Teaching Points of The Training Videos

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Addendum

Corruption Prevention Services for the Private Sector

Please note that with effect from 10 September 2026, the Corruption Prevention Advisory Service (CPAS) and the Hong Kong Business Ethics Development Centre (HKBEDC) of the Independent Commission Against Corruption (ICAC) have been restructured as the Private Sector Integrity Centre (PSIC).

Accordingly, any references to the CPAS and HKBEDC in this publication are to be read as referring to the PSIC from that date onwards.

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For enquires or services, please contact PSIC through the following channels:

- Hotline: 2526 6363
- Email: psic@cpd.icac.org.hk
- E-form: eform.cefs.gov.hk/form/ica004/en/
- Website: psic.icac.org.hk

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Private Sector Integrity Centre
Independent Commission Against Corruption
10 September 2026

廉政公署 ICAC

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The stories in this training package are based on the case study "Compliance and Beyond: A Tale of Two Companies" jointly developed by the Asia Case Research Centre (ACRC), The University of Hong Kong and Hong Kong Business Ethics Development Centre, ICAC. The original case study can be found at the website of the ACRC (www.acrc.hku.hk)

Unless otherwise explained, the discussions in the teaching notes are based on the laws and regulations in force in Hong Kong as at December 2016[1], irrespective of the time depicted in the relevant scenarios. The teaching notes cover only major points and do not cover all the issues dealt with. The provisions quoted in the teaching notes may have been summarised or edited. They are not necessarily quoted in their full and original versions.

The Main Board (MB) and the Growth Enterprise Market (GEM) of the Stock Exchange of Hong Kong are governed by two sets of listing rules, whilst the discussions in the videos focus on the MB Listing Rules, including the Corporate Governance Code, they apply equally to GEM Listing Rules.

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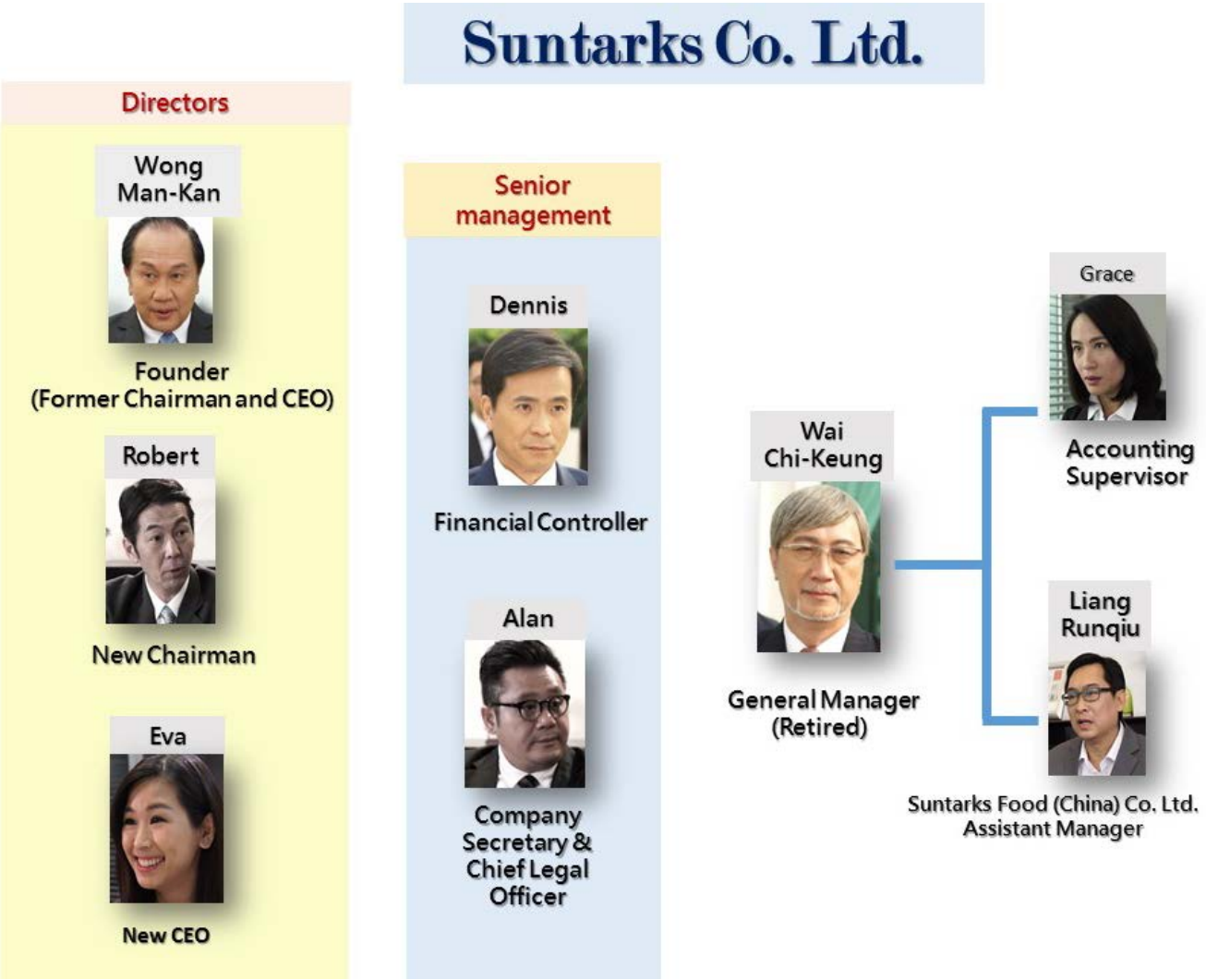
[1] Except for the *Code of Ethics for Professional Accountants* of Hong Kong Institute of Certified Public Accountants, which is effective from 15 July 2017

Story 1

Relationships of main characters



SYNOPSIS

Suntarks Co. Ltd. (Suntarks) was a Hong Kong listed company which evolved from three generations of family management from a small furniture company to a modern day conglomerate. Its founder, Mr WONG Man-Kan, believed in doing business with integrity and wanted his son, Robert, to take over the reins. When WONG stepped down in 1985, he retained the title of chairman and appointed Robert as executive director and CEO of the company. However, Robert was neither motivated nor interested in any aspect of the business. Even when Alan, the company secretary and chief legal officer, enthusiastically proposed mandatory compliance training programs for all employees and recommended a combination of executive and independent non-executive directors (INEDs) for Suntarks' board, Robert remained indifferent. He preferred acting as a rubber stamp and often shirked his responsibilities by leaving matters in the hands of his trusted general manager, WAI Chi-Keung (Ah Keung).

The third generation family member, Eva, was young, energetic and full of ambitions. However, most business matters including legal and compliance issues were over her head due to her youthfulness and lack of experience. After Ah Keung's retirement, Robert tasked Dennis YEUNG, the newly appointed financial controller, to look into all operations of Suntarks. Dennis was surprised to find out major lapses in the company's standard operating procedures and many Ah Keung's wrongdoings.

TEACHING POINTS

1. Ethical roles of company board and fiduciary duties of directors
2. Guardian roles of professionals
3. Bribery and cross-boundary corruption
4. Conflict of interest and other related crimes
5. Internal control and risk management

Issue 1 – Ethical roles of company board and fiduciary duties of directors

Suntarks' board of directors was mainly comprised of members of the WONG family.

Did Suntarks' board have a balanced composition?

No, Suntarks' board was mainly comprised of members of the WONG family (Robert, Eva and other grandchildren).

Though the like-mindedness of directors can ensure smooth co-operation among the directors and is conducive to the pursuit of common goals for the company, their connections might cast doubt on the credibility of the board and the objectivity of the board members. A balanced composition of directors on the board can render more effective monitoring of the company.

It is expected under the Corporate Governance (CG) Code that a board of directors of a listed company should have a balance of skills, experience and diversity of perspectives appropriate to the requirements of the company's business (CG Code para. A.3). In a board with a good mix of members, each director may bring valuable experience and skills that complement one another in order to arrive at well considered decisions at the highest level of a company. This will give a positive impact on all areas of company management including but not limited to strategy, risk management, compliance, business development and corporate culture.

Robert was indifferent in the family business. When he was the CEO, he often shirked his responsibilities to his trusted subordinate, Ah Keung.

Did Robert perform his duties as a company director well?

No, Robert's half-heartedness to the business is certainly not a good example to illustrate how a director should perform his duties. He shall exercise his duty as Suntarks' director with care, skill and diligence, applying the standards as required by laws and the MB Listing Rules.

The Stock Exchange of Hong Kong (SEHK) requires that every director shall have the experience and be able to demonstrate a standard of competence commensurate with his position as a director (Rule 3.09). He should also ensure that he can give sufficient time and attention to company affairs (CG Code A.6.3).

Worse still, Robert delegated much of his responsibility to Ah Keung. He shall perform his duty as a company director and must not delegate any of his powers except where he was authorised to do so by Suntarks' articles of association or by a proper resolution. He must exercise independent judgement in relation to any exercise of his powers (Principle 3 of the Company Registry's "A Guide on Directors' Duties").

Even if Robert had the proper authorisation to delegate his powers and functions, this did not absolve him from his responsibilities or from applying the required levels of skill, care and diligence. Robert still did not satisfy these required levels if he paid attention to Suntarks' affairs only at formal meetings. At a minimum, he must take an active interest in the company's affairs and obtain a general understanding of its business. He must follow up anything untoward that comes to his attention (Rule 3.08).

What was the role of Suntarks' board of directors in appointing Robert as director?

Suntarks' board should consider whether Robert is capable of being a director. A board of directors should also keep reviewing and monitoring the training and continuous professional development of directors and senior management (CG Code D.3.1). Suntarks' board should therefore provide Robert and other directors with training to ensure that they have the required level of skills to fulfil their duties.

While the board found it necessary to delegate the board's duties to management, the board should observe the company's constitution and have relevant resolutions passed before nominating Ah Keung to take up duties and responsibilities which should have been handled by Robert in his position as Suntarks' CEO. The board should also have a formal schedule of matters specifically reserved for board approval (CG Code D.1).

Dennis, the financial controller, reported to Robert on the major lapses in standard operating procedures and the misconduct of the general manager (Ah Keung). But he was brushed off by Robert without any useful instructions.

Did Robert handle the matter properly?

No, Robert brushed off Dennis and even tolerated Ah Keung's misconduct by asking Dennis to respect Ah Keung for his loyal service over the years. Robert just trusted Ah Keung blindly and did not care to look into the matter or review the systems.

As Suntarks' executive director and CEO, Robert was responsible for building an ethical corporate culture within the company. His failure to take appropriate action to address the company's deficiencies and staff misconduct might breach the duties as director to exercise care, skill and diligence as stipulated in laws and the MB Listing Rules.

What was the role of Suntarks' board of directors on this matter?

When the board received a report on this matter, it should consider carefully what follow up action to take, including the possibility of reporting the misconduct to the regulators and/or law enforcement agencies.

Since it was very likely that Dennis' findings would be categorised as "inside information", the board shall, as soon as reasonably practicable, disclose such information to the public according to Part XIVA of the Securities and Futures Ordinance (SFO).

More importantly, Suntarks' board had the responsibility to ensure that the company maintained sound and effective internal control. It has to ensure adequate resources for the company's accounting, internal audit and financial reporting functions. With the board setting an appropriate ethical tone at the top of the company's hierarchy, management should implement effective and concrete measures to give effect to such ethical values.

Eva, the inexperienced executive director, was unwilling to receive training for directors. As such, most business matters were over her head.

What was Eva's duty in this matter?

Eva shall exercise her duty as Suntarks' director with care, skill and diligence to the standards required by laws and the MB Listing Rules. The SEHK also requires that every director shall have the experience and be able to demonstrate a standard of competence commensurate with his position as a director (Rule 3.09).

In order to understand her own responsibilities and the company's conduct, business activities and development, Eva had the duty to receive a comprehensive, formal and tailored induction on appointment (CG Code A.6.1). She should also participate in continuous professional development to develop and refresh her knowledge and skills (CG Code A.6.5).

Issue 2 – Guardian roles of professionals

Alan, the company secretary and chief legal officer, diligently kept up with evolving rules and regulations and introduced various corporate governance measures in an effort to improve corporate governance of the company.

What position should Alan, as a company secretary, be placed in Suntarks' corporate governance?

As a general principle, Alan, as a company secretary, should support the board by ensuring good information flow within the board and that board policy and procedures are followed. He was also responsible for advising the board on governance matters (CG Code F).

Furthermore, Alan can be a promoter of Suntarks' corporate governance. As what he did right in the story, he should establish an effective working relationship with the chairman and the CEO, keep under close review all legislative, regulatory and corporate governance developments, advise the board on adopting the best practices (e.g., setting up an audit committee, introducing the INED system before the SEHK made it a mandatory requirement), facilitate induction and professional development of directors, etc.

In particular, the SEHK requires each company secretary to take no less than 15 hours of relevant professional training in each financial year (MB Listing Rule 3.29).

Eva, the inexperienced executive director, was unwilling to receive training.

What was the role of Alan as a company secretary on this matter?

Alan performed his duty as a company secretary by urging Eva to take the company's compliance training.

In case Eva did not take Alan's advice, Alan should report the issue to the board, which had the responsibility of reviewing and monitoring the training and continuous professional development of directors and senior management (CG Code D.3.1) and disclosing the compliance of each director, by name, with the training requirements in the CG Report.

Dennis, the financial controller, reported to Robert, the CEO, on the major lapses in standard operating procedures and Ah Keung's misconduct. But he was brushed off without any useful instructions.

What should Dennis do if he found Robert did not take appropriate action?

Dennis played a central management role in monitoring Suntarks' operations, in particular overseeing the company's financial activities and accounts to safeguard company assets and prevent fraud.

The Code of Ethics for Professional Accountants (HKICPA Code) of the Hong Kong Institute of Certified Public Accountants (HKICPA) sets out detailed guidance for senior professional accountants in business on how to respond to non-compliance with laws and regulations by their employers.

When a certified public accountant becomes aware of or suspects non-compliance in his company, he shall discuss with his immediate superior or a higher authority in the company, take appropriate steps to rectify or mitigate the consequences of the non-compliance, and decide whether it should be disclosed to the external auditor (HKICPA Code sections 360.16-18).

Applying this to the story, since the board had the ultimate responsibility for risk management and internal control of the company, Dennis shall raise the matter to the board, possibly through the audit committee, if he did not receive appropriate response from Robert.

In addition, Dennis shall also determine whether further action was needed, such as disclosing the matter to an appropriate authority and/or resigning from the company (HKICPA Code sections 360.19-27). In exceptional circumstances where an imminent breach of a law or regulation would cause substantial harm to investors, creditors, employees or the general public, Dennis might immediately disclose the matter to an appropriate authority. This would not be considered as a breach of the duty of confidentiality (HKICPA Code section 360.31).

Issue 3 - Bribery and cross-boundary corruption

Suntarks' assistant manager, LIANG Runqiu, was instructed by Ah Keung to work with the business consultant to send representatives of potential clients luxury goods, which were expensed as consultancy fees, in order to facilitate the procurement of contracts.

What were the legal implications of offering these gifts?

This was an act of bribery and may constitute criminal offences in several jurisdictions.

People's Republic of China (PRC)

Since the corrupt transactions took place in the mainland China, Ah Keung, LIANG and the business consultant violated the anti-bribery provisions in the PRC Criminal Law and the Anti-Unfair Competition Law (AUCL).

The PRC Criminal Law forbids any person, for the purpose of securing illegitimate benefits, from giving money or property to a State functionary (including an employee performing public duties in a State-owned enterprise) or (if the amount involved is relatively large) an employee of a company, etc. The unit(s) which offers bribes [Suntarks, Ganancia Natural Foods Limited (Ganancia) and/or Suntarks Foods (China) Company Limited (SFCCL)] shall also be fined if the circumstances are serious. The persons who are directly in charge shall be criminally liable.

The AUCL also prohibits business operators from using properties or other methods to bribe others in order to sell or purchase commodities.

Hong Kong (HK)

If any part of the bribery took place in Hong Kong, Ah Keung, LIANG and the business consultant would be found criminally liable under section 9 of the Prevention of Bribery Ordinance (PBO). It would be an offence if they, without lawful authority or reasonable excuse, offered gifts to representatives of potential clients as an inducement to or reward for securing contracts.

The United States of America (US)

Ganancia, SFCCL's holding company, was a US-listed company and therefore subject to the Foreign Corrupt Practices Act (FCPA). Any officer, director, employee or agent of Ganancia who participated in giving gifts to employees of Chinese state-owned enterprises, for the corrupt purpose of influencing an official decision, in obtaining or keeping business, may be prosecuted under the FCPA. Ganancia may also be liable under the FCPA for failing to keep accurate books and records and for failing to maintain a system of internal accounting controls in its subsidiary that may avoid or identify activities associated with bribery.

The United Kingdom (UK)

Similarly, since Ganancia had regional headquarters in the UK, it was under the jurisdiction of the UK Bribery Act 2010. Any British national, an ordinary resident in the UK and body incorporated in the UK may be prosecuted for bribing foreign public officials, including officers exercising public functions in state-owned enterprises, under section 6. With subsidiaries in both the UK and the PRC, Ganancia may also be liable under section 7 for failing to have adequate procedures to prevent its associated persons from bribing another person intending to obtain or retain business, even if such bribery took place in a non-UK territory.

Issue 4 - Conflict of interest and other related crimes

Ah Keung never disclosed to Suntarks that a regular supplier, Goldmark Company Limited. (Goldmark), was operated by his wife. The actual shipments delivered by Goldmark had been much fewer than what the accounting records showed.

Was there any breach of laws and regulations by Ah Keung and his wife?

There was a conflict of interest for Ah Keung because his wife was the sole director of Suntarks' supplier, Goldmark.

Ah Keung's private interest competed or conflicted with Suntarks' interest. Although a conflict of interest is normally not a criminal offence by itself, it leads to split loyalty. Ah Keung was in breach of his fiduciary duties as an employee of the company, such as the duty to act in good faith in the interests of the company, the duty to exercise powers for proper purpose, the duty to avoid conflicts of interest, etc. Ah Keung was therefore liable to compensate to Suntarks for any loss suffered.

More seriously, mishandling conflict of interest may lead to other associated criminal acts such as fraud against the company, corruption or submission of false documents to deceive the principal.

In the story, cheques had been regularly made out to Goldmark for fake shipments, all of which were handled by Ah Keung. He might also have intentionally omitted his relationship with Goldmark when submitting routine documents to declare his financial interest to Suntarks. Ah Keung therefore would have committed an offence under section 9(3) of PBO by using false documents with the intention to deceive Suntarks. It is also very likely that both Ah Keung and his wife were guilty of fraud and the common law offence of conspiracy to defraud.

In addition, it is very likely that the transactions between Suntarks and Goldmark were connected transactions under the MB Listing Rules. Ah Keung was a "connected person" under the MB Listing Rules because he was regarded as a "chief executive" of Suntarks (i.e. a person who is responsible under the immediate authority of the board of directors for the conduct of Suntarks' business). Goldmark was also a connected person if Ah Keung's wife (Ah Keung's immediate family member) could exercise 30% or more of the voting power at Goldmark's general meeting (MB Listing Rules 14A.07 and 14A.23). If that was the case, the transactions were subject to the requirements for connected transactions in the MB Listing Rules.

Issue 5 - Internal control and risk management

Dennis, the financial controller, discovered major lapses in standard operating procedures under Ah Keung's management.

What are these major lapses in standard operating procedures?

(i) Suntarks' accounting system was outdated and had not been updated for decades;

(ii) Approvals for expenses and payments were missing;

(iii) Large payments lacked adequate documentation (e.g. fully approved signed purchase orders and / or signed delivery slips) leaving incomplete paper trails.

How can Suntarks rectify these lapses?

Suntarks should tighten up its internal control system.

The company should have clear policies and procedures for all business functions, operations and processes so as to govern and provide adequate guidance on how they should be conducted. These should include clear definitions of the duties and responsibilities of each post, the procedures for carrying out business processes and the rank of staff responsible for them.

In addition, Suntarks should establish effective supervision. For example, supervisors should vet transactions and conduct spot checks. Important transactions and decisions should also be documented.

Companies are often cost conscious and are not prepared to invest in accounting and IT systems. An outdated accounting system may contribute to an ineffective internal monitoring system. As part of the internal control, the company should have adequate accounting functionality for reporting purposes, including the compilation of consolidated accounts for management purposes.

Suntarks' board plays a major role in enhancing internal control of the company. The chairman should take primary responsibility for ensuring that good corporate governance practices and procedures are established (CG Code A.2.5). This includes maintaining sound and effective internal control to safeguard the shareholders' investment and the company's assets.

The board should ensure that a review of the effectiveness of the company's risk management and internal control systems has been conducted at least annually, and report in the CG Report that it has done so (CG Code C.2.1). There should also be an internal audit function in the company (CG Code C.2.5). Such control mechanism should be properly positioned, staffed and resourced.

Suntarks' audit committee should also review the company's financial controls, risk management and internal control systems. Dennis, as the financial controller, should assist the board in achieving these aims.

Suntarks' assistant manager, LIANG Runqiu, was instructed by Ah Keung to work with the business consultant to send representatives of potential clients luxury goods, which were expensed as consultancy fees, in order to facilitate the procurement of contracts.

What can Suntarks and Ganancia do to prevent bribery in their companies as well as the companies under their control (such as SFCCL)?

Suntarks and Ganancia should ensure that they and the companies under their control (such as SFCCL) have robust internal control systems, so that all of them operate in compliance with the local laws and regulations and maintain their ethical corporate cultures. The fact that SFCCL is operated far from the principal places of business of Suntarks and Ganancia is not an excuse for lax supervision and control.

Suntarks and Ganancia should provide a mechanism to allow the board of directors and senior management to gain access to external legal or other professional advice at the company's expense when necessary to ensure that they could perform their duties in accordance with the laws and regulatory standards.

As far as preventing bribery and corruption is concerned, the companies should have an effective anti-corruption programme covering at least an anti-corruption policy and a code of conduct to provide anti-corruption guidance for all company personnel, including directors and staff.

Directors and employees should be specifically prohibited from offering any advantage, whether directly or indirectly, to others when conducting the company's business. Further rules, restrictions and guidelines governing the acceptance and offering of advantages and entertainment should be in place and communicated to all directors and all levels of staff. Training on the companies' anti-corruption policy and anti-corruption laws should be arranged to enhance staff knowledge and awareness.

Each company should establish a trustworthy system for individuals within or outside the company to make enquiry about the anti-corruption policy and report suspected irregularities in confidence. The Suntarks' board, and in particular its audit committee, may play an active role in providing such a channel (CG Codes C.3.7-8). This is particularly helpful because the bribery might have been prevented at the outset if LIANG had been able to make enquiries on the legality of the relevant act through a proper channel.

Ah Keung never disclosed to Suntarks that Goldmark was operated by his wife. The actual shipments delivered by Goldmark had been much fewer than what the accounting records showed.

How can Suntarks reduce the risk of being affected by conflicts of interest of its directors and employees?

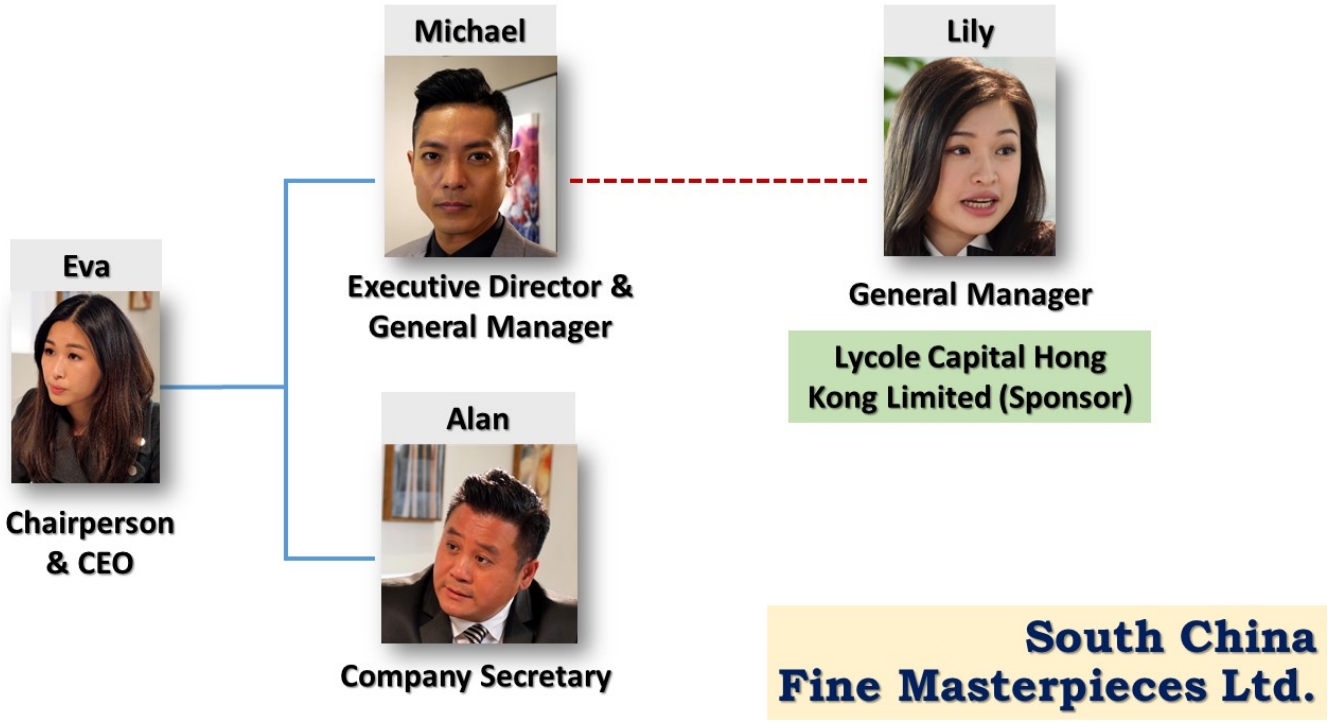
Suntarks should establish a mechanism for its directors and employees to manage conflicts of interest. For example, appointment letters, employment contracts and/or the company's code of conduct should specify the policies on handling conflicts of interest. The fundamental rule should be to avoid any conflict of interest, and if it cannot be avoided, the concerned director or employee should declare the conflict to the company. After receiving such declaration, Suntarks should take appropriate action to resolve the conflict, such as withdrawing the concerned member from performing the task or voting on the relevant matter.

The board should also closely monitor management's compliance with the board's directives and ensure that the company's key operations, especially the material transactions, are thoroughly reviewed and authorised by the board before being undertaken by management.

The company should also strengthen its internal control. For example, procurement duties can be carried out by two or more staff members or different teams to avoid abuse by any individual. Transaction records should be subject to random checks and audits.

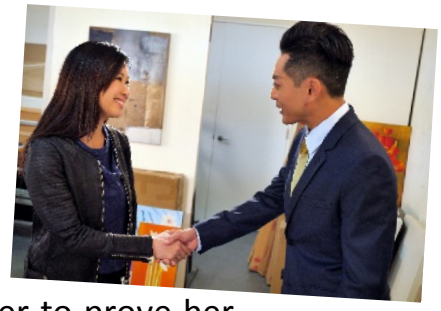
Story 2

Relationships of main characters



SYNOPSIS

Eva and Michael graduated from the same university in US, majoring in fine art and business respectively. After graduation, Eva joined her family business conglomerate founded by her grandfather and soon became an executive director of a listed company in Hong Kong. Despite her good performance and grandfather's recognition, she still felt lost because of her unfulfilled deep passion for fine art. On the other hand, Michael worked in an investment bank. Full of creative business ideas, he always wanted to have his own business but lacked capital.



The two bumped into each other one day and talked about the good old times. Michael seized the opportunity and masterminded a business concept which Eva believed was an idea to realise their dreams – together they founded South China Fine Masterpieces Limited (SCFM), a unique company offering clients a chance to invest in fine art. Eager to prove her abilities in combining her love of art with success in business to her family, Eva told her grandfather that SCFM had to be listed on the Stock Exchange of Hong Kong (SEHK) within four years of being established. Eva then pressured Michael and her subordinates to achieve the target.

Knowing Eva's determination, Michael ensured that SCFM would be listed as planned at all cost. On the fourth anniversary of SCFM's establishment, Eva banged the gong with a flourish at the market opening ceremony at the SEHK.

TEACHING POINTS

1. Ethical roles of company board and fiduciary duties of directors
2. Guardian roles of professionals
3. Bribery and other violations of laws / regulations
4. Conflict of interest and connected transaction

Issue 1 – Ethical roles of company board and fiduciary duties of directors

When Eva, SCFM's chairperson and CEO, queried Michael, the executive director and general manager, about SCFM's irregularities, Michael made a quick but flawed explanation. Then, Eva did not bother to pursue further enquiries.

Did Eva discharge her duties as a director on this occasion?

No, Eva failed to discharge her director's duty to exercise care, skill and diligence and did not monitor SCFM's financial position adequately.

Though she enquired about the irregularities, she did not pursue further when Michael gave a flawed explanation which could be easily detected. Eva placed too much trust on Michael and did not bother to examine the transactions in question.

As SCFM's chairperson, Eva should have a greater alertness to possible malpractice and should ensure that adequate risk management and internal control systems were in place in SCFM.

Michael created bogus transactions to inflate SCFM's sales figures, so that SCFM could satisfy the listing requirements and meet Eva's goal to have SCFM listed within four years.

What role did the board play to prevent such misconduct?

SCFM would have been able to prevent such misconduct, or at least detect such misconduct earlier, if it had tightened up its internal control system.

SCFM's board played a major role in enhancing the internal control. Although SCFM was not a listed company at the time being, it might take reference to the requirements for internal control in the Corporate Governance Code (CG Code).

For example, Eva, as the chairperson, should take primary responsibility for ensuring that good corporate governance practices and procedures are established. This includes maintaining sound and effective internal control to safeguard the shareholders' investment and the company's assets. SCFM should also separate the role of the chairperson and the CEO to maintain more effective control of executives. The board should ensure that a review of the effectiveness of the company's risk management and internal control systems had been conducted at least annually.

In order to circumvent the required lock-up period, Eva who took Michael's advice instructed a few SCFM employees to hold share options on her behalf.

Did Eva perform her fiduciary duties as a director in this matter?

Eva and Michael used their powers to instruct employees to hold share options on Eva's behalf in the furtherance of Eva's personal motive to liquidate her SCFM shares quickly. Such act was a breach of a director's duty to act in good faith in the best interests of the company.

Issue 2 - Guardian roles of professionals

SCFM's senior accountant informed Eva about the irregularities (e.g. using the same painting as collateral for three separate loans at three different banks) in the financial report.

Did the senior accountant fulfil his professional role?

SCFM's senior accountant largely performed his professional and guardian role by reporting irregularities in the financial report to Eva.

The Code of Ethics for Professional Accountants (HKICPA Code) of the Hong Kong Institute of Certified Public Accountants (HKICPA) specifies that a certified public accountant's (CPA) responsibility is not exclusively to satisfy the needs of an individual client or employer (HKICPA Code section 100.1). In acting in the public interest, a CPA shall observe and comply with the fundamental principles including integrity, objectivity, professional competence and due care, confidentiality and professional behaviour (HKICPA Code section 100.5).

In particular, the HKICPA Code specifies that the senior accountant shall take reasonable steps to maintain information which represents the facts accurately and completely in all materials respects (HKICPA Code section 320.3). He shall take action to reduce the threat, such as consulting with superiors, the audit committee (if any) or those changed with governance of the company (e.g. the board) (HKICPA Code section 320.6). Where it was not possible to reduce the threat to an acceptable level, the senior accountant shall refuse to be or remain associated with the misleading information (HKICPA Code section 320.7).

When the reporting accountant tried to follow up the serious issues in the listing process, SCFM immediately replaced her.

Did the reporting accountant discharge her role?

Yes. Being an independent accountant engaged by SCFM in preparing a report for inclusion in the prospectus, the reporting accountant discovered irregularities in the financial records, which were critical to the ascertainment of profit or the presentation of results. The reporting accountant also tried to undertake further detailed audit procedures when she could not satisfy herself in all material respects (HKICPA's Auditing Guideline 3.340).

The HKICPA Code sets out detailed guidance for professional accountants in public practice (for example the reporting accountant) on how to respond to non-compliance with laws and regulations by their clients. The reporting accountant shall determine whether further action was needed, such as disclosing the matter to an appropriate authority (HKICPA Code sections 225.23-32). In exceptional circumstances where an imminent breach of law or regulation would cause substantial harm to investors, creditors, employees or the general public, the reporting accountant might immediately disclose the matter to an appropriate authority. This would not be considered as a breach of the duty of confidentiality (HKICPA Code section 225.36).

Michael promised Lily, the general manager of SCFM's sponsor [Lycole Capital Hong Kong Ltd. (Lycole)], a secret cash bonus if the listing could be achieved in time. As a result, Lily's team hurriedly completed the due diligence process without reviewing key original documents.

Did Lily perform her professional role in this matter?

No. As a licensed person under the Securities and Futures Ordinance (SFO) for performing Type 6 activity (i.e. advising on corporate finance), Lily was expected under the SFO to be fit and proper for the regulated activity. She should act honestly, fairly and in the best interests of her clients and the integrity of the market. She should also act with due skill, care and diligence. [General Principles 1 & 2 of Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (SFC Code of Conduct)].

However, Lily agreed to accept Michael's secret bonus for assisting in SCFM's listing application. She expedited the due diligence by not reviewing many key original documents or verifying collateral for major loans. Sponsor checklists were simply ticked off on the basis of blanket statements signed by Michael. All these acts clearly did not meet the expected standard of conduct.

Alan, SCFM's company secretary, learnt from Lycole's due diligence unit in China that there were irregularities in respect of SCFM's operation in China, but he did not pursue the matter.

Was it right for Alan not to pursue the matter?

Although Alan was not directly involved in committing the irregularities, he, as part of the SCFM senior management team, should handle the discovery of material irregularities with care and diligence. Alan gave up too easily after Michael told him not to bother about the irregularities but to let Lily solve the problems. Alan should uphold his professional judgement even when under pressure to meet the listing deadline set by Eva. He should bring the issue to Eva if he suspected any non-compliance or misconduct.

As SCFM's company secretary, Alan had the responsibility to ensure the information in the listing document and the prospectus was true. He and other SCFM directors might be subject to criminal and civil liabilities under the SFO and the Companies (Winding Up and Miscellaneous Provisions) Ordinance [C(WUMP)O] if he knowingly or recklessly (or negligently on some occasions) authorised the disclosure of such false information to the public.

What should Lycole's due diligence unit in China do if SCFM did not follow up their findings?

It was Lycole's duty to have clear reporting lines and channels so that decisions on critical matters (such as the resolution of suspicious circumstances, conflicting information and material non-compliance by a listing applicant) would be made by Lycole's management rather than the transaction team carrying out the listing assignment (SFC Code of Conduct 17.11).

Therefore, Lycole's due diligence unit in China should bring the issue to the attention of Lycole's management when SCFM failed to clarify or explain the irregularities uncovered during the due diligence process.

Issue 3 – Bribery and other violations of laws / regulations

Michael promised Lily, Lycole's general manager, a secret cash bonus if the listing could be achieved in time. As a result, Lily's team hurriedly completed the due diligence process without reviewing original key documents.

Was there any violation of legislation / regulation?

Both Lily and Michael were liable for bribery under section 9 of the Prevention of Bribery Ordinance (PBO). Lily, as an employee of Lycole, accepted Michael's cash bonus (the bribe) without Lycole's approval for expediting the due diligence process without reviewing key original documents. At the same time, Michael was the offeror of the bribe.

Moreover, they also violated section 384 of the SFO for providing false information to the Securities and Futures Commission (SFC) and the Stock Exchange of Hong Kong (SEHK) in purported compliance with statutory requirements in the listing process. They were also subject to criminal and civil liabilities under the SFO and the C(WUMP)O as they knowingly authorised the disclosure of such false information to the public.

When Eva asked Michael about the irregularities (e.g. having the same painting as collateral for three loans at three different banks), Michael gave a quick but flawed explanation.

What was the possible reason for Michael's flawed explanation?

If the senior accountant's findings were valid, a possible reason for Michael's inconsistent explanation was that Michael wanted to hide his misconduct or non-compliance with laws and regulations.

Michael might have committed fraud against banks if he used the same painting as collateral for three separate loans at three different banks without informing the banks. He might also have committed theft if he misappropriated the funds after obtaining the loans. Furthermore, Michael, as an agent of SCFM, might have breached section 9(3) of the PBO if he used false accounting records with the intention to deceive his principal, SCFM.

Michael created bogus transactions to inflate SCFM's sales figures, so that SCFM could satisfy the listing requirements and meet Eva's goal to have SCFM listed within four years.

Did Michael commit any criminal offences?

In order to make SCFM meet the listing requirements, Michael inflated the sales figures of SCFM by creating bogus transactions with shell companies controlled by himself. He also falsified invoices and book records of SCFM to make the transactions more plausible.

Since SCFM was required under MB Listing Rule 9.11(3a) to lodge to the SEHK a written confirmation signed by each director that the information in the listing application documents was accurate and complete in all material respects and was not misleading or deceptive, Michael's act might amount to fraud against SEHK. Michael might also be subject to prosecution under section 384 of the SFO for knowingly providing false information to the SEHK and the SFC in purported compliance with statutory requirements in the listing process.

Moreover, as the listing document and the prospectus contained false information to induce investors to subscribe SCFM's shares, Michael also violated section 298 of the SFO and section 40A of the C(WUMP)O. He and SCFM might also have civil liabilities for disseminating such false information.

Did Eva contribute to Michael's misconduct?

Yes, Eva's rather unrealistic ambition to have SCFM listed within four years created excessive pressure on her subordinates. This partly contributed to Michael's fraudulent accounting practices as a way to cut corners.

As such, Eva as well as the board and the senior management should have a more realistic performance expectation, and should devise suitable strategies for SCFM's sustainable development.

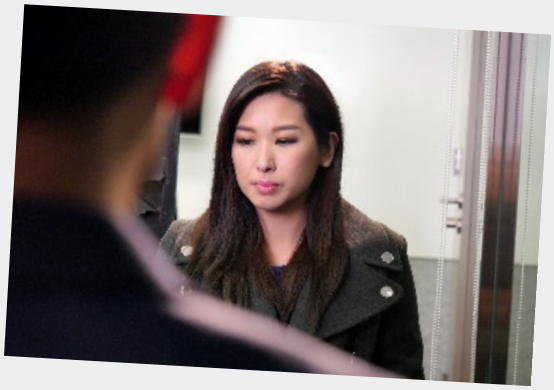
Was it possible for SCFM to prevent such misconduct?

Yes. SCFM would have been able to prevent such misconduct, or at least detect such misconduct earlier, if it had tightened up its internal control systems.

For example, the company should have maintained proper segregation of duties, so that important business processes (e.g., sales and marketing, inventory control) were carried out by more than one person. Important transactions and decisions should be well documented. An internal audit function should also be set up with adequate resources to perform periodic and surprise checks.

In order to circumvent the required lock-up period, Eva who took Michael's advice instructed a few SCFM employees to hold share options on her behalf.

Was it lawful to circumvent the lock-up period?



The MB Listing Rules require that controlling shareholders of a newly listed company shall not dispose of any options or interests in respect of the shares within the first six months of listing (MB Listing Rule 10.07).

The deliberate attempt of Eva and Michael to circumvent the lock-up requirement by granting share options to their employees as nominees constituted the common law offence of conspiracy to defraud. If the employees had the knowledge of the scheme, they would also be liable to prosecution.

As the grant of share options was not genuine and that Eva was still the beneficial owner of the options and shares held by the employees, disclosing the grant of share options in the prospectus could not absolve Eva and Michael from their liabilities.

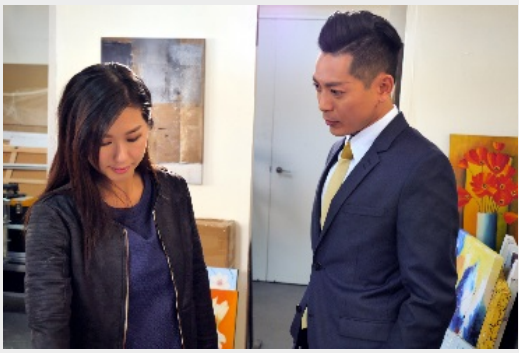
Issue 4 – Conflict of interest and connected transaction

SCFM had financial transactions with its chairperson and CEO, Eva, such as renting her warehouse and paying for renovations of the warehouse.

Were there any legal requirements for these transactions?

It is common that a company has financial transactions with its directors or shareholders. The rule of thumb is that the transactions shall not involve fraud; and the potential conflict of interest should be handled properly (such as proper disclosure of the conflict). As Eva, a director of SCFM, had significant interest in these transactions with the company and such transactions were significant in relation to SCFM's business, she must declare the nature and extent of the interest to other directors according to the Company Ordinance (section 536). Failure to do so is an offence (section 542).

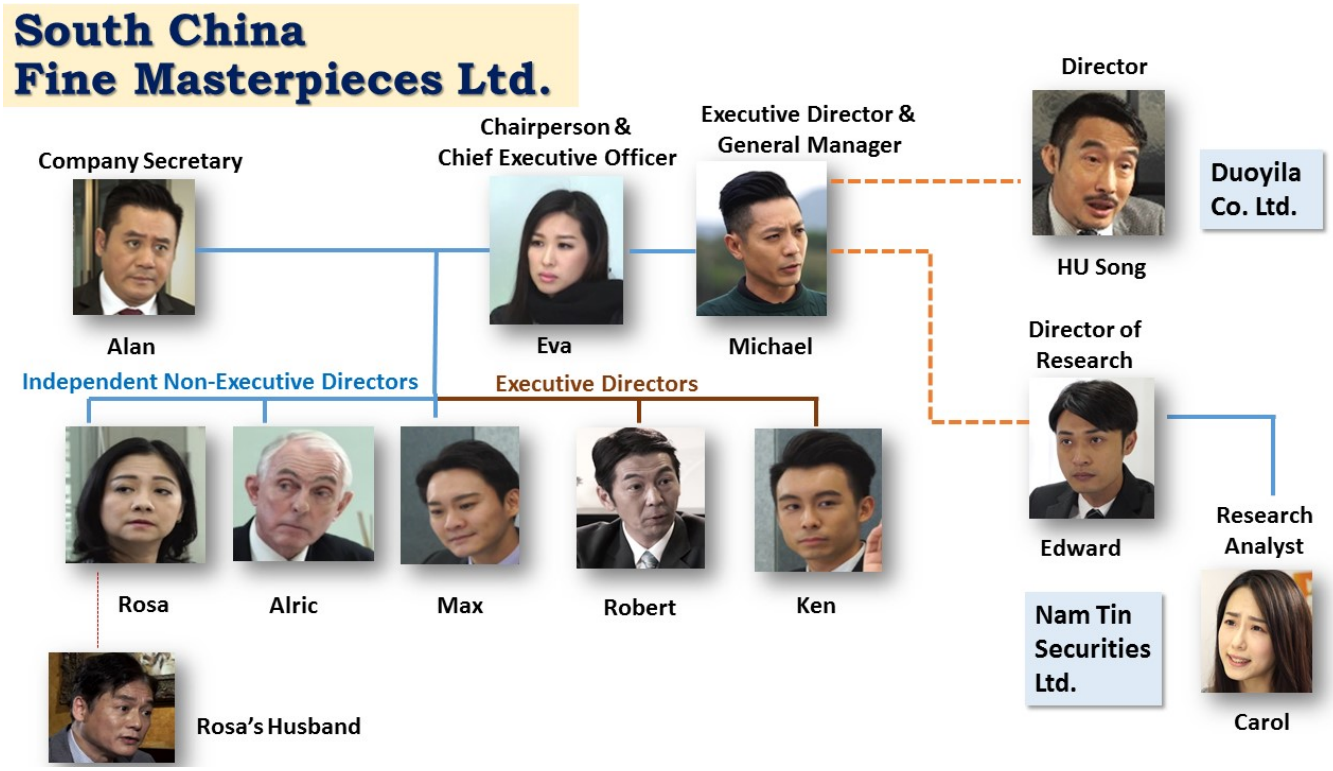
On the other hand, connected transaction is an example of conflict of interest that may occur in listed companies, and is governed by the MB Listing Rules. A connected transaction includes any transaction between a listed company or any of its subsidiaries and a connected person (e.g. a director, a chief executive or a substantial shareholder, etc.). The objectives are to ensure that listed companies take into account the interest of all shareholders with respect to connected transactions and more specifically to provide safeguards against directors and other senior managers taking advantage of their positions by requiring independent shareholders' approval for connected transactions.



Though SCFM was still a private company at this stage and was outside the ambit of the Listing Rules of the SEHK, renting the warehouse from Eva would become a continuing connected transaction when SCFM became a listed company later. SCFM and Eva shall follow the disclosure and approval requirements under Chapter 14A of the MB Listing Rules.

Story 3

Relationships of main characters



SYNOPSIS

Inside the conference room of South China Fine Masterpieces Limited (SCFM), the board members were leisurely chatting, waiting for the meeting to start. Indeed, most of them had no clues on the agenda because the meeting was summoned only a few days ago. In fact, they only concerned how soon the meeting would finish.

Eighteen months after the company went public, the executive director and general manager of SCFM, Michael, was approached by HU Song of Duoyila Co. Ltd. (Duoyila), a Shanghai auction house specializing in fine art, jewellery and collectibles. HU proposed a reverse takeover of SCFM as a way to get Duoyila listed on the Stock Exchange of Hong Kong (SEHK). He even sweetened the deal by offering Michael a substantial cash commission to bring SCFM's chairperson, Eva, onside.

On the other hand, a securities analyst, Carol, questioned SCFM's abnormal revenue growth and extraordinary inventory turnover. Despite Carol's repeated enquiries, SCFM did not answer her questions. To ensure a smooth reverse takeover, Michael asked Edward, Carol's supervisor, to publish a favourable "buy" report of SCFM and promised to reward Edward for his assistance.

The board meeting finally started. Alan, the company secretary, was asked by the chairperson to make a quick presentation on the offer. The only question raised by an independent non-executive director (INED) was interrupted and the board members were rushed to vote on the deal. After the board meeting, Alan received an anonymous letter reporting SCFM's fraud and corruption.

TEACHING POINTS

1. Ethical roles of company board and fiduciary duties of directors
2. Guardian roles of professionals
3. Bribery and other violations of laws / regulations
4. Insider trading
5. Whistleblowing and handling of misconduct

Issue 1 – Ethical roles of company board and fiduciary duties of directors

SCFM's board unanimously approved the transactions related to the reverse takeover at a short meeting without considering the proposal thoroughly.

Did the board fully discharge its duties in the approval process?

It was the board's responsibility to provide the company with leadership and guidance in formulating the company's long-term strategy. Each director must also take an active interest in the company's affairs and exercise care, skill and diligence when making decisions. The proposed deal was important to SCFM's development and should be thoroughly considered by members of the board before a vote was taken. However, SCFM's directors were not interested in or given the opportunity to carefully consider the proposal.

One of Eva's important roles as chairperson was to provide leadership to the board [Corporate Governance Code (CG Code) A.2.4]. She should have encouraged all directors to make a full and active contribution to the board's affairs, encouraged those with different views to voice their concerns and allowed sufficient time for discussion (CG Code A.2.6). However, Eva failed to do so and rushed the board members to show hands in favour of the transaction. She also did not intervene when Michael cut off an INED's question. Board members were not provided with the opportunity for discussion.

Besides, many of SCFM's directors were friends or members of the WONG family who apparently lacked knowledge of the company's business and/or did not have an interest in discussing the proposal seriously. They apparently did not prepare for the meeting. They also showed no interest in the discussion at hand and did not raise any questions. It is reasonable to conclude that they did not fully carry out their duties by actively contributing to learned and meaningful discussions about the company's affairs, and in particular that significant transaction.

Did the three INEDs (Max, Alric and Rosa) perform their roles well at the meeting?

While all directors, including INEDs, share the same duties and responsibilities, one of the special roles of INEDs and other non-executive directors is to bring an independent judgement to bear on board affairs (CG Code A.6.2). They should dare to challenge the proposals of management and speak out firmly and objectively on the issues that come before the board. Such independence is even more important in this story, where SCFM's chairperson and other directors appear to conform to "group think".

However, such duties were not discharged by the three INEDs of SCFM. It appears that the INEDs were ready to accept management's proposal without making in-depth enquiry. Alric PARKER did try to pose the only question asked at the meeting, but he was quickly brushed off by Michael and did not insist on pursuing the answer to his question. The result was that the proposal was approved by the board without truly being examined.

In fact, the independence and the suitability of some of SCFM's INEDs were also questionable. Max CHANG was appointed as INED mainly because he was a friend of the WONG family. If Max's decision to vote in favour of the reverse takeover was to consolidate his friendship with the Wong family, but not in the best interest of SCFM, he was in breach of his duty as a SCFM director to act in good faith and for a purpose for the benefit of the company as a whole (Principles 1 and 2 in the Company Registry's "A Guide on Directors' Duties").

Another INED Rosa MAK, a world renowned musician and once Eva's music tutor, had no knowledge of or experience in managing a business organisation like SCFM. It is therefore reasonable to question whether she could perform her roles with the required independence and level of competency. In deciding whether Rosa breached her duty as a SCFM director to exercise reasonable care, skill and diligence, both the general knowledge, skill and experience that may reasonably be expected of a director carrying out her functions as the director of the company (the objective test) and her own general knowledge, skill and experience (the subjective test) pursuant to section 465 of the Company Ordinance (CO) have to be considered.

SCFM was audited by a small accounting firm.

What is the role of SCFM's board in overseeing the company's financial reporting and audit process?

SCFM's board was responsible for establishing formal and transparent arrangements to consider how it would apply financial reporting, risk management and internal control principles and maintain an appropriate relationship with its auditors (CG Code C.3).

In particular, the board's audit committee, which must be mainly comprised of INEDs (MB Listing Rule 3.21), should review the external auditor's independence and objectivity and the effectiveness of the audit process. It should also monitor the integrity of the company's financial reports and review significant financial reporting judgement contained in them (CG Code C.3.3).

Issue 2 – Guardian roles of professionals

SCFM's external auditor was a small accounting firm and SCFM was its major client.

Was this firm an appropriate external auditor for a listed company like SCFM?

One of the issues determining whether an accounting firm is an appropriate external auditor is if the firm is independent of the company to be audited. Independence and integrity of an external auditor are of the utmost importance to ensure that the firm can provide an objective opinion on the truth and fairness of the financial statements and can maintain an attitude of professional scepticism.

According to the Code of Ethics for Professional Accountants (HKICPA Code) of Hong Kong Institute of Certified Public Accountants (HKICPA), the independence of the accounting firm in the story might be threatened. If the total fees from SCFM represented a large proportion of revenue of the firm, this might cause the firm a dependence on SCFM and concern about losing SCFM. The threat was even more apparent since the firm had a small operating structure. If the firm did not apply sufficient safeguards to reduce such threat to an acceptable level, there would be reasonable grounds to suspect that the firm was not independent enough to give a reliable "true and fair" view in the reports.

Edward, director of research at Nam Tin Securities Limited, accepted a secret commission from Michael, SCFM's executive director and general manager, for issuing a favourable "buy" report on SCFM.

Did Edward fulfill his fiduciary duties as a professional analyst?

No. Edward was a licensed person under the Securities and Futures Ordinance (SFO) to prepare and publish investment research on securities. He must be fit and proper to be licensed for the regulated activity and abide by the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (SFC Code of Conduct).

However, he failed to meet the requirements for he breached a number of general principles of the SFC Code of Conduct, including:

- GP1 – to act honestly, fairly, and in the best interests of their clients and the integrity of the market;
- GP2 – to act with due skill, care and diligence, in the best interests of their clients and the integrity of the market; and
- GP6 – to try to avoid conflicts of interest.

In addition, he breached the SFC Code of Conduct for failing to disclose the financial relationship with SCFM in the research report (SFC Code of Conduct para 16.8). It was also questionable whether he met the requirement to have a reasonable basis for his analyses and recommendations in the research report (SFC Code of Conduct para 16.11).

SCFM's board unanimously approved the transactions related to the reverse takeover at a short meeting without considering the proposal thoroughly.

Did Alan, the company secretary, performed his role well at the board meeting?

Alan performed his role as a company secretary dutifully by keeping SCFM's board informed of all the developments of the proposal. He prepared board meeting papers, made a detailed presentation at the meeting and solicited questions from board members, with the aim to facilitate meaningful discussion. However, when it became readily apparent that the directors were ready to accept whatever management proposed, Alan should act as the "conscience of the company" and provide an additional enquiring voice. He should also alert the board members to potential red flags as well as the nature and extent of risks related to the decision to be made.

Issue 3 – Bribery and other violations of laws / regulations

HU Song of Duoyila proposed a reverse takeover of SCFM. Having agreed to accept HU's substantial cash commission, Michael, SCFM's executive director and general manager, persuaded Eva to accept HU's offer.

Was there any misconduct in the negotiation for the reverse takeover deal?

Both Michael and HU committed a bribery offence under section 9 of the Prevention of Bribery Ordinance (PBO). It was an offence that Michael, as an agent of SCFM, agreed to accept a cash commission from HU, without SCFM's approval, as a reward for facilitating the reverse takeover offer. HU was also liable to prosecution for offering the bribes.

Moreover, it is clear that Michael breached his duty as a SCFM's director to act in good faith for the benefit of the company as a whole and to avoid conflict of personal interests against the interests of the company when entering into such deal.

Furthermore, the Stock Exchange of Hong Kong (SEHK) sets stringent requirements on reverse takeovers in its Listing Rules, Listing Decisions and Guidance Letters, etc. The Securities and Futures Commission (SFC) has also issued the Codes on Takeovers and Mergers to govern the conduct in takeovers. SCFM and Duoyila needed to comply with these requirements when proceeding with the deal.

Edward, director of research at Nam Tin Securities Limited, accepted a secret commission from Michael for issuing a favourable "buy" report on SCFM.

What liabilities did Edward and Michael have for this act?

Being an employee and agent of Nam Tin Securities Limited, Edward failed to perform his fiduciary duties in the interests of his employer. He also violated section 9 of the PBO for he, without his employer's approval, accepted a secret commission from Michael for issuing a favourable "buy" report on SCFM.

Michael, who offered the bribes to Edward, was also liable to prosecution.

Alan, the company secretary, received an anonymous letter with serious allegations of corruption and fraud in SCFM.

What were the legal implications if the allegations were true?

Although the anonymous report did not mention who created the fictitious sales of paintings and made false statements about the use of the land in Shanghai, it is reasonable to infer from the story that Michael is the person who committed such misconduct.

The false transactions may have been used to fulfil listing requirements. Since SCFM was required under MB Listing Rule 9.11(3a) to lodge to the SEHK a written confirmation signed by each director that the information in the listing application documents was accurate and complete in all material respects and was not misleading or deceptive, Michael's act might amount to fraud against the SEHK. Michael might also be subject to prosecution under section 384 of the SFO for knowingly providing false information to the SEHK in purported compliance with statutory requirements in the listing process.

Since the listing document and the prospectus may have contained false information to induce investors to subscribe for SCFM's shares, Michael may have violated section 298 of the SFO and section 40A of the Companies (Winding Up and Miscellaneous Provisions) Ordinance [C(WUMP)O]. He and SCFM might also have civil liabilities for disseminating such false information.

Issue 4 – Insider trading

After SCFM's board approved the transactions with Duoyila, Rosa, SCFM's INED, disclosed this news to her husband who immediately purchased shares of SCFM.

Was the news about the approval for the proposed transactions with Duoyila inside information under the SFO?

Yes. The news was inside information as defined under the SFO because it was about the listed company SCFM, it was not generally known; but would, if generally known, be likely to materially affect the share price of SCFM, i.e., price sensitive.

Were Rosa and her husband involved in insider dealing?

Yes. The purchase of SCFM's shares by Rosa's husband was insider dealing because he obtained such information from Rosa and purchased the SCFM shares in order to make profits before such information became public knowledge. He was subject to civil and criminal liabilities under the SFO.

Rosa might also be subject to such liabilities if she knew or had reasonable cause to believe that her husband would make use of the information for the purpose of dealing in the shares. In any case, she breached the requirement in the MB Listing Rules to take all reasonable steps to maintain the confidentiality of the inside information until it was announced (MB Listing Rule 13.06A). She also breached her duty as a director to act honestly and in good faith in the interests of the company as a whole.

What should SCFM's board do regarding this news?

Under Part XIVA of the SFO, SCFM must, as soon as reasonably practicable after any inside information had come to its knowledge, disclose the information to the public. One of the exceptions to the disclosure requirement is that SCFM took reasonable precautions for preserving the confidentiality of the information, and the information concerned an incomplete proposal or negotiation. (SFO sections 307B-D).

It was the responsibility of every officer of SCFM to take all reasonable measures from time to time to ensure that proper safeguards existed to prevent a breach of a disclosure requirement in relation to the corporation (SFO section 307G).

If SCFM's board determined that it should not disclose the news to the public at that moment, it should take reasonable precautions to safeguard confidentiality. The board, for example, should establish written guidelines for relevant employees and directors, and should have in place procedures and internal control for handling and disseminating inside information.

Issue 5 - Whistleblowing and handling of misconduct

Alan, the company secretary, received an anonymous letter with serious allegations of corruption and fraud in SCFM.

Was the whistleblowing mechanism adequate in SCFM?

There was no apparent whistleblowing mechanism in SCFM. The anonymous tipster had to resort to guessing how and to whom to make a whistleblowing report.

It is a recommended best practice under the CG Code that the audit committee should establish a whistleblowing policy and system for employees and other stakeholders to raise concerns about possible improprieties in a confidential manner (CG Code C.3.8). Such policy and system should be clearly written and relayed to relevant stakeholders, particularly employees, customers and suppliers.

What should Alan do after receiving the letter?

The company secretary's role as a promoter of corporate governance is highlighted by the Hong Kong Institute of Chartered Secretaries (HKICS) in its guide for members *The Essential Company Secretary*. The guide emphasises that "company secretaries cannot afford to ignore any cases of non-compliance with legislation or regulation that come to their attention, even if the directors have purported to make someone else responsible for those matters." (*The Essential Company Secretary* para 3.5).

Alan, as the company secretary, therefore had a responsibility to follow up the allegation of misconduct when it came to his attention. He should bring the case to the attention of SCFM's board and advise the board how to proceed with appropriate follow up action. He should also consider reporting the criminal offences and/or non-compliance with laws and regulations to the relevant authorities.

Furthermore, Alan must not participate in the furtherance of such fraud or criminal acts, otherwise he would also be potentially liable to prosecution. Although Alan was not a director of the company, if the company committed an offence by a contravention or failure under the CO, Alan would be liable as a "responsible person" of the company, which is defined in section 3(2) of the CO as an officer of the company (including a director, manager or company secretary) who "authorises or permits, or participates in the contravention or failure".

GLOSSARY

AUCL	Anti-Unfair Competition Law
C(WUMP)O	Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)
CEO	Chief executive officer
CG	Corporate Governance
CG Code	Corporate Governance Code (Appendix 14 of the MB Listing Rules)
CG Report	Corporate Governance Report
CO	Companies Ordinance (Cap 622)
CPA	Certified Public Accountant
Duoyila	Duoyila Company Limited (fictional)
FCPA	US Foreign Corrupt Practices Act of 1977
Ganancia	Ganancia Natural Foods Limited (fictional)
Goldmark	Goldmark Company Limited (fictional)
HKICPA	Hong Kong Institute of Certified Public Accountants
HKICPA Code	Code of Ethics for Professional Accountants
HKICS	Hong Kong Institute of Chartered Secretaries
INED	Independent non-executive director
Lycole	Lycole Capital Hong Kong Limited (fictional)

GLOSSARY

MB Listing Rules	Listing Rules of the Main Board of the Stock Exchange of Hong Kong
PBO	Prevention of Bribery Ordinance (Cap 201)
PRC	People's Republic of China
SCFM	South China Fine Masterpieces Limited (fictional)
SEHK	Stock Exchange of Hong Kong
SFC	Securities and Futures Commission
SFC Code of Conduct	Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission
SFCCL	Suntarks Foods (China) Company Limited (fictional)
SFO	Securities and Futures Ordinance (Cap 571)
Suntarks	Suntarks Company Limited (fictional)
UK	The United Kingdom
US	The United States of America