

**Bills Committee on
Financial Reporting Council Bill**

Ninth meeting on 23 January 2006

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

Clause 51 – Preservation of secrecy

1. Clause 51(1) requires specified persons (as defined in clause 51(13) to include, inter alia, the Financial Reporting Council (FRC), its members and officers) to preserve the secrecy of information obtained in the course of performing their functions. Clause 51(3)(b)(ix) permits the disclosure of information to the Official Receiver (OR) and clause 51(3)(c)(i) permits the disclosure of information to a person who is a liquidator or provisional liquidator appointed under the Companies Ordinance (Cap. 32). In this connection, the Administration is requested to consider and respond to the views and suggestions expressed by members to the Bills Committee, as follows:
 - (a) Given that OR may act as the liquidator or provisional liquidator of a company under liquidation, he will be able to get information from the FRC under the two disclosure gateways provided under clause 51(3)(b)(ix) and 51(3)(c)(i). This may put OR in a more advantageous position than other liquidators;
 - (b) The policy intent of clause 51(3)(b)(ix) and 51(3)(c)(i) is not clear and needs to be clarified. According to the Administration, clause 51(3)(b)(ix) would facilitate the OR in performing his statutory duties as OR in relation to administering the insolvency regime, while clause 51(3)(c)(i) would facilitate liquidators or provisional liquidators in carrying out their duties of looking into the affairs of the company in liquidation and ascertaining whether any misfeasance, fraudulent preference, or breach of trust by companies had been committed by any of its officers. However, these purposes are not reflected in the two subclauses;
 - (c) In connection with items (a) and (b) above, the Administration is requested to review the drafting of clause 51(3)(b)(ix) and 51(3)(c)(i), and consider the need to distinguish the two roles of OR and set out clearly that the purpose of disclosing the information to OR under clause 51(3)(b)(ix) is for him to perform the statutory duties of OR in his capacity as OR but not for other

purposes, such as the performance of the functions of a liquidator;
and

- (d) The Administration is also requested to consider how to address the concern that OR, after obtaining the information under clause 51(3)(b)(ix), may use the information to facilitate the performance of his other functions, such as those of a liquidator.
2. Members stress the need to protect the identity of the persons who lodge complaints about relevant irregularities and relevant non-compliances in relation to listed entities to the FRC. In this connection, the Administration is requested to consider some members' suggestion of setting out clearly in clause 51 that the identity of the complainants should be kept confidential. It is also suggested that reference be made to the relevant provisions of the Prevention of Bribery Ordinance (Cap. 201).

Clause 52 – Avoidance of conflict of interests

3. Clause 52(5) provides that after a member of the FRC, the Audit Investigation Board (AIB) or a Financial Reporting Review Committee (FRRC) has disclosed the nature of any interest in any matter, he shall not be present during any deliberation of the FRC, AIB, or FRRC with respect to the matter. In this connection, the Administration is requested to consider and respond to the views and suggestion expressed by members and the legal adviser to the Bills Committee, as follows:
- (a) In the absence of a quorum requirement for the AIB and a FRRC, if some members of the AIB and a FRRC have disclosed their interest in a matter and could not participate in the deliberation with respect to that matter, it is not clear as to whether the AIB and FRRC with the participation of very limited number of members, say, only one member, would meet the requirements on the minimum number of members set out in clauses 22(2) and 41(1) (i.e. the AIB and FRRC are to consist of at least two and five members respectively); and if they would, then the AIB and FRRC with the participation of only one member may conduct enquiries and make decisions. Such an arrangement is unfair to the parties concerned and may subject the legality of the decisions made 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;
 - (b) In connection with item (a) above, the Administration is requested to consider the following suggestions:
 - (i) To provide in the Bill a quorum requirement for the AIB and FRRC; and

- (ii) To set out clearly in the Bill that a member of the FRC, AIB and FRRC, who has disclosed the nature of any interest in any matter and shall not be present during any deliberation of the FRC, AIB, or FRRC with respect to the matter, is not counted towards the quorum for the FRC, AIB and FRRC.
- (c) The Administration is of the view that a change in the membership of a FRRC during an enquiry will not affect the FRRC's legal status and thus, the legality of evidence collected by it, and will not constitute a breach of natural justice. The Administration is requested to re-consider whether it is fair to the parties concerned if there is a change in membership at the final stage of the AIB's investigation or a FRRC's enquiry.

Clauses 34 and 58 – Retention or destruction of documents

4. Clause 58 provides that a person commits an offence if he destroys, falsifies, conceals or otherwise disposes of any record or document required to be produced under Part 3 or 4 of the Bill. In response to the suggestion that a provision be added to allow the retention of evidence for a certain period of time, the Administration advises that under clause 34(4)(a), any record or document removed upon the execution of a warrant issued under the clause may be retained for a period of not exceeding six months. Clause 34(4)(b) provides that if the record or document is or may be required for criminal proceedings or any proceedings under the Financial Reporting Council Ordinance, the record or document may be retained for such longer period as may be necessary for the purpose of those proceedings. In this connection, the Administration is requested to consider and respond to the views and suggestion expressed by members and the legal adviser to the Bills Committee, as follows:
 - (a) If no criminal proceedings are involved, the six-month retention period provided under clause 34(4)(a) will apply. Given the need to keep the records or documents for investigation and drafting of the investigation report, the six-month retention period may not be sufficient for the purpose. Moreover, such records or documents may be useful evidence supporting the AIB's investigation report, and may be used in the disciplinary proceedings of the Hong Kong Institute of Certified Public Accountants (HKICPA) if the cases concerned are subsequently referred to the Institute; and
 - (b) In connection with item (a) above, it is suggested that a provision be added to allow the FRC and AIB to apply for the extension of the record retention period when necessary.

Clauses 49 and 50 – Revision of financial reports

5. Clause 49 provides that the FRC may secure the removal of the relevant financial non-compliance by requesting the directors of the listed entity concerned to cause the relevant financial report to be revised in such manner as the FRC considers necessary. Clause 50 provides that if the request under clause 49 is not complied with, the FRC may apply to the court for an order of mandatory revision of the financial report. The court's decisions in this regard are appealable. In this connection, the Administration is requested to respond to members' concerns and provide the required information, as follows:
- (a) Given that the FRC is tasked to enquire into financial non-compliances of listed entities and does not have sanctioning power, it seems not justified to empower the FRC to request listed entities to revise their defective financial reports;
 - (b) According to the Administration, the compliance with the request referred to in clause 49 is voluntary and that failure to comply will not amount to an offence or other sanctions. However, this policy intent is not reflected in the clause;
 - (c) The request for a listed entity to revise its financial report would mean that there is a relevant non-compliance in relation to the entity and the reporting accountant concerned has committed professional misconduct for having failed to prepare the reports in accordance with the relevant financial standards. Such a conclusion is against the principle of law given that no prosecution against the entity or the reporting accountant concerned has taken place;
 - (d) In connection with item (c) above, the Administration is requested to clarify the implications of the FRC's request for a listed entity to revise its financial report on the entity and the reporting accountant concerned;
 - (e) By virtue of clause 50, the court is required to judge whether the relevant financial report has complied with the relevant financial standards and issue an order requiring revision of the relevant financial report. It is inappropriate to require the court to take such actions before any prosecution takes place; and
 - (f) In connection with items (a) to (e) above, the Administration is requested to review clauses 49 and 50. Given that clauses 49 and 50 are modelled on the relevant provisions of the UK Companies Act 1985, the Administration is also requested to provide the UK

experience in this respect, including information on the compliance of listed entities with the request for revision of financial reports, any problems encountered by the UK authority in enforcing the relevant provisions, and any measures put in place to address the problems.

Council Business Division 1
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