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Code of Ethics for Professional Accountants
Part E Section 500

Professional Ethics in Liquidation and Insolvency



Hong Kong Institute of
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香港會計師公會

SECTION 500
PROFESSIONAL ETHICS IN LIQUIDATION AND INSOLVENCY
(EFFECTIVE ON 1 APRIL 2012)
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Section 500

Professional Ethics in Liquidation and Insolvency

This section should be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Part A of the Code of Ethics for Professional Accountants ("the Code").

Part 1 – General Application

Introduction

- 500.1 This section of the Code is intended to assist an insolvency practitioner meets the standards of conduct and ethics expected of him when undertaking or preparing to undertake liquidation and insolvency appointments. It should be noted that this section does not purport to cover the requirements that are imposed by authorities in other jurisdictions. It is also not intended to detract from any responsibilities which may be imposed by law or regulations. The headings in this section are intended to facilitate its presentation only and do not in any way affect the interpretation or meaning of its contents.
- 500.2 For avoidance of doubt, the use of the word "shall" in this section imposes a requirement on the insolvency practitioner or practice to comply with the specific provision in which "shall" has been used. Compliance is required unless an exception is permitted by this section.

Scope

- 500.3 This section of the Code is applicable to and governs the standards of conduct of all insolvency practitioners. An insolvency practitioner shall take steps to ensure that this section is applied in all professional work relating to liquidation and insolvency appointments, and to any professional work that may lead to such appointments. Although such an appointment will normally be of the insolvency practitioner personally rather than his practice, he shall ensure that the standards set out in this section are applied to all members of the insolvency team and his practice, where appropriate.
- 500.4 The appointments, to which this section of the Code refers, include but are not limited to the following appointments, whether in insolvent or solvent estates:
- (a) liquidator, provisional liquidator, special manager, receiver (or receiver and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement;
 - (b) administrator, manager, adjudicator or any other similar role, however described in respect of a scheme of arrangement between a company and its creditors;
 - (c) administrator under the Securities and Futures Ordinance (Cap. 571); and
 - (d) examiner in bankruptcy cases under the Official Receiver's Office tender scheme.

Fundamental Principles

- 500.5 An insolvency practitioner shall comply with the fundamental principles set out under paragraph 100.5 of this Code. The five fundamental principles are:
- (a) *Integrity* – to be straightforward and honest in all professional and business relationships.
 - (b) *Objectivity* – to not allow bias, conflict of interest or undue influence of others to override professional or business judgements

- (c) *Professional Competence and Due Care* – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques, and act diligently and in accordance with applicable technical and professional standards.
- (d) *Confidentiality* – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the insolvency practitioner or third parties.
- (e) *Professional Behaviour* – to comply with relevant laws and regulations and avoid any action that discredits the profession.

500.6 It is important for an insolvency practitioner to be aware of the intention of this section of the Code. An insolvency practitioner shall look to and comply with the fundamental principles and not merely focus on the specific situations analysed in this section. All of the fundamental principles are important. They direct the attention of an insolvency practitioner to the overriding importance of professional ethics in his professional life. They are as important in the acceptance and conduct of liquidation and insolvency work as in any other area of professional life.

500.7 As it is the fundamental principle of objectivity that more frequently gives rise to ethical dilemmas, this section of the Code provides more specific guidance primarily in respect of objectivity. The preservation of objectivity needs to be demonstrated by the maintenance of an insolvency practitioner's independence from influences, which could affect his objectivity. An insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgement, decisions and conduct, but shall also be mindful of how his objectivity may be perceived by others. An insolvency practitioner shall also be aware of the possible threat to objectivity if he engages in regular or reciprocal arrangements in relation to appointments with another practice or organisation.

Framework Approach

500.8 Paragraphs 100.6 to 100.11 of this Code set out the conceptual framework approach that requires a professional accountant to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate such threats; and
- (c) address such threats in an appropriate manner.

500.9 This section of the Code provides a framework which insolvency practitioners can use to identify actual or potential threats to compliance with the fundamental principles, and determine whether there are any safeguards that may be available to mitigate them. As well as including illustrative guidance, it includes examples of specific threats and possible safeguards. These examples are illustrative only and are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats or safeguards. It is impossible to define all circumstances that may create threats to compliance with the fundamental principles or to specify safeguards that may be available.

Identification of threats to the fundamental principles

- 500.10 An insolvency practitioner shall take reasonable steps to identify the existence of any threats to compliance with the fundamental principles which arise during the course of his professional work.
- 500.11 An insolvency practitioner shall take particular care to identify the existence of threats which exist prior to or at the time of taking an appointment or which, at that stage, may reasonably be expected to arise during the course of such an appointment. Paragraphs on accepting or not accepting appointments and professional and personal relationships below contain particular factors an insolvency practitioner shall take into account when deciding whether to accept an appointment.
- 500.12 In identifying the existence of any threats, an insolvency practitioner shall have regard to relationships whereby the practice is held out as being part of a network, which is aimed at (a) co-operation and (b) profit or cost sharing or which shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.
- 500.13 Many threats fall into one or more of five categories:
- (a) *Self-interest threat* – The threat that a financial or other interest will inappropriately influence the insolvency practitioner's judgement or behaviour;
 - (b) *Self-review threat* – The threat that an insolvency practitioner will not appropriately evaluate the results of a previous judgement made or service performed by him, or by another individual within his practice or employing practice, on which the insolvency practitioner will rely when forming a judgement as part of providing a current service;
 - (c) *Advocacy threat* – The threat that an insolvency practitioner or an individual within the practice will promote a position to the point that the insolvency practitioner's objectivity is compromised;
 - (d) *Familiarity threat* – The threat that due to a long or close relationship with others, an insolvency practitioner or an individual within the practice will be too sympathetic to the interests of others or too accepting of the work of others; and
 - (e) *Intimidation threat* – The threat that an insolvency practitioner will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the insolvency practitioner.
- 500.14 The following paragraphs give examples of the possible threats that an insolvency practitioner may face. These examples are illustrative only and they are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats.
- 500.15 Examples of circumstances that may create self-interest threats for an insolvency practitioner include:
- (a) An individual within the practice having an interest in a creditor or potential creditor with a claim which requires adjudication.
 - (b) Concern about the possibility of damaging a business relationship.
 - (c) Concern about potential future employment.
- 500.16 Examples of circumstances that may create self-review threats include:
- (a) The acceptance of an appointment in respect of an entity where an individual within the practice has recently been employed by or seconded to that entity.

- (b) An insolvency practitioner or the practice has carried out professional work of any description, including sequential appointments, for that entity.

Such self-review threats may diminish over the passage of time.

500.17 Examples of circumstances that may create advocacy threats include:

- (a) Acting or having acted in an advisory capacity for a creditor of an entity which subsequently becomes insolvent.
- (b) Acting or having acted as an advocate for a client in litigation or dispute with an entity which subsequently becomes insolvent.

500.18 Examples of circumstances that may create familiarity threats include:

- (a) An individual within the practice having a close relationship with any individual having a financial interest in the entity.
- (b) An individual within the practice having a close relationship with a potential purchaser of an insolvent entity's assets and/or business.

In this regard a close relationship includes both a close professional relationship and a close personal relationship.

500.19 Examples of circumstances that may create intimidation threats include:

- (a) The threat of dismissal or replacement being used to:
 - (i) apply pressure not to follow regulations, this section of the Code, any other applicable code, technical or professional standards.
 - (ii) exert influence over an appointment where the insolvency practitioner is an employee rather than a principal of the practice.
- (b) Being threatened with litigation.
- (c) The threat of a complaint being made to the insolvency practitioner's professional body and/or his employer.

Evaluation of threats

500.20 An insolvency practitioner shall take reasonable steps to evaluate any threats to compliance with the fundamental principles when he knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles.

500.21 An insolvency practitioner shall exercise judgment to determine how best to deal with threats that are not at an acceptable level, whether by applying safeguards to eliminate the threat or reduce it to an acceptable level or, particularly where this is not possible, by terminating or declining the relevant appointment. In exercising this judgment, an insolvency practitioner shall consider whether a reasonable and informed third party, weighing all the specific facts and circumstances available to him at that time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of safeguards, such that compliance with the fundamental principles is not compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the appointment and the structure of the practice.

Possible safeguards

500.22 Having identified and evaluated threats to compliance with the fundamental principles, an insolvency practitioner shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. The relevant safeguards will vary depending on the circumstances. Generally, safeguards fall into two broad categories. Firstly, safeguards created by the profession, legislation or regulation. Secondly, safeguards in the work environment. In the insolvency or liquidation context, safeguards in the work environment can include safeguards specific to an appointment. These are considered in the paragraphs on accepting or not accepting appointments below. In addition, safeguards can be introduced across the practice. These safeguards seek to create a work environment in which threats are identified and the introduction of appropriate safeguards is encouraged. Some examples include:

- (a) Leadership of the practice that stresses the importance of compliance with the fundamental principles.
- (b) Policies and procedures to implement and monitor quality control of appointments.
- (c) Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant appointment.
- (d) Documented internal policies and procedures requiring compliance with the fundamental principles.
- (e) Policies and procedures to consider the fundamental principles of this section of the Code before the acceptance of an appointment.
- (f) Policies and procedures that will enable the identification of interests or relationships between the insolvency practitioner or the practice or individuals within the practice and third parties.
- (g) Policies and procedures to prohibit individuals (including those who are not members of the insolvency team) from inappropriately influencing the outcome of an appointment.
- (h) Timely communication of a practice's policies and procedures, including any changes to them, to all individuals within the practice, and appropriate training and education on such policies and procedures.
- (i) Designating a member of senior management to be responsible for overseeing the adequate functioning of the practice's quality control system.
- (j) A disciplinary mechanism to promote compliance with policies and procedures.
- (k) Published policies and procedures to encourage and empower individuals within the practice to communicate to senior levels within the practice and/or the insolvency practitioner any issue relating to compliance with the fundamental principles that concerns them.

Part 2 – Specific Application

Accepting or Not Accepting Appointments

- 500.23 The practice of liquidation and insolvency is principally governed by statute and secondary legislation and in many cases is subject ultimately to the control of the court. Where circumstances are dealt with by statute or secondary legislation, an insolvency practitioner shall comply with such provisions. An insolvency practitioner shall also comply with any relevant judicial authority relating to his conduct and any directions given by the court.
- 500.24 An insolvency practitioner shall act in a manner appropriate to his position as an officer of the court (where applicable) and in accordance with any fiduciary or other duties that he may be under.
- 500.25 Before accepting an appointment (including a joint appointment), an insolvency practitioner shall determine whether acceptance would create any threats to compliance with the fundamental principles. Of particular importance will be any threats to the fundamental principles of objectivity and integrity created by conflicts of interest or by any significant professional or personal relationships. These are considered in more detail below.
- 500.26 In considering whether objectivity or integrity may be threatened, an insolvency practitioner shall identify and evaluate any professional or personal relationship (see paragraphs 500.54 to 500.57 below dealing with the assets of an entity) which may affect compliance with the fundamental principles. The appropriate response to the threats arising from any such relationships shall then be considered, together with the introduction of any possible safeguards.
- 500.27 Generally, it will be inappropriate for an insolvency practitioner to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment unless:
- (a) prior to the appointment, disclosure of the existence of such a threat is made to the court or to the creditors on whose behalf the insolvency practitioner would be appointed to act and no objection is made to the insolvency practitioner being appointed; and
 - (b) if the threat is other than trivial, safeguards are or will be available to eliminate or reduce that threat to an acceptable level.
- 500.28 The following are among the safeguards that may be considered:
- (a) Involving and/or consulting another insolvency practitioner from within the practice to review the work done.
 - (b) Consulting an independent third party, such as a creditors' committee, a professional body or another insolvency practitioner.
 - (c) Involving another insolvency practitioner to perform part of the work, which may include another insolvency practitioner taking a joint appointment where the conflict arises during the course of the appointment.
 - (d) Obtaining legal advice from a solicitor or barrister with appropriate experience and expertise.
 - (e) Changing the members of the insolvency team.
 - (f) The use of separate insolvency practitioners and/or staff.
 - (g) Procedures to prevent access to information (e.g. strict physical separation of such insolvency teams, confidential and secure data filing).

- (h) Clear guidelines for individuals within the practice on issues of security and confidentiality.
- (i) The use of confidentiality agreements signed by individuals within the practice.
- (j) Regular review of the application of safeguards by a senior individual within the practice not involved with the appointment.
- (k) Terminating the financial or business relationship that gives rise to the threat.
- (l) Seeking directions from the court.

500.29 As regards joint appointments, where an insolvency practitioner is specifically precluded by this section of the Code from accepting an appointment as an individual, a joint appointment will not be an appropriate safeguard and will not make accepting the appointment appropriate.

500.30 In deciding whether to take an appointment in circumstances where a threat to the fundamental principles has been identified, an insolvency practitioner shall consider whether the interests of those on whose behalf he would be appointed to act would best be served by the appointment of another insolvency practitioner who does not face the same threat and, if so, whether any such appropriately qualified and experienced other insolvency practitioner is likely to be available to be appointed.

500.31 An insolvency practitioner may encounter situations where no safeguards can reduce a threat to an acceptable level. Where this is the case, an insolvency practitioner shall conclude that it is not appropriate to accept the appointment.

500.32 Following acceptance of an appointment, any threats shall continue to be kept under appropriate review and an insolvency practitioner shall be mindful that other threats may come to light or arise. There may be occasions when the insolvency practitioner is no longer in compliance with this section of the Code because of changed circumstances or something that has been inadvertently overlooked. This would generally not be an issue, provided the insolvency practitioner has appropriate quality control policies and procedures in place to deal with such matters and, once discovered, the matter is corrected promptly and any necessary safeguards are applied. In deciding whether to continue an appointment, the insolvency practitioner may take into account the wishes of the creditors, who after full disclosure has been made have the right to retain or replace the insolvency practitioner.

500.33 In all cases an insolvency practitioner shall exercise his judgment to determine how best to deal with an identified threat. In exercising his judgment, an insolvency practitioner shall take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the insolvency practitioner at the time, including the significance of the threat and the efficacy of the safeguards applied, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles would not be compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the work and the structure of the practice.

Conflicts of interest

500.34 An insolvency practitioner shall take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may create threats to compliance with the fundamental principles. Examples of where a conflict of interest may arise are where:

- (a) An insolvency practitioner has deal with claims between the separate and conflicting interests of entities over which he is appointed. He should be particularly aware of the difficulties likely to arise from the existence of inter-company transactions or guarantees in group, associated or "family-connected" company situations. Acceptance of an appointment in relation to more than one company in the group or association may raise

issues of conflict of interest. Nevertheless it may be impracticable for a series of different insolvency practitioners to act. An insolvency practitioner therefore should not accept multiple appointments in such situations unless he is satisfied that he is able to take steps to minimise potential conflicts and that his overall integrity and objectivity are, and are seen to be maintained.

- (b) There are a succession of or sequential appointments (see examples in category B of Part 3 on the application of the framework to specific situations).
- (c) A significant relationship has existed with the entity or someone connected with the entity (see also paragraphs 500.49 to 500.53 below on professional and personal relationships). An insolvency practitioner, or a member of his practice, who is acting as insolvency practitioner in relation to an individual debtor may be asked to accept an appointment in relation to an entity of which the debtor is a major shareholder or creditor or where the entity is a creditor of the debtor. It is essential that, if the insolvency practitioner is to accept the new appointment, he should be able to show that the steps indicated in paragraph 500.34(a) above have been taken. Similar considerations apply if it is the entity appointment which precedes the individual appointment.

500.35 It is important to note that conflicts may arise not only at the time an appointment is offered but also after it has been accepted. It is always a matter for an insolvency practitioner to assess whether he may accept and/or continue an engagement in the particular context that applies at the time. It will always be up to an insolvency practitioner to justify his actions in cases of doubt. Whether an insolvency practitioner takes or continues an appointment will depend on what threats there are and whether, in the event that there are threats, the introduction of safeguards will overcome those threats. Sometimes, though, the mere perception of risk or conflict will make acceptance or continuation unwise so that the insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgment, decisions and conduct but also shall be mindful of how his objectivity could be perceived by others.

500.36 Some of the safeguards listed at paragraph 500.28 may be applied to reduce the threats created by a conflict of interest to an acceptable level. Where a conflict of interest arises, the preservation of confidentiality will be of paramount importance; therefore, the safeguards used should generally include the use of effective information barriers.

Practice mergers

500.37 Where practices merge, they shall subsequently be treated as one for the purposes of assessing threats to the fundamental principles. At the time of the merger, existing appointments shall be reviewed and any threats identified. Principals and employees of the merged practice become subject to common ethical constraints in relation to accepting new appointments to clients of either of the former practices. However, existing appointments which are rendered in apparent breach of this section of the Code by such a merger need not be determined automatically, provided that a considered review of the situation by the practice discloses no obvious and immediate ethical conflict.

500.38 Where an individual within the practice has, in any former practice, undertaken work upon the affairs of an entity in a capacity that is incompatible with an appointment of the new practice, the individual shall not personally work or be employed on that assignment.

Transparency

500.39 Both before and during an appointment an insolvency practitioner may acquire personal information that is not directly relevant to the insolvency or confidential commercial information relating to the affairs of third parties. The information may be such that others might expect that confidentiality would be maintained.

500.40 An insolvency practitioner in the role as office holder has a professional duty to report openly to those with an interest in the outcome of the insolvency or liquidation. An insolvency practitioner shall report on his acts and dealings as fully as possible having regard to the circumstances of the case, in a way that is transparent and understandable. An insolvency practitioner shall bear in mind the expectations of others and what a reasonable and informed third party would consider appropriate.

Professional competence and due care

500.41 Prior to accepting an appointment an insolvency practitioner, to the extent reasonably possible, shall ensure that he is satisfied that the following matters have been taken into consideration:

- (a) Obtaining knowledge and understanding of the entity, its owners, managers and those responsible for its governance and business activities.
- (b) Acquiring an appropriate understanding of the nature of the entity's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- (c) Acquiring knowledge of relevant industries or subject matters.
- (d) Possessing or obtaining experience with relevant regulatory or reporting requirements.
- (e) Assigning sufficient staff with the necessary competencies.
- (f) Using experts where necessary.
- (g) Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

500.42 The fundamental principle of professional competence and due care imposes an obligation on an insolvency practitioner to only accept an appointment that the insolvency practitioner is competent to perform. For example, a self-interest threat to professional competence and due care is created if the insolvency team does not possess or cannot acquire the competencies necessary to properly carry out the appointment. Expertise will include appropriate training, technical knowledge, knowledge of the entity and the business with which the entity is concerned.

500.43 If any appointment necessitates the employment of agents, an insolvency practitioner shall exercise care to retain overall control of the conduct of the engagement. An insolvency practitioner shall not accept any insolvency or liquidation work as agent of another insolvency practitioner unless satisfied that he has been employed on this basis and the other insolvency practitioner has retained overall control of the conduct of the engagement.

500.44 Maintaining and acquiring professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments, including:

- (a) Developments in insolvency and related legislation.
- (b) The regulations of the Institute, including the continuing professional development requirements.
- (c) Guidance issued by the Institute, e.g. Insolvency Guidance Notes, and relevant circulars issued by regulatory bodies.
- (d) Technical issues being discussed within the profession.

Professional and Personal Relationships

500.45 The environment in which an insolvency practitioner works and the relationships formed in his professional and personal life can lead to threats to compliance with the fundamental principle of objectivity.

Identifying relationships

500.46 In particular, the principle of objectivity may be threatened if any individual within the practice, the close relative of an individual within the practice, or the practice itself, has or has had a professional or personal relationship which relates to the appointment being considered.

500.47 Professional or personal relationships may include, but are not restricted to, relationships with:

- (a) the entity;
- (b) any director or shadow director or former director or shadow director of the entity;
- (c) shareholders of the entity;
- (d) any principal or employee of the entity;
- (e) business partners of the entity;
- (f) companies or entities controlled by the entity;
- (g) companies which are under common control;
- (h) creditors (including debenture holders or floating charge holders) of the entity;
- (i) debtors of the entity;
- (j) close relative of the entity (if an individual) or its officers (if a corporate body);
- (k) others with commercial relationships with the practice.

500.48 A practice shall have policies and procedures to identify relationships between individuals within the practice and third parties in a way that is proportionate and reasonable in relation to the appointment being considered.

Is the relationship significant to the conduct of the appointment?

500.49 Where a professional or personal relationship of the type described in paragraph 500.46 has been identified, an insolvency practitioner shall evaluate the impact of the relationship in the context of the appointment being sought or considered. Issues to consider in evaluating whether a relationship creates a threat to compliance with the fundamental principles may include the following:

- (a) The nature of the previous duties undertaken by a practice during an earlier relationship with the entity.
- (b) The impact of the work conducted by the practice on the financial state and/or the financial stability of the entity in respect of which the appointment is being considered.
- (c) Whether the fee received for the work by the practice is or was significant to the practice itself or is or was substantial.

- (d) How recently any professional work was carried out. It is likely that greater threats will arise (or may be seen to arise) where work has been carried out within the previous two years. However, there may still be instances where, in respect of non-audit work, any threat is at an acceptable level. Conversely, there may be situations whereby the nature of the work carried out was such that a considerably longer period should elapse before any threat can be reduced to an acceptable level.
- (e) Whether the appointment being considered involves consideration of any work previously undertaken by the practice for that entity.
- (f) The nature of any personal relationship and the proximity of the insolvency practitioner to the individual with whom the relationship exists and, where appropriate, the proximity of that individual to the entity in relation to which the appointment relates.
- (g) Whether any reporting obligations will arise in respect of the relevant individual with whom the relationship exists (e.g. an obligation to report on the conduct of directors and shadow directors of a company to which the appointment relates).
- (h) The nature of any previous duties undertaken by an individual within the practice during any earlier relationship with the entity.
- (i) The extent of the insolvency team's familiarity with the individuals connected with the entity.

500.50 Having identified and evaluated a relationship that may create a threat to compliance with the fundamental principles, an insolvency practitioner shall consider his response including the introduction of any possible safeguards to reduce the threat to an acceptable level.

500.51 Some of the safeguards which may be considered to reduce the threat created by a professional or personal relationship to an acceptable level are considered in paragraph 500.28. Other safeguards may include:

- (a) Withdrawing from the insolvency team.
- (b) Terminating (where possible) the financial or business relationship giving rise to the threat.
- (c) Disclosure of the relationship and any financial benefit received by the practice (whether directly or indirectly) to the entity or to those on whose behalf the insolvency practitioner would be appointed to act.

500.52 An insolvency practitioner may encounter situations in which no or no reasonable safeguards can be introduced to eliminate a threat arising from a professional or personal relationship, or to reduce it to an acceptable level. In such situations, the relationship in question will constitute a significant professional relationship or a significant personal relationship. Where this is the case, the insolvency practitioner shall conclude that it is not appropriate for him or any member of his practice to take the appointment.

500.53 Consideration should always be given to the perception of others when deciding whether to accept an appointment. Whilst an insolvency practitioner may regard a relationship as not being significant to the appointment, the perception of others may differ and this may in some circumstances be sufficient to make the relationship significant.

Dealing with the Assets of an Entity

500.54 Actual or perceived threats (for example self-interest threats) to compliance with the fundamental principles may arise when during an appointment, an insolvency practitioner realises assets.

- 500.55 An insolvency practitioner appointed to, or who is providing services which may lead to an appointment in relation to an entity shall not acquire, directly or indirectly, any of the assets of the entity. An insolvency practitioner shall not knowingly permit any individual within the practice, or any close relative of the insolvency practitioner or of an individual within the practice, directly or indirectly, to do so, save in circumstances which clearly do not impair the insolvency practitioner's objectivity.
- 500.56 Where the assets and business of an insolvent company are sold by an insolvency practitioner shortly after appointment on pre-agreed terms, this could lead to an actual or perceived threat to objectivity. The sale may also be seen as a threat to objectivity by creditors or others not involved in the prior agreement. The threat to objectivity may be eliminated or reduced to an acceptable level by safeguards such as obtaining an independent valuation of the assets or business being sold, or the consideration of other potential purchasers.
- 500.57 It is also particularly important for an insolvency practitioner to take care to ensure (where to do so does not conflict with any legal or professional obligation) that his decision making processes are transparent, understandable and readily identifiable to all third parties who may be affected by the sale or proposed sale.

Obtaining Specialist Advice and Services

- 500.58 When an insolvency practitioner intends to rely on the advice or work of another, the insolvency practitioner shall evaluate whether such reliance is warranted. The insolvency practitioner shall consider factors such as reputation, expertise, resources available and applicable professional and ethical standards. Any payment to the third party shall reflect the value of the work undertaken.
- 500.59 Threats to compliance with the fundamental principles (for example familiarity threats and self-interest threats) can arise if services are provided by a regular source even if it is independent of the practice.
- 500.60 Safeguards should be introduced to eliminate such threats or reduce them to an acceptable level. These safeguards should ensure that a proper business relationship is maintained between the parties and that such relationships are reviewed periodically to ensure that best value and service are being obtained in relation to each appointment. Additional safeguards may include clear guidelines and policies within the practice on such relationships. An insolvency practitioner shall also consider disclosure of the existence of such business relationships to the general body of creditors or the creditor's committee if one exists.
- 500.61 Threats to compliance with the fundamental principles can also arise where services are provided from within the practice or by a party with whom the practice, or an individual within the practice, has a business or personal relationship. An insolvency practitioner shall take particular care in such circumstances to ensure that the best value and service are being provided.

Fees and Other Types of Remuneration

- 500.62 Where an engagement may lead to an appointment, an insolvency practitioner shall make any party to the work aware of the terms of the work and, in particular, the basis on which any fees are charged and which services are covered by those fees.
- 500.63 An insolvency practitioner shall not accept referral fees or commissions in relation to an appointment, as accepting referral fees or commissions could represent a significant threat to objectivity. For the avoidance of doubt, any amounts paid on account of liquidation costs (including the insolvency practitioner's fees and expenses) should not be regarded as referral fees or commissions and are not prohibited by this paragraph.

500.64 Insolvency practitioners should note that under the Prevention of Bribery Ordinance (Cap. 201), there are provisions governing acceptance of any payment by someone who is in an agent-principal relationship with another person. For example, if an agent receives payment from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the payment in order to avoid the risk of contravening the Prevention of Bribery Ordinance. The same principle applies to someone who is paying another person who is in an agent-principal relationship with some other person: the payer should ensure that the agent has obtained permission from his principal for receiving the payment. Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Insolvency practitioners should consult their own legal advisers as and when necessary.

Obtaining Appointments

500.65 The special nature of appointments makes the payment or offer of any commission for, or the furnishing of any valuable consideration towards, the introduction of such appointments inappropriate. For the avoidance of doubt, this does not, however, preclude:

- (a) An arrangement between an insolvency practitioner and his practice's employee whereby the employee's remuneration is based in whole or in part on introductions obtained for the insolvency practitioner through the efforts of the employee.
- (b) Change of appointment resulting from transfer/sale of an existing practice due to, e.g., the sale or merger of an insolvency practice or retirement of the outgoing insolvency practitioner (owner of the practice).

500.66 When an insolvency practitioner solicits an appointment or work that may lead to an appointment through advertising or other forms of marketing, there may be threats to compliance with the fundamental principles.

500.67 An insolvency practitioner shall satisfy himself that any advertising or other form of marketing in relation to soliciting appointments:

- (a) Is fair and not misleading.
- (b) Avoids unsubstantiated or disparaging statements.
- (c) Complies with other codes of practice and guidance in relation to advertising, where applicable. For example, members of the Institute shall take note of section 250 of the Code "Marketing Professional Services" and section 450 of the Code "Practice Promotion".

500.68 Advertisements and other forms of marketing should be clearly identified as such and conform to the basic principles of legality, decency, clarity, honesty and truthfulness.

500.69 If reference is made in advertisements or other forms of marketing to fees or to the cost of the services to be provided, the basis of calculation and the range of services that the reference is intended to cover should be provided. Care should be taken to ensure that such references do not mislead as to the precise range of services and the time commitment that the reference is intended to cover.

500.70 An insolvency practitioner shall never promote or seek to promote his services, or the services of another insolvency practitioner, in such a way, or to such an extent as to amount to harassment.

- 500.71 Where an insolvency practitioner or the practice advertises for work via a third party, the insolvency practitioner is responsible for ensuring that the third party follows the above guidance.

Gifts and Hospitality

- 500.72 An insolvency practitioner, or a close relative, may be offered gifts and hospitality. In relation to an appointment, such an offer may create threats to compliance with the fundamental principles. For example, self-interest or familiarity threats to objectivity may be created if a gift is accepted; and intimidation threats to objectivity may result from the possibility of such offers being made public.
- 500.73 The existence and significance of any threat will depend on the nature, value and intent of the offer. Where gifts or hospitality are offered that a reasonable and informed third party, weighing all the specific facts and circumstances, would consider trivial and inconsequential, an insolvency practitioner may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or obtain information. In such cases, the insolvency practitioner may generally conclude that any threat to compliance with the fundamental principles is at an acceptable level.
- 500.74 An insolvency practitioner shall evaluate the significance of any threats and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, an insolvency practitioner shall not accept such an offer.
- 500.75 In the light of the above, an insolvency practitioner shall also not offer or provide gifts or hospitality where this would give rise to an unacceptable threat to compliance with the fundamental principles.
- 500.76 An insolvency practitioner should also note the implications of the Prevention of Bribery Ordinance (Cap. 201) when accepting and/or offering advantages (including gifts). If in doubt legal advice should be sought.

Record Keeping

- 500.77 It will always be for an insolvency practitioner to justify his actions. An insolvency practitioner will be expected to be able to demonstrate the steps that he took and the conclusions that he reached in identifying, evaluating and responding to any threats, both leading up to and during an appointment, by reference to written contemporaneous records.
- 500.78 The records an insolvency practitioner maintains, in relation to the steps that he took and the conclusions that he reached, should be sufficient to enable a reasonable and informed third party to reach a view on the appropriateness of his actions.

Part 3 – The Application of the Framework to Specific Situations

Introduction to specific situations

- 500.79 The general principle is that it is inappropriate for an insolvency practitioner or any member of his practice to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment where safeguards are not or will not become available to eliminate such a threat, or to reduce it to an acceptable level (see paragraph 500.27). The following examples outline some specific circumstances and professional or personal relationships that will create threats to compliance with the fundamental principles. The examples may also assist members of the insolvency team to assess the implications of similar, but different, circumstances and relationships.
- 500.80 The examples are divided into two categories. Category A are examples which do not relate to a previous or existing appointment while Category B are examples that do relate to a previous or existing appointment. The examples are not intended to be exhaustive and should not be treated as such.

Category A Examples that do not relate to a previous or existing appointment

- 500.81 The following situations involve a professional relationship which does not consist of a previous appointment.

500.82 **Appointment following audit related work**

Relationship:

The practice or an individual within the practice has previously carried out audit related work within the previous two years.

Response:

Except in the case of a members' voluntary liquidation, as provided for below, and in some limited circumstances in relation to an insolvent scheme of arrangement, as provided for in paragraph 500.85, a significant professional relationship¹ will arise. An insolvency practitioner should conclude that it is not appropriate to take the appointment, whether that appointment be as liquidator, provisional liquidator, special manager, receiver (and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement, or any other appointment referred to in paragraph 500.4 .

Where audit related work was carried out more than two years before the proposed date of the appointment of the insolvency practitioner, a threat to compliance with the fundamental principles may still arise. The insolvency practitioner should evaluate any such threat and consider whether the threat can be eliminated or reduced to an acceptable level by the existence or introduction of safeguards, including disclosure to creditors of the previous professional relationship.

This restriction does not apply where the appointment is in relation to a members' voluntary liquidation. An insolvency practitioner is not generally prevented from taking an appointment as liquidator in a members' voluntary liquidation in this situation. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles. Further, the insolvency practitioner should satisfy himself that the directors' certificate of solvency in a members' voluntary liquidation is likely to be substantiated by events.

¹See paragraphs 500.49 to 500.53.

500.83 Appointment – relationship with the holder of a debenture or floating charge

Relationship:

An insolvency practitioner, or an individual within his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder.

Response:

An insolvency practitioner should, in general, decline to accept an appointment in relation to an entity if he, or a member of his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder of the entity as might impair or appear to impair the insolvency practitioner's objectivity. Under normal circumstance, it is not considered likely that a close and distinct business connection would normally exist between an insolvency practitioner and, for example, a major financial institution simply because he is a retail customer of that institution. However, such a close and distinct business connection would exist where the insolvency practitioner, or a member of his practice, holds an appointment over such a financial institution.

500.84 Appointment following appointment as investigating accountant

Relationship:

The practice or a member of the practice was instructed by, or at the instigation of, a creditor or other party having an actual or potential financial interest in an entity to investigate, monitor or advise on its affairs.

Response:

A significant professional relationship would not normally arise in these circumstances provided that there has not been a direct involvement by an individual within the practice in the management of the entity or business. If the circumstances of the initial appointment were such as to prevent open discussion of the financial affairs of the entity with the directors, the investigating member or other individuals within the practice may be called upon to justify the propriety of their acceptance of the subsequent appointment.

500.85 Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client

Relationship:

A significant professional relationship.

Where there has been a significant professional relationship with a client, no individual within the practice unit should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement of that insolvent client. However, for the purposes of this paragraph a significant professional relationship shall not be deemed to have arisen by virtue of the appointment of an individual within the practice unit as liquidator or provisional liquidator of the client.

Response:

As indicated in paragraph 500.82, where there has been a significant professional relationship with a client, no individual within the practice should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement made by that insolvent client. However, this restriction may not apply in circumstances which clearly do not impair, and would not be perceived as impairing, his objectivity. This may be the situation where the scheme assets and scheme liabilities are substantially different from the assets and liabilities of the company that were previously audited. Nevertheless, in such cases, an insolvency practitioner should satisfy himself that there is no self-review threat or any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

Category B Examples relating to previous or existing appointments

500.86 The following situations involve a prior professional relationship that involves a previous or existing appointment.

500.87 Appointment following appointment as receiver

Previous/existing appointment:

An individual within the practice is, or in the previous two years has been, a receiver (or receiver and manager) of an entity or any of its assets.

Proposed appointment:

Appointment in an insolvent liquidation.

Response:

No individual within the practice should accept an appointment in relation to the entity in an insolvent liquidation. This restriction does not apply where the previous appointment was made by the court. However, before a court-appointed receiver accepts a subsequent appointment, he should disclose the position to the relevant parties. Even if the creditors do not object to the appointment, he should give careful consideration as to whether there are any circumstances that give rise to an unacceptable threat to compliance with the fundamental principles, such as whether his objectivity might be, or appear to be, impaired, and, if so, the appointment should be refused.

500.88 Conversion of members' voluntary winding-up into creditors' voluntary winding-up

Previous/existing appointment:

An individual within the practice has been the liquidator of a company in a members' voluntary winding-up.

Proposed appointment:

Liquidator in a members' voluntary winding-up, where it has been necessary to convene a creditors' meeting under section 237A of the Companies (Winding Up and Miscellaneous Provisions) Ordinance because it appears that the entity will be unable to pay its debts in full within the period stated in the certificate of solvency. The insolvency practitioner's continuance as liquidator will depend on whether or not he believes on reasonable grounds that the entity will eventually be able to pay its debts in full.

Response:

If the entity will not be able to pay its debts in full:

- (a) Where there has been a significant professional relationship, an insolvency practitioner should not accept nomination under the creditors' winding-up.
- (b) In situations where an insolvency practitioner has had no significant professional relationship, he may continue or accept an appointment as liquidator, subject to creditors' approval. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

If the insolvency practitioner concludes that the entity will eventually be able to pay its debts in full, he may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken, and where he has previously had a significant professional relationship, the insolvency practitioner must then resign and should not seek re-appointment.

500.89 **Trustee in bankruptcy following appointment as nominee of an individual voluntary arrangement**

Previous/existing appointment:

An individual within the practice has been the nominee of an individual voluntary arrangement in relation to a debtor.

Proposed appointment:

Trustee in bankruptcy.

Response:

An insolvency practitioner may normally accept an appointment as trustee in bankruptcy of that debtor provided that it is effected by a general meeting of creditors under the provisions of section 17 of the Bankruptcy Ordinance (Cap. 6). However, the insolvency practitioner should consider whether there are any circumstances that give rise to an unacceptable threat, in particular self-review threats, to compliance with the fundamental principles.

500.90 **Appointment as independent trustee of provident fund schemes of companies in liquidation or receivership**

Previous/existing appointment:

An insolvency practitioner who is the liquidator, provisional liquidator or receiver of a company.

Proposed appointment:

Independent Trustee of the provident fund scheme of such company.

Response:

An insolvency practitioner should not act and should not appoint an individual within his practice, or any close relative of any of the above or of himself, as "Independent Trustee" of the provident fund scheme of a company of which he is the liquidator, provisional liquidator or receiver.

500.91 **Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client**

Previous/existing appointment:

An individual within the practice has been the liquidator or provisional liquidator of an insolvent company.

Proposed appointment:

Administrator, manager or adjudicator of a scheme of arrangement of such company.

Response:

An insolvency practitioner may normally accept an appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client. However, when considering whether to accept such appointments, an insolvency practitioner should satisfy himself that there are no circumstances that give rise to an unacceptable threat, in particular self-review threat, to compliance with the fundamental principles.

Definitions

500.92 In section 500 of the Code, the following expressions have the following meanings:

Close relative	Includes a spouse (or equivalent), dependant, parent, grandparent, child or sibling, parents' sibling and his child.
Code	Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants.
Entity	Any natural or legal person or any group of such persons, including a partnership.
He/she	In this section, "he" is to be read as including "she".
Individual within the practice	The insolvency practitioner, any principals in the practice and any employees within the practice.
Institute	Hong Kong Institute of Certified Public Accountants.
Insolvency practitioner	An individual who has been appointed in respect of an appointment referred to in paragraph 500.4, or who provides professional services which may lead to such an appointment.
Insolvency team	An insolvency practitioner and any person under the control or direction of the insolvency practitioner.
Practice	The organisation in which the insolvency practitioner practises.
Principal	In respect of a practice: <ul style="list-style-type: none"> (a) which is a company: a director; (b) which is a partnership: a partner; (c) which is comprised of a sole practitioner: that person; Alternatively any person within the practice who is held out as being director or partner.

Effective Date

500.93 This section of the Code is effective on 1 April 2012.