

**Bills Committee on
Financial Reporting Council Bill**

Eighth meeting on 12 January 2006

List of follow-up actions to be taken by the Administration

Funding of the Financial Reporting Council (FRC)

1. The Administration has undertaken at the meeting held on 7 October 2005 to revert to the Bills Committee as early as practicable on the outcome of the Administration's discussion with the Hong Kong Institute of Certified Public Accountants (HKICPA), the Securities and Futures Commission, and the Hong Kong Exchanges and Clearing Company Limited (HKEx) on whether the proposed annual budget of \$10 million and reserve fund of \$10 million would be sufficient for the effective operation of the FRC, and whether additional resources should be injected to the FRC. Apart from the points of concern expressed by members at previous meetings, the Administration is also requested to take into account the following points raised by members:
 - (a) The need for the FRC to employ competent staff and experts to undertake investigation of the Audit Investigation Board (AIB) and enquiry of the Financial Reporting Review Committees (FRRCs);
 - (b) The future workload of the AIB and FRRCs, including increase in workload arising from the surge in the number of cases; and
 - (c) The need for the FRC to meet substantial legal costs arising from litigations against its decisions.

Use of incriminating evidence in criminal proceedings

2. Having noted the Administration's response to the concern about the proposal to abrogate the common law privilege against self-incriminating (clause 31(9)) and replace it with a statutory prohibition against the admissibility of self-incriminating evidence in criminal proceedings (clause 30(2)) (paragraph 15 of LC Paper No. CB(1)665/05-06(01)), some members raise further questions on clause 30(2). In this connection, the Administration is requested to provide a written response covering the following items:

- (a) Justifications for not applying the statutory prohibition against the admissibility of self-incriminating evidence in criminal proceedings provided in clause 30(2) to the explanations or statement in which the person concerned is charged with an offence under Part V of the Crimes Ordinance (Cap. 200), or for perjury; and
- (b) In connection with item (a) above, the exclusion of Part V of the Crimes Ordinance and perjury cases from the application of clause 30(2) may result in a situation where the information provided by a person to the AIB, which is different from the false information provided by the same person to another body in the latter's proceedings, such as a proceeding conducted by the SFC, may be admitted as evidence against the person concerned for having given false information to the other body. The Administration is requested to clarify its policy intent in this regard and examine whether the policy intent is clearly reflected in clause 30(2).

Organizational structure of a FRRC

3. In order to enhance the transparency of the operation of the FRRC, the Administration undertakes to consider proposing a Committee Stage amendment (CSA) requiring the FRC or a FRRC to inform the parties concerned of the change in the membership of the FRRC (paragraph 7 of LC Paper No. CB(1)665/05-06(07)).
4. According to the Administration, a change in the membership of a FRRC during the course of an enquiry will not by itself constitute a breach of the principles of natural justice, and will not affect a FRRC's legal status and thus, the legality of evidence collected by it (paragraph 6 of LC Paper No. CB(1)665/05-06(07)). The Administration is requested to examine whether the drafting of the relevant provisions in the Bill is clear enough to ensure that a FRRC's legal status, or the legality of its evidence, would not otherwise be subject to grounded legal challenge in the event of a change in its membership.
5. Some members are of the view that the Administration's written response (paragraphs 8 to 10 of LC Paper No. CB(1)665/05-06(07)) has not fully addressed the concerns expressed at the meeting on 20 December 2005 about the operation of a FRRC in the absence of a quorum requirement. The Administration is requested to consider and respond to the further views expressed by members and/or the legal adviser to the Bills Committee, as follows:
 - (a) In the absence of a quorum requirement for FRRC meetings, it is not clear as to whether a FRRC with the participation of less than five members would meet the requirement of clause 41(1) that a

FRRC is to consist of at least five members of the Financial Reporting Review Panel (FRRP); and if it would meet the requirement of clause 41(1), then a FRRC with the participation of only one member can conduct enquiries and make decisions, and the legality of the decisions made may be subject to legal challenge. The Administration is requested to clarify its policy intent in this regard and consider whether the drafting of the relevant provisions needs to be revised to clearly reflect the policy intent. In this connection, the Administration is requested to consider providing in the Bill an upper limit on the number of members of a FRRC and a quorum requirement for its meetings;

- (b) In connection with item (a) above, consideration should be given to appoint more than five members to a FRRC; and
- (c) In connection with item (a) above, the Administration has pointed out that section 51(a) of the Interpretation and General Clauses Ordinance (Cap. 1) provides that where any committee is established by or under any Ordinance, the powers of such committee shall not be affected by any vacancy in the membership thereof. Given that clause 41(1) sets out the minimum number of members of a FRRC, it would appear that the general principle in section 51(a) of Cap. 1 may not apply when there is a vacancy in the membership of a FRRC.

Immunity

- 6. The Administration undertakes to consider proposing a CSA to clause 53 to include an additional immunity clause to the effect that a person who complies with a requirement under any provision of the Financial Reporting Council Ordinance shall not incur any civil liability to any person by reason only of that compliance (paragraph 17 of LC Paper No. CB(1)665/05-06(07)).
- 7. In connection with item 6 above, the Administration is requested to consider and respond to a member's suggestion that it should be clearly set out in the Bill that the additional immunity in clause 53 should not affect the legal professional privilege in clause 55.

Checks and balances of a FRRC

- 8. The Administration undertakes to consider proposing a CSA to the effect that any person who may be the subject of any criticism in a FRRC's enquiry report shall be given a reasonable opportunity of being heard (paragraph 14 of LC Paper No. CB(1)420/05-06(02)).

Enquiry report of a FRRC

9. The Administration undertakes to consider proposing a CSA to clause 47 to carve out the admissibility of FRRC's enquiry reports in criminal proceedings as evidence of the facts stated in the reports (paragraph 16 of LC Paper No. CB(1)420/05-06(02)).

10. Clause 48 provides that upon consideration of the FRRC's enquiry report, the FRC may secure the removal of the relevant financial non-compliance by seeking the voluntary revision of accounts by the directors of the listed entity concerned (clause 49) or mandatory revision of accounts through the application of a court order (clause 50). In this connection, the Administration is requested to provide a written response to the concerns of members, as follows:
 - (a) Given that listed entities' compliance with the FRC's request under clause 49 is voluntary and that non-compliance will not amount to an offence or other sanctions, the listed entities concerned may not comply with the FRC's request. While the FRC may apply to the court for an order under clause 50, the court's decisions in this regard are appealable. As a result, the FRC may be involved in lengthy legal proceedings, thus incurring substantial legal costs;

 - (b) According to the Administration, the publication of FRRC's enquiry reports will exert public pressure on the listed entities concerned to rectify the relevant financial non-compliances. Moreover, listed entities are required under Appendix 16 of the Listing Rules to comply with the International Accounting Standards and relevant accounting requirements under the Companies Ordinance (Cap. 32) in preparing their financial reports. The HKEx may, based on the published enquiry reports, take appropriate follow-up action on the listed entities for any non-compliance with the requirements in Appendix 16 of the Listing Rules. In this connection, the Administration is requested to provide information and respond to members' view, as follows:
 - (i) To provide a copy of the Appendix 16 of the Listing Rules with information on sanctions for non-compliance with the requirements stated therein; and

 - (ii) In connection with item (a) above, the Administration should consider whether the FRC is provided with sufficient powers under clauses 49 and 50 to seek rectification of the relevant financial non-compliances, and the need of providing the FRC with additional power in this respect.

Comparison of powers of the AIB and a FRRC

11. Members note that failure to comply with an information-gathering requirement without reasonable excuse imposed by the AIB is an offence (clause 31) or may result in an application by the AIB for a court order compelling compliance or sanctioning the failure (clause 32). However, failure to co-operate with a FRRC with respect to a requirement under clause 43 is not an offence, but a FRRC may apply to the court under clause 45 for an order that the person shall comply with the information-gathering requirement imposed by the FRRC. In this connection, the Administration is requested to provide a written response to the concerns of members and/or the legal adviser to the Bills Committee, as follows:
- (a) Whether it is justified to provide a FRRC with less extensive powers than the AIB;
 - (b) Given that failure to co-operate with a FRRC with respect to a requirement under clause 43 is not an offence, it may result in a situation where the parties concerned may not co-operate with the FRRC, thus undermining the effectiveness and efficiency of its enquiry work. It may also increase the resources required for completing an enquiry and involve the FRRC in lengthy legal proceedings; and
 - (c) Under the Professional Accountants Ordinance (Cap. 50), the HKICPA may initiate disciplinary proceedings against a professional accountant who has failed to comply with the requirements of its Investigation Committee. It is however not clear in the Bill whether professional accountants failing to comply with the requirements of the AIB or a FRRC would be subject to disciplinary proceedings of the HKICPA.