

For discussion

**Bills Committee on
Financial Reporting Council Bill**

**Follow-up actions arising
from the meeting held on 10 February 2006**

PURPOSE

This paper sets out the Administration's responses to the follow-up actions arising from the meeting held on 10 February 2006.

APPLICATION OF INTERPRETATION AND GENERAL CLAUSES ORDINANCE

2. With respect to the operation of a Financial Reporting Review Committee (FRRC), Members have noted the Administration's explanation that, in the very unlikely situation where most or all of the members of a FRRC cannot or should not continue to serve, section 42(b) of Interpretation and General Clauses Ordinance (Cap. 1) will empower the Financial Reporting Council (FRC) to dissolve the FRRC¹. In this regard, the Legal Adviser to the Bills Committee has invited the Administration to consider whether it is necessary for the Financial Reporting Council Bill (the Bill) to expressly provide what the aforesaid provision in Cap. 1 already provides.

3. As we have explained at the meeting on 10 February 2006, Cap. 1 provides for, amongst other things, general provisions relating to the construction, application and interpretation of other ordinances. It is not necessary to provide in the Bill what section 42(b) of Cap. 1 has

¹ Please refer to paragraph 7 of the Administration's paper entitled "Follow-up actions arising from the meeting held on 12 January 2006" (LC Paper No. CB(1)866/05-06(02)), as discussed by the Bills Committee at its meeting held on 10 February 2006.

provided, as the application of that provision in relation to a FRRC has not been excluded by any contrary intention in the Bill.

DISCIPLINARY PROVISIONS UNDER THE PROFESSIONAL ACCOUNTANTS ORDINANCE

4. A Member of and the Legal Adviser to the Bills Committee have asked the Administration to -

- (a) invite the Hong Kong Institute of Certified Public Accountants (HKICPA) to reconsider whether it is necessary to amend the Professional Accountants Ordinance (PAO, Cap. 50) to provide that a certified public accountant who fails to comply with an information-gathering requirement imposed by the FRC should be subject to disciplinary actions; and
- (b) consider putting in place administrative arrangements for the FRC to inform the HKICPA of instances where a certified public accountant does not provide the FRC with the required information during an investigation or enquiry.

5. Regarding paragraph 4(a), the Administration has invited the HKICPA to give further consideration to the matter. Having considered that the FRC will take over part of the investigation work from the HKICPA's Investigation Committees and that it is important for the relevant certified public accountants to co-operate with the FRC during investigations and enquiries, the HKICPA has no in-principle objection to the Administration proposing Committee Stage Amendments (CSAs) to the relevant provisions of the PAO to empower the Institute to discipline its members who have failed to comply with an information-gathering requirement imposed by the FRC in the investigations and enquiries.

6. Regarding paragraph 4(b), 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.

POST-ENQUIRY ACTIONS OF A FRRC

7. The Bills Committee noted the Administration's elaboration on the intent of **clauses 49** (regarding the request made by the FRC for the listed entity to voluntarily revise financial reports) and **50** (regarding the application for the court to order mandatory revision)². In response to a Member's questions, we have reviewed the drafting of the relevant clauses with a view to closely aligning **clauses 49** and **50** with the relevant provisions in the United Kingdom Companies Act 1985³. We will consider proposing CSAs to revise the drafting of the two clauses as demonstrated at **Annex B**.

PROTECTION OF INFORMERS' IDENTITY

8. We note some Members' concerns whether the identity of the informers would be obliged to be disclosed in the relevant proceedings and their suggestion that the Bill should make express provisions in this regard with reference to the relevant provisions of other ordinances. We are reviewing the matter with the Department of Justice and will revert to the Bills Committee when ready.

PRESERVATION OF SECRECY

9. The Bills Committee has noted that **clause 51(3)(b)(ix)** is intended to refer to the situation where the Official Receiver is acting otherwise than as a liquidator or provisional liquidator and that **clause 51(3)(c)** is intended to permit the disclosure of information to a liquidator or provisional liquidator (including the Official Receiver acting in such a capacity). We will consider proposing CSAs to revise the drafting of

² Please refer to paragraphs 12 to 15 of the Administration's paper entitled "Follow-up actions arising from the meeting held on 12 January 2006" (LC Paper No. CB(1)866/05-06(02)), as discussed by the Bills Committee at its meeting held on 10 February 2006, and paragraphs 10 to 13 of the Administration's paper entitled "Follow-up actions arising from the meeting held on 23 January 2006" (LC Paper No. CB(1)866/05-06(04)).

³ See **Annex A**.

clauses 51(3)(b)(ix) and (c) as demonstrated at **Annex C**.

AVOIDANCE OF CONFLICT OF INTERESTS

10. With respect to **clause 52** (regarding the avoidance of conflict of interests), some Members have invited the Administration to clarify the following matters -

- (a) the circumstances under which disclosure of an interest should be made and the scope of the interests that are required to be disclosed;
- (b) whether **clause 52(3)** will apply to require disclosure of an interest in a matter which relates to an entity with which a person's past employer has previously merged;
- (c) whether a member who has disclosed the nature of an interest in a matter shall not take part in any meetings of the FRC, the AIB or a FRRC with respect to the matter, and in this connection, whether the FRC should be in a position to determine that the member concerned should otherwise attend the meeting after the disclosure;
- (d) whether the Bill should provide expressly in **clause 52(5)** that a person having disclosed the nature of interest in any matter shall not be given any document relating to the matter; and
- (e) whether the heading of **clause 52** reflects the intent of the provisions within the clause.

11. Regarding paragraph 10(a), as we explained at the meeting held on 23 January 2006⁴, **clause 52(2)** provides that if, in the course of performing a function under this Ordinance, a person is required to consider a matter in which he has an interest, he shall immediately

⁴ Please refer to paragraphs 7 and 8 of the Administration's paper entitled "Component Four: Miscellaneous Matters" (LC Paper No. CB(1)665/05-06(08)), as discussed by the Bills Committee held on 23 January 2006.

disclose the nature of the interest to the FRC. **Clauses 52(3) and (9)** define the scope of interests which should be disclosed. **Clause 52(3)**, which is modelled on section 379(3) of the Securities and Futures Ordinance (SFO, Cap. 571)⁵, provides that a person has an interest in a matter if the matter relates to (a) a listed entity (in which he has an interest); or (b) his, past or present, employers, clients or associates; or (c) another person whom he knows is or was a client of his, past or present, employers or associates. **Clause 52(9)**, which mirrors the same definition under Part 1 of Schedule 1 to the SFO⁶, defines the term “associate” to mean a close family member of a person, any corporation of which the person is a director or with which the person has a close business relationship, any employee or partner of the person, or any other related party.

12. Regarding paragraph 10(b), under **clause 52(3)(b)(i)**, a person has an interest in a matter if the matter relates to *another person by whom he is or was employed* (i.e. his, past or present, employer). On construction of **clause 52(3)(b)(i)**, if a person’s previous employer (Entity A) has merged with another entity (Entity B) to form a new entity (Entity C) and where Entity A has ceased to exist after the merger and Entity C is the subject matter at issue, the person is not required to disclose his past employment relationship with Entity A which no longer exists and is not the subject matter at issue.

13. Regarding paragraph 10(c), **clause 52(5)** provides that, after a person has disclosed the nature of any interest in any matter, he shall not, **unless** the FRC otherwise determines -

- (a) be present during any deliberation of the FRC, the AIB or a FRRC, or a committee established by the FRC, with respect to the matter; or
- (b) take part in any decision of the FRC, the AIB or a FRRC, or such a committee, with respect to the matter.

⁵ See Annex D.

⁶ See Annex D.

It should be stressed that, pursuant to **clause 52(5)**, a person will, **automatically and by default**, be excluded from participating at the relevant meeting if he has disclosed the nature of any interest in a matter, *unless the FRC determines otherwise*. The Administration considers it justifiable to leave the FRC with the discretion to determine, after having considered all relevant considerations, whether a member should otherwise not be excluded from the meeting. In our view, such discretion is necessary as **not all declaratory interests must be exclusionary in nature**, particularly in the light of the extensiveness of the “interests” referred to in **clauses 52(3) and (9)**⁷ and the functions of the FRC which does not possess any sanctioning powers. While a member is required to disclose all the relevant interests, it is very unlikely that a very remote interest (for example, a short employment relationship over 40 years ago) disclosed by a member will render the member concerned being unsuitable to take part in the deliberation of the case.

14. Consequently, we, on balance, consider that this discretion will not compromise the objective of ensuring that the FRC will, and will be seen to, discharge its function impartially. As a point of reference, this discretion is also available in the “disclosure of interests” regime of many other statutory bodies. These bodies include the Mandatory Provident Fund Schemes Authority (c.f. section 7(4) of Schedule 1A to the Mandatory Provident Fund Schemes Ordinance (Cap. 485)); the Airport Authority (c.f. section 13(2)(b) of the Airport Authority Ordinance (Cap. 483)); the Urban Renewal Authority (c.f. section 7(5) of the Urban Renewal Authority Ordinance (Cap. 563)); and the Legal Aid Services Council (c.f. section 8(2) of the Legal Aid Services Council Ordinance (Cap. 489)), etc⁸.

⁷ We note the views of some deputations concerning the extensiveness of the interests subject to the disclosure requirement and the consequences of non-compliance. For example, the Law Society of Hong Kong notes that, given the “onerous disclosure obligations and severity of the sanctions”, it may be difficult to pull together sufficient number of qualified and suitable candidates to take up the appointments to serve the FRC. The HKICPA considers that the preferred approach is to enunciate the general principles of avoiding bias rather than to define the scope of potential conflicts in such detail.

⁸ See Annex D.

15. Regarding paragraph 10(d), we consider it *implicit* that a member of the FRC, the AIB or a FRRC, who, pursuant to **clause 52(5)** or **(6)**, is not permitted to be present at the relevant deliberation or take part in any decision or determination with respect to the matter, will not be given the relevant documents. In response to some Members' views, we agree to propose a CSA to expressly provide that the person excluded under **clause 52(5)** or **(6)** shall not be given any document, or the relevant part of it, that contains a record of, or is issued for the purpose of, the relevant deliberation, decision or determination.

16. Regarding paragraph 10(e), as we have explained at the meeting held on 10 February 2006, the disclosure of interests regime in **clause 52** is aimed to avoid the occurrence of a conflict of interests situation during an investigation or enquiry of the FRC. We consider that the heading of the clause reflects this intent and is thus appropriate. The same heading is used in section 379 of the SFO.

Financial Services and the Treasury Bureau
February 2006

Annex A

UK Companies Act 1985

Current through 6 February 2006

245A Secretary of State's notice in respect of annual accounts

(1) Where--

(a) copies of a company's annual accounts or directors' report have been sent out under section 238, or
(b) a copy of a company's annual accounts or directors' report has been laid before the company in general meeting or delivered to the registrar, and it appears to the Secretary of State that there is, or may be, a question whether the accounts or report comply with the requirements of this Act, he may give notice to the directors of the company indicating the respects in which it appears to him that such a question arises or may arise.

(2) The notice shall specify a period of not less than one month for the directors to give him an explanation of the accounts or report or prepare revised accounts or a revised report.

(3) If at the end of the specified period, or such longer period as he may allow, it appears to the Secretary of State that the directors have not--

(a) given a satisfactory explanation of the accounts or report, or
(b) revised the accounts or report so as to comply with the requirements of this Act, he may if he thinks fit apply to the court.

(4) The provisions of this section apply equally to revised annual accounts and revised directors' reports, in which case they have effect as if the references to revised accounts or reports were references to further revised accounts or reports.

245B Application to court in respect of defective accounts

(1) An application may be made to the court--

(a) by the Secretary of State, after having complied with section 245A, or
(b) by a person authorised by the Secretary of State for the purposes of this section, for a declaration or declarator that the annual accounts of a company do not comply, or a directors' report does not comply, with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation) and for an order requiring the directors of the company to prepare revised accounts or a revised report.

(2) Notice of the application, together with a general statement of the matters at issue in the proceedings, shall be given by the applicant to the registrar for registration.

(3) If the court orders the preparation of revised accounts, it may give directions with respect to--

(a) the auditing of the accounts,
(b) the revision of any directors' report, directors' remuneration report or summary financial statement, and
(c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous accounts, and such other matters as the court thinks fit.

(3A) If the court orders the preparation of a revised directors' report it may give directions with respect to--

- (a) the review of the directors' report by the auditors,
- (b) the revision of any directors' report, directors' remuneration report or summary financial statement,
- (c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous report, and
- (d) such other matters as the court thinks fit.

(4) If the court finds that the accounts or report did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation) it may order that all or part of--

- (a) the costs (or in Scotland expenses) of and incidental to the application, and
 - (b) any reasonable expenses incurred by the company in connection with or in consequence of the preparation of revised accounts or a revised report,
- shall be borne by such of the directors as were party to the approval of the defective accounts or report.

For this purpose every director of the company at the time of the approval of the accounts or report shall be taken to have been a party to the approval unless he shows that he took all reasonable steps to prevent that approval.

(5) Where the court makes an order under subsection (4) it shall have regard to whether the directors party to the approval of the defective accounts or report knew or ought to have known that the accounts or report did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), and it may exclude one or more directors from the order or order the payment of different amounts by different directors.

(6) On the conclusion of proceedings on an application under this section, the applicant shall give to the registrar for registration an office copy of the court order or, as the case may be, notice that the application has failed or been withdrawn.

(7) The provisions of this section apply equally to revised annual accounts and revised directors' reports, in which case they have effect as if the references to revised accounts or reports were references to further revised accounts or reports.

Financial Reporting Council Bill

Mark-up version of clauses 49 and 50 (extract) with the proposed Committee Stage Amendments (CSAs)

49. Council to give notice to operator of listed entities to secure removal of relevant non-compliance

(1) If it appears to the Council that there is or may be a question whether or not there is a relevant non-compliance in relation to a listed entity, the Council may give a written notice to the operator of the entity in accordance with subsection (1A).

(1A) The notice is to -

(a) indicate the respects in which it appears to the Council that such a question arises or may arise;

(b) specify -

(i) such manner of revising the relevant financial report of the entity as the Council considers necessary; or

(ii) such other remedial action concerning that report as the Council considers necessary; and

(c) specify a period for the operator to -

(i) give a satisfactory explanation of the relevant financial report of the entity;

(ii) cause that report to be revised in such manner as specified in the notice; or

(iii) take such other remedial action concerning that report as specified in the notice.

Note : The wording of the CSAs is subject to any refinement by the Law Draftsman.

(1) If it appears to the Council that there is a relevant non-compliance in relation to a listed entity, the Council may, by a written notice to the operator of the entity

- (a) specify why, in the Council's opinion, there is a relevant non-compliance in relation to the entity; and
- (b) request the operator to
 - (i) cause the relevant financial report of the entity to be revised in such manner as the Council considers necessary; or
 - (ii) take such other remedial action concerning that report as the Council considers necessary,

within the period specified in the notice.

(2) In this section, "operator" (營辦人) -

- (a) in relation to a listed corporation, means the directors of the corporation;
- (b) in relation to a listed collective investment scheme, means the manager of the scheme.

50. Council may apply to Court of First Instance to secure removal of relevant non-compliance

(1) This section applies if -

- (a) the Council gives a notice to the directors of a listed corporation under section 49(1); and
- (b) at the end of the period specified in the notice, or such longer period as the Council may allow, it appears to the

Council that the directors have not -

- (i) given a satisfactory explanation of the relevant financial report of the corporation;
- (ii) caused that report to be revised in such manner as specified in the notice; or
- (iii) taken such other remedial action concerning that report as specified in the notice.

(1) This section applies if

- (a) the Council makes a request to the directors of a listed corporation under section 49(1)(b); and
- (b) those directors fail to comply with the request.

(2) The Council may, by originating summons, apply to the Court of First Instance for -

- (a) a declaration that there is a relevant non-compliance in relation to the listed corporation; and
- (b) an order requiring the directors of the corporation to -
 - (i) cause the relevant financial report of the corporation to be revised in such manner as the Court considers necessary; or
 - (ii) take such other remedial action concerning that report as the Court considers necessary,

within the period specified in the order.

(3)-(10)

Financial Reporting Council Bill

**Mark-up version of clause 51 (extract) with the proposed
Committee Stage Amendments (CSAs)**

51. Preservation of secrecy

(1) - (2).....

(3) Despite subsection (1), the Council may -

(a)

(b) subject to subsection (4), disclose information to -

(i) the Chief Executive;

(ii) the Financial Secretary;

(iii) the Secretary for Justice;

(iv) the Secretary for Financial Services and the Treasury;

(v) the Commissioner of Police of Hong Kong;

(vi) the Commissioner of the Independent Commission Against Corruption;

(vii) the Commissioner of Inland Revenue;

(viii) the Registrar of Companies;

(ix) the Official Receiver in a capacity other than that of a liquidator or provisional liquidator appointed under, or holding such office by virtue of, the Companies Ordinance (Cap. 32);

(x) the Monetary Authority;

(xi) the Securities and Futures Commission;

(xii) the Market Misconduct Tribunal;

(xiii) the Insurance Authority;

Note : The wording of the CSAs is subject to any refinement by the Law Draftsman.

- (xiv) the Mandatory Provident Fund Schemes Authority;
- (xv) the HKICPA;
- (xvi) an inspector appointed by the Financial Secretary under section 142 or 143 of the Companies Ordinance (Cap. 32) to investigate the affairs of a corporation;
- (xvii) a public officer authorized by the Secretary under subsection (12); or
- (xviii) a company recognized as an exchange company under section 19(2) of the Securities and Futures Ordinance (Cap. 571);

(c) disclose information to -

(i) the Official Receiver in the capacity of a liquidator or provisional liquidator appointed under, or holding such office by virtue of, the Companies Ordinance (Cap. 32);

(ii) any other person who -

(A) is a liquidator or provisional liquidator appointed under the Companies Ordinance (Cap. 32);
or

(B) acts in a similar capacity under
any law of a place outside Hong
Kong,

for the purpose of enabling or assisting
him to perform his functions as such
liquidator or provisional liquidator or in
such similar capacity;

~~(e) disclose information to a person who~~
~~(i) is a liquidator or provisional~~
~~liquidator appointed under the~~
~~Companies Ordinance (Cap. 32); or~~
~~(ii) acts in a similar capacity under any~~
~~law of a place outside Hong Kong,~~
~~for the purpose of enabling or assisting~~
~~the person to perform his functions as~~
~~such liquidator or provisional liquidator~~
~~or in such similar capacity;~~

~~(d)-(f)~~

~~(4)-(13)~~

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Chapter:	571	Title:	SECURITIES AND FUTURES ORDINANCE	Gazette Number:	L.N. 12 of 2003
Section:	379	Heading:	Avoidance of conflict of interests	Version Date:	01/04/2003

(3) Any member of the Commission or any person performing any function under any of the relevant provisions shall forthwith inform the Commission if, in the course of performing any function under any such provisions, he is required to consider any matter relating to-

- (a) any securities, futures contract, leveraged foreign exchange contract, regulated investment agreement, or an interest in any securities, futures contract, leveraged foreign exchange contract, collective investment scheme or regulated investment agreement-
 - (i) in which he has an interest;
 - (ii) in which a corporation, in the shares of which he has an interest, has an interest; or
 - (iii) which-
 - (A) in the case of securities, is of or issued by the same issuer, and of the same class, as those in which he has an interest; or
 - (B) in the case of a futures contract, is interests, rights or property based upon securities of or issued by the same issuer, and of the same class, as those in which he has an interest; or
- (b) a person-
 - (i) by whom he is or was employed;
 - (ii) of whom he is or was a client;
 - (iii) who is or was his associate; or
 - (iv) whom he knows is or was a client of a person with whom he is or was employed or who is or was his associate.

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Chapter: 571 Title: SECURITIES AND FUTURES Gazette Number: L.N. 154 of 2004
Schedule: 1 Heading: ORDINANCE
INTERPRETATION AND
GENERAL PROVISIONS Version Date: 03/12/2004

[sections 2, 19, 66, 164, 171,
174, 175, 202 &
406 & Schedule 9]

PART 1

INTERPRETATION

"associate" (有聯繫者), in relation to a person, means-

- (a) the spouse, or any minor child (natural or adopted) or minor step-child, of the person;
- (b) any corporation of which the person is a director;
- (c) any employee or partner of the person;
- (d) the trustee of a trust of which the person, his spouse, minor child (natural or adopted) or minor step-child, is a beneficiary or a discretionary object;
- (e) another person in accordance with whose directions or instructions the person is accustomed or obliged to act;
- (f) another person accustomed or obliged to act in accordance with the directions or instructions of the person;
- (g) a corporation in accordance with the directions or instructions of which, or the directions or instructions of the directors of which, the person is accustomed or obliged to act;
- (h) a corporation which is, or the directors of which are, accustomed or obliged to act in accordance with the directions or instructions of the person;
- (i) a corporation at general meetings of which the person, either alone or together with another, is directly or indirectly entitled to exercise or control the exercise of 33% or more of the voting power;
- (j) a corporation of which the person controls the composition of the board of directors;
- (k) where the person is a corporation-
 - (i) each of its directors and its related corporations and each director or employee of any of its related corporations; and
 - (ii) a pension fund, provident fund or employee share scheme of the corporation or of a related corporation of the corporation;
- (l) without limiting the circumstances in which paragraphs (a) to (k) apply, in circumstances concerning the securities of or other interest in a corporation, or rights arising out of the holding of such securities or such interest, any other person with whom the person has an agreement or arrangement-
 - (i) with respect to the acquisition, holding or disposal of such securities or such interest; or
 - (ii) under which they undertake to act together in exercising their voting power at general meetings of the corporation;

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Chapter:	485	Title:	MANDATORY PROVIDENT FUND SCHEMES ORDINANCE	Gazette Number:	L.N. 293 of 1998
Schedule:	1A	Heading:	PROVISIONS RELATING TO AUTHORITY	Version Date:	24/07/1998

7. Disclosure of pecuniary interests

[section 6A]

(4) After a director has disclosed the nature of any interest in any matter, the director must not, unless the Authority otherwise determines-

- (a) be present during any deliberation of the Authority with respect to the matter; or
- (b) take part in any decision of the Authority with respect to the matter.



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Chapter:	483	Title:	AIRPORT AUTHORITY ORDINANCE	Gazette Number:
Section:	13	Heading:	Disclosure of interest etc.	Version Date: 30/06/1997

(2) A member of the Authority (including the Chairman and the Chief Executive Officer) who is in any way directly or indirectly interested in a contract made or proposed to be made by the Authority, or in any other matter whatsoever which is to be considered, decided or determined by the Board, shall comply with the following requirements-

- (b) he shall withdraw from the meeting while the matter is being discussed or considered unless-
- (i) if he is not the person presiding at such meeting of the Board, he is permitted to take part in such discussion or consideration by the person so presiding; or
 - (ii) if he is the person so presiding, a majority of the other members present at the meeting decide so to permit him; and

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Chapter:	563	Title:	URBAN RENEWAL AUTHORITY ORDINANCE	Gazette Number:	L.N. 92 of 2001
Section:	7	Heading:	Members to declare interests	Version Date:	01/05/2001

(5) A member of the Board of the Authority, including the Chairman and the Managing Director, who is in any way directly or indirectly interested in a contract made or proposed to be made by the Authority, or in a contract made or proposed to be made by a servant or an agent or a partner of the Authority, or, by a body corporate established by the Authority which is brought up for consideration by the Board, shall disclose the nature of his interest at a meeting of the Board; and the disclosure shall be recorded in the minutes of the meeting of the Board, and the member shall not without the permission of the Chairman, and in the case of the Chairman, the permission of the majority of the members present at the meeting, take any part in any deliberation of the Board with respect to that contract and shall not in any event vote on any question concerning it.



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Chapter:	489	Title:	LEGAL AID SERVICES COUNCIL ORDINANCE	Gazette Number:
Section:	8	Heading:	Disclosure of interests by members	Version Date: 30/06/1997

(2) Where a member makes a disclosure in respect of a matter, the other members of the Council may decide whether the member is able to take part in the deliberation of and voting on the matter.

(Enacted 1996)