

For discussion

**Bills Committee on
Financial Reporting Council Bill**

**Follow-up actions arising
from the meeting held on 6 December 2005**

PURPOSE

At the meeting held on 6 December 2005, the Bills Committee deliberated, among other things, the Administration's paper entitled "Component Two: Audit Investigation Board" (LC Paper No. CB(1)286/05-06(03)). This paper sets out the Administration's responses to the follow-up actions as set out in the letter of 9 December 2005 from the Clerk to the Bills Committee.

**INTERFACE BETWEEN INVESTIGATION AND DISCIPLINARY
PROCEEDINGS**

2. Noting that the Financial Reporting Council Bill (the Bill) contains a number of provisions¹ ensuring that there would be a smooth interface between (i) investigations of the Financial Reporting Council (FRC) and (ii) the disciplinary proceedings of the Hong Kong Institute of Certified Public Accountants (HKICPA) and proceedings of other agencies, some Members invited the Administration to consider the following matters / views -

- (a) As the FRC would be empowered to refer cases or complaints to the HKICPA, administrative arrangements should be put in

¹ Please refer to paragraphs 10 and 11 of the Administration's paper entitled "Functions of the Financial Reporting Council" (LC Paper No. CB(1)2288/04-05(34)) as discussed by the Bills Committee at its meeting held on 17 November 2005.

place for the HKICPA to inform the FRC of the follow-up action taken on the cases and their outcome; and

- (b) Noting that, after investigation, the FRC would be empowered to refer a case to the HKICPA for instituting disciplinary proceedings, some Members asked whether the Bill should provide that the HKICPA should be required to refer any fresh evidence obtained or new complaints revealed in the course of the disciplinary proceedings back to the FRC for review or further investigation.

3. Regarding paragraph 2(a), as we explained at the meeting held on 17 November 2005, the hearings of a Disciplinary Committee constituted by the HKICPA are generally held in public pursuant to section 36(1A) of the Professional Accountants Ordinance (PAO, Cap. 50)². In this light, the public (including the future FRC) is already able to keep track of the outcome of the cases³ in respect of which disciplinary proceedings have commenced. Having said this, we will convey Members' suggestion to the HKICPA and the future FRC for their consideration when they discuss the administrative arrangements governing the activities of the two bodies.

4. Regarding paragraph 2(b), where evidence not revealed in preceding investigation is uncovered during the disciplinary proceedings, the Disciplinary Committee has powers to receive and consider the evidence, as well as to examine the witness regarding the weight of such evidence during the proceedings⁴. Moreover, where the situation warrants, it is possible for the FRC to assist the HKICPA in considering the newly-revealed evidence. In this respect, **clause 9(g)** of the Bill provides that it is within the functions of the FRC to provide assistance to a specified body on the body's dealing with the case or complaint

² See **Annex**.

³ Moreover, if a Disciplinary Committee is satisfied that a complaint is proved and orders that the name of the certified public accountant be removed from the register, section 35(3) of the PAO (see **Annex**) provides that the Committee shall cause a copy of the disciplinary order made, together with a summary of the nature of the complaint to which the order relates, to be published in the Gazette.

⁴ In this respect, sections 36(1)(a) and (b) of the PAO (see **Annex**) provide that the Disciplinary Committee shall have the powers to take evidence and examine a witness.

concerned. In addition, if the evidence reveals a suspected irregularity which likely constitutes a separate case or complaint, the HKICPA may refer the new case or complaint to the FRC for any necessary investigation. In view of the above, the Bill and the PAO already contain provisions to deal with the above-mentioned situations.

COMPOSITION AND RESOURCE REQUIRMENTS OF THE AUDIT INVESTIGATION BOARD

5. In relation to the composition and resource requirements of the Audit Investigation Board (AIB)⁵, some Members invited the Administration to elaborate on the following matters -

- (a) the membership and selection criteria of the members of the AIB;
- (b) the anticipated workload of the AIB; whether the Chairman of the AIB will be able to oversee the investigation work of all cases; and whether sufficient resources will be available for the AIB to engage competent employees and consultants to undertake the investigation; and
- (c) whether the turnover of the members of the AIB will result in the persons under investigation being denied of a fair investigation.

6. Regarding paragraph 5(a), for the purpose of investigating relevant irregularities of auditors and reporting accountants of listed entities, the “**Audit Investigation Board**” shall be established under the FRC pursuant to **clause 22(1)**. The AIB shall be regarded as the FRC’s executive arm which works on a day-to-day basis to undertake the ground investigation work. The AIB shall operate as per the directions of the FRC pursuant to **clause 23** and the Board’s policies and activities shall be overseen by the FRC pursuant to **clause 9(e)**. **Clause 22(2)** provides that the AIB “is to consist of (a) the Chief Executive Officer of the

⁵ Please refer to paragraphs 5 and 6 of the Administration’s paper entitled “Component Two: Audit Investigation Board” (LC Paper No. CB(1)286/05-06(03)) as discussed by the Bills Committee at its meeting held on 6 December 2005.

Council, as an ex officio member and chairman; and **(b)** at least one other member appointed by the Council”. The reference to “other member appointed by the Council” in **clause 22(2)(b)** means the **other members of the AIB** appointed by the FRC. Insofar as the selection criteria of AIB members are concerned, while the appointment is a matter for the FRC to decide, we envisage that the FRC may appoint full-time senior investigation officers of the FRC, or other consultants, agents and advisers, to the AIB, who will assist the Chief Executive Officer to undertake the investigation work. Where the situation warrants, **clause 22(2)(b)** also allows the FRC to appoint members of the Council as members of the AIB.

7. Regarding paragraph 5(b), it is difficult, if not impossible, to forecast the future workload of the AIB. As a ballpark reference, based on the information provided by the HKICPA, since the introduction of investigation powers under the PAO in 1994, there have been a total of 14 cases (concerning listed entities) for which the Council of the HKICPA has formed an Investigation Committee. In this light, the Administration does not consider that there are difficulties for the Chief Executive Officer of the FRC, who will work full time and will be supported by other members of the AIB and other employees or consultants of the FRC, to discharge its duties as the Chairman of the AIB effectively. Furthermore, although there will be only one AIB, it will have the ability, if necessary, to undertake several investigations concurrently as it will comprise largely, if not solely, full time employees of the FRC. Moreover, although the AIB is to consist of a minimum of two members, there is no upper limit to the number of AIB members. As regards the resource requirements, the Administration has been guided by the principles that it is necessary to maintain a lean structure for the FRC but that, at the same time, the resources available to the FRC should be adequate for the FRC to discharge its functions effectively⁶.

8. Regarding paragraph 5(c), the Department of Justice has advised that a change in the membership of the AIB (due to, for instance, the resignation, replacement, or staggered appointments of AIB members) during the course of an investigation will not of itself constitute

⁶ In response to the request by the Bills Committee, the Administration is discussing with the HKICPA, Securities and Futures Commission and Hong Kong Exchanges and Clearing Limited whether additional resources should be injected to the FRC.

unfairness to the persons being investigated nor can it be considered inherently unjust. Under **clauses 23(1)(b), (2)(b) and (3)(b)**, the directions given by the FRC are given to the AIB, not to the members comprising it. It is this executive Board which is to comply with the Council's directions.

9. It must be stressed that the function of the AIB is to investigate and set out the findings of an investigation. It is not vested with any powers to sanction any person or impose a penalty on its own. The investigations undertaken by the AIB will be overseen by the FRC pursuant to **clause 9(e)**. Furthermore, an investigation report prepared by the AIB would be referred to another agency only if the FRC so directs. In addition, there are a range of checks and balances measures that underpin the operations of the FRC and the AIB. The Administration has also agreed to consider proposing a Committee Stage Amendment to put in place a statutory protection of the "reasonable opportunity of being heard" for persons who will be criticized in an investigation report⁷. *To view the aforesaid measures as a package*, we consider that there are already sufficient checks and balances in the AIB's investigatory regime.

POWERS OF THE AUDIT INVESTIGATION BOARD

10. In relation to the powers of the AIB⁸, some Members invited the Administration to elaborate on the following matters -

- (a) when the FRC will investigate an irregularity *by itself* or direct the AIB to undertake the investigation (c.f. **clauses 23(1), (2) and (3)**); and
- (b) the purposes of **clause 23(4)** and the circumstances under which the FRC may direct the AIB to cease the investigation of a case.

⁷ Please refer to paragraphs 19 and 20 of the Administration's paper entitled "Component Two: Audit Investigation Board" (LC Paper No. [CB\(1\)286/05-06\(03\)](#)) as discussed by the Bills Committee at its meeting held on 6 December 2005.

⁸ Please refer to paragraphs 14 to 16 of the Administration's paper entitled "Component Two: Audit Investigation Board" (LC Paper No. [CB\(1\)286/05-06\(03\)](#)) as discussed by the Bills Committee at its meeting held on 6 December 2005.

11. Regarding paragraph 10(a), **clauses 23(1)(b), (2)(b) and (3)(b)** provide that the FRC may *direct the AIB* to investigate the relevant irregularities of auditors and reporting accountants in relation to listed entities. At the same time, **clauses 23(1)(a), (2)(a) and (3)(a)** preserve the powers of the FRC to investigate an irregularity *by itself*. We envisage that, in normal circumstances, the FRC will direct the AIB, which is the executive arm of the FRC, to carry out an investigation. However, it is necessary to provide the FRC with the investigatory powers under **clauses 23(1)(a), (2)(a) and (3)(a)**, as one of the functions of the Council is to investigate relevant irregularities. In order to avoid any confusion, **clause 23(6)** expressly provides that, if the AIB is directed by the FRC to conduct an investigation concerning a relevant irregularity, the FRC itself shall not, for the purpose of investigating the irregularity, exercise the same investigatory powers.

12. Regarding paragraph 10(b), **clause 23(4)** provides that, after having directed the AIB to conduct an investigation under **clause 23(1)(b), 2(b) or (3)(b)**, the FRC may direct the AIB to cease the investigation. **Clause 23(4)** should be considered in the proper perspective. As we have mentioned, the AIB is the executive arm of the FRC in carrying out investigation work. **Clause 9(e)** provides that one of the functions of the FRC is to oversee the policy and activities of the AIB. As the FRC has the power to direct the AIB to *initiate* an investigation, it is logical that the FRC shall possess the power to direct the AIB to *cease* an investigation.

13. One of the possible situations where the FRC may direct the AIB to cease an investigation is when the investigation reveals evidence of possible commission of a criminal offence. Furthermore, under **clause 23(1)(b), 2(b) or (3)(b)**, the FRC may only direct the AIB to exercise investigatory powers if it appears to the FRC that there are circumstances suggesting that there is a relevant irregularity in relation to a listed entity, or if the FRC has reasonable cause to believe that there is or may be a relevant irregularity in relation to a listed entity. In other words, the powers can only be invoked when the statutory thresholds are crossed. When the circumstances no longer suggest that there is a relevant irregularity or when the FRC no longer has reasonable cause to believe in the occurrence of an irregularity, the AIB should not continue

its investigation. In this case, **clause 23(4)** will come into play so that the FRC may direct the AIB to cease the investigation.

CHECKS AND BALANCES OF THE AUDIT INVESTIGATION BOARD

14. A Member of the Bills Committee invited the Administration to elaborate on the following matters -

- (a) how **clause 30(2)** is consistent with Article 14(3)(g) of the International Covenant on Civil and Political Rights (ICCPR); and whether the statutory prohibition against the use of incriminating evidence under **clause 30(2)** should be extended to cover disciplinary proceedings of accountants; and
- (b) whether the Bill should provide that a person under an investigation by the AIB should be given the right to seek legal representation.

15. Regarding paragraph 14(a), the Department of Justice is of the view that **clause 30(2)** is capable of being given effect to in a manner which is consistent with Article 14(3)(g) of the ICCPR (which is replicated in Article 11(2)(g) of the Hong Kong Bill of Rights⁹), which guarantees that a person is not to be compelled to testify against himself or to confess guilt in the determination of any criminal charge against him. **Clause 31(9)** provides that a person is not excused from complying with an information-gathering requirement under **clause 25, 26, 27 or 28**. The common law privilege against self-incriminating evidence is thereby abrogated and replaced with a statutory prohibition under **clause 30(2)** against the admissibility of self-incriminating evidence in criminal proceedings. **Clause 30(2)** is modelled on section 187(2) of the SFO, section 145(3A) of the CO and section 42D(4) of the PAO¹⁰.

⁹ See Annex.

¹⁰ See Annex.

16. The Department of Justice has considered whether disciplinary proceedings under the PAO involve any determination of a criminal charge for the purposes of Article 11(2) of the Hong Kong Bill of Rights. Although the circumstances of each case need to be considered, the reported cases decided by the European Court of Human Rights and the United Kingdom¹¹ suggest that the relevant principles are as follows -

- (a) The following are strong indicators of a criminal charge:
 - (i) The provision potentially applies to the whole population, rather than to a specific and limited class of persons;
 - (ii) The existence of a power to imprison a person;
 - (iii) Entering the findings, and the penalty, on the person's criminal record;
 - (iv) The relevant conduct is generally dealt with by criminal law in Contracting Parties.

¹¹ For example, in Brown v United Kingdom [1998], the European Court of Human Rights found that a complaint by a solicitor that a fine of £10,000 imposed by the Solicitors' Complaints Tribunal for professional misconduct did not involve "criminal charge". The Court found, among other things, that the charge related to matters of professional behaviour and organization within a specific professional group rather than the conduct of members of the general public, that there was no involvement of the police or the prosecuting authorities, and that the Tribunal had no power to imprison. The Court stated that "having regard in particular to the essential disciplinary context of the charges, the Court finds that the severity of the penalty was not, of itself, such as to render the charges 'criminal' in nature."

In Wickramsinghe v United Kingdom [1997], the European Commission of Human Rights concluded that disciplinary proceedings by the General Medical Council were not "criminal", even though the sanction – removal of Applicant's name from the register – was "likely to have far-reaching consequences for the individual concerned". This was because the sanction was "essentially disciplinary and directed to protecting the public and the reputation of the medical profession".

In R v Securities and Futures Authority Ltd. ex parte Fleurose [2002], the English Court of Appeal held that disciplinary decisions of the Securities and Futures Authority did not involve a "criminal charge". This was despite the fact that the available sanctions included the relevant person being debarred from earning a living. The Court of Appeal cited its decision in Han v Customs and Excise Commissioners [2001], where it was stated "where the offence is limited to a restricted group, as is generally the case in relation to disciplinary offences, the Court is unlikely to classify a charge under the applicable disciplinary and regulatory code as criminal, at least unless it involves or may lead to loss of liberty".

- (b) Where the proceedings are regulatory, preventive or compensatory, the proceedings are unlikely to be “criminal”, even though a substantial fine is imposed.

17. Having examined Part V of the PAO (regarding disciplinary proceedings) against the principles set out in paragraph 16, the Department of Justice advised that those proceedings do not involve any determination of a criminal charge for the purposes of Article 11(2) of the Hong Kong Bill of Rights. Accordingly, the fact that self-incriminating evidence are not inadmissible in evidence against the person in disciplinary proceedings under **clause 30(2)** will not render the clause inconsistent with Article 14(3)(g) of the ICCPR.

18. Regarding paragraph 14(b), it is our intention that, in the course of the AIB’s investigation, any person who is requested to attend before the investigator or to give explanation or produce documents, shall always be entitled to seek his own legal advice. In this regard, Article 35 of the Basic Law provides, among other things, that “Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies”. It is not necessary to repeat in the Bill a right guaranteed under the Basic Law.

Financial Services and the Treasury Bureau
January 2006


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Section:	36	Heading:	Powers of Disciplinary Committee with regard to obtaining evidence and the conduct of proceedings	Version Date: 08/09/2004

(1) For the purposes of proceedings under section 35 a Disciplinary Committee shall have the following powers-

- (a) to take evidence on oath;
- (b) to summon any person to attend the proceedings to give evidence or produce any document or other thing in his possession and to examine him as a witness;

(1A) Every hearing of the Disciplinary Committee shall be held in public unless the Disciplinary Committee-

- (a) on its own motion; or
- (b) on the application of-
 - (i) the complainant; or
 - (ii) the certified public accountant against whom the complaint is made,

determines that in the interests of justice a hearing or any part thereof shall not be held in public in which case it may hold the hearing or the part thereof (as the case may be) in private. (Added 23 of 2004 s. 39)

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(3) A Disciplinary Committee shall cause a copy of any order made under subsection (1)(a) or, if the order is varied on appeal, the order as so varied to be published in the Gazette together with a summary of the nature of the complaint to which the order relates:

Provided that no order shall be so published before the expiry of 30 days after the date of service of the order on the professional accountant under section 38(1) or, in the case of an appeal made to the Court of Appeal against the order under section 41, before the appeal is finally determined.

(Amended 10 of 2005 s. 51)

(Amended 96 of 1994 s. 23)

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PART II

THE HONG KONG BILL OF RIGHTS

Article 11

Rights of persons charged with or
convicted of criminal offence

(2) In the determination of any criminal charge against him, everyone shall be entitled to the following minimum guarantees, in full equality-

(g) not to be compelled to testify against himself or to confess guilt.

[cf. ICCPR Art. 14.2 to 7]

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Chapter:	571	Title:	SECURITIES AND FUTURES ORDINANCE	Gazette Number: L.N. 12 of 2003
Section:	187	Heading:	Use of incriminating evidence in proceedings	Version Date: 01/04/2003

(2) Notwithstanding any other provisions of this Ordinance, where-

- (a) an authorized person within the meaning of section 179 requires a person to provide or make an explanation or statement under that section; or
- (b) an investigator requires a person to give an explanation or further particulars or to give an answer to any question under section 183,

and the explanation or statement, the explanation or further particulars, or the answer (as the case may be) might tend to incriminate the person and the person so claims before providing or making the explanation or statement, giving the explanation or further particulars, or giving the answer (as the case may be), then the requirement as well as the explanation or statement, the explanation or further particulars, or the question and answer (as the case may be) shall not be admissible in evidence against the person in criminal proceedings in a court of law other than those in which the person is charged with an offence under section 179(13), (14) or (15) or 184, or under section 219(2)(a), 253(2)(a) or 254(6)(a) or (b), or under Part V of the Crimes Ordinance (Cap 200), or for perjury, in respect of the explanation or statement, the explanation or further particulars, or the answer (as the case may be).

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Chapter:	32	Title:	COMPANIES ORDINANCE	Gazette Number:	
Section:	145	Heading:	Production of documents, and evidence, on investigation	Version Date:	30/06/1997

(3A) A person is not excused from answering a question put to him under this section by an inspector on the ground that the answer might tend to incriminate him but, where such person claims, before answering the question, that the answer might tend to incriminate him, neither the question nor the answer shall be admissible in evidence against him in criminal proceedings other than proceedings in relation to a charge of perjury or proceedings for an offence under section 36 of the Crimes Ordinance (Cap 200) in respect of the answer. (Added 6 of 1984 s. 99. Amended 72 of 1994 s. 2)

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(4) A person is not excused from complying with a requirement of an Investigation Committee under subsection (1) on the ground that to do so might tend to incriminate him but, where that person claims, before he answers a question put to him under subsection (1)(a)(ii), that the answer might tend to incriminate him, neither the question nor the answer is admissible in evidence against him in criminal proceedings.