards that are reasonably designed to deter wrongdoing and to promote:

- Honest and ethical conduct including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships
- Full, fair, accurate, timely and understandable disclosure in reports and documents that a company files with or submits to the SEC and in other public communications made by the company
- Compliance with applicable governmental laws, rules and regulations
- The prompt internal reporting of any violations of the code of ethics to an appropriate person or persons identified in the code of ethics
- Accountability for adherence to the code of ethics

Expanding on s 406, in 2003 the SEC approved the final New York Stock Exchange (NYSE) Corporate Governance Rules which were later codified in the NYSE Listed Company Manual and under which every company listed on the exchange has to adopt a code of business conduct and ethics for its directors, officers and employees. The code must contain the topics specified in the NYSE Listed Company Manual and the compliance standards and procedures that will facilitate the effective operation of the code. The code must also require that any waiver of the code for executive officers or directors can only be made by the board or a board committee and must be promptly disclosed to shareholders\(^{11}\). In addition, the code should be made available on the company’s website.

B. Australia

Companies listed on the Australian Stock Exchange (ASX) have to comply with the Principles of Good Corporate Governance and Best Practice Recommendations which were issued in 2003, and which were revised in August 2007 and renamed the ASX Corporate Governance Principles and Recommendations (Revised Principles).

Under the Revised Principles, which will take effect in the first financial year commencing on or after 1 January 2008, companies listed on the ASX are recommended to “establish a code of conduct and disclose the code or a summary of the code as to (i) the practices necessary to maintain confidence in the company’s integrity; (ii) the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders; and (iii) the responsibility and accountability of individuals for reporting and investigating reports of unethical practices”. This recommendation is based on the principle of promoting ethical and responsible decision-making. The listed companies are reminded that the making of ethical and responsible decisions does not merely mean compliance with their legal obligations. They should also consider the reasonable expectations of their stakeholders including shareholders, employees, customers, suppliers, creditors, customers and the broader community in which they operate\(^{12}\).

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\(^{10}\) See s 406 of SOX which directs the SEC to issue rules requiring a company that is subject to the reporting requirements of ss 13(a) or 15(d) of the Exchange Act to disclose whether or not the company has adopted a code of ethics for its senior financial officers.

\(^{11}\) See s 303A of the NYSE’s Listed Company Manual.

The “comply or explain” approach applies to the recommendations set out in the Revised Principles. Companies have to make a disclosure in their annual report stating the extent to which they have adopted these recommendations in the reporting period and giving reasons for not following them as appropriate\textsuperscript{13}.

C. Hong Kong

After looking at the regulatory frameworks in the US and Australia, there comes the question of whether Hong Kong should follow these countries’ footsteps. Or should the issue of a code of ethics remain unregulated in Hong Kong?

A code of ethics (or code of conduct as it is called in Australia) is regarded as being of great importance by the regulators in the US and Australia, although they deal with this issue in a somewhat different way. In the US, a code is made mandatory under the NYSE Listed Company Manual while in Australia, it is a recommendation which the listed companies have to adopt or explain their non-adoption. This is similar status to the code provisions in Hong Kong\textsuperscript{14}.

The fact that high profile corporate scandals involving giant companies like Enron, WorldCom and Tyco occurred in the US does not mean that similar scandals will not appear in Hong Kong. It is dangerous for Hong Kong to be complacent. In fact, Hong Kong has not been short of corporate scandals over the past few years\textsuperscript{15}. Some relate to listed companies and have undermined the investing public’s confidence in the integrity of the Hong Kong financial market. Corporate failures which drove the US regulator to mandate a code of ethics there are not unique to the US.

Australia adopts the “comply or explain” approach which gives listed companies some flexibility. Despite this, the Australian regulator has highlighted the importance of ethics in senior management’s decision making as well as in the recognition of stakeholders’ interests.

In our survey, the suggestion of making the issue of a code of ethics a recommended best practice received the support of 91\% of respondents while the idea of making it a code provision received support from 74\% of respondents. It is not difficult to predict that the less stringent approach will always get wider support but it is worth noting that the discrepancy between the two figures is not tremendous. Based on the following results from our survey, our recommendation is that a code provision may be a more appropriate approach in Hong Kong.

- 93\% of respondents think that a code of ethics is effective in ensuring ethical business behaviour in a company
- 96\% of respondents agree that good business ethics is important and essential for running a successful business
- 90\% of respondents find that there is growing concern about business ethics in society
- 64\% of the respondents which do not currently have a code of ethics said “not a legal requirement” was the main reason for them not issuing a code
- 86\% of the respondents which do not have a code of ethics indicated that making it a “mandatory legal requirement” would be the driver for them to issue a code

\textsuperscript{13} ASX Listing Rule 4.10.

\textsuperscript{14} Appendix 14 of the Main Board Listing Rules or Appendix 15 of the GEM Listing Rules.

\textsuperscript{15} The scandals involving Euro Asia Agricultural (Holdings) Limited, Skyworth Digital Holdings Limited, Ocean Grand Holdings Limited.
The NYSE Listed Company Manual succinctly summarises the purposes of a code of ethics as follows:

“No code of business conduct and ethics can replace the thoughtful behaviour of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability”.

Given the multiple functions that a code of ethics can serve, it is in the interest of every listed company in Hong Kong to put one in place. Since this is an issue which is closely related to corporate governance, it is appropriate to incorporate this requirement into the CG Code. By introducing it as a code provision, similarly to the situation in Australia, listed companies can still have the flexibility of not complying with the provision as long as they can give a valid explanation for their non-compliance. To enhance their transparency, listed companies should also be required to disclose in their annual reports whether there was any identified malpractice during the relevant period (excluding cases which are still under investigation).

WHEN DOES THE NEED FOR A WHISTLE-BLOWING POLICY ARISE?

While a code of ethics is more for the purpose of prevention of malpractice within a corporation, a whistle-blowing policy aims mainly to deter malpractice by increasing the possibility of detection and punishing perpetrators.

As a means of uncovering misconduct or even significant risks within a corporation, whistle-blowing is an essential part of an effective internal controls and risk management system. The importance of whistle-blowing is generally recognised and it should be encouraged as far as possible while a mechanism should also be established to discourage malicious allegations which are made in bad faith.

a. Is there any incentive for whistle-blowing?

Few people are willing to be a whistle-blower as whistle-blowing is generally perceived as an act which gives no clear personal benefit while it may lead to reprisal. While the company can benefit by identifying the malpractice and making corrections as early as possible, the whistle-blower is the one who has to shoulder the personal costs especially when there is no or insufficient support and protection against retaliation or there is little appreciation for whistle-blowing in society. To encourage a person to stand up and speak out against any wrongdoing, appreciation should be shown by the organisation concerned and the community for the brave act of the whistle-blower. Most importantly, a system should be put in place within an organisation and in society to shield whistle-blowers from any possible consequential harm and loss.

b. Is a whistle-blowing policy necessary?

According to the survey, 51% of respondents have put a whistle-blowing policy in place in their companies. And 24 of the 33 respondents (73%) with a code of ethics have also published a whistle-blowing policy in their companies. The survey further shows that 87% of respondents believed that it is necessary for a company to have a whistle-blowing policy.

Though whistle-blowing may not occur very frequently, it is still necessary for the company to establish a formal channel and a set of procedures for complaints and reporting of malpractice to be made. Without a whistle-blowing policy, an employee will not know to whom he should make a report and the relevant procedures for making it. As a result, he may simply give up on the idea of “blowing the whistle”.

16 Whistle-blowers played an important role in uncovering the frauds at Enron and Worldcom. In 2002, Time Magazine named whistle-blowers Cynthia Cooper of WorldCom, Sherron Watkins of Enron and Coleen Rowley of the FBI as its "Persons of the Year".
c. **What should a whistle-blowing policy include?**

A well-drafted whistle-blowing policy should include at least the following:

- A statement which encourages whistle-blowing
- Examples of misconduct to which the whistle-blowing policy is applicable and the level of proof required
- A statement that the identity of the whistle-blower and the details of the report will be kept confidential
- The consequence of false or malicious accusations, e.g., that these may lead to disciplinary action or dismissal
- Reporting channels
- Investigation procedures
- Statement of acknowledgement and recognition of whistle-blowing

As shown in the survey, "fear of being accused of insufficient evidence" is the main reason for not reporting an act of misconduct. It would therefore be useful for the company to provide some examples of misconduct or guidance on the level of seriousness and evidence which are expected from the intended whistle-blower. While employees should be reminded to take great care when checking the accuracy of the information before it is provided to the company, there should also be assurance that an employee who provides wrong information—so long as this act is unintentional and in good faith—will not result in any disciplinary action. This would encourage the employees to raise any legitimate concerns without fear of punishment.

Confidentiality is the most important weapon in shielding a whistle-blower from any threat or harassment. Employees should be assured that whistle-blowers will have no chance of being victimised. Confidentiality is also crucial for protection of sensitive information and evidence which, if leaked, may make it difficult to prove the case against the perpetrators.

To ensure that there will be no abuse of the whistle-blowing mechanism, it should be made clear in the whistle-blowing policy that any whistle-blowing has to be made in good faith and any malicious allegations will lead to discipline or dismissal.

The reporting channels and the relevant procedures should be set out very clearly in the whistle-blowing policy so that the whistle-blower knows to whom he should make the report. The concern which the whistle-blower intends to raise may be related to staff of different levels or even to top management. It may be necessary to set different reporting lines for different scenarios. For example, a report of a misconduct concerning a fellow staff member could be made to the department head while one concerning a director may have to be made to the chairman or the audit committee. Every company should set appropriate reporting lines according to its own structure and should set them out clearly in its whistle-blowing policy.

It is necessary to let the employees know the action and procedures which will be taken after the report is made, e.g., the investigation procedures, approximate time that the investigation will take and whether the whistle-blower will be notified of the progress of the investigation.

As mentioned earlier, whistle-blowing is generally regarded as a risky act from which the whistle-blower can yield little personal benefit. As an encouragement, the company should, in its policy, acknowledge and recognise the courage and contribution of whistle-blowers who are essentially participating in the promotion of corporate governance of the company.
The company should make sure that each employee has a copy of the whistle-blowing policy. For it to be successfully implemented, employees’ confidence in the procedures is crucial. Getting the employees involved in the establishment and continuous monitoring of the procedures by way of appointment of an employee representative may be helpful in building up such confidence. It may also be useful for the company to publicise examples of successful action taken pursuant to whistle-blowing.

SHOULD THERE BE A LEGAL FRAMEWORK FOR WHISTLE-BLOWING IN HONG KONG?
In Hong Kong, the issue of a whistle-blowing policy is voluntary as there is neither a statutory requirement nor any requirement from the regulatory bodies on this topic. The protection provided to whistle-blowers depends very much on the effectiveness of an individual company’s whistle-blowing policy. In recent years, there has been a lot of discussion and debate in many jurisdictions as to whether greater protection should be given to whistle-blowers by way of legislation. It is interesting to look at the regulatory development and practices of several major markets in the promotion of whistle-blowing and whistle-blowers’ protection. The focus here, however, is on the private sector.

A. The UK
The issue of whether or not to have a whistle-blowing policy is voluntary for listed companies in the UK. However, the Combined Code on Corporate Governance (the Combined Code) does provide that “the audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee’s objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action”.

Whistle-blowing is considered to be an element of an effective internal controls system. The Turnbull Guidelines suggest that the board should consider whether there are established channels of communication for individuals to report suspected breaches of laws or regulations or other improprieties when it carries out its annual assessment of the effectiveness of its risk and control procedures.

The UK’s Financial Services Authority (FSA), which is the regulator responsible for the supervision in the financial services industry, recognises the importance of an effective whistle-blowing mechanism in the financial industry where malpractice is more common. While encouraging firms to set up internal whistle-blowing arrangements, the FSA also provides an alternative way for individuals who do not feel able to raise or resolve a concern within their own companies to voice their concerns directly to the FSA via a whistle-blowing line.

Whistle-blowers’ protection was codified in the Public Interest Disclosure Act 1998 (PIDA). As long as a whistle-blower acts in good faith and has satisfied the test of a “qualifying disclosure” – i.e. disclosure which, in the reasonable belief of the employee, is a criminal offence, failure to comply with any legal obligation, a miscarriage of justice, the putting of the health and safety of any individual in danger, damage to the environment or deliberate concealment relating to any of the above – he will be protected from any detriment by any act or omission of his employer under the name of redundancy, demotion or any other kind of penalty. The whistle-blower can bring a legal action against his employer in respect of any victimisation as a result of the whistle-blowing. The protection given to the whistle-blower extends to external disclosures so long as the outside body is a prescribed body under the PIDA (such as the FSA) and the disclosures meet the test laid down therein.

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18 Provision C.3.4 of the UK Combined Code.
19 The PIDA came into force in 1999. It is employment legislation which creates a framework for whistle-blowers across the private and public sectors.
One can see that, in the UK, whistle-blowing has been promoted by the regulators as a tool to promote the internal control, risk management system and corporate governance of a company. Though the issue of a whistle-blowing policy remains voluntary, companies are encouraged to put an internal whistle-blowing policy in place while the regulator still provides an external system as a support for companies where internal whistle-blowing procedures do not exist or are inadequate. In addition, the interests of the whistle-blowers are protected under the law, which provides them the right not to be victimised and, if necessary, to claim for damages against their employer.

B. Australia

The Revised Principles issued by the ASX Corporate Governance Council recommend that listed companies put in place a code of conduct which, among other things, will “identify measures the company follows to encourage the reporting of unlawful or unethical behaviour and to actively promote ethical behaviour. This might include reference to how the company protects those, such as whistle-blowers who report violations in good faith and its processes for dealing with such reports”. As in the UK, the issue of a whistle-blowing policy is voluntary and there is protection under the law for whistle-blowers.

In Australia, whistle-blower legislation has been passed at both federal and state levels and there are some differences between the levels of protection given to whistle-blowers under these laws. Most are limited to government entities and their agencies with the notable exception of The Corporations Act 2001, which extends to officers and employees of companies throughout Australia.

Starting from July 2004, the Corporations Act offers protection to whistle-blowers who are officers, employees or contractors of a company and who make “protected disclosure” in good faith. There is limitation on the scope of reports that are protected under the Corporations Act. The reports should indicate that the company or an officer or employee of that company has or may have breached the Corporations Act or the Australian Securities and Investments Commission Act 2001. The whistle-blower making such protected disclosure will be protected from civil and criminal liability for making the disclosure. Victimisation of the whistle-blower has been made a crime under the Corporations Act and a whistle-blower suffering from victimisation is also entitled to seek damages.

Different states in Australia have enacted their own legislation with a view to providing protection to whistle-blowers. There are however differences in the scope and level of protection and such inconsistencies are, to a certain extent, a result of the constitutional constraints which prevent the Commonwealth from implementing comprehensive nationwide legislation. There has been a lot of discussion in Australia recently about reforming the whistle-blowing legislation on grounds that there are many inconsistencies between the different acts passed in different states and that all of them have some weaknesses which need to be addressed.

20 Refer to p.34 of this report which provides the definition.

21 Principle 3.1 of the Revised Principles.


23 See the new issues paper entitled “Public Interest Disclosure Legislation in Australia: Towards the Next Generation” issued by the Commonwealth Ombudsman, NSW Ombudsman and Queensland Ombudsman in November 2006 and which calls for a coherent and national approach to the revision of whistle-blower protection laws in public sector.
C. The US

Like Australia, the US has state laws and federal laws dealing with whistle-blowing. Over the last 40 years, the federal government has passed over 90 laws and regulations covering whistle-blowers but there is so far no national whistle-blowing law in the US. Whistle-blowers’ protection is a topical issue in the US and there has been lobbying over the years for a national whistle-blowing act to offer stronger protection to whistle-blowers. In 2007, the House of Representatives approved the Whistleblower Protection Enhancement Act which overhauls federal whistle-blower law.

SOX stipulated certain requirements concerning whistle-blowing. Section 806 provides protection to employees of publicly traded companies who report suspected violation of certain sections of SOX, any rule or regulation of SEC or any provision of federal law relating to fraud against shareholders to any federal regulatory or law enforcement agency, any member or committee of Congress or any person with supervisory authority over the employee. The relevant employee will be protected from any retaliation from any officer, employee, contractor, subcontractor, or agent of the company. Any employee who suffers from the prohibited retaliation shall be entitled to “all relief necessary to make the employee whole”.

Section 301 provides that the audit committee should establish procedures for handling complaints received by the company regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.

Section 1107 further provides that any person who retaliates (in the form of interfering with that person’s lawful employment or livelihood) against any informant who supplies to a law enforcement officer any truthful information relating to violation of a federal law may be fined and/or imprisoned for up to ten years. The protection provided under this section extends beyond public corporations.

As the focus of SOX is on the integrity of financial reporting, the whistle-blowing provisions contained in the act also emphasise this area. For example, the procedures which the audit committee must establish under s 301 cover the handling of complaints concerning accounting and auditing matters.

Whistle-blowers’ protection is an issue which has received a lot of attention in the US. The existing legal framework has been described by some as a patchwork since the protection afforded to whistle-blowers may vary according to the subject matter of each individual case and the state in which the case arises. Whether the protection offered to whistle-blowers under the existing laws is sufficient is subject to debate. As noted earlier, there has been lobby for a national whistle-blowing act and stronger protection for whistle-blowers which shows that many people, especially whistle-blowers themselves, still find it necessary to further strengthen their rights.

24 The National Whistleblower Center has been petitioning for a national whistle-blowing act. A Whistleblower Week was held between 13-19 May 2007 in Washington with the objective of raising the awareness of the need for stronger protection for whistle-blowers.

25 This Act, if passed, will provide greater protection for whistle-blowers who provide information on suspected corporate or governmental wrongdoing. It was passed by the House in March 2007 and is now pending the approval of the Senate.
D. **Hong Kong**

Some Asian countries have also provided statutory protection for whistle-blowers. For example, the Whistle-blower Protection Act was enacted in Japan in 2004. With the increase of the number of corporate scandals which have been reported by whistle-blowers, there has been a great deal of debate in the PRC\(^{26}\) and Taiwan about the need to enact laws to protect whistle-blowers. Compared to other countries in Asia, it seems that this is not a very popular issue in Hong Kong and the subject has attracted little debate here.

There is no requirement under the Listing Rules for listed companies to issue a whistle-blowing policy although it is recommended best practice that the audit committee should be required to “review arrangements by which employees of the issuer may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. That audit committee should ensure that proper arrangements are in place for fair and independent investigation of such matters and for appropriate follow up action.”\(^{27}\) The wording is similar to the relevant provision contained in the UK Combined Code mentioned above. However, the status given to this requirement is different. While listed companies in the UK are subject to the “comply or explain” approach, this is only a recommended best practice in Hong Kong which means it is a guideline which Hong Kong listed companies have no obligation to follow.

According to our survey results, 87% of respondents believe that it is necessary to issue a whistle-blowing policy while only about half of them have issued one. In the absence of any statutory requirement and in the belief that whistle-blowing is not something which will happen frequently, it is not surprising that most of the companies surveyed do not have the urge to publish a whistle-blowing policy. There has been some discussion in Hong Kong about enhancing protection for whistle-blowers in the past, but there was insufficient concern to push forward any reform in this area. This might also be a reflection of the culture in the Chinese community, in which “each family should only wipe the snow in front of its own door” (家家自掃門前雪). This results in a relatively limited supply of whistle-blowers in Hong Kong. But is it still the model under which the Hong Kong business community is operating? Or is the Hong Kong business community evolving towards a new direction as it tries to enhance its corporate governance?

As noted earlier, whistle-blowing is a very important tool in combating malpractice and enhancing corporate governance in a company. Trickily, this is an act which will certainly benefit the company but will possibly put the life and livelihood of the whistle-blower at risk if the company has not put an effective policy and procedures in place to prevent reprisals against the whistle-blower. A whistle-blower’s vulnerability can be further exacerbated by the lack of any statutory protection given to them. As a result, whistle-blowers in Hong Kong face greater risks than their counterparts in other major jurisdictions where legal frameworks have been established for their protection.

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\(^{27}\) See C.3.7 of Appendix 14 of Rules Governing The Listing of Securities on the Stock Exchange of Hong Kong Limited.
While most major markets including the UK, the US, Australia and Japan have already enacted legislation to protect whistle-blowers, Hong Kong is clearly lagging behind here. It is now time for Hong Kong to seriously consider institutionalising whistle-blowing and enacting a whistle-blower protection law in order to catch up with the international arena. While this is underway, the regulator should, as an initiative to enhance the corporate governance in listed companies, encourage these companies to put in place a whistle-blowing policy and relevant mechanisms by making the issuing of a whistle-blowing a code provision in the CG Code. As an employee risks his personal interests in blowing the whistle while the company and the public yield the benefit, it is neither adequate nor satisfactory to give the company absolute freedom in deciding whether it will put a whistle-blower policy and the relevant mechanisms in place. It is therefore our recommendation that this should be introduced as a code provision instead of a recommended best practice, taking into account the fact that no statutory protection is currently available for whistle-blowers in Hong Kong.

ETHICAL LEADERSHIP

The role to be played by the corporate leaders in promoting business ethics is another important issue which deserves attention. Many high profile corporate scandals such as Enron and WorldCom involved unethical behaviour by top management. As a result, ethical leadership has become a global concern. The quality and style of leadership in a company sets the tone for the entire business and the corporate culture. The chairman, chief executive, directors and senior management are collectively regarded as the leaders in this context.

Leading by example is a concept which should be easily understood by everyone. Leaders who have no regard for business ethics convey a simple yet strong message to all the employees that they are expected to strive for success at any cost even if it means they have to compromise on ethics. The example set at the top will cascade down the company and be followed by staff at different levels. Even leaders who are silent on business ethics may be taken by their staff as indicating neutrality or ambivalence towards good ethics. Hence, in addition to acting ethically and providing a reference point for ethics, top management should openly and regularly talk about the importance of business ethics in different kinds of gatherings within the company or in the corporate newsletter. This serves to build up and reinforce an ethical culture within a company. In order not to give employees the impression that it is all about complaints and negative things, companies may consider planning a programme of sharing the good stories with their staff. These can be motivating and helpful in building up an ethical culture in the company.

The survey shows that some companies might believe that ethical training is more relevant to general staff and that board members do not need to undertake this training. This mindset does not help foster ethical leadership.

On another front, the board’s involvement in the promotion of business ethics should also be enhanced. An “enlightened board” should regularly discuss issues relating to business ethics including the effectiveness of the code of ethics, the company’s whistle-blowing policy, ethics training programmes and the appropriate disciplinary action for malpractices.

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28 The Prevention of Bribery Ordinance (PBO) provides protection to the whistle-blowers who make reports to the ICAC. Section 30A of PBO prohibits the disclosure of the identity and address of the informer.
With the growth of importance of business ethics, more and more companies are choosing to set up a high-level ethics committee. This is a good development which indicates that the companies are taking business ethics seriously and are willing to allocate more resources for its promotion. The independent non-executive directors are probably the most appropriate members or chairs of ethics committees in view of their independence and external perspective. The ethics committee can take up several responsibilities such as reviewing effectiveness of ethics training, determining the disciplinary action for breach of a code of ethics and conducting ethical due diligence on targets of mergers and acquisitions, suppliers, borrowers or other business partners. Ethical due diligence, which can be applied to different circumstances where companies are going to enter into legal relationships with other parties, is becoming increasingly popular. It is an extension of traditional due diligence which focuses on verification of facts.

CONCLUSIONS

Business ethics used to be regarded as an abstract and philosophical topic which few people bothered to discuss. That changed with the high-profile corporate scandals which emerged a few years ago. These corporate scandals have led to the growth in importance of corporate governance all over the world.

In most developed countries, ethics has a close relationship with law. This is not to say that all laws are ethical. However, the domain of ethics usually overlaps and then extends beyond the law by including issues which the law does not address. The law only stipulates the minimum requirements, the mere compliance with which may not in itself help a company achieve success and excellence.

Apart from being a set of moral principles and values, business ethics is about human conduct and is an extension of good management which is required for running a successful business – something with which an overwhelming majority of the respondents to our survey agreed. As employees are the most important asset underpinning the success of a company, companies should put a great deal of effort into nurturing them, both technically and ethically. Some people might feel doubtful about the effectiveness of ethics training on grounds that ethical behaviour only relies on good character, which is inborn rather than shaped. Contrary to this common belief, business ethics is something which can be taught and trained. In a highly developed commercial city where there are many complex commercial transactions, employees should be well equipped to identify conflicts of interest and the ethical dilemmas involved with these transactions and to make the most appropriate and ethical decisions.

In this report, we examine the concept of business ethics, its functions and its importance. As an integral part of the internal control and risk management system, business ethics is essentially a way of enhancing the corporate governance of a company. Putting a code of ethics in place and having it implemented effectively are crucial steps for ethical management and building up an ethical culture within a company. While a code of ethics is aimed at preventing malpractice from taking place, a whistle-blowing policy is a necessary tool to help identify malpractice and to stop it from blossoming.

29 See the Business Ethics Briefing on “Business Ethics Committees” published by The Institute of Business Ethics in June 2007 for the functions and benefits of ethics committee.

Given their importance in the promotion of business ethics and the regulatory development of other major markets, it is our recommendation that the issue of a code of ethics and whistle-blowing policy should be introduced as a code provision in Hong Kong, giving listed companies the freedom to “comply or explain”. This general approach seems to have worked well since the coming into effect of the CG Code in January 2005.

In the long run, it is our recommendation that Hong Kong should enact a whistle-blower protection ordinance. Apart from being an assurance to the whistle-blowers that they can look to the law for protection, it will also serve to encourage more people to stand up against malpractice. Being an important facet of corporate governance, whistle-blowing should be encouraged rather than stifled for reasons such as the lack of statutory protection for whistle-blowers against victimisation and retaliation. Regrettably, it transpires from our research that Hong Kong does not seem to have given sufficient thought to this issue as compared with other major financial cities.

The importance of ethical leadership is also addressed in this report. It is a direct and effective way of promoting business ethics. There is plenty of evidence which shows that the lack of ethical leadership, or worse still, unethical behaviour, by top management is the best guarantee for the downfall of any company, including giant ones. At the other end of the spectrum an enlightened board is able to demonstrate its ethical acumen and leadership under all kinds of circumstances, regardless of whether the company is experiencing ups or downs.

It is worth noting that many respondents to the survey indicated that “not being a legal requirement” is a main reason for them not putting a code of ethics in place. This clearly shows the prevailing mindset of the business community in Hong Kong, i.e. companies are only prepared to comply with the minimum requirements set by the law. They put their “focus on more important matters”. These responses indicate that promotion of business ethics has been accorded little priority or importance by many companies in Hong Kong.

For Hong Kong to maintain its competitive edge in the long run, the business community should develop a vision for long-term success and avoid the pitfall of a kind of ethical myopia, which prompts companies to focus only on short-term financial results even if it means that these can only be achieved by compromising on business ethics. As it becomes increasingly easier for overseas companies to gain direct access to the Mainland China market, Hong Kong’s position as a preferred gateway to the Mainland may start to diminish. To maintain its long-term competitiveness, Hong Kong has to adopt the moral high ground and develop a business culture where companies with low ethical standards fear to tread while high-quality companies choose to develop and expand in the city. Achieving this goal depends on the concerted effort of the business community and the regulators in the promotion of business ethics in Hong Kong.

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31 According to the “Analysis of Corporate Governance Practices Disclosure in 2005 Annual Report” published by the Hong Kong Exchanges and Clearing Limited in March 2007, all the 621 issuers under review met the “comply or explain” requirements in their 2005 annual reports in respect of all the Code Provisions.

32 In a survey conducted by CPA Australia and the Corporate Governance & Financial Reporting Centre on the members of CPA Australia in Singapore, Malaysia and Hong Kong in 2006, almost all the respondents (97%) indicated their support for enacting legislation to protect whistle-blowers. https://www.cpaaustralia.com.au/cps/rde/xchg/SD-5F57FECA-F681E76B/cpa/fsx/724_19706_ENA_HTML.htm.

33 See the article entitled “A Question of Value” written by Professor Michael Hough (p.30-32 of January 2007 edition of CSJ, the official publication of The Hong Kong Institute of Chartered Secretaries).
ANNEX

QUESTIONNAIRE – BUSINESS ETHICS
Purpose: The Hong Kong Institute of Chartered Secretaries and Hong Kong Shue Yan University are working on a joint research project relating to Business Ethics. The purpose of this survey is to collect your views and comments on this issue. All data and information collected will be kept strictly confidential for analysis only. Views and information of individual companies will not be identified.
1. Has business ethics (i.e. ethical values based on which a high standard of business behaviour is maintained) been integrated into your company’s mission, strategy or corporate goals?

☐ Yes  ☐ No

2. In your opinion, what are the main drivers for running a business in an ethical manner? (Please choose a maximum of 3 and number accordingly, with ‘1’ indicating the most important reason)

☐ To enhance corporate governance
☐ To be socially responsible
☐ To improve financial performance and profitability
☐ To minimize corruption, fraud and other malpractices
☐ To strengthen the internal control and risk management
☐ To gain loyalty and trust from investors, suppliers and customers
☐ To address society’s rising concern about business ethics
☐ To match with competitors’ practices
☐ Others (please specify) __________________________________________________________

3. In your opinion, which of the following malpractices are most common in your industry/sector (Not in your company)? (Please circle the most appropriate number with ‘1’ indicating the most common malpractice and ‘6’ being the least common malpractice)

**Bribery and corruption**

(1 2 3 4 5 6 N.A)

**Conflict of interest**

(1 2 3 4 5 6 N.A)

**Abuse of position to obtain personal gain**

(1 2 3 4 5 6 N.A)

**Insider dealings**

(1 2 3 4 5 6 N.A)

**Unfair competition**

(1 2 3 4 5 6 N.A)
Improper procurement procedures e.g. excessive purchases, purchase from connected suppliers and leakage of tender prices etc.

(1  2  3  4  5  6  N.A)

Abuse of authority or the use of authority for improper purpose

(1  2  3  4  5  6  N.A)

Evasion of tax obligation

(1  2  3  4  5  6  N.A)

Abuse/improper use of IT systems (e.g. leakage of sensitive digital information)

(1  2  3  4  5  6  N.A)

False or misleading financial reporting

(1  2  3  4  5  6  N.A)

Decisions subjected to political influence

(1  2  3  4  5  6  N.A)

Breach of product safety standards

(1  2  3  4  5  6  N.A)

Misrepresentation in product or services advertisements

(1  2  3  4  5  6  N.A)

Breach of environmental laws or standards (e.g. air pollution)

(1  2  3  4  5  6  N.A)

Others (please specify) ________________________________

(1  2  3  4  5  6  N.A)
4. Have you come across misconduct at work in the past 12 months?

☐ Yes  ☐ No

4a. Will you report to the relevant authorities if you come across misconduct at work?

☐ Yes (please go to Q5)  ☐ No (please answer Q4b)

4b. What are the reasons for not reporting such misconduct? (You may select more than one)

☐ Not something serious  ☐ Fear of revenge
☐ Fear of demoralising the staff  ☐ Fear of tarnishing the reputation of the company
☐ Fear of being accused of insufficient evidence  ☐ Others (please specify) ________________________________

5. Has your company provided any training on business ethics to the staff or management in the past two years?

☐ Yes  ☐ No (please go to Q6)

5a. What is/are the target group(s) of such training? (You may select more than one)

☐ Board of directors  ☐ Senior management  ☐ General staff
☐ Procurement managers  ☐ Others (please specify) __________________________________________

5b. What major area(s) is/are addressed in such training? (You may select more than one)

☐ Offer/receipt of gift or hospitality  ☐ Bribery and corruption
☐ Transparency on tendering procedures  ☐ Selection of suppliers and transparency in procurement policy
☐ Avoidance of conflict of interests  ☐ Proper use of IT systems
☐ Discrimination in the workplace  ☐ Workplace safety
☐ Environmental regulations  ☐ Others (please specify) ________________________________

5c. How frequent is such training conducted?

☐ > Twice every year  ☐ Twice every year  ☐ Once every year
☐ < Once every year  ☐ Only provide training to newly employed members

5d. Do you think such training is effective in cultivating an ethical culture?

☐ Yes, in what aspects? (Please specify) __________________________________________

☐ No
6. Has your company issued a code on business ethics (the “Code of Ethics”)?

☐ Yes (please go to Part A)  ☐ No (please go to Part B)

Part A — For companies with a Code of Ethics

A1. Which of the following areas have your company’s Code of Ethics provided advice on? (You may select more than one)

☐ Offering advantage  ☐ Accepting/soliciting advantage
☐ Entertainment  ☐ Conflict of interest
☐ Handling of confidential information/company property
☐ Observing local laws when working in other countries
☐ Reporting channels  ☐ Others (please specify) ________________________________

A2. Is the Code of Ethics made public?

☐ Yes  ☐ No
(please answer both A2a & A2b)  (please answer A2b)

A2a. Is the Code of Ethics published in the following public channels? (You may select more than one)

☐ Company’s annual report  ☐ Corporate website
☐ Stand-alone publications such as brochure or leaflet
☐ Others (please specify) ________________________________

A2b. Is the Code of Ethics published in the following internal channels? (You may select more than one)

☐ Employees’ handbook  ☐ Intranet
☐ Internal circulars or memorandum
☐ Others (please specify) ________________________________

A3. What are the steps which the employees are advised to take if they observe malpractices in your company?

☐ Call an ethics or compliance hotline
☐ Report to the immediate supervisor or manager
☐ Report to the Company Secretary
☐ Report to the Legal Department
☐ Report to the Internal Audit Department
☐ Report to the Human Resources Department
☐ Report to the Board or Audit Committee
☐ Others (please specify) ________________________________
A4. Which functional department or independent committee (if any) is responsible for the implementation of the Code of Ethics?

☐ Legal Department
☐ Company Secretarial Department
☐ Human Resources Department
☐ Internal Audit Department
☐ Ethics Committee
☐ Audit Committee
☐ None
☐ Others (please specify) ______________________________

A5. Does the implementation of the Code of Ethics involve any senior level participation?

☐ Yes, from:
  ☐ Board of directors
  ☐ Senior management
  ☐ Others (please specify) ______________________________

☐ No (please go to A6)

A5a. If yes, how exactly do they participate? (You may select more than one)

☐ Planning
☐ Resource Allocation
☐ Receipt of report
☐ Decision Making
☐ Others (please specify) ______________________________

A6. Does your company provide the following channels to address employees’ queries on business ethics? (You may select more than one)

☐ A hotline/helpline
☐ An independent advisor/consultant
☐ None
☐ Others (please specify) ______________________________

A7. Is compliance with the Code of Ethics a prerequisite to the commencement or continuation of employment?

☐ Yes
☐ No

A8. How does your company measure the effectiveness of the implementation of the Code of Ethics? (You may select more than one)

☐ External audit
☐ Internal audit
☐ Review by the Board
☐ Staff feedback
☐ Review by Audit Committee
☐ Others (please specify) ______________________________

A9. How often is the Code of Ethics reviewed and updated?

☐ > Once every year
☐ Once every year
☐ Once every two years
☐ We never review it
☐ Not specified, we review it whenever it is necessary

This is the end of Part A, please go to Part C.
Part B — For companies currently NOT having a Code of Ethics

B1. **Is your company planning to issue a Code of Ethics in the coming two years?**
   - Yes
   - No (Please go to B3)

B2. **What preparation work do you think is necessary? (You may select more than one)**
   - Get endorsement from the Board of Directors
   - Seek help from external parties on drafting the Code of Ethics
   - Conduct survey with the employees to identify the area of concerns or the topics which require specific guidance
   - Others (please specify)

B3. **What are the main reasons for your company not having in place a Code of Ethics? (Please choose a maximum of 3 and number accordingly, with ‘1’ indicating the most important reason)**
   - Lack of in-house expertise
   - Implementation is difficult
   - Effectiveness is doubtful
   - Not a legal requirement
   - Budget concern
   - Our company is small in scale
   - Our staff are honest
   - We focus on more important matters
   - Business ethics is not an issue of concern in our company
   - Others (please specify)

B4. **What drivers would encourage your company to issue a Code of Ethics? (You may select more than one)**
   - Evidence that it can enhance corporate governance of the company
   - Evidence of reducing business risks (e.g. risks of litigation)
   - Mandatory legal requirement
   - Industry norm
   - Demand from stakeholders group
   - Supply chain requirement
   - Others (please specify)

This is the end of Part B, please go to Part C.

Part C — Whistle-blowing policy

C1. **Does your company have a policy (published or unpublished) in handling any reported case of malpractice or whistle-blowing?**
   - Yes
   - No

C2. **Is there any whistle-blower protection policy in your company (i.e. a policy according to which an employee who has raised concerns about possible malpractices within the company will be protected from retaliation by the concerned party so as to encourage whistle-blowing practice)?**
   - Yes
   - No (please go to Part D)
C2a. If yes, what are the mechanisms to protect the whistleblower (i.e. the person who lodges the complaint)? (You may select more than one)

☐ The whistle-blower can remain anonymous if he/she wishes
☐ Details of complaint are kept confidential
☐ Reported cases are handled only by independent personnel with dedicated authority such as independent non-executive directors, chairman of audit committee, or internal auditor
☐ Any retaliation will be penalized with disciplinary action

This is the end of Part C, please go to Part D.

Part D — General Opinion

Please circle the most appropriate number

(1 = Strongly agree, 2 = Agree, 3 = Slightly agree, 4 = Slightly Disagree, 5 = Disagree, 6 = Strongly Disagree)

1. Issuing a Code of Ethics is effective in ensuring ethical business behaviours in a company

2. Good business ethics is important and essential for running a successful business

3. Business misconduct or malpractice is prevalent in our industry or business sector

4. Cross-border businesses are particularly vulnerable to potential ethics problems

5. There is a growing concern about business ethics in society

6. Issuing a Code of Ethics should be a Recommended Best Practice in the Code on Corporate Governance Practices of the Listing Rules (“CG Code”) for listed companies

7. Issuing a Code of Ethics should be a Code Provision in the CG Code for listed companies

8. It is necessary for a company to put in place a whistle-blowing policy
9. **Has your company adopted any other measures to ensure ethical business behaviour? (Please specify)**

________________________________________________________________________

________________________________________________________________________

10. **Do you have any other comment on business ethics issues?**

________________________________________________________________________

________________________________________________________________________

**Part E — Company General Information**

Company Name ___________________________________________________________________

Stock Code (if applicable) __________ Industry/Sector ___________________________________________________________________

Place of Listing

☐ HK  ☐ PRC  ☐ USA  ☐ Europe  ☐ Others (please specify) ___________________________________________________________________

Number of employees (in Hong Kong)

☐ <100  ☐ 100-500  ☐ 501-1000  ☐ 1000-2000  ☐ >2000

Interviewee (Position) ___________________________________________________________________

Contact Detail: (Tel) ___________________________________________________________________ (email) ___________________________________________________________________

**End of Questionnaire**

Thank you for your participation

Please return by **14 May 2007** the completed questionnaire by post to HKICS (3/F Hong Kong Diamond Exchange Building, 8 Duddell Street, Central, Hong Kong) or by fax (852-2881 5050) or by email (researchkics.org.hk)
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A Path to Success

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