

September 14, 2005

Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Attention: Ms. Connie Szeto, Clerk to Bills Committee

Dear Sirs,

**Bills Committee on Financial Reporting Council Bill (the "Bill")
Invitation for Submissions**

We refer to your letter to Dr Lily Chiang, Deputy Chairman of The Chamber of Hong Kong Listed Companies (the "**Chamber**"), inviting us to give our views on the Bill. The Chamber has considered the issues relating to the Bill and would respond as follows. Unless otherwise defined, terms and expressions used in this letter will have the same meaning as those defined in the Bill.

Overall

In general, the Chamber shares the view that it is of paramount importance that Hong Kong should maintain an effective regulatory regime for the accounting profession and therefore there is a need to introduce a legislative framework for the establishment of the Financial Reporting Council ("**FRC**"). On this basis, we have the following points of principle for the consideration of the Bills Committee.

Our Views

1. Importance of Coordinated Efforts

1.1 Understandably, the position of the Chamber is "pro-market". Thus, rather than looking from regulatory point of view, the Chamber emphasizes the importance of looking at this also from the point of view of the market and in this context of our members, who are listed companies. Therefore the first point to make is that any investigations to be taken by the FRC should cause minimum adverse impact on the normal business operations of the party under investigation. The reason is that there should always be a healthy balance struck between maintaining a robust financial reporting and governance framework for the benefit of the market and the investing public in Hong Kong on one hand, and to avoid the risks of allocating too much regulatory and investigatory powers to law enforcement agencies, thereby stifling the normal business operations of listed companies and/or the accounting profession. In simple language, we should not in any way indirectly punish the "good guys" just because we have to go after a few "bad guys".

1.2 The Chamber would make a cautionary note that there may be a certain degree of overlapping between the work of the other law enforcement agencies, regulators and professional bodies, especially those "specified enforcement agencies" as defined in the Bill, e.g. the Police, SFC,

HKEC, HKICPA, ICAC, the Companies registry, Market Misconduct Tribunal, and many others. Thus, there is therefore a strong likelihood that for a particular case involving party under investigation, there are two or more of such agencies carrying on investigations and the normal day-to-day operations will be adversely affected.

- 1.3 Given this, the Chamber would suggest that FRC should be placed under a legal responsibility that, whenever it intends to start an investigation on a party (which may be a listed company or an accounting firm), it should enquire and/or consult, on a strictly confidential basis, with other related law enforcement agencies so that besides the FRC, the chances of a party under investigation having to deal with two or more investigators at the same time arising from the same matter be kept to a minimum. The only exception is unless it can be shown by the FRC that it is an absolute operational necessity.

2. Issuing Guidelines

2.1 Section 13 provides that the FRC may issue guidelines indicating the manner in which the FRC proposes to perform its functions and providing guidance on the operation of any provision of the Financial Reporting Council Ordinance (when it becomes law). In the interests of transparency but without unwittingly hampering the investigatory power of the FRC, the Chamber would stress the importance of issuing guidelines in good time as the establishment of the FRC is a new matter and the market needs clear guidance on the operational level.

- 2.2 The Chamber suggests that guidelines, especially on the manner in which the FRC proposes to perform its functions, should be issued simultaneously at the time the Bill is in force. The guidelines should be in clear language to give work-level guidance to the market on how the FRC is to carry out investigations and what should the listed companies and their auditors do when an investigation is carried out on it, e.g.

- will the FRC only act upon receiving complaints and/or reports made to it, or will it pro-actively and spontaneously carry out investigations;
- will it systematically review all annual and interim reports issued by listed companies and make enquiries with the companies and/or their respective auditors;
- is the listed company under investigation expected to make an announcement once an investigation started against it.

3. Composition of the Audit Investigation Board ("AIB")

Presumably the AIB is to investigate suspected irregularities of auditors of listed companies in relation to audit of published accounts or financial statements of such entities and the preparation of financial reports for inclusion of prospectuses or other listing documents. However, based on section 22, the AIB may have as few as two members and given such a small size, we are not certain if the AIB would be able to cope with its duties and workload, which must be enormous and sometimes highly technical in nature.

4. Appeal procedures

- 4.1 We understand that in case of a relevant non-compliance relating to a listed company, the FRC may enquire into the questionable financial reports or to constitute a Financial Reporting Review Committee ("FRRC") to conduct an enquiry. If the enquiry concludes that the financial reports do not comply with the relevant requirements or standards, the FRC may require a voluntary rectification, or seek a court order to mandate such a rectification.

4.2 The Chamber appreciates that the role of the FRC is basically investigatory and enquiry in nature without any power to impose sanctions. That however does not necessarily mean that the opportunity of the party under investigation to make an appeal can then be dispensed with. The arguments that the party affected may apply to court for judicial review, or lodge a complaint with the Ombudsman's office is, with respect, an unsatisfactory one. The Chamber strongly recommends that there is a genuine need to put in place a set of appeal procedures because:

- (a) the FRC is, understandably, given very extensive regulatory power in the Bill and it is in the interests of natural justice and minimizing any chances of any regulatory abuse; and
- (b) the accountability measures for the work of the FRC, e.g. approval of the FRC's budget, auditing of the FRC's accounts, laying of reports and accounts and auditor's report before Legislative Council, are basically financial and routine in nature and it is open to doubt as to whether such measures are practically sufficient, e.g. members of the Legislative Council are too busy to allocate time and resources or have the requisite technical expertise to supervise the day-to-day modus operandi of the FRC. In this regard, with an appeal mechanism, from the number of appeal cases and in particular, those allowed, will at least serve as a comparatively more objective yardstick on the quality of work of the FRC.

5. Reasonable compensation

While it is the obligation of a party under investigation to cooperate fully with the FRC in any such investigations, if in case it turns out that there are not any irregularities or incidents of non-compliance, or that there is a legally justifiable defence made by it, the party under investigation should be entitled to seek reasonable compensation from the FRC for all costs and expenses incurred and loss suffered by it owing to the time and resources reasonably devoted for assisting and cooperating with the FRC in its investigations. In addition to the appeal procedures, this also serves as an effective check and balance measure to avoid any investigations being started unreasonably or when started, being carried on with undue delay.

5. CEO of the FRC

- 5.1 It provides that the term of office of the CEO is three years and is eligible for re-appointment (Schedule 3, para. 1). There is therefore a loophole that a particular person may take up this position for an exceedingly long period of time if he is eligible for re-appointment every time his tenure of office is due for renewal. The Chamber considers that there is a need to impose a maximum time limit, say, not more than two terms, to avoid this from happening.
- 5.2 There is no mentioning here of the remuneration of the CEO and in light of the recent public criticism on the extraordinarily high package enjoyed by CEOs of other statutory bodies, consideration should be given to specified here that his remuneration be referable to a certain pay level of a civil servant of a comparable rank.
- 5.3 Further, as the CEO is a key figure in the FRC, there should also be mandatory provisions on the notice period in case of his resignation, e.g. at least three to six months, to ensure that there will be a smooth transition. Moreover, to avoid actual or possible conflict of interests and to safeguard impartiality in discharging his duties, the CEO should not be permitted to take up any position in a, say, accounting firm which will be, or may be seen to be, in conflict with his position as CEO within a period of 12 months after termination.

Lastly, we wish to note that the Chamber now has more than 100 members who are Hong Kong listed companies, comprising those listed on the Main Board and the Growth Enterprise Market, and associate members including accounting firms. While the views contained in this letter represent those of the Chamber, they do not necessarily represent the views of individual members, who may make known their own viewpoints with due regard to their own circumstances. The Chamber has no objection that the views stated above be available to the media.

We would appreciate it if you would duly considered the above views.

Yours faithfully,
For and on behalf of
The Chamber of Hong Kong Listed Companies

Lawrence Ho
Chairman