

Financial Reporting Council Bill
Administration's Responses
to the Submissions made to the Bills Committee

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Financial Reporting Council Bill

Administration's Responses¹ to the Submissions made to the Bills Committee

(1) The Association of International Accountants (Hong Kong Branch) (CB(1)2288/04-05(01) – Revised)

	Summary of Comments ²	Administration's Responses
1	General: Accountability of financial information disclosed by public companies involves two parties, directors (who prepare the financial information) and auditors (who attest the financial information). Any regulatory regime established should be able to effectively police the works of both directors and auditors.	The major driver of the establishment of the Financial Reporting Council (FRC) is the need to upgrade the investigation function with respect to any irregularities of the auditing profession in the audit of listed entities. In respect of preparation of financial reports, the FRC is also proposed to be empowered to request directors of listed entities to voluntarily revise accounts under clause 49. However, it should be noted that the proposals in the Bill are not intended to build a regulatory regime for directors of listed entities, in addition to what is already stipulated in the Securities and Futures Ordinance (SFO, Cap. 571) and Companies Ordinance (CO, Cap. 32).
2	Clause 7(3) (Definition of “public officer”): It is suggested that a definition of “public officer” should be inserted.	According to section 3 of the Interpretation and General Clauses Ordinance (Cap. 1), a “public officer” means any person holding an office of emolument under the Government, whether such office be permanent or

¹ We have prepared these consolidated responses in consultation with the Department of Justice and the Companies Registry.

² For details of the comments, please refer to the original submissions from the relevant deputations.

	Summary of Comments ²	Administration's Responses
		<p>temporary. For the purposes of the Bill, we intend that a public officer does not include (a) a judicial officer; or (b) a public officer by virtue only of his being the chairman of a board or tribunal established under an Ordinance. We will propose a Committee Stage Amendment (CSA) to put our intent beyond doubt.</p>
3	<p>Clause 7 and Schedule 2 (Appointment of FRC members) : Although there are provisions in Schedule 2 relating to the removal of members of the FRC in certain circumstances, there are no similar considerations in the Schedule relating to initial appointment. It may be sensible to include similar circumstances relating to the appointment, perhaps to be determined by the appointer or nominator.</p>	<p>The Administration's intention is to establish an independent FRC with a wide and balanced composition. The Chief Executive (CE) would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.), so that the FRC could discharge its functions effectively. That said, we do not propose to set out the detailed qualification requirements in the Bill, so as to facilitate the CE in appointing the best available candidates in the light of actual circumstances.</p>
4	<p>Section 7 of Schedule 2 (Transaction of business by circulation of papers): Resolutions at FRC meetings are passed by majority vote of the members present. However, written resolutions must be passed unanimously by members present in Hong Kong. Is there any reason why a written resolution should not be passed by a majority of the Council members present in Hong Kong at the time?</p>	<p>Section 7 of Schedule 2 to the Bill provides that that the FRC may transact any business by circulation of papers. Usually the matters to be transacted by circulation of papers are routine or administrative in nature, and may not require discussion among members during a Council meeting. In this regard, we prescribe that a written resolution should be approved by all the members of the FRC present in Hong Kong (being not less than the number required to constitute two thirds of the members</p>

	Summary of Comments ²	Administration's Responses
		<p>of the FRC). If the proposed resolution cannot be unanimously passed, the matter should be discussed at the Council meeting during which the matter is to be determined, pursuant to section 6(8) of Schedule 2, by a majority of the votes of the members of the Council present at the meeting.</p> <p>Section 7 of Schedule 2 to the Bill is modelled on section 7 of Schedule 2 to the Deposit Protection Scheme Ordinance (Cap. 581).</p>
5	<p>Clauses 25 and 26 (Power to require production of records and documents): The two clauses authorize the Audit Investigation Board (AIB) to require a “<i>relevant undertaking</i>” to produce records and documents, but not an “<i>associated undertaking</i>”. In view of the similarity in the meanings of “<i>relevant undertaking</i>” and “<i>associated undertaking</i>”, we consider that it is clearer to include “<i>associated undertaking</i>” under these two clauses.</p>	<p>The definition of the term “<i>associated undertaking</i>”, which appears in clause 54, extends the definition of “<i>relevant undertaking</i>” (which basically covers the subsidiary of the listed entity) to cover (a) an undertaking in which the corporation has an interest (whether held by that corporation directly or indirectly through any other corporation or corporations) that is accounted for by that corporation in its accounts using equity accounting; or (b) a corporation a substantial shareholder of which is also a substantial shareholder of the corporation. This enables the immunity in relation to the “whistle-blowing” under clause 54 to be afforded to a wider class of persons (i.e. auditors of the associated undertakings of a listed entity). The definition of “<i>associated undertaking</i>” is modelled on section 381(5) of the SFO which is also an immunity clause in relation to the “whistle-blowing” by auditors.</p> <p>For the investigation powers under clauses 25(2)(c) and</p>

	Summary of Comments ²	Administration's Responses
		<p>26(2)(c), we consider it sufficient and prudent to provide that the investigator may require the “<i>relevant undertaking</i>” of the listed entity to produce documents or records. This should be considered alongside clauses 25(5) and 26(5), which provide that the investigator may require production of documents or records from any person, who (a) has directly or indirectly dealt with or has had dealing directly or indirectly with the listed entity or a relevant undertaking of the entity, or (b) is otherwise in possession of records or documents that relate to the audit of the accounts of the entity or undertaking or to the preparation of a specified report required for a listing document.</p>
6	<p>Clauses 25 and 26 (Power to require production of records and documents): We consider it necessary to specifically extend to officers of the listed entity, a relevant undertaking, or an associated undertaking, the statutory obligation to produce records and documents.</p>	<p>Clause 27 contains provisions supplementary to clauses 25 and 26. Clause 27(2) provides that if a person produces a record or document pursuant to a requirement imposed on him under clause 25 or 26, the investigator may in writing require the person, <i>or where the person is a corporation, an existing, or past, officer or employee of that person</i>, to give an explanation, or make a statement, on matters relating to the document.</p>
7	<p>Clauses 25 to 28 (Authorized Officer): A reference to an “<i>authorized officer</i>” assisting the investigator appears in clause 28(1)(b) and (6). It is not clear from clauses 25, 26 and 27 whether an authorized officer can assist the investigator for the purposes of those sections, although</p>	<p>Clause 28(1)(b) makes a specific reference to an “<i>authorized officer</i>”, so that a person concerned shall only attend before an authorized officer (i.e. a member of the investigator, or who is employed by the FRC to assist the investigator, as defined in clause 28(6)), instead of all</p>

	Summary of Comments ²	Administration's Responses
	<p>clause 30 seems to suggest this can be the case in relation to clause 27. Perhaps clauses 25, 26 and 27 should contain similar references to an authorized officer.</p>	<p>members of the FRC/AIB, during the interview. For the other requirements to be imposed by the investigator (e.g. the requirement for production of records and documents), the requirements would be made in the name of the investigator. Hence, there is no need to make a specific reference to "<i>an authorized officer</i>" other than in clause 28(1)(b). Separately, clause 10(2)(a) provides that the FRC may employ persons to assist the FRC and AIB in the performance of their functions.</p>
8	<p>Clauses 30 and 35 (Use of Incriminating Evidence in Proceedings): Clause 30 suggests that evidence collected from a person in an investigation by the AIB is not admissible in criminal proceedings against that person. However, clause 35(5) provides that the AIB's report on its findings in the investigation is admissible as evidence of the facts stated in the report in certain proceedings.</p>	<p>Clause 30(2), which seeks to prohibit the admission of self-incriminating evidence in criminal proceedings, starts with the words "(d)espite anything in this Ordinance". This statutory prohibition on the use of self-incriminating evidence overrides any other provisions in the Ordinance concerning the admissibility of evidence in criminal proceedings. The same applies to clause 44(2).</p> <p>Having considered the comments of some deputations, we have reviewed with the Department of Justice clauses 35(5) and 47(5) concerning the admissibility of evidence in relevant proceedings. We accept that we should be slow to create statutory exceptions to the rule against hearsay in criminal proceedings. We would consider proposing a CSA to carve out the admissibility of the investigation/enquiry reports in criminal proceedings as evidence of the facts stated therein.</p>

	Summary of Comments ²	Administration's Responses
9	<p>Clause 31 (Offences relating to the requirements under Division 2 of Part 3): Under clause 31 which deals with fines for offences relating to requirements under Division 2, we consider that the level of fine under subsection (13) should be raised to give more deterring effect.</p> <p>The magnitude of fine under subsection (12) and subsection (13) is the same (both being HK\$1,000,000), even though the offences under subsection (13) are of a more serious nature, being “<i>with intent to defraud</i>”.</p>	<p>Clause 31 sets out the offences for failures to comply with requirements imposed under Division 2 of Part 3 of the Bill, which concerns non-compliance with a requirement in relation to production of records or documents or provision of assistance during investigation. The offences are not intended to be a punishment in relation to auditors' irregularities or other types of market misconduct itself. The level of fines in clause 31 are modelled on sections 184(2) and (3) of the SFO. Although the level of fines for an offence under sub-clause (2), (3), (4), (5), (6) and (7) is the same, an offender may be subject to a longer period of imprisonment in relation to an offence under sub-clause (2), (3), (6) and (7) which encompasses the element of “<i>intent to defraud</i>”. The Department of Justice has been consulted on the appropriateness of the proposed penalty levels.</p>
10	<p>Clause 37 (Costs and expenses of investigation): First, if the prosecution results in a fine, will an award of a sum to meet the costs and expenses of the FRC take into account the financial penalty already imposed by the court?</p> <p>Second, is there a danger that this provision may create a conflict of interest in investigations? There are financial benefits to the FRC, who appoint the AIB to investigate if an investigation leads to a report that initiates a successful</p>	<p>Clause 37(1) provides that if, on a prosecution instituted as a result of an investigation under Part 3 of the Bill, a person is convicted by a Court or Magistrate, the Court or Magistrate may order the person to pay to the FRC the sum the Court or Magistrate <i>considers appropriate</i> for the costs and expenses in relation or incidental to the investigation <i>reasonably incurred</i> by the FRC. The Court or Magistrate therefore has the discretion to consider all relevant factors in determining the amount of</p>

	Summary of Comments ²	Administration's Responses
	prosecution.	<p>the costs and expenses to be paid by the person convicted.</p> <p>We do not believe that there will be a conflict of interest in investigations. The FRC shall discharge its investigatory functions with due diligence all the time, and it is the Court or Magistrate (but not the FRC) that convicts a person. At present, section 35(1)(d) of the PAO also provides that a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants (HKICPA) may make an order that the certified public accountant pay the costs and expenses of and incidental to an investigation under the PAO against him, if the Committee is satisfied that a complaint is proved.</p>

(2) **British Chamber of Commerce in Hong Kong (CB(1)2288/04-05(02))**

	Summary of Comments²	Administration's Responses
1	General: To maintain the quality of listed company audits in Hong Kong, and to prevent accounting scandals from affecting the capital markets, it is vital that checks and balances are implemented properly. The Chamber fully supports the implementation of the FRC and agrees with the proposed modus operandi.	Noted.
2	Clauses 9(f) and (g) (Referral of cases and provision of assistance to a specified body): We understand that the AIB will handle investigations but in terms of fines and penalties, the Securities and Futures Commission (SFC) will in most cases impose penalties, should they be necessary. This process will particularly need to be reviewed in the light of experience.	The FRC will be an investigatory body responsible for investigation of auditors' irregularities and enquiry into non-compliances of financial reports concerning listed entities. Upon completion of an investigation/enquiry, the FRC is empowered, under clauses 9(f) and (g) to refer to a specified body, or provide assistance to a specified body on the body's investigation or enquiry into or dealing with, any case or complaint concerning a relevant irregularity or relevant non-compliance. The SFC is one of the specified bodies as defined in clause 2(1).
3	Clauses 35 and 47 (Publication of reports): Whether reports will be published is left open to the FRC. It is the checks and balances in the operation of the FRC which will be most important going forward and the Director of Audit may be in the best position to have a general oversight of the number and types of cases investigated and the outcomes, and indeed whether details	Clauses 35(4) and 47(4) provide that the FRC shall take into account the following considerations before deciding whether to publish the report or part of the report :- (a) whether or not the publication may adversely affect any criminal proceedings before a Court or Magistrate, proceedings before the Market Misconduct Tribunal, or any proceedings under Part V or VA of the Professional

	Summary of Comments ²	Administration's Responses
	are reported.	Accountants Ordinance (PAO, Cap. 50), that has been or is likely to be instituted; (b) whether or not the publication may adversely affect any person named in the report; and (c) whether or not the report should be published in the interest of the investing public or in the public interest. This already provides for an important "checks and balances" measure in relation to the decision of whether an investigation/enquiry report should be published. Separately, it should be noted that, under clause 19, the Director of Audit is the auditor of the <i>accounts</i> of the FRC.
4	Clause 6 (Establishment of the FRC): We do not object to the FRC being set up as a statutory body, although we note that the equivalent body in the UK is a UK company limited by guarantee.	Noted.
5	Clause 7 (Composition of the FRC): Any person nominated as a member of the FRC by the HKICPA should be from their Secretariat, and not from an audit firm. We may also perhaps suggest that a representative from a Chamber of Commerce is one of the nominated members and also a lawyer who is an expert in the listing rule area. The Chairman should not be anyone from the HKICPA, Hong Kong Exchanges and Clearing Limited (HKEx) or SFC.	We intend to leave it to the HKICPA which is the statutory regulatory body of the accountancy profession to make the nomination to the CE. It is our intention to establish an independent FRC with a wide and balanced composition. The CE would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.) so that the FRC could discharge its function effectively. To help uphold the independence of the FRC, the CE shall appoint, under clause 7(4) of the Bill, the Chairman of the

	Summary of Comments ²	Administration's Responses
		FRC from amongst the appointed members of the FRC who are lay persons.
6	General (Funding arrangement for the FRC): We think an initial contribution of HK\$2.5 million and then three years contribution of HK\$2.5 million each is steep for the four bodies (including Companies Registry) to bear. Since this is proposed to be a statutory body we believe the Government should fund the operations initially and the body should move towards a levy which would eventually fund all its operations. A more obvious mechanism will likely emerge after the FRC has been in operation for two years or so.	We note that some Members of the Bills Committee and deputations have expressed views about the adequacy of the funding for the FRC, which will be set out in a memorandum of understanding signed among the four funding parties. We have been guided by the principles that it is necessary to maintain a lean structure for the FRC and that, at the same time, the funding arrangement should be adequate for the FRC to discharge its functions effectively. The Administration has written to the HKICPA, SFC and HKEx to explore whether additional resources should be injected to the FRC.
7	General (Role and powers of the AIB): We agree that the AIB should pursue investigations and not also handle disciplinary matters. We agree that the AIB should be staffed by employees of the FRC, although they may subcontract investigatory work to suitable parties if required. We agree that investigations can cover the audit firm, its principals and staff, and may be instituted where there is reasonable cause to believe there has been an irregularity.	Noted. The HKICPA has confirmed in its submission that the Institute should continue to act as the profession's regulatory body and to be responsible for the disciplinary role of which the prosecution role is an integral part.
8	Clause 4 (Relevant irregularity): We are not sure what is intended to be covered by paragraph 5.11(h) of the Consultation Paper, which mentioned the reference to	We have noted this previous comment in response to the Consultation Paper issued in February 2005. Clause 4(3)(d) of the Bill has incorporated this comment by

	Summary of Comments ²	Administration's Responses
	<p>“dishonourable conduct” as an irregularity.</p>	<p>modelling on the interpretation of “dishonourable conduct” in section 34(2) of the PAO. The type of irregularity referred to in clause 4(3)(d) of the Bill now reads as “(the auditor or reporting accountant) did or omitted to do something that, were the auditor or reporting accountant an individual certified public accountant, would reasonably be regarded as bringing or likely to bring discredit upon the auditor or reporting accountant himself, the HKICPA or the accountancy profession”.</p>
9	<p>Clauses 37, 71, 80 (Recovery of the investigation cost): Where an irregularity is proved we agreed that the costs of the investigation can in some suitable instances be recovered from the auditor; although in cases where the auditor is clearly a victim of an unscrupulous client such costs should not necessarily be recoverable, but perhaps they can be recoverable from the guilty party.</p>	<p>Noted. Clauses 37, 71 and 80 provide that a Court or Magistrate, Market Misconduct Tribunal, or a Disciplinary Committee of the HKICPA, may order a person convicted or found to have engaged in a market misconduct, or an certified public accountant who is found to have committed an irregularity (as the case may be), to pay to the FRC the sum the Court, Magistrate, Market Misconduct Tribunal or the Disciplinary Committee considers appropriate for the costs and expenses in relation or incidental to the investigation reasonably incurred by the FRC.</p>
10	<p>Clauses 39, 41 and 50 (The Financial Reporting Review Committee's enquiry): We agree with the “group” approach, where the Financial Reporting Review Panel (FRRP) will comprise not less than 20 professionals chosen by the CE, with five being chosen to review any</p>	<p>Noted.</p>

	Summary of Comments²	Administration's Responses
	particular case and a Financial Reporting Review Committee (FRRC) chaired by a Panel Convenor.	
11	Clauses 35 and 47 (Publication of reports): We agree that the FRC should have discretion as to whether reports about cases should be published.	Noted.
12	Clause 54 (Immunity in respect of communication with the FRC by auditors of listed entities): We agree that auditors should be able to have immunity in reporting to the FRC on any suspected fraud or irregularities in current or previous audits.	Noted.
13	Clauses 61 to 63 (Revision of defective accounts): We agree with the publication of revised accounts after the filing of a "caution" with the Registrar of Companies.	Noted.

(3) Deloitte Touche Tohmatsu (CB(1)2288/04-05(03))

	Summary of Comments ²	Administration's Responses
1	<p>Clause 4 (Definition of “relevant irregularities”) – The FRC should be restricted to launching investigations only in respect of material irregularities in the accounts of listed companies and the matter <i>raises or appears to raise important issues affecting the public interest</i> in Hong Kong. Other matters should be left to normal processes of self regulation if it is deemed necessary to pursue them.</p>	<p>Auditors’ irregularities or non-compliances of financial reports relating to listed entities should be of sufficient public interest <i>per se</i>, as such irregularities and non-compliances will have a bearing on the quality of listed entities’ financial reporting which underpins investor confidence in the financial markets. We do not consider it appropriate to include an additional “public interest/materiality” test for the initiation of an investigation or enquiry as this test is a concept incapable of precise definition. We consider that there is already a demonstrably far greater degree of “<i>public interest</i>” in “<i>listed entities</i>” than “<i>unlisted entities</i>”, while the term “<i>listed entity</i>” is capable of precise definition unlike the term “<i>public interest</i>”.</p> <p>As a reference, sections 179 and 182 of the SFO do not impose any further restriction on the SFC for investigation of misconduct/market misconduct. The SFC does not need to demonstrate that the suspected misconduct/market misconduct “raises or appears to raise important issues affecting the public interests in Hong Kong” before exercising its investigation powers under the relevant sections.</p>
2	<p>Clause 4(3)(c) (Definition of “relevant irregularity”) – The irregularity referred to in this clause (i.e. <i>being</i></p>	<p>Clauses 4(3)(c) and 4(3)(d) of the Bill make clear that “<i>being negligent in the conduct of an auditor’s</i></p>

	Summary of Comments ²	Administration's Responses
	<p><i>negligent in the conduct of an auditor's profession</i>) is included in section 34 of the PAO, but it is inappropriate because clause 4(3) also contains sub-paragraph (d) which is sufficient to encompass any negligence which would legally constitute professional misconduct. Given that an occurrence of an act of negligence by itself is not necessarily professional misconduct we query its appropriateness even in the PAO.</p>	<p><i>profession</i>" and "<i>being guilty of professional misconduct</i>" are two separate defined "specified events". These mirror equivalent provisions in sections 34(1)(a)(iv) and (viii) of the PAO which are two types of irregularities subject to investigatory and disciplinary action by the HKICPA's Investigation and Disciplinary Committees. Furthermore, the irregularity of "<i>being negligent in the conduct of an auditor's profession</i>" relates directly to the discharge of the auditor's duty. Having considered the interest of the profession and the public, we do not see why these two quite separate irregularities should be merged. We maintain that "<i>negligent conduct</i>" should retain its status as a separate "<i>relevant irregularity</i>" as defined in clause 4 of the Bill.</p>
3	<p>Clause 25 (Powers to require production of documents and records) – This relates to requiring an accountant to produce documents in his possession relating to a listed entity or a relevant undertaking of that entity. There may be problems in this regard because of the highly developed cross boundary nature of Hong Kong listings.</p>	<p>Noted. Where appropriate, the FRC, pursuant to clause 12, may refer cases to a specified authority (which may be outside Hong Kong), or provide assistance to a specified authority on the authority's investigation or enquiry into or dealing with, any case or complaint concerning a relevant irregularity or relevant non-compliance.</p>
4	<p>Clause 28(1)(d) (Power to require assistance in connection with the Investigation) – This sub-paragraph is too vague and too wide. What could be encompassed by the expression in sub-paragraph (d) "<i>all other assistance in connection with the investigation that he is</i></p>	<p>The requirement of giving the investigator all assistance in connection with the investigation that a person is <i>reasonably</i> able to give is also found in section 42D(1)(a)(iii) of the PAO (which provides for the investigation powers of the HKICPA's Investigation Committees) and section 183(1)(d) of the SFO (which</p>

	Summary of Comments²	Administration's Responses
	<i>reasonably able to give</i> ”?	provides for the investigation powers of the SFC). This is a sweep-up clause which enables the investigator to conduct an investigation effectively with the assistance to be reasonably given by the person concerned.
5	Clause 34 (Magistrate's warrants) – This clause potentially applies to the premises of anybody whether they have anything to do with the listed company or the auditors or not. It has the potential to be intrusive on innocent third parties. We consider that domestic premises should be excluded from this power. Alternatively, we would submit that if there is to be a warrant for domestic premises then that has to be approved by a High Court judge rather than by a magistrate.	Clause 34 of the Bill is modelled on section 191 of the SFO. This power is important as it enables the investigator to seize important evidence which may otherwise be destroyed in the conduct of an irregularity. Circumscribing the class of the premises will run the risks of creating a loophole that the person under investigation may be tempted to transfer documents relevant to investigation from premises subject to a search warrant to those not. The fact that the warrant is to be issued by a magistrate has provided for an appropriate check and balance.
6	Clause 35(5) (Admissibility of investigation reports as evidence) – This provision is quite inappropriate. The report of the AIB will no doubt contain large amounts of hearsay and expressions of opinion put forward as matters of fact. It is inappropriate for that material to be submitted to any court or magistrate in any criminal proceedings. It is equally inappropriate to make such a report evidence in any civil proceedings. The problem is that the machinery of the FRC and the AIB will be potentially misused by would be civil litigants and their lawyers in order to promote the prospect of success in	Having considered the comments of some deputations, we have reviewed with the Department of Justice clauses 35(5) and 47(5) concerning the admissibility of evidence in relevant proceedings. We accept that we should be slow to create statutory exceptions to the rule against hearsay in criminal proceedings. We would consider proposing a CSA to carve out the admissibility of the investigation/enquiry reports in criminal proceedings as evidence of the facts stated therein. As for the admissibility of investigation/enquiry reports in

	Summary of Comments ²	Administration's Responses
	<p>later litigation. Clause 35(5) should be limited to enabling facts stated in the report to be only <i>prima facie</i> evidence in the Market Misconduct Tribunal or in disciplinary proceedings under the PAO, but not otherwise be admissible in proceedings in any court.</p>	<p>other proceedings, it should be stressed that such reports are not admissible as evidence of the <i>opinions (but facts)</i> stated therein, and that the reports are not automatically considered as conclusive evidence of such facts. The persons concerned may still produce evidence before the court to prove that what was stated in the report is not true. The Court, Market Misconduct Tribunal or a Disciplinary Committee of the HKICPA would then decide on the issue after considering all evidence.</p>
7	<p>General (FRC as a complainant in the disciplinary proceedings under the PAO): The Bill is silent on who is to take responsibility for a prosecution in disciplinary proceedings under the PAO. Where a matter is of sufficient public interest for the FRC to have taken action it appears logical, practical and expedient for the FRC to fill the role of prosecutor.</p> <p>It is unfair to expect the HKICPA to bear the cost of a prosecution in respect of which it has had no role.</p>	<p>Please refer to the Administration paper's entitled "Functions of the Financial Reporting Council" which sets out our justifications for the role of the FRC being purely investigatory. In essence, the FRC will only be an investigatory body. The Registrar of HKICPA should retain his function to prosecute (i.e. to present a case against) a certified public accountant in the disciplinary proceedings under the PAO. Furthermore, the HKICPA has confirmed in its submission that the Institute should continue to act as the profession's regulatory body and be responsible for the disciplinary role of which the prosecution role is an integral part.</p> <p>It is fair for the HKICPA to undertake the prosecution role and bear the cost of a prosecution as, under section 7 of the PAO, it is within the objects of the HKICPA, as a statutory <i>self-regulatory professional body</i>, to regulate the practice of the accountancy profession, discourage</p>

	Summary of Comments ²	Administration's Responses
		<p>dishonourable conduct by certified public accountants, and to hold inquiries into the conduct of certified public accountants, firms and corporate practices. The HKICPA should therefore have a key role to play in respect of the disciplinary action against its own members. Section 35(1) of the PAO also provides that the Disciplinary Committee may in any case make such order as the Committee thinks fit with regard to the payment of costs and expenses of and incidental to the proceedings, <i>whether of the Institute (including the costs and expenses of the Disciplinary Committee)</i> or of any complainant or of the certified public accountant.</p> <p>Furthermore, as the FRC will take over the responsibility for investigating the audits of listed entities, the HKICPA will no longer have to bear the full cost of undertaking these investigations in respect of their members.</p>
8	<p>Clause 36(2) (FRC's power to close case, suspend investigation and follow up, etc.) – We see no reason why merely because a matter has been placed in the hand of the AIB that this should deprive the FRC of the power to cease any investigation or suspend same.</p>	<p>If the FRC has directed the AIB to conduct an investigation and the AIB is in the process of investigation, we consider that the FRC shall not be allowed to close a case, suspend an investigation or carrying out any follow-up actions, unless and until it receives a report from the AIB with regard to the progress and results of investigation. It should also be noted that, before the completion of investigation, the FRC is empowered, under clause 35(2), to require the AIB to</p>

	Summary of Comments ²	Administration's Responses
		submit an interim report on the investigation.
9	Clause 47(5) (Admissibility of enquiry reports as evidence) – We have the same comment as under clause 35(5).	Please refer to item (6) above regarding the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 15).
10	Clause 48(2) (FRC's power to close case, suspend investigation and follow up, etc.) – Again we have the same comment as under clause 36(2).	Please refer to item (8) above regarding the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 17).
11	<p>Clause 52 (Avoidance of conflict of interests) – There are several clauses that are exceptionally wide and confusing of interpretation and will only have the effect of discouraging people with knowledge and experience of business and the markets from wanting to be involved in the FRC's work.</p> <p>First, in sub-clause (2), a person should only be required to disclose an interest immediately he becomes aware of it.</p> <p>Secondly, we query why sub-clause (3)(b)(iv) is necessary. We are concerned about the potential breadth of it as it refers to a person having an interest in a matter if it relates to someone who he knows is or <u>was</u> a client of a third person by whom he is or <u>was</u> employed or who is or <u>was</u> his associate. The problem is further compounded when one is taken to the definition of "<i>associate</i>" in</p>	<p>Given the proposed powers of the FRC, there are strong policy reasons to put in place a proper system to ensure that members or employees of the FRC, or other persons performing a function or exercising a power under the Bill are not involved in any possible conflict of interest, as such conflicts, whether genuine or perceived, would undermine the credibility of the FRC and the effectiveness of the whole new set-up. As the FRC's powers are closely modelled on sections 179 and 183 of the SFO, in the drafting of the Bill we have made reference to section 379 of the SFO to devise the declaration regime in relation to conflict of interests. However, in the light of the concerns expressed, we will reconsider the proportionality of the proposed provisions and, if considered appropriate, make revised proposals in due course for Members' consideration.</p>

	Summary of Comments ²	Administration's Responses
	<p>sub-clause (9) which again is very wide.</p> <p>Thirdly, for the definition of “<i>associate</i>” in sub-clause (9)(k), this is far too wide because it relates not only to directors of a corporation and its related corporations but, in respect of the related corporations, even extends to employees. The same reference is made to a pension or provident fund or an employee share scheme of the corporation or the related corporation of that corporation.</p>	
12	<p>General (Duplicate investigation): There is no provision in the Bill to prevent duplicate investigations against the same auditor or accountant. In respect of an auditor, a provision should be inserted in the Bill that, if the FRC has already commenced or decided to commence an investigation in respect of an auditor, the HKICPA should be precluded from commencing any investigation or continuing any investigation already commenced which relates to the same issue.</p> <p>We would submit on behalf of accountants who are financial controllers or finance directors of listed companies that they also have the potential to be seriously prejudiced by multiple investigations because they may at the same time as being investigated by the FRC, the HKICPA and the SFC.</p>	<p>At present, the HKICPA possesses investigatory powers under the PAO to investigate suspected irregularities involving its registered members and practice units. The FRC will, upon its establishment, investigate auditors' irregularities involving listed entities, whereas the HKICPA will continue to deal with other cases involving its own members and practice units (including those cases in the non-listed sectors). In essence, the FRC will simply take over the responsibility for investigating auditors' irregularities concerning listed entities. As a transitional arrangement, the FRC will not deal with cases which have, before its establishment, been received by the HKICPA.</p> <p>The above arrangement between the interface of the HKICPA and the FRC are expected to be set out in a memorandum of understanding between the two bodies, pursuant to clause 10(2)(d) of the Bill, with a view to facilitating cooperation and avoiding any</p>

	Summary of Comments ²	Administration's Responses
		<p>unnecessary duplication of work. We also consider that the current division of responsibilities between the SFC and the HKICPA will, by and large, apply to that between the SFC and the FRC. Both the SFC and the Administration do not anticipate that there will be undue overlap between the FRC's and the SFC's investigations.</p>

(4) **The Chamber of Hong Kong Listed Companies (CB(1)2288/04-05(04))**

	Summary of Comments²	Administration's Responses
1	General: 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 FRC.	Noted.
2	General (Impact of investigation on listed entities): Any investigation to be taken by the FRC should cause minimum adverse impact on the normal business operations of the party under investigation.	We believe that effective investigation of a relevant irregularity concerning auditors/reporting accountants and enquiry into a non-compliance concerning a financial report would improve the quality of financial reporting of listed entities . This will enhance Hong Kong's corporate governance regime. In this regard, we are mindful that the proposed investigation powers should be sufficient and also proportionate in meeting this objective. For example, clauses 25 and 26 set out the conditions of "relatedness" and "relevance" which underpin the FRC's requirement for the listed entity and its relevant undertakings to produce documents and records, and should be certified by the FRC as having being met.
3	General (Division of responsibilities and coordination of enforcement actions among the FRC and other bodies): There may be a certain degree of overlapping between the work of the other law enforcement agencies,	We appreciate there is a need for the planned investigation of the FRC to be coordinated with the enforcement actions of other bodies or regulators where the situation warrants. In this regard, clauses 24 and 42 require the

	Summary of Comments ²	Administration's Responses
	<p>regulators and professional bodies. The FRC should be placed under a legal responsibility that, whenever it intends to start an investigation on a party, it should enquire and/or consult, on a strictly confidential basis, with other law enforcement agencies.</p>	<p>FRC to notify the relevant financial services regulators when the FRC initiates an investigation or enquiry in relation to a listed entity which is a regulatee of such other regulators. Clauses 29 and 43 require the investigator/enquirer to consult the relevant financial services regulators when a requirement in connection with the production of records or documents or giving of information is imposed on a person who is a regulatee of the other regulators.</p>
4	<p>Clause 13 (FRC may issue guidelines): 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.</p>	<p>Clause 13(1) provides that the FRC may issue guidelines not inconsistent with the Ordinance (a) indicating the manner in which it proposes to perform its functions; or (b) providing guidance on the operation of any provision of the Ordinance. Since the authority for issuing such guidelines is the FRC, the guidelines could only be issued upon the establishment of the FRC after the commencement of the legislation.</p>
5	<p>Clause 22 (Audit Investigation Board): 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.</p>	<p>Clause 22(2)(a) provides that the Chief Executive Officer (CEO) of the FRC is an ex officio member and chairman of the AIB. Under our proposal, the AIB is to be overseen by the CEO of the FRC who will be supported by the full-time employees of the FRC and any other consultants, agents or advisers appointed by the FRC. Therefore, in essence, the AIB is the executive arm of the FRC and carries out one of the main functions of the FRC, namely the investigation of relevant irregularities as</p>

	Summary of Comments ²	Administration's Responses
		<p>directed by the FRC pursuant to clause 23. Although the AIB is to consist of two members at a minimum, there is no upper limit of the number of members so that the FRC would have the flexibility to decide on the size of the AIB in the light of caseload and resources available.</p>
6	<p>General (Whether there is a need to establish an appeal panel): There is a genuine need to put in place appeal procedures because –</p> <p>(a) the FRC is 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</p> <p>(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.</p>	<p>We have given considerable thought to the need to set up an independent tribunal to hear appeals from any parties aggrieved by the actions of the FRC. Our view is that it is not necessary to establish such an appeal tribunal, as the FRC's role is confined to investigatory and enquiry work and the FRC is not vested with any disciplinary powers to sanction anyone or impose a penalty on its own. In this regard, we have been advised that the investigation/enquiry and the referral of cases to a specified body by the FRC are too remote from the determination of a civil right or obligation of the person to which the case or complaint relates³. As a benchmark comparison, there is also no appeal mechanism against an investigation by the Investigation Committee of the HKICPA and the HKICPA Council's decision to refer a case to a Disciplinary Committee.</p> <p>Having said so, any party aggrieved by the action of the FRC may apply to the court for a judicial review of</p>

³ Article 14(1) of the International Covenant on Civil and Political Rights (replicated in Article 10 of the Hong Kong Bills of Rights) guarantees that everyone shall be entitled to a fair and public hearing by a competent, independent and impartial tribunal established by the law *in the determination of any criminal charge against him, or of his rights and obligations in a suit at law.*

	Summary of Comments ²	Administration's Responses
		<p>the action concerned. Moreover, both the disciplinary decisions under the PAO and Court's decisions regarding the revision of accounts are appealable.</p>
7	<p>General (Reimbursement of costs and expenses for assistance rendered in investigation): 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.</p>	<p>The FRC is established to serve the public interest in the integrity and quality of financial reporting of listed entities, which underpins investor confidence in Hong Kong's financial markets. Hence, we propose that the FRC should be statutorily empowered to require production of certain documents, provision of assistance, or attendance of certain persons during an investigation/enquiry. This thus becomes a public duty for the persons concerned to comply with a requirement of the FRC during the investigation/enquiry, and failure to comply without reasonable excuse is an offence. We see no reason that the person should be compensated or reimbursed for discharging a public duty.</p> <p>In any case, the powers of the FRC must be exercised reasonably, legally and for proper purpose. If they are not so exercised, the FRC may be subject to a judicial review. This provides for a safeguard against any unreasonable requirements/requests imposed by the FRC on a person in the course of an investigation/enquiry.</p>
8	<p>Section 1 of Schedule 3 (Tenure of the CEO): It</p>	<p>Clause 8(4) provides that the CEO of the FRC is the</p>

	Summary of Comments ²	Administration's Responses
	<p>provides that the term of office of the CEO is three years and is eligible for re-appointment. There is a need to impose a maximum time limit, say, not more than two terms.</p>	<p>administrative head of the FRC. As his post is an executive post, we consider that re-appointments should be allowed, having considered the post-holder's experience and capability in administering the affairs of the FRC. Therefore, we do not propose any limits on the number of terms a person could be appointed as the CEO of the FRC.</p> <p>As for other members of the FRC, there is already a <i>general</i> guideline within the Administration that a non-official member of a statutory body should not serve more than six years in any one capacity. We do not consider it necessary to prescribe this in the Bill, in order for the Administration to take into account the exigency of circumstances.</p>
9	<p>Section 3 of Schedule 3 (Terms and conditions of appointment of the CEO): Consideration should be given to be specified in the Bill that the remuneration of the CEO be referable to a certain pay level of a civil servant of a comparable rank.</p>	<p>Section 3 of Schedule 3 provides that all matters relating to the terms and conditions of the appointment of the CEO of the FRC are to be determined by the CE. In order to exercise flexibility in deciding the remuneration packages of individuals after taking into account their background, capability and performance, together with the pay trends and levels in comparable bodies, we do not consider it appropriate to prescribe rigidly the pay level in the legislation. That said, we envisage that proper disclosure of the remuneration package of key personnel of the FRC will be made in the FRC's annual report, which is required to be laid before Legislative Council under</p>

	Summary of Comments ²	Administration's Responses
		clause 20.
10	<p>Section 3 of Schedule 3 (Terms and conditions of appointment of the CEO): As the CEO is a key figure in the FRC, there should be mandatory provisions on the notice period in case of his resignation, e.g. at least three to six months. Moreover, the CEO should not be permitted to take up any position in an, 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.</p>	<p>We consider that matters relating to the notice period in connection with a resignation and the post-appointment sanitization period of an ex-CEO of the FRC should be determined by the CE in accordance with section 3 of Schedule 3. The detailed terms and conditions should be set out in the appointment contract, instead of in the Bill. It is our policy objective to ensure that the terms and conditions of the appointment of the CEO would contribute to the public confidence in the credibility of the FRC.</p>

(5) **Hong Kong Institute of Certified Public Accountants (CB(1)2288/04-05(05))**

	Summary of Comments²	Administration's Responses
1	<p>General: In 2003 the HKICPA advocated a number of significant changes to the regulatory and oversight structures that governed the activities of the auditing and accounting profession in Hong Kong, in recognition of the need for a greater level of transparency in our activities and the need for the strengthening of public trust in the work of our members. One of our recommendations was the establishment of the FRC. We have worked closely with the Administration and the other sponsoring bodies to develop the Bill.</p> <p>The HKICPA fully supports the legislative objectives of the Bill and believes that the benefits that the FRC will bring to the better regulation of the auditing profession and financial reporting by listed companies are significant. We would like to acknowledge the efforts of the Financial Services and the Treasury Bureau together with HKEx, SFC and the Companies Registry in bringing the Bill to LegCo in such a timely manner and look forward to its enactment in an equally timely manner.</p>	<p>We note that the Bill has received the full support from the HKICPA, which is the statutory professional accountancy body in Hong Kong.</p>
2	<p>General (Whether the FRC should have the disciplinary function and act as a “prosecutor” in disciplinary proceedings): We reiterate the HKICPA Council's determination that the Institute should continue to act as the profession's regulatory body and to be</p>	<p>We note that the HKICPA agrees with the Administration's proposal that the FRC should only be an investigatory body. The HKICPA is also in agreement with the proposed arrangement whereby the Registrar of the HKICPA would continue to be the “prosecutor”</p>

	Summary of Comments ²	Administration's Responses
	<p>responsible for the disciplinary role of which the prosecution role is an integral part. This determination together with the views of Government and the other regulators form the bedrock of the Bill.</p> <p>This said, we have been mindful that the FRC's investigation role and the Institute's prosecution and disciplinary roles should be properly defined in order for the process to be coordinated. As soon as the FRC is established, the FRC will work closely with the HKICPA to develop the non-statutory protocols, guidelines and/or Memorandum of Understanding in order to enable the Institute to discharge the prosecution role effectively.</p>	<p>against the auditor in the disciplinary proceedings under the PAO, upon receipt of the referral of investigation findings from the FRC. We envisage that the FRC may enter into memoranda of understanding in relation to matters about provision of assistance and referral of cases at various stages of the FRC's investigations.</p>
3	<p>General (Consultation with the HKICPA as regards the interpretation of Hong Kong Financial Reporting Standards): While it may be inappropriate for the HKICPA to be involved in the work of the FRRRC, there is one particular aspect, namely the interpretation of Hong Kong Financial Reporting Standards, which the FRRRC should consult the HKICPA. We expect this to be specified in the protocols, guidelines and/or memoranda of understanding, as appropriate.</p>	<p>There may be occasions that the FRC <i>may</i> see it necessary to communicate with or consult relevant experts and the HKICPA on the interpretation of financial reporting standards. We agree that the FRC may, pursuant to clause 10(2)(d), enter into memoranda of understanding with the HKICPA regarding the communication or consultation in this regard.</p>
4	<p>Clause 50 (FRC may apply to Court to secure removal of relevant non-compliance): The FRC is not empowered under clause 50 to seek a Court order to mandate rectification of the annual financial statements</p>	<p>Based on our legal advice, we propose that the FRC should only be empowered to seek a Court order to mandate revision of the annual accounts of Hong Kong incorporated companies under the requirements of the CO</p>

	Summary of Comments ²	Administration's Responses
	<p>generally. The HKICPA considers that, if this power is only to apply to Hong Kong incorporated companies, the effect will be that the FRC will be unable to oblige some 80% of listed companies which are incorporated outside Hong Kong to revise their financial statements.</p> <p>We are advised that, because of an extra-territoriality aspect of imposing obligations on entities incorporated outside Hong Kong, the only manner in which these companies can be compelled to revise their financial statements would be by giving statutory force to the Listing Rules. If this is the case, we encourage all concerned to move forward with the legislation necessary to give such statutory backing to the Listing Rules so that all listed companies are subject to the same degree of regulation.</p>	<p>or any specified report that are required under the CO to be included in a prospectus. This is because to empower the FRC to apply for an order to compel compliance with the financial reporting standards, Listing Rules or relevant code issued by the SFC, which are non-statutory <i>per se</i>, would arguably give statutory effect to such standards, rules or codes, and hence convert non-compliances with the non-statutory standards, rules or codes into legal wrongs that are subject to legal sanctions by way of a Court orders. Accordingly, Part 2 of Schedule 1 to the Bill is prescribed for the purpose of the provisions (i.e. clauses 5(2) and 50) relating to the Court order for mandatory revision of accounts. In effect, the Court may only declare non-compliances of a financial report <i>under the CO</i> with the accounting requirements as to the matters or information to be included in the report <i>as provided in the CO</i>. The relevant arrangements in the UK are similar.</p> <p>As the Government and the SFC plan to give statutory backing to certain Listing Rules such as those regarding financial disclosures, we would review the scope of the “<i>relevant financial reports</i>” and “<i>relevant requirements</i>” for the purpose of clause 50 in due course.</p>
5	<p>Clause 4(2)(a) (Relevant irregularity): At the end of clause 4(2)(a), whether the word “and” should be replaced with the word “or”?</p>	<p>The word “<i>and</i>” is just to join two separate definitions of “<i>auditing irregularity</i>” and “<i>reporting irregularity</i>”. The use of the word “<i>and</i>” does not necessarily mean the two</p>

	Summary of Comments ²	Administration's Responses
		definitions could not function without the other.
6	<p>Clause 4(3) (Relevant irregularity): This sub-clause is similar to but not the same as section 34(1)(a) of the PAO.</p> <p>There may be a danger of an event under the FRC Bill and not being such under the PAO and vice versa.</p>	<p>There would be no risk of an irregularity stipulated in the Bill not fallen within the jurisdiction of the disciplinary proceedings under the PAO. Clause 4(3)(a), (c) and (d) of the Bill is modelled on sections 34(1)(a)(iii)(A), (1)(a)(iv) and (1)(a)(viii) of the PAO. Clause 4(3)(b) of the Bill is modelled on section 34(1)(a)(iii)(B) of the PAO, with minor alteration. We used the past tense in clause 4(3)(b) as the materiality of the statement and the maker's knowledge or belief should be contemporary with the making of the statement. Clause 4(3)(e) of the Bill is modelled on section 34(1)(a)(x) of the PAO taking into account, with minor necessary adjustment, the definition of "dishonourable conduct" in section 34(2) of the PAO. Section 34(1)(a)(vi) of the PAO finds its way into clauses 4(4)(a)(v), (5)(a) and (6)(a) of the Bill. Section 34(1)(a)(ix) of the PAO finds its way into clauses 4(4)(a)(vi), (5)(b) and (6)(b) of the Bill. Sections 34(1)(a)(xi) and (xii) of the PAO find their way in clause 4(4)(b) of the Bill.</p>
7	<p>Clause 6(2)(c) (Status of the FRC): The FRC can be sued under clause 6(2)(c). However, under Clause 53, the FRC is immune or not liable. Consideration needs to be given to the significance of any contradiction.</p>	<p>The FRC is capable of being sued, as provided under clause 6(2)(c). Clause 53 only affords the FRC with immunity in relation to anything done, or omitted to be done, in good faith in the performance, or purported performance, of the functions of the Council. Clause 53</p>

	Summary of Comments ²	Administration's Responses
		does not give an unqualified immunity to the FRC.
8	Clause 7(1) (Composition of the FRC): There is no mention whether the Council Members should be paid.	We envisage, save for the CEO who would assume an executive post, the other members of the FRC (including the Registrar of Companies as an ex officio member) would serve on a <i>pro bono</i> basis for this public service. According to section 4 of Schedule 2 and section 3 of Schedule 3, all matters relating to the terms and conditions of the appointment of the appointed members and CEO of the FRC are to be determined by the CE.
9	Clause 10(2)(a) and (b) (Powers of the FRC). In sub-clause (2)(a) the word "employ" is used, and in sub-clause (2)(b) the word "appoint" is used. Consideration needs to be given to the significance of any contradiction.	We consider that the above drafting is in order. A person " <i>employed</i> " under clause 10(2)(a) is an employee, while a person " <i>appointed</i> " under clause 10(2)(b) is not necessarily so. Similar wording is adopted in sections 7(f), (g) and (h) of the Deposit Protection Scheme Ordinance (Cap. 581).
10	Clause 13(1)(a) (FRC may issue guidelines): Should the word "performs" be replaced with "perform"?	Agreed.
11	Clauses 25(1) and (2) (Powers of Investigation): There are differences between these clauses and section 42D of the PAO which sets out the powers of an HKICPA's Investigation Committee.	The proposed investigation powers are not modelled on the PAO, as the FRC should be given stronger investigatory teeth to undertake investigations more effectively. Therefore, clause 25 of the Bill does not necessarily follow section 42D of the PAO. Instead, the clause is modelled on section 179 of the SFO.

	Summary of Comments²	Administration's Responses
12	General: Comparable obligations for retention of records.	Clause 27(2)(a) empowers the investigator to make copies, or otherwise record the details, of the record or document. If necessary, an investigator may seize or remove the document if he is authorized to do so under a warrant issued under clause 34.
13	Clause 52 (Avoidance of conflict of interests): Clause 52 is an attempt to define potential conflicts in detail and, as such, is probably doomed to failure. Consideration should be given to enunciating the general principle of avoiding bias and then provide examples of conflicts.	Please refer to item (11) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 18).
14	Clause 58 (Destruction of documents): Consideration needs to be given to whether clause 58 should be extended to require evidence to be kept upon the conclusion of an AIB/FRC investigation until either the HKICPA decides whether to prosecute or the prosecution (and any appeal) are concluded.	Clause 58 provides for an offence that targets at any person who intends to conceal any facts or matters from the investigator. This has nothing to do with the period for which the records or documents may be retained. If an investigator retains the records or documents under a warrant issued under clause 34, clause 34(4) deals with the period for which the records or documents may be retained by the investigator.
15	Clause 71 (Disciplinary Powers of Disciplinary Committee): Guidance should be given under clause 71 as to the level of costs to be awarded.	Clause 71 seeks to amend section 35(1) of the PAO to empower a Disciplinary Committee to order the certified public accountant to pay to the FRC the sum the Committee <i>considers appropriate</i> for the costs and expense in relation or incidental to the investigation <i>reasonably incurred</i> by the FRC. There is no existing

	Summary of Comments ²	Administration's Responses
		<p>provision under section 35(1) of the PAO to provide guidance as to the level of costs in relation to a Disciplinary Committee's power to order the payment of the investigation costs. The Bill does not alter this status quo. A certified public accountant aggrieved by an order made in respect of him under section 35(1) of the PAO may appeal to the Court of Appeal under section 41(1) of the PAO.</p>
16	<p>Section 4 of Schedule 3 (Removal of the CEO): Consideration should be given to whether the provisions of section 4(1)(d) of Schedule 3 are sufficiently stringent.</p>	<p>Section 4(1)(d) of Schedule 3 provides that if the CE is satisfied that the CEO of the FRC is convicted in Hong Kong of an offence that is <i>punishable</i> by imprisonment for 12 months or more or is convicted elsewhere than in Hong Kong of an offence that, if committed in Hong Kong, would be an offence so punishable, the CE may remove the CEO of the FRC. We consider that this is an appropriate arrangement. A similar provision is found in section 4(1)(e) of Schedule 1A to Mandatory Provident Fund Schemes Ordinance (Cap. 485) which concerns the removal of directors of the Mandatory Provident Fund Schemes Authority.</p>

(6) CPA Australia (Hong Kong China Division) (CB(1)2288/04-05(06))

	Summary of Comments ²	Administration's Responses
1	General: Hong Kong is a unique jurisdiction and the FRC cannot be entirely modelled on any other framework in overseas jurisdictions.	Noted. We agree that, while being useful, the international experience should be considered in a proper context.
2	General (Cooperation among the FRC and other regulators): To enhance the interaction and communication between the investigatory function and subsequent prosecution, it is important for the FRC and the relevant enforcement agency or professional body to have a good understanding and consensus of the terms of reference as well as the scope of investigation. This could be facilitated by a memorandum of understanding between the FRC and the relevant bodies.	We agree that the FRC may enter into memoranda of understanding, under clause 10(2)(d) of the Bill, with the HKICPA and other regulators to set out the detailed arrangements such as matters relating to the referral of cases and cooperation among themselves.
3	General (Whether there is a need to establish an appeal panel): To ensure there is a high defence of equity in the proposed framework, an appeal process should be in place.	Please refer to item (6) of the Administration's responses to the comments of the Chamber of Hong Kong Listed Companies (at page 23).
4	Clause 7 (Composition of the FRC): It is important for FRC staff and members to have the relevant experience and expertise in listed companies to enable them to have a good understanding of the case issues. For flexibility, it is suggested that members can be appointed from a pool of experts which consists of a balanced number of accountants	It is our intention to establish an independent FRC with a wide and balanced composition. The CE would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.), so that the FRC could discharge its functions effectively. We also envisage that the FRC

	Summary of Comments²	Administration's Responses
	and lay persons.	will employ persons, pursuant to clause 10(2)(a), with the necessary background to assist in the FRC/AIB/FRRC in the performance of their functions. Furthermore, clause 10(2)(b) provides that the FRC may appoint persons as consultants, agents or advisers to assist the FRC in the performance of its functions.
5	General (Funding Arrangement for the FRC): We suggest that the funding should come from the Government, the professional body and the business community in particular from listed companies in Hong Kong by enforcing a levy to be charged to them which will be maintained in a segregated account by the FRC to support the prosecution expenses. The cost-sharing approach would benefit all parties and is consistent with the international trends.	Noted. Please refer to item (6) of the Administration's responses to the comments of the British Chamber of Commerce in Hong Kong (page 10).

(7) Chartered Institute of Management Accountants (Hong Kong Division) (CB(1)2288/04-05(07))

	Summary of Comments ²	Administration's Responses
1	<p>General: The concept of the new FRC is welcomed, as is the proposed composition of overwhelmingly “lay” members.</p>	<p>Noted.</p>
2	<p>General (Role of the FRC): The powers proposed differ from those of the UK FRC, in that they are to be used solely in reaction to possible misdemeanours. There is no obvious scope for the proposed FRC to be pro-active.</p>	<p>Clauses 9(b) and (c) provide that the functions of the FRC are to investigate or enquire, in response to a complaint or otherwise, auditors’ irregularities or non-compliances of financial reports in relation to listed entities. Therefore, a complaint is not a precondition for the FRC to initiate an investigation or enquiry. The FRC may initiate an investigation or enquiry power as and when the statutory thresholds set out in clause 23 or 40, as the case may be, are passed.</p>
3	<p>General (Structure of the FRC): The FRC seems to delegate much of its power to the proposed AIB and the FRRC. We question whether the structure as proposed is unnecessarily complex.</p>	<p>Clause 9(e) provides that one of the functions of the FRC is to approve and oversee the policies and activities of the AIB, a FRRC and a committee established by the FRC. Under clauses 35 and 47, an investigation report of the AIB and an enquiry report of a FRRC shall be submitted to the FRC for consideration. This reporting mechanism introduces checks and balances in the overall structure of the FRC, which should not be viewed as unnecessarily complex.</p>

	Summary of Comments²	Administration's Responses
4	<p>General (Whether the FRC should be purely investigatory): The AIB is not responsible for the discipline function. This differs from the role of the Audit Investigation and Disciplinary Board (AIDB) in the UK, which may not only investigate, but also deliver disciplinary sanctions in such cases.</p>	<p>Please refer to the Administration's paper entitled "Functions of the FRC" which sets out the Administration's justification for the FRC's role being investigatory. As we also mentioned in paragraph 12 of the Administration's paper entitled "International Experience", while both investigation and disciplinary functions are technically performed by one party (i.e. the AIDB) in the UK, in practice, the functions are separated as the "investigation" and "prosecution" are undertaken by the Executive Counsel of the AIDB and the "disciplinary" function performed by a "separate" Disciplinary Tribunal of the AIDB.</p> <p>It should also be stressed that the HKICPA fully supports the legislative proposals of the Bill and reiterates the Council's determination that the Institute should continue to act as the profession's regulatory body and to be responsible for the disciplinary role of which the prosecution role is an integral part.</p>
5	<p>Clauses 39 and 41 (Financial Reporting Review Panel and Financial Reporting Review Committee): The proposal for the establishment of a FRRP, and the use of the panel to provide members for FRRCs for individual cases is strongly supported.</p>	<p>Noted.</p>
6	<p>General (Funding arrangement for the FRC): An annual budget of HK\$10 million is likely to be</p>	<p>Noted. Please refer to item (6) of the Administration's responses to the comments of the British Chamber of</p>

	Summary of Comments ²	Administration's Responses
	<p>inadequate. A formula for cost-apportionment which relies more substantially on the shoulders of the auditors than on the general membership of the HKICPA might be more equitable.</p>	<p>Commerce in Hong Kong (at page 10).</p> <p>Clauses 68 of the Bill seeks to amend section 18 of the PAO to empower the Council of the HKICPA to fix fees to be payable by the practice units, or a class thereof, to the HKICPA for the purpose of the Institute's contribution to the FRC. The HKICPA has indicated that the fees would be payable by those practice units which perform audit for clients in the listed sector.</p>
7	<p>General (Right of the person under investigation/enquiry): While the investigatory provisions of the Bill will confer adequate powers on the FRC to conduct its necessary investigations, there is inadequate protection offered to those under investigation, whether identified in reports from the AIB under clause 35 or the FRRC under clause 47. We suggest that it should be mandatory for the AIB and FRRC to provide copies of draft reports to the individuals identified in those reports, and to consider any representations which might be made as a result, before such reports are formally submitted to the FRC.</p>	<p>We believe that, having regard to the public interest and the need to maintain the transparency of the work of the FRC, there is a case for the FRC to have the discretion to publish investigation or enquiry reports. As provided in clauses 35 and 47, the FRC may cause to be published an investigation or enquiry report or any part of such a report. We have built in a requirement in clauses 35(4) and 47(4) for the FRC to take into account the following considerations in deciding whether or not to cause a report or a part of the report to be published :- (a) whether the publication may adversely affect any criminal proceedings before a Court or Magistrate, or any proceedings before the Market Misconduct Tribunal; or any proceedings under Part V or VA of PAO, that has been or is likely to be instituted; (b) whether the publication may adversely affect any person named in the report; and (c) whether the report, or a part of the report, should be published in the interest of the investing public or in the public interest. Having considered the deputations' comments, we are</p>

	Summary of Comments²	Administration's Responses
		<p>reviewing with the Department of Justice the provisions and considering whether there is a need to add an express provision in the Bill to require the FRC to give the relevant person a reasonable opportunity of being heard during the preparation of investigation/enquiry reports and before its publications. It is always our objective to ensure that the Bill is compatible with the human rights provisions in the Basic Law, the Hong Kong Bill of Rights, and the rules of natural justice.</p>

(8) Mr. Chan Sai Hoi (CB(1)2288/04-05(08))

	Summary of Comments²	Administration's Responses
1	I fully support the Bill.	Noted.

(9) The Chinese General Chamber of Commerce (CB(1)2288/04-05(09))

	Summary of Comments ²	Administration's Responses
1	<p>General: The Chamber agrees that the regime for financial reporting should be improved, but considers that this may not be the appropriate time to set up the FRC. Priority should be given to addressing other more imminent regulatory issues in the securities and futures sectors. Moreover, the Chamber considers that the establishment of the FRC is not the only most effective way to improve the financial reporting regime.</p>	<p>The notable corporate failures (for example, Enron and Worldcom) in other parts of the world over the past few years have highlighted the importance of enhancing the effectiveness, transparency and accountability of the regulatory regime for the accountancy profession in Hong Kong.</p> <p>Notwithstanding the reforms of the investigation regime taken forward under the Professional Accountants (Amendment) Ordinance 2004, the HKICPA pointed out in its <i>Proposals to Strengthen the Regulatory Framework of the Accountancy Profession</i> in January 2003 that it was necessary to deal with the outstanding issues of –</p> <ul style="list-style-type: none">(a) the perception that greater independence is needed for investigation of auditing irregularities in relation to listed entities; and(b) the lack of adequate powers under the PAO to compel non-HKICPA members to provide information. <p>Furthermore, there is an international trend towards greater independence from the accounting profession in the oversight of auditors. During the two public consultation exercises conducted in September 2003 and February 2005, there was overwhelming support from</p>

	Summary of Comments ²	Administration's Responses
		<p>respondents to establish an independent investigation board to investigate complaints against the public interest activities of auditors. In this light, we consider that the current proposal, i.e. to establish the FRC as a new statutory body.</p> <p>The establishment of the FRC will further help enhance the regulation of auditors and the quality of financial reporting of listed entities. Thus, it will have a significant bearing on enhancing Hong Kong's corporate governance regime and investor confidence.</p>
2	<p>Clauses 23 and 40 (Initiating Investigation or Enquiry): Since the words "<i>circumstances suggesting</i>" or "<i>there is or may be a question</i>" appear to be ambiguous, we suggest that some more objective standards should be in place.</p>	<p>The purpose of prescribing statutory thresholds in clauses 23 and 40 is to provide for checks and balances for the exercise of the investigatory/enquiry powers. Without passing such thresholds, the FRC/AIB/FRRC may not exercise its powers. The thresholds "<i>circumstances suggesting an irregularity</i>" or "<i>reasonable cause to believe</i>" in clause 23, in relation to an investigation of a relevant irregularity, are modelled on sections 179 and 183 of the SFO. The threshold "<i>there is or may be a question whether or not there is a relevant non-compliance</i>" is modelled on section 245F(1) of the UK's Companies Act 1985. Further, given that the initiation of the investigation and enquiry powers by the FRC/AIB/FRRC may be subject to a judicial review by the court, we consider that the prescribed thresholds are appropriate, in terms of both law drafting and policy.</p>

	Summary of Comments ²	Administration's Responses
		<p>We appreciate that the market may need further guidance in relation to the manner in which the FRC may perform its functions. Clause 13 provides that the FRC may issue non-statutory guidelines not inconsistent with the provisions of the Bill, indicating the manner in which the FRC may perform its function or providing guidance on the operation of any provision of the Bill.</p>
3	<p>Clauses 37, 71 and 80 (Costs and Expenses of an Investigation): Since the investigation cost incurred may be very high, the Chamber proposes that there should be a cap for the payment of costs, so as to ensure that the investigation costs will not be incurred unreasonably. The Government should also consider how to deal with the investigation cost, where there is no case after an investigation or the auditor is not found to have committed an irregularity.</p>	<p>Clause 37 provides that if, on a prosecution instituted as a result of an investigation under Part 3 of the Bill, a person is convicted by a Court or Magistrate, the Court or Magistrate may order the person to pay to the FRC the sum the Court or Magistrate <i>considers appropriate</i> for the costs and expenses in relation or incidental to the investigation <i>reasonably incurred</i> by the FRC. Similarly, in clauses 71 and 80, we propose consequential amendments to section 35(1)(d) of the PAO and section 257(1) of the SFO to empower a Disciplinary Committee of the HKICPA or a Market Misconduct Tribunal to order the relevant person to pay to the FRC the sum the Disciplinary Committee or Tribunal <i>considers appropriate</i> for the costs and expenses in relation or incidental to the investigation <i>reasonably incurred</i> by the FRC. In this light, the Court or Magistrate, the Market Misconduct Tribunal, or the Disciplinary Committee of the HKICPA shall consider all relevant circumstances before ordering the payment of an appropriate amount of costs and expenses reasonably incurred during the</p>

	Summary of Comments ²	Administration's Responses
		<p>investigation of the FRC. The decision of the Court or Magistrate, Market Misconduct Tribunal or the Disciplinary Committee of the HKICPA is also appealable.</p> <p>If there is no case after an investigation or the person is not found to have committed an irregularity, the FRC will not recover the investigation cost from any person.</p>
4	<p>Clauses 35 and 47 (Publication of Investigation/Enquiry Reports): We are concerned that the FRC may decide when it is appropriate to publish the investigation or enquiry reports, as an appropriate timing <i>per se</i> is a matter of subjective judgment. Since the report may likely to be market sensitive, an inappropriate disclosure may lead to undesirable consequences on market transactions.</p>	<p>Clauses 35(4) and 47(4) provide that the FRC shall take into account the following considerations before deciding whether to publish the report or part of the report :- (a) whether or not the publication may adversely affect any criminal proceedings before a Court or Magistrate, proceedings before the Market Misconduct Tribunal, or any proceedings under Part V or VA of the PAO, that <i>has been or is likely to be instituted</i>; (b) whether or not the publication may adversely affect any person named in the report; and (c) <i>whether or not the report should be published in the interest of the investing public</i> or in the public interest. This provides for an important “checks and balances” measure in relation to the decision of whether an investigation/enquiry report should be published at a particular timing.</p>

(10) Mandatory Provident Fund Schemes Authority (CB(1)2288/04-05(10))

	Summary of Comments²	Administration's Responses
1	General: We do not have further submission of comments.	Noted.

(11) Office of the Privacy Commissioner for Personal Data, Hong Kong (CB(1)2288/04-05(11))

	Summary of Comments ²	Administration's Responses
1	<p>General: The Administration had taken steps to revise the provisions of the Bill by building in the relevancy and relatedness safeguards when FRC exercises its powers to request the furnish of information or documents.</p>	Noted.
2	<p>Clause 12 (Referral or Provision of Assistance to Specified Authority): The FRC is empowered under clause 12 to render assistance to a specified authority by referring to the latter any case when the conditions laid down in clause 12(2) are met, one of which being that it is not contrary to public interest to do so. The conditions so worded in clause 12(2)(b) can be easily met so long as the FRC opines that it is <i>not contrary to the public interest</i> that the complaint case be referred or assistance be provided. In contrast, the burden of proof appears to be higher in the case of directly showing the existence of public interest, i.e. whether it is <i>in the public interest</i> to do so. Given that information containing personal data may be disclosed as a result, a higher standard of requirement is preferred.</p>	<p>Apparently, that the Commissioner is of the view that, to the extent that clause 12 conflicts with the Personal Data (Privacy) Ordinance (PDPO, Cap. 486), the FRC may consider itself not bound by the latter, hence the need to revise the “<i>not contrary to the public interest</i>” threshold. In this regard, we wish to emphasize that the PDPO shall bind the proposed FRC, subject to the exemption pursuant to a proposed consequential amendment to section 2(1) of the PDPO under clause 79 of the Bill. Accordingly, unless the Bill expressly excludes the application of the PDPO, the FRC shall operate in such a manner that is consistent with the requirements enshrined in the PDPO (including the data protection principles (DPP) in Schedule 1 thereto).</p> <p>Given the FRC will already be bound by the PDPO, we do not see it necessary to examine the fine difference between the “<i>not contrary to the public interest</i>” and “<i>in the public interest</i>” tests. There are also a number of precedents regarding the “not contrary to the public interest” test in existing legislation, for instance, section</p>

	Summary of Comments ²	Administration's Responses
		<p>50(4) of the Clearing and Settlement Systems Ordinance (Cap. 584), section 120(5)(f)(ii) of the Banking Ordinance (Cap. 155), and section 186(3)(b) of the SFO.</p>
3	<p>Clause 51 (Preservation of Secrecy): Although the Bill has made an express provision under clause 51(8) that the duty of secrecy does not affect the operation of section 44(8) of the PDPO in relation to disclosure for the purpose of an investigation by the Commissioner, section 44(8) of the PDPO applies only when the Commissioner summons the person to furnish information and the Commissioner may not necessarily exercise such power in each case especially when requesting information in the preliminary enquiry stage. Such being the case, it is advisable to include the Commissioner under Clause 51(3)(b) of the Bill so that the Commissioner falls within the excepted category of persons to whom information may be disclosed without fear of breach of duty of secrecy.</p>	<p>Section 44(1) of the PDPO provides that the Commissioner may require a person <i>whom he summoned before him</i> to produce any document or thing which, in the opinion of the Commissioner, is relevant to the investigation and which may be in the possession or under the control of any such person. Section 44(8) of the PDPO declares that no obligation to maintain secrecy or other restriction, imposed by law, upon the disclosure of any information or documents that is or has been in the possession or under the control of any person referred to in section 44(1) of PDPO shall apply to its disclosure for the purposes of the Commissioner's investigation. To avoid any incompatibility with section 44(8) of the PDPO, clause 51(8) of the Bill expressly provides that the secrecy provision in clause 51(1) of the Bill does not affect the operation of section 44(8) of the PDPO. In other words, the FRC shall accede to the request for the production of any information when the Commissioner exercises his powers under section 44(1) of the PDPO. Furthermore, clause 51(2)(e) provides that the FRC may disclose information <i>in accordance with a law or a requirement made under a law</i>. This should be sufficient as a gateway for the disclosure by the FRC to the</p>

	Summary of Comments ²	Administration's Responses
		<p>Commissioner, should the Commissioner request production of information in accordance with the PDPO or any requirement under the PDPO.</p> <p>This being the case, we do not see the need to put in place an additional disclosure gateway in clause 51(3) for the Commissioner. Moreover, it must be noted that inclusion of the reference to “the Commissioner” in the list of persons under clause 51(3)(b) of the Bill will put any disclosure by the FRC to the Commissioner subject to the <i>restrictions or conditions</i> set out in clauses 51(4) to (7), hence rendering clause 51(3)(b) incompatible with section 44(8) of the PDPO.</p>
4	<p>Clause 54 (Immunity in respect of communication with the FRC by auditors of listed entities): Clause 54 provides that an auditor who communicates in good faith to the FRC of any information or opinion on a specified matter is exempt from civil liability by reason of such communication. Since communication might involve the disclosure of personal data, the immunity so conferred will affect the operation of other statutory provisions where civil liability attaches, such as section 66 of the PDPO. This anomaly is undesirable in view of the powers already given to the FRC to apply for court orders or search warrants to search and seize documents. Also, the auditor in question may in appropriate cases claim exemption under section 58(2) of the PDPO when disclosure of the personal data is for <i>the prevention</i></p>	<p>The development of financial markets and the increasing complexity of financial transactions have provided greater scope for persons responsible for fraud and other questionable practices to disguise the true nature of their activities. The past or present auditors and reporting accountants, in the course of carrying out their duties, may identify the possibility of a fraud or an irregularity/non-compliance. In such a circumstance, they may wish to serve the public interest by reporting their concerns to the FRC. The immunity referred to in clause 54 of the Bill is thus necessary as the auditors or reporting accountants “blowing the whistle”, albeit in good faith, may face a civil claim (whether arising in contract, tort, defamation, equity or otherwise) brought by the listed entity in question for, among other things,</p>

	Summary of Comments ²	Administration's Responses
	<p><i>preclusion or remedying of unlawful or seriously improper conduct, or dishonesty or malpractice by persons</i> (section 58(1)(d) of the PDPO refers) and the non-disclosure may prejudice such exempted purpose(s) (section 58(2) of the PDPO refers).</p> <p>We do not see the justification for granting such immunity as proposed.</p>	<p>breach of confidentiality and, consequently, suffer financial loss.</p> <p>Bearing in mind the aftermath of the corporate scandals in other parts of the world over the past few years which have revealed the potential repercussions of auditors' irregularities and questionable financial reporting, we consider it justifiable to put in place this immunity provision, which is modelled on section 381 of the SFO and is similar to section 42A of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) and section 53D of Insurance Companies Ordinance (Cap. 41).</p> <p>We cannot merely rely on the exemption under section 58(2) of the PDPO, which only relates to the relevant data protection principles under the PDPO. It does not cover other types of civil liability arising from communication with the FRC by the auditors or reporting accountants.</p>
5	<p>Clause 79 (Consequential Amendment to PDPO): It is noted that consequential amendments were proposed to add "FRC" under the definition of "<i>financial regulator</i>" under section 2(1) of the PDPO. We have no in-principle objection to the proposed amendments with the result that the exemptions afforded under sections 58(1)(f)(ii) and (g) of the PDPO could avail the FRC in appropriate cases.</p>	Noted.

(12) The Office of The Ombudsman (CB(1)2288/04-05(12))

	Summary of Comments ²	Administration's Responses
1	<p>Clause 76 (Consequential Amendments to The Ombudsman Ordinance): The Ombudsman notes that clause 76 includes the FRC in the schedule of public organizations under The Ombudsman Ordinance (Cap. 397) subject to her jurisdiction and welcomes the inclusion. Through doing so, this will allow The Ombudsman to assist the FRC to maintain a high standard of administration.</p>	<p>We welcome The Ombudsman's agreement to the proposal of including the FRC in the jurisdiction of The Ombudsman Ordinance. This is a "checks and balances" measure to ensure that the FRC maintains a fair and efficient administration.</p>
2	<p>Clause 51 (Preservation of Secrecy): To ensure that the Office of The Ombudsman can discharge its functions and duties in respect of the FRC, it is of importance that The Ombudsman can avail herself of the full range of investigation powers provided by Cap. 397. In particular, powers for requiring the FRC to furnish information and to produce documents should be the same as those in respect of other organizations within our jurisdiction. We note that clause 51(8) of the Bill ensures that The Ombudsman's investigation powers will not be affected by the FRC's duty to maintain secrecy.</p> <p>We wish to emphasize that The Ombudsman and her staff are bound to maintain secrecy under section 15(1) of Cap. 397.</p>	<p>We have consulted the Office of The Ombudsman during the drafting of the Bill. Clause 51(8) has been added to the Bill to expressly provide that the secrecy provision in clause 51(1) of the Bill does not affect the operation of section 13(3) of Cap. 397, which provides that, subject to certain exemptions, no obligation to maintain secrecy or other restriction, imposed by law, upon the disclosure of any information, document or other thing, that is or has been in the possession or under the control of an organization, shall apply to its disclosure for the purposes of an investigation under Cap. 397.</p>

(13) KPMG (CB(1)2288/04-05(13))

	Summary of Comments ²	Administration's Responses
1	General: We are generally supportive of the proposals contained in the Bill. We support the establishment of the FRC, AIB, FRRP and FIRC. These proposals will enhance the regulatory regime governing the quality of financial reporting by listed issuers, as well as the accountability of their auditors.	Noted.
2	Clause 9 (Functions of the FRC): We further support the proposed functions of investigating instances of irregularities and non-compliances and then referring cases or complaints to the specified bodies.	Noted.

	Summary of Comments ²	Administration's Responses
3	<p>Clauses 9 and 12 (Referral to A Specified Body): We recommend that clauses 9 and 12 be clarified as to whether the FRC will act in the capacity of complainant or whether it will be purely referring the case to the HKICPA for its further action. Whilst we would agree that, with the commencement of the Professional Accountants (Amendment) Ordinance 2004, the independence and transparency of the disciplinary proceedings of the HKICPA have been substantially enhanced, it would facilitate the disciplinary process if the FRC was to act as the complainant.</p>	<p>The Administration is of the view that the FRC should only be an investigatory body. After an investigation, the FRC is empowered to refer cases or complaints to the professional bodies concerned (including the HKICPA) or other enforcement agencies for disciplinary or other follow-up action. In the disciplinary proceedings under PAO, the FRC will <i>assist</i> the Registrar of the HKICPA to present the case against the auditor concerned <i>but will not act as a “complainant”</i>. The justifications for this arrangement are set out in detail in the Administration's paper entitled “Functions of the Financial Reporting Council”.</p> <p>It should also be noted that the HKICPA has confirmed in its submission that the Institute should continue to act as the profession's regulatory body and to be responsible for the disciplinary role of which the prosecution role is an integral part.</p>
4	<p>General (Whether there is a need to establish an Appeal Tribunal): We agree that where the role of the FRC is to investigate a complaint, and then refer the case to the appropriate regulatory authorities for their further consideration, there is no need for the FRC itself to be subject to an appeal tribunal process.</p>	Noted.

	Summary of Comments ²	Administration's Responses
5	<p>Clauses 49 and 50 (Voluntary and Mandatory Revision of Accounts): Given the powers to request voluntary revision of accounts and apply to the Court for mandatory revision of accounts under clauses 49 and 50, we are concerned that the proposals do not include a requirement for the FRC to consult the HKICPA, where the directors of the listed entity and/or the listed entity's auditors do not agree with the FRC's interpretation of the relevant Financial Reporting Standards.</p> <p>Without consultation, there is the risk that the interpretations of the financial reporting standards made by the FRC may not be consistent with the interpretations that the standard setters themselves would have made.</p>	<p>Please refer to item (4) of the Administration's responses to the comments of the HKICPA (at page 28).</p>
6	<p>Clause 9 (Functions of the FRC): Clause 9 provides that the functions of the FRC include investigating or enquiring "<i>in response to a complaint or otherwise</i>". This provides the FRC with the power to be proactive in its work, rather than solely acting on referrals and other information received.</p> <p>Whilst we agree that it is important to allow the FRC flexibility in order to carry out its duties, we believe the FRC's scope should primarily remain reactive upon receipt of referrals from other regulators and complaints. In addition, particularly in the case of proactive investigations, we consider it desirable that there should</p>	<p>The Administration considers that it is best for the FRC, as an independent investigation body, to decide its enforcement approach having regard to the caseload, resources, and other relevant considerations. Clauses 23 and 40 set out the statutory thresholds which the FRC has crossed before it <i>may</i> initiate an investigation or enquiry. In essence, the FRC may initiate (i) an investigation if "there are <i>circumstances suggesting</i> an irregularity" (c.f. clauses 23(1) and (2)), or "the FRC has <i>reasonable causes to believe</i> that there is or may be a relevant irregularity" (c.f. clause 23(3)); or (ii) an enquiry if "it appears to the FRC that <i>there is or may be a question</i> whether or not there is a relevant non-compliance" (c.f. clause 40(1)).</p>

	Summary of Comments²	Administration's Responses
	<p>be checks and balances to ensure that due consideration is given to whether the benefits of the investigation and its outcome are likely to outweigh the significant cost and resources the investigation may entail.</p>	<p>The FRC shall certify in writing that the thresholds have been passed before initiating the investigation/enquiry powers. In any circumstance, the FRC is not able to “fish” for evidence without having passed these thresholds.</p>

(14) Standing Committee on Company Law Reform (CB(1)2288/04-05(14))

	Summary of Comments ²	Administration's Responses
1	<p>General: Members of the Committee were generally in support of the proposals to establish the FRC, AIB and FRRC.</p>	Noted.
2	<p>Clause 2(1) (Definitions of “specified report” and “listing document”): First, the definition of “listing document” in the Bill does not cover the listing documents prepared in connection with applications for listing by way of introduction (i.e. introduction documents) whereby no offers of securities are made in the primary market. These introduction documents are considered by investors in the secondary markets to be as important as prospectuses.</p> <p>Secondly, the definition of “specified report” does not cover financial reports included in circulars required to be prepared and circulated by listed companies in connection with major transactions, substantial acquisitions and substantial disposals. They are of no less significance to the investing public.</p> <p>Consideration should be given to appropriately expand the definitions of “specified report” and “listing document”.</p>	<p>We consider that the present definition is adequate to enable the FRC, as a new body, to focus on investigations of and enquiries into the audit and reporting of key financial information that is published under the relevant statutory or regulatory requirements and involves a greater degree of public interest. After the establishment of the FRC, we may review the scope of the FRC's investigations/enquiries in the light of market development.</p> <p>It may be useful to refer to the experience of Financial Reporting Review Panel which was established in the United Kingdom (UK) in 1990. Previously it was only tasked to review the annual accounts prepared under the UK's Companies Act 1985. It was only in 2004 that legislative amendments were introduced to empower the Secretary of State to appoint the Panel to keep under review <i>periodic</i> accounts and reports that are produced by issuers of listed securities and are required to comply with any accounting requirements imposed by listing rules. In the light of the UK's experience, we consider it prudent to adopt a pragmatic and focused approach in prescribing</p>

	Summary of Comments ²	Administration's Responses
		the scope of the FRC's work.
3	<p>Clauses 49 and 50 (Voluntary and Mandatory Revision of Accounts): One commenting member agrees that there is no need to set up a separate body to hear appeals against the decisions of the FRC, but only insofar as the FRC is performing its investigatory/enquiry role against suspected irregularities concerning auditors, which if established, would be referred to an appropriate regulatory authority for follow-up action. As regards enquiries into suspected non-compliance with financial reporting standards, the lack of some sort of appeal tribunal provisions (other than judicial review) may not be appropriate.</p> <p>In addition, there is no provision in the Bill which confers power on the FRC to consult with the HKICPA in cases of revision of accounts under clauses 49 and 50 when the directors or auditors of the listed entities do not agree with the FRC's interpretation of the relevant Financial Reporting Standards. The absence of such a consultation process may result in the FRC interpreting certain Financial Reporting Standards differently from the standard setters themselves, although the likelihood of this is remote.</p>	<p>It should be emphasized that the FRC has no power to sanction any person for failing to revise its accounts as requested by the FRC. If the directors of a listed corporation do not comply with the request for voluntary revision of accounts, the FRC may apply to the Court for a declaration of non-compliance and an order for mandatory revision of accounts. The Court's decision in this regard is appealable.</p> <p>Please also refer to item (3) of the Administration's responses to the comments of HKICPA (at page 28), regarding the matter on the communication between the HKICPA and the FRC on the interpretations of the Financial Reporting Standards.</p>
4	<p>Clause 9 (Functions of the FRC): Clause 9 provides that the functions of the FRC include investigating or enquiring "<i>in response to a complaint or otherwise.</i>" This provides the FRC with the power to adopt a proactive approach to its</p>	<p>Please also refer to item (6) of the Administration's responses to the comments of KPMG (at page 53).</p>

	Summary of Comments ²	Administration's Responses
	<p>work, rather than solely relying on referrals and other information received. Whilst it is important to allow the FRC flexibility in the performance of its duties, its scope should remain primarily reactive upon receipt of referrals from other regulators and complainants.</p>	
5	<p>Clause 71 (Recovery of Costs): A legal cost reclaim mechanism should be established to enable the HKICPA to recover costs in relation to cases referred to them by the FRC for taking disciplinary proceedings.</p>	<p>There is already a legal cost reclaim mechanism under the PAO which enables the HKICPA to recover the costs and expenses in relation to its disciplinary proceedings. The existing section 35(1)(iii) of PAO provides that a Disciplinary Committee may make such order as the Committee thinks fit with regard to the payment of costs and expenses of and incidental to the proceedings, whether of <i>the Institute</i> (including the costs and expenses of the Disciplinary Committee) or of any complainant or of the certified public accountant.</p> <p>Separately, clause 71 of the Bill contains a consequential amendment to the PAO to enable a Disciplinary Committee of the HKICPA to order that the certified public accountant concerned shall pay to the FRC for the costs and expenses in relation or incidental to the investigation reasonably incurred by the FRC, where the disciplinary proceedings were instituted as a result of an investigation by the FRC.</p>
6	<p>Clause 9 (Functions of the FRC): There should be clear provisions in the Bill giving a FRRC the discretion to</p>	<p>Clause 9(b) and (c) provides that the functions of the FRC are to investigate or enquire, <i>in response to a complaint</i></p>

	Summary of Comments ²	Administration's Responses
	decide whether to take a “proactive approach” in performing its functions.	<i>or otherwise</i> , into a “relevant irregularity” or a “relevant non-compliance”.
7	Clauses 9, 23 and 40 (Referral of cases between the AIB and a FRRC): There should be clear provisions in the Bill permitting cross-referral of cases between the AIB and a FRRC.	As provided in clauses 9(e), 23 and 40, the FRC is to direct the AIB or a FRRC to investigate a “relevant irregularity” or enquire into a “relevant non-compliance”. The FRC may trigger its investigation and/or enquiry powers as and when the statutory thresholds in clause 23 and/or 40 are passed. Therefore, where necessary, a case may be looked into by both the AIB and a FRRC if the FRC sees fit to direct so. Furthermore, as AIB and a FRRC are required to submit reports to the FRC respectively under clauses 35 and 47, the FRC may where necessary and after considering the reports, refer an AIB case to a FRRC, or <i>vice versa</i> , for further action pursuant to clauses 36 and 48.
8	Clause 10 (Powers of the FRC): There should be clear provisions in the Bill enabling the FRC to engage full time staff to assist in the work of the AIB and a FRRC.	Clause 10(2)(a) provides that the FRC may employ persons to assist the FRC, the AIB, a FRRC, or any or all of them, in the performance of its or their functions.
9	Clause 9 (Referral to a Specified Body): There should be clear provisions in the Bill enabling the FRC to refer those matters beyond its remit to other relevant authorities for appropriate follow-up action.	Clauses 9(f) and (g) provide that the functions of the FRC are to refer to a specified body, or provide assistance to a specified body on the body’s investigation or enquiry into or dealing with, any case concerning a “relevant irregularity” or a “relevant non-compliance” in relation to a listed entity.

	Summary of Comments²	Administration's Responses
10	Clauses 35 and 47 (Publication of Investigation/Enquiry Reports): There are concerns on whether it is appropriate to empower the FRC to publish AIB/FRRC investigation reports.	Please refer to item (7) of the Administration's responses to the comments of the Chartered Institute of Management Accountants (Hong Kong Division) (at page 38).
11	Clause 51(3)(c) (Disclosure to Liquidators): There are concerns on whether liquidators should be included as a "relevant body" to whom the FRC may refer a case or disclose the relevant information obtained.	One of the important duties of a liquidator is to look into the affairs of the company in liquidation and ascertain whether any misfeasance, fraudulent preference, or breach of trust has been committed by any of its officers and, if necessary, he must take proceedings in respect of these. Given this, there is sufficient justification in the public interest that the FRC be allowed to disclose confidential information regarding the auditor of a listed entity (which may include information on suspected fraud or breach of trust committed by its officers) to the liquidator. The disclosure gateway is set out in clause 51(3)(c).

(15) Hong Kong General Chamber of Commerce (CB(1)2288/04-05(15))

	Summary of Comments ²	Administration's Responses
1	General: We fully agree that it is of paramount importance that we maintain an effective regulatory regime for the accounting profession.	Noted.
2	General: The underlying assumption of the proposal is that HKEx, HKICPA and SFC are not adequately able to oversee the audit of listed companies. If this is indeed the case, the specific shortcomings within each of these institutions should be addressed directly. We do not, however, see how the establishment of new statutory body will improve the regulatory regime.	Please refer to item (1) of the Administration's responses to the comments of the Chinese General Chamber of Commerce (at page 41).
3	Clause 7 (Composition of the FRC): We are concerned that the composition of the FRC – to include a majority of lay persons – is inappropriate. We believe investigation as to whether there were irregularities in an audit should be made by professionals.	The appointment of lay members to the FRC helps ensure the independence of the investigatory regime. It is our intention to establish an independent FRC with a wide and balanced composition. The CE would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.), so that the FRC could discharge its functions effectively. It may be highlighted that, with the commencement of the Professional Accountants (Amendment) Ordinance 2004, the majority of an Investigation Committee of the HKICPA are also lay persons.

(16) Hong Kong Trustees Association Ltd (CB(1)2288/04-05(16))

	Summary of Comments²	Administration's Responses
1	We have no substantive comment on the Bill.	Noted.

(17) **The Association of Chartered Certified Accountants (Hong Kong) (CB(1)2288/04-05(17))**

	Summary of Comments²	Administration’s Responses
1	General: We welcome the establishment of a FRC to oversee both the AIB and FRRC.	Noted.
2	Clause 7 (Composition of the FRC): Clause 7 sets out the proposed composition of the FRC. This includes “not fewer than 4, and not more than 6, other members appointed by the CE”. It has yet to be incorporated in the Bill that the members of the FRC should represent the stakeholder groups that the FRC is intended to protect.	Please refer to item (3) of the Administration’s responses to the comments of the Association of International Accountants (Hong Kong Branch) (at page 2).
3	Section 2 of Schedule 2 (Tenure of appointed members of the FRC): Section 2 of Schedule 2 to the Bill states that appointments to the FRC should be for a term not exceeding three years, although members can be reappointed. As a good corporate governance practice, there should be a maximum term for any member reappointed. The Bill is silent in this respect.	There is already a <i>general</i> guideline within the Administration that a non-official member of a statutory body should not serve more than six years in any one capacity. We do not consider it necessary to prescribe this in the Bill, in order for the Administration to take into account the exigency of circumstances.
4	Clause 14 (Directions of the CE): We consider that the proposal to include in the Bill a provision allowing the CE to give the FRC written directions as he thinks fit as to the performance of any of its functions may be perceived as a lack of independence.	The proposed reserve power in clause 14 is a tool of last resort for the Government, through the CE, to implement necessary remedial measures in the most pressing and extreme circumstances. The CE would not give directions to the FRC, unless necessary in the public interest and after consulting the FRC Chairman . We consider the provision necessary to enable the

	Summary of Comments ²	Administration's Responses
		Administration to continue to account to the Legislative Council and the public for effective regulation of the profession. Similar power also exists in the ordinances providing for the establishment of, for example, the SFC, Mandatory Provident Fund Schemes Authority, and Hong Kong Deposit Protection Board.
5	<p>General (Whether the FRC should assume the disciplinary role): The current situation – that the function of the FRC should remain purely investigatory – are inappropriate. The regulatory process is undermined if disciplinary action remains in the hands of a professional accountancy body. Where the FRC does not possess any disciplinary power, it should at least have the power to refer cases that are warranted of disciplinary action directly to the Disciplinary Committee of the local statutory professional accountancy body, and act as the complainant to present the case in front of the Disciplinary Committee.</p>	<p>Please refer to the Administration paper's entitled "Functions of the Financial Reporting Council" which sets out our justifications for the role of the FRC being purely investigatory. In essence, it must be stressed that the accountancy profession in Hong Kong is subject to, a large extent, a "self-regulatory" regime. The HKICPA is established under the PAO with a clear purpose of controlling and regulating the accountancy profession. The registration and disciplinary powers of the HKICPA should thus be viewed as the two sides of the same coin. If the disciplinary function was taken away from the HKICPA, at least in respect of listed entities, this could have adverse implications for the continued viability of the whole self-regulatory regime.</p> <p>Furthermore, the HKICPA has confirmed in its submission that the Institute should continue to act as the profession's regulatory body and to be responsible for the disciplinary role of which the prosecution role is an integral part.</p>

	Summary of Comments²	Administration's Responses
6	General (Whether there is a need to establish an appeal tribunal): On the assumption that the FRC is finally vested with the necessary disciplinary powers, the need for a separate appeal tribunal becomes stronger.	Noted. Please refer to item (6) of the Administration's responses to the comments of the Chamber of Hong Kong Listed Companies (at page 23).
7	General (Funding arrangement): It is important that the funding arrangements demonstrate the independence of the FRC and is adequate to allow the FRC to perform its functions fully.	Please refer to item (6) of the Administration's responses to the comments of the British Chamber of Commerce in Hong Kong (at page 10).
8	General (Human resources policy of the FRC): Apart from clause 52 which sets out the provisions relating to the avoidance of the conflict of interests, internal guidelines (possibly in the form of a staff code of conduct) should be released. These should provide for a sufficient "cool down period" for any members and other persons performing any function to the FRC.	The FRC may issue internal guidelines to indicate arrangement such as staff code of conduct. We consider that matters relating to, say, the post-appointment sanitization period of any members of the FRC and other persons performing any function of the FRC should be determined by the appointment authority and set out in the appointment contract instead of in the legislation. It is our policy objective to ensure that the terms and conditions of the appointment of the CEO would contribute to the public confidence in the credibility of the FRC.
9	Clause 52 (Avoidance of conflict of interests): Clause 52 does not explain what is meant by an "interest" in a listed entity. The Bill should refer to a "direct or indirect interest", thereby including the interests of a spouse, a	Please refer to item (11) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 18).

	Summary of Comments²	Administration's Responses
	trust of which a member is a trustee, or any other person included within subsection (3)(b).	
10	Clauses 23 and 40 (Initiating investigation concerning relevant irregularity and enquiry into non-compliances): The FRC must be seen to be investigating irregularities/non-compliances where there is public interest. "Public interest entities" and "listed entities" have a high degree of overlap, but are not identical: the former also includes unlisted public companies, large charities, insurance companies and pension funds. There is currently no provision within the Bill to extend the scope of investigation of the AIB and FRRC to other public interest entities.	Please refer to item (1) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 13).
11	Clauses 39 and 41 (Financial Reporting Review Panel and Financial Reporting Review Committee): Clause 41 gives no further detail of the expertise required of members of a FRRC. The Bill is currently silent regarding the expertise of members of the FRRP. However, we maintain that, in view of the technical expertise required, the FRRP and each FRRC should consist of a majority of accountants, who should be drawn from a variety of backgrounds, and bring to the Panel and the Committees experience in a variety of sectors.	With reference to the membership base of the UK FRRP, we envisage that the CE will consider appointing professionals with the expertise and backgrounds in the accounting, auditing, legal, banking, financial services or commercial field to the FRRP. We do not propose to set out the detailed qualification requirements in the Bill, so as to facilitate the CE in appointing the best available candidates, in the light of actual circumstances, from different backgrounds and disciplines to enable the FRRP and FRRC to discharge their functions effectively. It should be noted that the UK Companies Act also does not set out the detailed qualification requirements of the

	Summary of Comments ²	Administration's Responses
		membership of the FRRP in the UK.
12	<p>Clause 49 (FRC to give notice to operator of listed entities to secure removal of relevant non-compliance): The Bill does not refer to the speed of the FRC's action to request the removal of any non-compliance, or the period within which the operator of the entity must take the remedial action (although it states that the period must be specified in the notice). It may be that these details are not required in the legislation, and it is the intention that the FRC publishes more detailed operational procedures in due course.</p>	<p>Clause 49(1) empowers the FRC to request the operator of a listed entity to revise the accounts voluntarily or take such other remedial action concerning the financial report as necessary <i>within the period specified in the notice</i>. If necessary, the FRC may consider publishing guidelines pursuant to clause 13 to indicate how it proposes to exercise its powers referred to in clause 49.</p>
14	<p>General (Role of the FRC): There should be provision for the accountancy bodies regulating its members who are authorized to conduct audit work in Hong Kong to report on their activities to the FRC on the cases referred for disciplinary proceedings, and for the FRC to inspect/investigate such activities of these accountancy bodies.</p>	<p>We wish to stress that the FRC is not intended to be a regulatory body with a disciplinary function. In view of the self-regulatory regime of the profession, we consider that the professional accountancy bodies should continue to discharge their disciplinary functions. As the establishment of the FRC is to provide for a much independent investigation of auditors' irregularities in relation to listed entities, the FRC should be an impartial and effective "fact-finder" to assist, instead of becoming a party to, subsequent disciplinary proceedings. It is thus not necessary and appropriate to put in place additional provisions to subject the accountancy bodies to any reporting requirement to the FRC, once a case is referred to an accountancy body and enters into the disciplinary</p>

	Summary of Comments ²	Administration's Responses
		proceedings.
15	<p>Clause 2(1) (Definition of “specified authority”): The interpretation of a “<i>specified authority</i>” includes an accountancy body that is a member of the International Federation of Accountants (IFAC). In view of the different categories of IFAC membership (including affiliate membership), this requirement should refer to current full membership of IFAC.</p>	<p>The definition of “<i>lay person</i>” under section 2(1) of the PAO also makes reference to “<i>a member of the International Federation of Accountants</i>”. We do not think it necessary to further narrow down the scope concerning the membership of the IFAC, insofar as the definitions of “<i>specified authority</i>” and “<i>lay persons</i>” in clause 2(1) of the Bill are concerned. According to the IFAC’s website, there are only 4 affiliate member bodies of the IFAC, which are located in the United States (two of them), France and Bahrain respectively.</p>
16	<p>Schedule 1 (Definitions of “<i>relevant financial report</i>” and “<i>relevant requirement</i>”): The definition of “<i>relevant requirement</i>”, set out in Parts 1 and 2 of Schedule 1 to the Bill, is in relation to an “<i>accounting requirement</i>”, and therefore does not include compliance of other information issued with financial statements (e.g. director’s reports) with relevant legal requirements.</p> <p>Similarly, the definition of “<i>relevant financial report</i>” set out in Parts 1 and 2 of Schedule 1 to the Bill, is in relation to a balance sheet and accounts annexed to it in accordance with section 129C(1) of the CO. Therefore, the directors report (required to be attached by section 129D of the CO) is not included within the definition of “<i>relevant financial report</i>”. We recommend</p>	<p>The major objective of a FIRC is to enquire into non-compliance of the financial reports concerning listed entities. The FIRC is not intended to extend its remit beyond the function of financial reporting. Even though directors’ report, management discussions and analysis reports may form part of the annual or interim reports issued by listed entities, strictly speaking these disclosures are, by their very nature, not governed by matters of accounting requirements set out in the CO, SFC Codes, Financial Reporting Standards or Listing Rules. Consequently, we propose that a FIRC should limit its remit to relevant financial reports (in the form of accounts of financial statements) presented in accordance with the relevant accounting requirements.</p>

	Summary of Comments²	Administration's Responses
	that this be changed in order to remove the inconsistency between the objectives of the FRRC and the FRRP and the scope of their reviews.	
17	Clause 50 (FRC may apply to Court of First Instance to secure removal of relevant non-compliance): We consider that the scope of clause 50 should not be limited to a listed corporation, but should refer to a listed entity as interpreted under clause 3 as well.	Please refer to item (4) of the Administration's responses to the comments of the HKICPA (at page28).

**(18) The Law Society of Hong Kong (Companies and Financial Law Committee and Securities Law Committee)
(CB(1)2288/04-05(18))**

	Summary of Comments²	Administration's Responses
1	General: The Law Society generally supports the proposals to establish the FRC.	Noted.
2	<p>Clauses 25, 26 and 28 (Powers of Investigation): The powers of the FRC and the AIB in relation to an investigation of auditors' irregularities, as set out in clauses 25, 26 and 27, appear to be over extensive and are wider than the equivalent power of investigations provisions. In the UK, the powers of the FRC (which derived its powers from the Companies Act 1985 and the Companies (Audit, Investigations and Community Enterprise Act) 2004) to require production of document and information from the company and any officer, employee or auditor of the company. In the US, the powers of the Public Company Accounting Oversight Board (created by the Sarbanes-Oxley Act to oversee the auditors of public companies) to require the accounting firm and person associated with such firm to comply with their orders.</p> <p>In our view, the power of investigation by the FRC and the AIB should enable it to compel the provision of information and documents by auditors and listed companies, but not further. In particular, such power should not extended to, for instance, legal advisers whose</p>	<p>It is necessary to sufficiently empower the AIB in order for it to carry out investigations effectively. The Bill proposes that the AIB's powers of investigation should be modelled on those currently possessed by the SFC in relation to an investigation of a listed corporation under sections 179 and 183 of the SFO, so that the FRC/AIB may require (a) auditors/reporting accountants of the listed entity and of its relevant undertaking, (b) the listed corporation, (c) a responsible person of the listed collective investment scheme, (d) a relevant undertaking of the listed entity, (e) authorized institutions and (f) any other persons in possession of records, documents or information relevant to the irregularity to produce the records, documents or provide information in connection with the investigation. The Bill contains a set of "checks and balances" measures (for example, the thresholds in clause 23, and the conditions required to be met for the exercise of powers under clauses 25, 26 and 28) to ensure that the powers would not be abused.</p> <p>Please refer to the Administration's paper entitled "International Experience" which compares the</p>

	Summary of Comments ²	Administration's Responses
	<p>legal professional privilege may not always be successfully claimed, for whatever reason, notwithstanding clause 55.</p>	<p>investigatory regime of the FRC with that of the similar bodies in overseas jurisdictions. It should be pointed out that the powers of the UK's FRC (which derived its powers from the Companies Act 1985 and the Companies (Audit, Investigations and Community Enterprise Act) 2004) to require production of document and information from the company and any officer, employee or auditor of the company are exercisable in relation to the enquiry of the Financial Reporting Review Panel, not Audit Investigation and Disciplinary Board (AIDB). In relation to investigations of auditors' irregularities, the relevant powers of the UK's AIDB under the FRC are not backed by legislation, but administrative arrangements agreed with the professional bodies to which the accountant belongs. Therefore, it may not be appropriate to make a direct comparison in this regard. In the US, although the investigatory powers of Public Company Accounting Oversight Board apply only to an accountant or associated persons (including employees or independent contractors of a public accounting firm), the Board may seek the issue by the Securities and Exchange Commission of a subpoena to require the testimony of, and production of any document in the possession of, any person under the Sarbanes-Oxley Act.</p> <p>Clause 55(1) expressly provides that any claims, rights or entitlements that arise on the ground of legal professional privilege would not be affected. This is modelled on section 380(4) of the SFO. We have no</p>

	Summary of Comments ²	Administration's Responses
		intention to disrupt or alter the common law rules on legal professional privilege. Where such privilege cannot be claimed by reason of such rules (for instance, when the communications are made for a fraudulent or illegal purpose or when the client has waived the privilege and permits disclosure), we fail to see the justification for a statutory carve-out for legal advisers.
3	Clause 43 (Powers of enquiry): We agree that the scope of such power is appropriate.	Noted.
4	Clause 52 (Avoidance of conflict of interests): We are concerned that the provisions relating to avoidance of conflict of interests may be too harsh. The list of interest required to be declared is very extensive. The consequence of any contravention, including omission, is severe. Consideration should be given as to whether such onerous disclosure obligations and severe sanctions regarding disclosure obligations are necessary.	Please refer to item (11) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 18).

(19) The Hong Kong Chinese Enterprises Association (CB(1)2288/04-05(19))

	Summary of Comments ²	Administration's Responses
1	<p>General (Overall comment): We consider that the proposed FRC does not have a clear purpose, functions and status. The “checks and balances” measures are not adequate. Therefore, we believe that there is no need to rush the establishment of the FRC at this stage. Consideration should be given to whether the legislative objectives could also be achieved through reforming the existing system.</p>	<p>The major objective of the Bill, as set out in the long title, is to establish the FRC, which is, in essence, tasked to (a) investigate irregularities of auditors of listed entities; and (b) make enquiries into financial reports of such entities to ensure that they comply with the relevant legal, accounting and regulatory requirements. The FRC is to be a statutory body, as established by virtue of clause 6 of the Bill. The functions of the FRC are set out in clause 9. The Bill prescribes a set of “checks and balances” measures. These include the appointment of lay members to the FRC (c.f. clause 7), the approval of the FRC’s budget by the Secretary for Financial Services and the Treasury (c.f. clause 17), the audit of the FRC’s accounts by the Director of Audit (c.f. clause 19), and the laying of annual reports and accounts together with the auditor’s report before the Legislative Council (c.f. clause 20). Clause 52 also provides for the mechanism to avoid conflict of interests in respect of FRC members/staff and other related persons.</p> <p>Please refer to item (1) of the Administration’s responses to the comments of the Chinese General Chamber of Commerce (at page 41), regarding the justification for and the importance of the proposed establishment of the FRC.</p>

	Summary of Comments ²	Administration's Responses
2	<p>General (Self-regulatory regime of the accountancy profession): The establishment of the FRC may change the “self-regulatory” regime of the accountancy profession. The appointment of lay members to the FRC may undermine the professionalism and creditability of investigation. Consideration may instead be given to setting up a “Listed Entities Financial Reporting Committee” within the HKICPA to discharge the functions of the proposed FRC.</p>	<p>The Professional Accountants (Amendment) Ordinance 2004, which commenced operation in November 2004, had already reformed the membership of the Investigation Committees of the HKICPA, each of which now comprises a majority of lay members. However, the HKICPA proposed to the Administration that, notwithstanding this reform, it was necessary to address the outstanding issues of the perception that greater independence should be required for investigations of auditing irregularities in relation to listed entities. We consider that the establishment of the FRC will enhance the independence of the investigatory function from the profession, whereas the retention of the HKICPA's functions in disciplinary proceedings preserves the “self-regulatory” regime of the profession. Moreover, we propose that the FRC should be vested with greater investigatory powers so that investigations could be carried out more effectively, insofar as cases or complaints relating to listed entities are concerned. This will significantly enhance Hong Kong's corporate governance regime.</p> <p>Please refer to item (1) of the Administration's responses to the comments of the Chinese General Chamber of Commerce (at page 41), regarding the justification for and the importance of the proposed establishment of the FRC.</p>

	Summary of Comments ²	Administration's Responses
3	<p>General (Division of Roles and Responsibilities among the Relevant Bodies): We are concerned whether the functions of the FRC will overlap with those of the SFC and HKICPA.</p>	<p>Upon its establishment, the FRC will investigate auditors' irregularities involving listed entities, whereas the HKICPA will continue to deal with other complaints about its registered members and practice units including those in relation to the non-listed sectors. This should not affect the current responsibilities of other regulators including the SFC and HKEx. We envisage the present division of responsibilities between SFC/HKEx and HKICPA will, by and large, apply to that between the SFC/HKEx and the FRC. The SFC also confirmed in its submission that there is no undue overlap as regards the jurisdictions of the FRC and the SFC.</p>
4	<p>General (Funding Arrangement for the FRC): We are concerned that the establishment might increase the operation cost of listed entities as these entities might need to cooperate with the FRC during the investigation. The present funding arrangement might also indirectly burden the Company Registry, Stock Exchange of Hong Kong Limited and SFC. If in future a levy was to be charged on listed entities, this would pass the burden to such entities.</p>	<p>Please refer to item (6) of the Administration's responses to the British Chamber of Commerce in Hong Kong (at page 10).</p>
5	<p>Clauses 25 to 28 (Power to require production of records and documents): We are concerned that listed banks might be asked to disclose the information of a customer. According to clause 6, the FRC does not</p>	<p>Clause 25(4) expressly provides that the investigator may require an authorized institution to produce any record or document specified in the requirement if the investigator has reasonable cause to believe, and certifies in writing</p>

	Summary of Comments²	Administration's Responses
	<p>enjoy the status, immunity or privilege of the Government. In this light, the disclosure of information by authorized institution does not fall within exemption of the secrecy obligations of banks. Therefore, the Bill should state it clearly that the “records” or “explanation” required to be produced or given does not include the information of a customer of banks. Otherwise, the Bill may need to confer privilege to the FRC by deeming the FRC as a part of the Government.</p>	<p>that it has reasonable cause to believe, that (a) the institution is in possession of records or documents that relate to the audit of the accounts of the listed entity or its relevant undertaking; and (b) the record or document specified in the requirement relates to the audit of the accounts of the entity or undertaking and is relevant to the <i>auditing irregularity</i> or to the question whether or not there is such an irregularity. A similar provision is contained in clause 26(4) in relation to investigation of a <i>reporting irregularity</i>. Clauses 25(4) and 26(4) are modelled on section 179(6) of the SFO.</p> <p>Furthermore, clause 28(5) provides that the investigator shall not require an authorized institution to disclose any information, or produce any record or document, relating to the affairs of a customer of the institution under that clause unless (a) the customer is a person whom the investigator has reasonable cause to believe may be able to give information relevant to the investigation; and (b) the investigator is satisfied, and certifies in writing that it is satisfied, that the disclosure or production is necessary for the purpose of the investigation. Clause 28(5) is modelled on section 183(4) of the SFO.</p> <p>The aforesaid provisions allow banks to disclose information in relation to the affairs of its customer where the situation warrants. We believe the proposed powers are justified in view of the need to enhance the investigatory function of the accountancy profession.</p>

	Summary of Comments ²	Administration's Responses
6	<p>General (Referral of cases): We are concerned about the referral of cases from the FRC to a specified body. This may create confusion in operation.</p>	<p>Clauses 9(f) and (g) provide that the FRC may refer to a specified body, or provide assistance to a specified body on the body's investigation or enquiry into or dealing with, any case or complaint concerning a relevant irregularity or a relevant non-compliance. Clause 12 elaborates on the conditions that underpin the referral of cases to a <i>specified authority</i>, which is within the definition of "<i>specified body</i>" under clause 2(1). Referral of cases and provision of assistance are commonly found in the regulation of the financial markets. We do not consider that in practice it will lead to any confusion.</p>
7	<p>General: The Government has not established the framework for the registration and qualification accreditation of the auditors of listed entities. It is not appropriate for the Government to establish the FRC.</p>	<p>The PAO and CO, together with the relevant code published by the SFC and the Listing Rules, contain provisions governing the appointment of auditors for companies.</p>
8	<p>General (Whether there should be an appeal tribunal): There should be an appeal mechanism to enable a listed entity to appeal against the FRC's decision to request the entity to revise the accounts.</p>	<p>It should be emphasized that the FRC has no power to sanction any person for failing to revise its accounts as requested by the FRC. If the directors of a listed corporation do not comply with the request for voluntary revision of accounts, the FRC may apply to the Court for a declaration of non-compliance and an order for mandatory revision of accounts. The Court's decision in this regard is appealable.</p>

**(20) The DTC Association (Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)
(CB(1)2288/04-05(20))**

	Summary of Comments²	Administration's Responses
1	General: We are broadly supportive of the proposals formulated in the consultation paper. However, we would add a note that it will be vital to keep costs under control and the detailed scope of the Council's work will need careful consideration.	Noted.

(21) Securities and Futures Commission (CB(1)2288/04-05(21)(a) & CB(1)2288/04-05(21)(b))

SFC's Investor Education Advisory Committee

	Summary of Comments ²	Administration's Responses
1	<p>Clause 9 (Functions of the FRC): A member of the Committee expressed concern on the clarity of the Bill in defining the role of the FRC in relation to the AIB, in particular the extent to which the FRC conducts its investigation and how much evidence it would gather.</p>	<p>The functions of the FRC are set out in clause 9. Fundamentally, under clauses 9(b) and (c), the key functions of the FRC are to investigate “<i>relevant irregularities</i>” (as defined in clause 4) and enquire into “<i>relevant non-compliances</i>” (as defined in clause 5). Upon completion of an investigation or enquiry, the FRC may decide on and carry out the appropriate action in accordance with the Ordinance (c.f. clause 9(d)). The FRC is also empowered under clauses 9(f) and (g) to refer to a specified body any case or complaint and to provide assistance to a specified body on the body’s investigation or enquiry into or dealing with any case or complaint.</p> <p>The intention, as expressed in the long title of the Bill, makes clear that the FRC is an investigatory body.</p>
2	<p>General (Current sanctions under the Professional Accountants Ordinance): A member of the Committee expressed concerns regarding the sanctions available to the HKICPA, which would not be sufficient to deter serious wrongdoings. The maximum sanctions that the HKICPA could impose are a fine of HK\$500,000 and/or order that the name of the professional accountant be</p>	<p>Integrity is the core value that underpins the auditing profession. The risk of losing clients’ confidence has often been a very effective, albeit intangible, deterrent against professional misconduct.</p> <p>In any case, it has to be pointed out that the purpose of the Bill is to establish the FRC which is an investigatory body. Matters concerning the severity of disciplinary</p>

	Summary of Comments ²	Administration's Responses
	removed from the register permanently.	orders made by a Disciplinary Committee of the HKICPA under section 35 of the PAO are not consequential to the proposals of the Bill and may be re-visited in a separate context as appropriate.
3	General (Transparency of the work of the FRC): The investigation results and disciplinary actions taken (also actions not taken) should be made transparent to the public to help achieving deterrent effects on wrongdoers and strengthening regulatory accountability.	We appreciate that there is a public interest dimension in the publication of investigation/enquiry reports which will enhance the transparency of the work of the FRC. In this regard, clauses 35 and 47 provide that the FRC may publish its investigation/enquiry reports after taking into account the relevant considerations as set out in clauses 35(4) and 47(4). Furthermore, the FRC shall prepare an annual report on the activities of the Council, and the report will be laid on the table of the Legislative Council pursuant to clause 20. Such reports enable the public to scrutinize the performance of the FRC in exercising its functions.
4	General (Funding of the FRC): The budget of the FRC is small as compared to the budgets of similar bodies overseas.	Please refer to item (6) of the Administration's responses to the British Chamber of Commerce in Hong Kong (at page 10).
5	General (Shareholder remedies): We support the provision allowing investors to use findings of the FRC and that of disciplinary actions of the HKICPA in their civil actions for damage.	The main purpose of an investigation/enquiry by the FRC is to help enhance the regulation of auditors and the quality of financial reporting of listed entities. While clause 35(5) provides that the investigation/enquiry reports of the FRC are admissible as evidence of the facts stated in the report in certain proceedings, the

	Summary of Comments²	Administration's Responses
		admissibility of HKICPA's disciplinary decisions in legal proceedings is entirely a separate issue.

SFC's Public Shareholders Group

	Summary of Comments²	Administration's Responses
1	General (Funding of the FRC): A member of the Group was of the view that the budget of the FRC was small as compared to budgets of similar bodies overseas.	Please refer to item (6) of the Administration's responses to the British Chamber of Commerce in Hong Kong (at page 10).
2	General (Cooperation between the SFC and FRC): Members of the Group were of the view that because the proposed function of the AIB is actually a part of the current functions of the HKICPA, there is no change from the current situation in terms of overlapping of functions with the SFC. Members were pleased to see that the Bill promotes two-way sharing of information between the FRC and the SFC which is an improvement from the current one-way flow of information from the SFC to the HKICPA only.	Noted. We agree that the current division of work between the SFC and the HKICPA applies, by and large, to the future division of work between the SFC and the FRC in future. Furthermore, the notification concerning the initiation of investigation/enquiry under clauses 24 and 42, the consultation under clauses 29 and 43, the referral of cases and provision of assistance under clauses 9(f) and (g), and the gateway for disclosure of information to the SFC under clause 51(3)(b)(xi) will all contribute to the co-operation between the SFC and the FRC in combating irregularities and non-compliances in the financial markets.

	Summary of Comments²	Administration's Responses
3	<p>General (Whether the FRC shall have the disciplinary function): Members of the Group advised that they would feel more comfortable if the FRC also has a disciplinary function. Members are concerned that if the investigation and disciplinary functions are housed in different bodies, disciplinary cases may not proceed after referral. If the FRC budget is a concern, members considered that the required funding could come from the HKICPA as that part of its current function would be transferred to the FRC.</p>	<p>Please refer to item (5) of the Administration's responses to the comments of the Association of Chartered Certified Accountants (Hong Kong) (at page 63).</p>
4	<p>General (Shareholder Remedies): A member suggested that the law be changed to allow findings of the FRC and findings of the disciplinary actions of the HKICPA to be used by investors in their civil actions for damages.</p>	<p>Please refer to item (5) above regarding the Administration's responses to the SFC's Investor Education Advisory Committee (at page 79).</p>
5	<p>Clause 54 (Immunity in respect of communication with the FRC): Members were of the view that whistleblower protection is important for staff of audit firms and staff of the listed companies.</p>	<p>Noted.</p>

SFC's Staff

	Summary of Comments²	Administration's Responses
1	General (Division of Roles and Responsibilities between the SFC and FRC): We do not anticipate that there will be undue overlap between the FRC's investigations and the SFC's own investigations. When the FRC is investigating the work of auditors, the FRC and SFC may well both be looking at issues arising from the same events concerning corporations. However, the FRC will be looking for evidence of auditor malpractice, particularly whether the audit work was sufficient and whether appropriate judgments were made, whereas the SFC will be looking for evidence of corporate fraud or misconduct, breach of Listing Rules or market misconduct. Overall whilst we recognize the need for co-operation between the SFC and the FRC, we do not consider that there will be duplication of effort, wastage of resources and delays in taking action against the parties involved.	Noted. We agree that there will not be undue overlap as regards the jurisdictions of the FRC and the SFC.
2	General (Whether the FRC shall has the disciplinary function): The SFC staff has no view on whether the FRC should have purely an investigative role or whether it should take on some of the prosecution work of the HKICPA. Whether the roles should be separated is therefore a policy question.	Noted.

(22) The Hong Kong Institute of Chartered Secretaries (CB(1)2288/04-05(22))

	Summary of Comments ²	Administration's Responses
1	General: We are in full support of the Bill.	Noted.
2	Clause 7 (Composition of the FRC): We support the proposal that the majority of the FRC should be lay persons. Such a proposal is in line with the international trend towards making the oversight of auditors and financial reporting of listed entities more independent from the accounting profession. However, we are concerned about the criteria for the choice of lay members of the FRC. It is important that such persons shall possess relevant, personal, specific experience and expertise.	Noted. Please refer to item (3) of the Administration's responses to the comments of the Association of International Accountants (Hong Kong Branch) (at page 2).
3	General (Division of Rules and Responsibilities among the Relevant Bodies): It is critical to ensure that there is no duplication of or confusion about the respective roles of the FRC and other authorities such as SFC and HKEx. We suggest that there should be communication between the FRC and the police or the relevant authorities throughout the investigations such that the FRC is advised on the kind of information or evidence which it should collect for an offence or disciplinary action to be established.	<p>In devising the functions and powers of the FRC, we are mindful of the need to avoid any duplication of work among the FRC, the HKICPA, and other financial services regulators.</p> <p>Upon its establishment, the FRC will investigate auditors' irregularities involving listed entities, whereas the HKICPA will continue to deal with other complaints about its registered members and practice units including those in relation to the non-listed sectors. This should not affect the current responsibilities of other regulators including the SFC and HKEx. We envisage the present division of responsibilities between SFC/HKEx and</p>

	Summary of Comments²	Administration's Responses
		<p>HKICPA will, by and large, apply to that between the SFC/HKEx and the FRC.</p> <p>The Bill contains a number of provisions to ensure a smooth interface between (i) the investigations of the FRC and (ii) the disciplinary proceedings of the HKICPA or proceedings of other law enforcement agencies. Clause 4 is modelled on sections 34 and 41 of the PAO so as to ensure that the relevant irregularities investigated by the FRC can fall within the jurisdictions of the disciplinary proceedings under the PAO. Clauses 9(f) and (g) provide that it is the FRC's functions to refer a case to a specified body, and provide assistance to that body on the body's investigation or enquiry into or dealing with the case. Clause 10(2)(d) empowers the FRC to enter into any memorandum of understanding with other parties, with a view to building cooperation between the FRC and other regulators. Clauses 35(5) and 47(5) provide that a copy of the Investigation Report by the AIB and the Enquiry Report by a FRRC is admissible as evidence of the facts stated in the report in certain proceedings.</p> <p>Moreover, where the FRC has unveiled evidence of criminal conduct, it would suspend the investigation pursuant to clause 36(1)(b) and refer the matter to the police or other relevant law enforcement agencies pursuant to clause 9(f) of the Bill.</p>

	Summary of Comments ²	Administration's Responses
4	Clause 23 (Initiating investigation concerning relevant irregularity): It is not clear what “ <i>circumstances suggesting</i> ” and “ <i>reasonable cause to believe</i> ” mean. We suggest that FRC should issue guidelines (with examples given) under clause 13 for this purpose.	Please refer to item (2) of the Administration's responses to the comments of the Chinese General Chamber of Commerce (at page 42).
5	Clauses 9, 23 and 40 (Referral of cases between the AIB and a FRRC): Are the powers of the AIB and those of a FRRC to be exercised on a mutually exclusive basis? Will the consequence of the non-compliance be the major consideration in deciding which should be the body in charge i.e. the cases with more serious consequences will be handled by AIB while the less serious ones will be dealt with by the FRRC even if negligence of auditors is suspected?	As provided in clauses 9(e), 23 and 40, the FRC may direct the AIB or a FRRC to investigate a “relevant irregularity” or enquire into a “relevant non-compliance”. The FRC may trigger its investigation and/or enquiry powers as and when the statutory thresholds in clauses 23 and/or 40 are passed. It should be noted that the focus of the AIB's investigation is <i>auditors'</i> irregularity, whereas that of a FRRC's enquiry is a non-compliance with an accounting requirement as to the matters to be included in a <i>financial report</i> . That said, where necessary, a case may be looked into by both the AIB and a FRRC if the FRC sees fit to direct so and certifies that the respective thresholds under clauses 23 and 40 have both been passed.
6	Clauses 29 and 43 (Consultation with other financial regulators): While the plain meaning of “ <i>consultation</i> ” certainly does not equate to <i>consent</i> , it can be foreseen that a dilemma or deadlock will arise if the consulted body is not agreeable to the proposed exercise of the power by AIB or FRRC.	The consultation requirements in clauses 29 and 43 are measures to ensure that the planned investigation of the FRC will be coordinated with the enforcement actions of other financial services regulators where the situation warrants. It is rightly pointed out that the word <i>consultation</i> does not require the FRC, as an independent investigatory body, to obtain the <i>consent</i> of the party

	Summary of Comments ²	Administration's Responses
		<p>being consulted before exercising the relevant investigation/enquiry powers. We envisage that, in practice, through communication, accumulation of experience, and building of understanding among regulators, the likelihood of a deadlock (if any) among regulators will be minimal.</p>
7	<p>General (Funding Arrangement of the FRC): We support the idea of having a review of the funding arrangement in three years time. We appreciate that the FRC intends to have a lean structure, however, it is very probable that the annual funding of HK\$10 million together with the reserve of HK\$10 million is not sufficient for the running of the FRC.</p>	<p>Please refer to item (6) of the Administration's responses to the British Chamber of Commerce in Hong Kong (at page 10).</p>
8	<p>Clauses 35 and 47 (Publications of Investigation/Enquiry Reports): Apart from the factors set out in clauses 35(4) and 47(4), we find the timing of the publication of great importance and extreme care should be taken in determining the timing. Every investigation report may implicate persons involved with the case and thus publication of the same can be damaging to the reputation of the persons concerned. We suggest that the FRC should issue guidelines on the circumstances and timing of the publication of the investigation report with a view to balance the need for transparency and protection of privacy. Subject to other considerations, we propose that an investigation report shall only be</p>	<p>As set out in clauses 35(4)(a) and 47(4)(a), the FRC shall consider, among other things, whether or not the publication of investigation/enquiry reports may adversely affect any criminal proceedings before a Court or Magistrate, any proceedings before the Market Misconduct Tribunal, or any proceedings under Part V or VA of the PAO, <i>that has been or is likely to be instituted</i>. This already covers the need for the FRC to take into account the timing of the publication before deciding to publish an investigation/enquiry report. Clauses 35(4)(b) and 47(4)(b) also address the need for the FRC to balance against the consideration of whether or not the publication may <i>adversely affect any person named in</i></p>

	Summary of Comments²	Administration's Responses
	<p>published after the relevant authority or the police have confirmed that it will take up and pursue the case. Consideration may also have to be given as to whether investigation reports relating to closed or suspended cases should be published.</p>	<p><i>the report.</i> Where necessary, the FRC may exercise its power under clause 13 to publish guidelines to indicate the manner in which it proposes to exercise its powers under clauses 35 and 47.</p>

(23) National Institute of Accountants of Australia (China Branch) (CB(1)2288/04-05(23))

	Summary of Comments ²	Administration's Responses
1	General: The Institute is broadly supportive of the proposals as set out in the Bill and believes that it will provide reassurance for the markets and the users of financial reports and help to cement the position of Hong Kong as the region's financial centre.	Noted.
2	Clause 6 (Establishment of the FRC): The Institute is pleased that the decision was taken to ensure that the FRC is an independent statutory body rather than set it up as a company limited by guarantee.	Noted.
3	Clause 7 (Composition of the FRC): The proposed mix of representatives is the right mix. Where possible, those "lay" members should have at least a working knowledge of financial and accounting issues. There should also be some consideration to ensuring that there is one representative of the wider community, who is not a representative of the business community.	Please refer to item (3) of the Administration's responses to the comments of the Association of International Accountants (Hong Kong Branch) (at page 2).
4	General (Functions of the FRC): One area of potential additional reform would be for the FRC in Hong Kong to take on the role of oversight of the adoption of accounting and auditing standards. The Institute is not suggesting that the FRC should take a role in setting the standards, but act in manner similar to the FRC in Australia and	The HKICPA is established under the PAO to provide for a self-regulatory regime for accountants and their practice in Hong Kong. Section 18A of the PAO provides that the Council of the HKICPA may, in relation to the practice of accountancy, issue or specify any statement of professional ethics, or standards of accounting, auditing

	Summary of Comments²	Administration's Responses
	provide a mechanism for public oversight.	and assurance practices, required to be observed, maintained or otherwise applied by any certified public accountants. The issue of the oversight of accounting standards is in essence a separate matter.
5	General (Funding Arrangement for the FRC): The Hong Kong FRC is proposed to be funded through a mechanism in which the four principle stakeholders are the HKEx, the HKICPA, the SFC and the Administration. This is a suitable mechanism.	Noted.
6	Clauses 17 and 19 (Estimates and the audit of the FRC's accounts): The Institute is pleased to see that the FRC appears to have greater control over its own budget as this is important to the proper functioning of an independent statutory body. The FRC should have to keep and maintain proper sets of accounts and that the Director of Audit should have responsibility for the audit.	Noted.
7	Clause 14 (Directions of the CE): The Institute would be concerned with the potential for political interference through the use of such power.	Please refer to item (4) of the Administration's responses to the comments of the Association of Chartered Certified Accountants (Hong Kong) (at page 62).
8	General (Whether there should be an appeal tribunal): The Institute agrees that since the proposals in relation to the FRC only provide it to have investigative powers that there is no need to have a separate appeal tribunal. If	Noted. Please refer to item (6) of the Administration's responses to the comments of the Chamber of Hong Kong Listed Companies (at page 23).

	Summary of Comments ²	Administration's Responses
	<p>however, the FRC was to have a role in relation to disciplining auditors, as the Institute will suggest it should, there would need to be an appeal tribunal.</p>	
9	<p>General (Whether the FRC should have a disciplinary function): The Institute agrees that an independent and effective investigation regime is fundamental to ensuring public trust in the audit profession. However, the Institute believes that public trust is best served by also having an independent disciplinary system for company auditors, in concert with maintaining discipline by the profession.</p>	<p>Please refer to the Administration's paper entitled "Functions of the Financial Reporting Council" which sets out our justifications for the role of the FRC being purely investigatory. It is also relevant to point out that, with the commencement of the Professional Accountants (Amendment) Ordinance 2004 in November 2004, the independence and transparency of the disciplinary proceedings of the HKICPA have been substantially enhanced. The majority of the members of a Disciplinary Committee under the HKICPA must now be lay persons, and in general the proceedings of the Committee are open to the public.</p> <p>Please also refer to item (5) of the Administration's responses to the comments of the Association of Chartered Certified Accountants (Hong Kong) (at page 63).</p>
10	<p>Clause 4 (Relevant Irregularity): The Institute agrees with the list of "irregularities" that could be investigated by the AIB. The Institute would also suggest that some additional irregularities might also be looked into. In particular, the issue of "independence" could be seen as a separate and distinct category of irregularity.</p>	<p>The issue of "auditors' independence" is addressed in the professional standards issued by the HKICPA. Having failed or neglected to observe, maintain or otherwise apply a professional standard is within the scope of "relevant irregularities" under clause 4 of the Bill.</p>

(24) Ernst & Young (CB(1)2288/04-05(24))

	Summary of Comments ²	Administration's Responses
1	<p>Clause 4 (Definition of “relevant irregularity”): FRC enquiries and investigations should be launched only when a significant public interest exists. Some degree of proportion, materiality and context should be brought to bear in a decision to launch an enquiry or investigation.</p> <p>An example of wording which does not enshrine a consideration of proportion, materiality, context and public interest is included in section 4(4)(a)(vi) and 4(6)(b), which seems unnecessarily wide-ranging in referring to refusal or neglecting to comply with the provisions of “any bylaw or rule made or any direction lawfully given by the HKICPA Council”. A similar degree of proportion, materiality and context seems to be absent from the subsection which addresses a situation where an auditor or reporting accountant is deemed to be “negligent in the conduct of his profession”.</p>	<p>In relation to the “public interest/materiality” threshold, please refer to item (1) of the Administration’s responses to the comments of Deloitte Touche Tohmatsu (at page 13).</p> <p>The irregularities set out in clauses 4(4)(a)(vi) (that an auditor refused or neglected to comply with the provisions of any bylaw or rule made or any direction lawfully given by the HKICPA Council) and 4(3)(c) (that the auditor has been negligent in the conduct of his profession) are modelled on section 34(1)(a)(ix) and (iv) of the PAO respectively. An Investigation Committee of the HKICPA may currently investigate such irregularities pursuant to section 42C(2)(a) of the PAO. Upon its establishment, the FRC will take over cases concerning auditors of listed entities. Since the types of irregularities concerned are currently subject to the investigation by HKICPA’s Investigation Committees, we fail to see why these should not fall within the jurisdiction of the FRC in relation to cases concerning listed entities which generally carry a sufficient public interest dimension.</p>
2	<p>Clause 4(3)(c) (Definition of “relevant irregularity”): Clause 4(3)(c) should not be included in the Bill because :</p> <ul style="list-style-type: none">- (i) it does not state a proviso that negligence should	<p>Please refer to item (2) of the Administration’s responses to the comments of Deloitte Touche Tohmatsu (at</p>

	Summary of Comments²	Administration's Responses
	have had a material or public interest effect in order to warrant consideration by the FRC; and (ii) a material negligent act, or one with a public interest effect or a course of negligent behaviour is already addressed by sub-section 4(3)(d) which deals with professional misconduct.	page 13).
3	Clauses 25 to 28 (Investigation powers): Clause 25, etc require an auditor or reporting accountant to produce records or documents in his possession to the investigator. An issue may arise, however, in respect of such documents physically located in jurisdictions outside Hong Kong.	Please refer to item (3) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 14).
4	Clauses 35(4) and 47(4) (Publication of Investigation/Enquiry Reports): Clauses 35(4)(a)(i) and 47(4)(a)(i) require the FRC's consideration of whether or not the publication of an FRC investigation report may adversely affect " <i>any criminal proceedings before a court or magistrate</i> ". To " <i>any criminal proceedings</i> " should also be added " <i>any civil proceedings</i> " – an example illustrating the necessity for this additional wording being proceedings commenced by liquidators.	The proposal to include "any civil proceedings" is too wide since that could include any unrelated private law disputes between any persons named in the report with any other parties where the publication of the report may have no bearing on or relevance to on such private law disputes. In any case, the contents of any report published are not the conclusive evidence of the facts stated therein, and the auditor or other persons may adduce evidence to defend himself.
5	Clauses 35 and 47 (Publication of Investigation/Enquiry Reports): There should be a requirement that the FRC informs the affected auditor,	Please refer to item (7) of the Administration's responses to the comments of the Chartered Institute of Management

	Summary of Comments²	Administration's Responses
	<p>reporting accountant, persons, etc (the “affected parties”) of an intention to publish the report.</p> <p>Further provisions should be added to the Bill to provide the affected parties with a right to representation and an entitlement to make submissions to the FRC in respect of such a situation.</p>	Accountants (Hong Kong Division) (at page 38).
6	<p>Clauses 35(5) and 47(5) (Admissibility of investigation/enquiry reports as evidence of facts in proceedings): By their nature, FRC investigation reports are likely to include expressions of opinion from the FRC, any expert advisers that have been consulted, and those that have been required to provide information under the investigation. While an FRC investigation report could be used as the basis for initiating court or disciplinary proceedings, it should not have the status of being “admissible as evidence of the facts stated in the report” in such proceedings. The court or disciplinary body should use the FRC investigation report as it deems appropriate in implementing its normal procedures, and such procedures should be conducted in accordance with their usual rules, requiring (if necessary) the calling of witnesses as to fact and expert witnesses as to expressions of opinion.</p>	Please refer to item (6) of the Administration’s responses to the comments of Deloitte Touche Tohmatsu (at page 15).
7	<p>Clauses 51(3)(b)(ix) and (3)(c) (Disclosure of information to Official Receiver and liquidators):</p>	Please refer to item (11) of the Administration’s responses to the comments of the Standing Committee of Company

	Summary of Comments ²	Administration's Responses
	<p>Clause 51(3)(b)(ix) and (3)(c) permit the FRC to disclose information to the Official Receiver and liquidators. The disclosure of FRC investigation information or reports to a liquidator or provisional liquidator is wholly inappropriate. It is inequitable that the investigative and other powers of the FRC should be available to liquidators in the pursuit of litigation against auditors.</p>	<p>Law Reform (at page 59).</p>
8	<p>Clause 52 (Avoidance of conflict of interest): Given the nature of the type of investigations undertaken by the FRC, in some circumstances it may not immediately be apparent to an FRC member that a conflict of interest exists. We suggest that the wording of section 52(2) be extended to include wording along the lines of “<i>when the FRC member becomes aware, or reasonable grounds exist for him to become aware</i>” that he is required to consider a matter in which he has an interest.</p>	<p>Please refer to item (11) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 18).</p>
9	<p>Schedule 1 (Definition of “relevant requirements”): Our understanding of the Listing Rules relating to such requirements and the intended logic of the Bill wording, is that the following accounting standards are <i>mutually exclusive</i> alternative options in the circumstances they are referred to in the Bill :</p> <ul style="list-style-type: none"> ● “the standards of accounting practices issued ... under section 18A of the Professional Accountants Ordinance”; 	<p>For the purpose of the definitions of “relevant requirements”, it is not necessary to deal with the question as to whether or not a set of accounting standards are mutually exclusive to the others. In Part 1 of Schedule 1, “<i>relevant requirement</i>” in relation to a “<i>relevant financial report</i>” means an accounting requirement as to the matters or information to be included in the report, as provided under the CO, the Listing Rules, the standards of accounting practice issued under section 18A of the PAO, the International Financial Reporting Standards, <i>or</i> other</p>

	Summary of Comments ²	Administration's Responses
	<ul style="list-style-type: none"> ● “the International Financial Reporting Standards issued by the International Accounting Standards Board”; or ● “any generally accepted accounting principles allowed for usage under the Listing Rules”. <p>Our opinion is that the drafting of these sections of the Bill should therefore set out these options in a similar logic format to that illustrated below, rather than under the existing four points of equivalent weighting :</p> <p>“(a) <i>the following accounting standards :</i></p> <ul style="list-style-type: none"> (i) the standards of accounting practices issued under section 18A of the Professional Accountants Ordinance; (ii) the International Financial Reporting Standards issued by the International Accounting Standards Board; <i>or</i> (iii) any <i>other</i> generally accepted accounting principles allowed for usage under the Listing Rules; and <p>(b) the Listing Rules.”</p>	<p>accounting principles allowed for usage under the Listing Rules. If the CO, the Listing Rules, or the various types of accounting standards or principles does not provide for any accounting requirement in relation to the particular “relevant financial report”, it is not necessary to consider that instrument in the context of the definition.</p>
10	<p>Clauses 24 and 42 (FRC to notify other regulators of the initiation of investigation/enquiry): There should be some mechanism inserted in the Bill for confidential</p>	<p>Please refer to item (3) of the Administration's responses to the comments of the Chamber of Hong Kong Listed</p>

	Summary of Comments²	Administration's Responses
	communication between the FRC and, for example, the HKICPA and the SFC when an enquiry or investigation is planned by the FRC.	Companies (at page 21).

(25) Hong Kong Bar Association (CB(1)2288/04-05(25))

	Summary of Comments²	Administration's Responses
1	The Bar Association has no comment on the proposed structure of the disciplinary process for auditors contemplated in the Bill.	Noted.

(26) Mr. Oscar Wong Sai-hung (CB(1)2288/04-05(27))

	Summary of Comments ²	Administration's Responses
1	<p>General: I fully support the legislative efforts to set up an independent statutory body to oversee the work of auditors and the financial reporting of listed companies. I believe that this may tighten the independent regulation of the audit profession and improve public confidence in corporate reporting, corporate governance, accounting and auditing of listed companies.</p>	<p>Noted.</p>
2	<p>General: In order to instill public confidence, the investigation of suspected cases of accounting irregularities and corporate scandals has to be conducted effectively. Further, the membership of the FRC should include a balanced representation of the interested parties.</p>	<p>To enhance the effectiveness of the investigation, the Bill proposes a set of investigation powers modelled on the SFC's investigation powers under sections 179 and 183 of the SFO. As regards the membership of the FRC, we intend to establish an independent FRC with a wide and balanced composition. In accordance with clause 7(2), the majority of the FRC members comprise lay persons. Subject to this requirement, the CE would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.), so that the FRC could discharge its functions effectively.</p>
3	<p>Clause 10 (Power of the FRC to appoint consultants, agents or advisers): Possible complex cases of accounting irregularities may put pressure on the FRC in</p>	<p>Clause 10(2)(b) empowers the FRC to appoint persons as consultants, agents or advisers to assist the FRC in the performance of its functions. This being an</p>

	Summary of Comments²	Administration's Responses
	respect of manpower, expertise, time and costs. The Bill proposes that the FRC may hire external expertise to assist in the investigation of large corporate scandal case. The procedures for hiring external expertise have not been set out in the Bill. It would be useful if certain guidelines are available.	administrative matter of the FRC, the Council may, where necessary, issue guidelines pursuant to clause 13 to indicate the manner in which it propose to exercise its powers to appoint consultants, agents or advisers under clause 10(2)(b).
4	Clauses 35 and 47 (Publication of Investigation / Enquiry Reports): The FRC may publish investigation or enquiry reports submitted by the AIB or a FRRC. The power to publish reports should be exercised with due care and the publication of reports should not prejudice subsequent proceedings or those persons affected by the publication. It would be helpful if the rights of the persons being affected can be further elaborated, for example, their right to be given reasonable opportunity to make representation prior to the publication of the report.	Please refer to item (7) of the Administration's responses to the comments of the Chartered Institute of Management Accountants (Hong Kong Division) (at page 38).
5	General (Right to legal representation): Persons being investigated should be properly informed of their rights, for example, their right to legal representation.	The Bill does not contain any provision that restricts the right to legal representation.

(27) Mr. Simon N. M. Young (CB(1)2288/04-05(28))

	Summary of Comments ²	Administration's Responses
1	<p>General (Overall): The idea of having an overarching body to receive and investigate complaints concerning the accounting irregularities of listed companies is most welcome.</p>	Noted.
2	<p>Clauses 30 and 44 (Use of incriminating evidence in proceedings): At common law, an individual's privilege against self-incrimination entitles him to refuse to answer any questions or participate in any conduct which could result in his direct incrimination. Clauses 30 and 44 expressly abrogate this privilege and require the individual to comply even if compliance would result in the materialization of self-incriminating evidence. The only saving grace is a claim-based use immunity given to the individual. In other words, where the individual makes an express claim of the privilege the answers, which still must be given, cannot be used against the individual as evidence in any subsequent prosecution. It follows that those answers which are not prefaced or qualified by a claim of privilege can be used as incriminating evidence at trial.</p> <p>The claim-based system can be awkward in practice as it can interfere with the free-flow of the interview. One can imagine innocent reasons for why an individual might fail or forget to make the necessary claim before</p>	<p>Clauses 31(9) and 43(3) abrogate the common law privilege against self-incrimination and replace it with a statutory prohibition on how an answer given in an investigation/enquiry can be used. If a person makes a claim under clauses 30(2) and 44(2) before answering the investigator/enquirer's question, the self-incriminating answer is not admissible against him in criminal proceedings. Clauses 30(1) and 44(1) require the investigator/enquirer to inform or remind the person concerned of the limitations on the admissibility in evidence imposed by clauses 30(2) and 44(2).</p> <p>If a person has not made a claim under clauses 30(2) and 44(2), the statutory prohibition does not apply. However, a court has the general residual discretion to exclude evidence where this is necessary to ensure a fair trial for the accused. The requirement of a fair trial involves the observance of the principle, among others, that no man is to be compelled to incriminate himself. Therefore, clauses 30(2) and 44(2) are capable of being given effect to in a manner which is consistent</p>

	Summary of Comments ²	Administration's Responses
	<p>providing a potentially incriminating answer. Having blanket use immunity also obviates the need to warn the individual of the right to claim the use immunity and thus avoids potential legal wrangle in cases where the investigators have failed to give the required warning.</p>	<p>with Article 11(2)(g) of the Hong Kong Bill of Rights, 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.</p> <p>It should be noted that clauses 30 and 44 are modelled on section 187 of the SFO. A similar provision can be found in section 145(3A) of the CO. We consider it justified to introduce the claim-based statutory prohibition. There would be a wide range of information obtained under an investigation or enquiry. The claim-based requirement is useful for parties to the proceedings to quickly identify possibly self-incriminating evidence with a view to ensuring that such evidence will not be admitted against the person who has given the information in the first place.</p>
3	<p>Clause 29 (Consultation with other regulators): It is not clear from clause 29 what the consequences are to the investigator and/or investigation where he fails to consult the required regulatory body before embarking on the exercise of his powers. Is it the case in this situation that the investigator would be acting without jurisdiction and all the information and evidence gathered could not be used for any purpose? The consequences for failing to consult should be made clearer.</p>	<p>In our view, the statutory condition to consult is a directory, rather than mandatory, procedure. Failure to comply with the condition will not invalidate the investigation. This is a question of statutory construction – in the light of the purpose of the legislation and the importance of the condition. We accept that if the condition is a procedural safeguard imposed for the benefit of persons affected by the exercise of powers, the condition will normally be regarded as mandatory. In this case, however, the consultation is to help ensure that the planned investigation of the FRC will be coordinated with the enforcement action of other relevant regulators</p>

	Summary of Comments ²	Administration's Responses
		<p>where the situation warrants. The harm caused by a failure to consult the relevant regulators is not so serious as to justify a prohibition on using the evidence or information obtained during the investigation.</p>
4	<p>Clause 32 (Court of First Instance to inquire into failure to comply with the requirements in relation to the production of documents): A person who fails to comply with a demand by the investigator can either be charged with a criminal offence or face contempt of court proceedings in the Court of First Instance. The question is whether the contempt power is necessary given the availability of a host of criminal offences in clause 31 for which the individual could be prosecuted. It is noteworthy that even the Independent Commission Against Corruption has not been given recourse to a contempt power where there is non-compliance with authorizations issued pursuant to section 13 of the Prevention of Bribery Ordinance (Cap 201).</p> <p>The difficulty with the proposed contempt mechanism is that imprisonment for contempt can occur without the usual safeguards of the criminal process. What seems to be contemplated is punishment (up to at least two years of imprisonment) after an inquiry (not a trial) by the Court of First Instance. The rules of evidence in criminal proceedings would not apply to this proceeding, and thus hearsay evidence would be generally admissible.</p>	<p>Clauses 31 and 32 offer two alternative ways to deal with a failure to comply with a requirement imposed by the investigator. Under clause 31, the person who fails to comply is prosecuted for the appropriate offence. Clause 32 empowers the investigator to apply, by originating summons, to the Court for an inquiry into the failure, in which case the Court may order the person to comply with the requirement and, if there is no reasonable excuse for the failure, punish the person for the failure. In this light, clause 32, which mirrors section 185 of the SFO, mainly concerns the Court's assistance in compelling compliance with the investigator's requirements for the purpose of the investigation. Clauses 31(10) and 32(4) provide that there will be no double jeopardy in relation to the conviction or punishment by the Court under clause 31 or 32.</p> <p>Although hearsay evidence is admissible in civil contempts, the burden is on the investigator to prove beyond reasonable doubt that the failure was without reasonable excuse. These rules are applicable to all other proceedings for civil contempts.</p>

	Summary of Comments ²	Administration's Responses
5	<p>Clause 31 (Offences relating to requirements in an investigation): There is no apparent reason why the offence in clause 31(1) should be one of strict liability. One can imagine many situations where someone might innocently fail to comply with an investigator's demand and should not be subjected to a criminal prosecution. It is recommended that the <i>mens rea</i> requirement of "<i>knowingly or recklessly</i>" be expressly added to this offence.</p>	<p>Clause 31(1) is modelled on section 179(13) of the SFO and provides that a person commits an offence if he, without reasonable excuse, fails to comply with a requirement imposed on him under clauses 25, 26, 27 or 28. This proposes a strict liability offence, as contrasted with other offence provision under clause 31 which requires proof of either "intent to defraud" or "knowledge /recklessness". It should be stressed that the offence referred to in clause 31(1) allows the defence of "reasonable excuse", such that a person who innocently fails to comply with a requirement may be able to establish the defence of "reasonable excuse".</p>
6	<p>Clauses 35(5) and 47(5) (Admissibility of Evidence in Proceedings): The Bill proposes to create a hearsay exception to make the facts asserted in the investigator's report admissible for their truth in criminal and other proceedings. There seems to be no justification for creating this exception (at least insofar as it applies in criminal proceedings). As in all criminal trials, the investigator should be required to attend the proceedings as a witness and be subjected to full cross-examination as to his or her findings. Written reports of this kind will most likely contain hearsay upon hearsay, mere suspicious and other innuendoes which would not normally be admissible in a criminal trial.</p>	<p>Having considered the comments of some deputations, we have reviewed with the Department of Justice on clauses 35(5) and 47(5) concerning the admissibility of evidence in relevant proceedings. We accept that we should be slow to create statutory exceptions to the rule against hearsay in criminal proceedings. We would consider proposing a CSA to carve out the admissibility of the investigation/enquiry reports in criminal proceedings as evidence of the facts stated therein.</p>

(28) Mr. David Gunson (CB(1)2288/04-05(29))

	Summary of Comments ²	Administration's Responses
1	<p>General (Reforms in trustee investment laws, tax laws and tax avoidance laws): Reforms should also be undertaken in respect of certain trustee investment laws, tax laws and tax avoidance laws.</p>	<p>The major objective of the Bill is to establish the FRC, which is tasked to (a) investigate irregularities of auditors of listed entities; and (b) make enquiries into financial reports of such entities to ensure that they comply with the relevant legal, accounting and regulatory requirements. We would forward the comments relating to the trustee investment laws, tax laws and tax avoidance laws, which are separate matters, to the relevant departments for consideration.</p>

(29) Dr. Peter P. F. Chan (CB(1)2288/04-05(30))

	Summary of Comments²	Administration's Responses
1	General: Small practitioners, if I may say on their behalf, will welcome the Bill. It was felt desirable to remove the disciplinary and investigative functions from the HKICPA. Any accountant who is subject to the Disciplinary Committee hearing may choose to be heard by the AIB at his choice.	We note the support for the Bill. Please refer to the Administration's paper entitled "Functions of the FRC" which set out the Administration's justifications that the FRC should be purely an investigatory body.

(30) Mr. Peter H. Y. Wong (CB(1)2288/04-05(31))

	Summary of Comments ²	Administration's Responses
1	<p>General: The rules and procedures, particularly as to the adducing of evidence by the FRC during the investigation phase and HKICPA both during the formulation and preparation of the prosecution phase as well as the disciplinary hearing phase, have to be efficient, relevant and matching. The existing Disciplinary Rules of the HKICPA were formulated many years ago when it was a “trial by one’s peers” whereas today, it is more akin to a court of law with the majority of members being non-accountants. The whole approach has to be revisited.</p>	<p>We consider that the Bill has provided sufficient powers for the FRC to conduct investigations effectively with a view to referring a case to the HKICPA or other specified bodies for disciplinary or other follow-up action. However, as the FRC is purely investigatory, the rules of disciplinary proceedings of the HKICPA should be considered in a separate context as appropriate. Section 51(f) of the PAO empowers the Council of the HKICPA to make rules regulating the conduct of inquiries by a Disciplinary Committee.</p>
2	<p>Clause 4(3) (Definition of “relevant irregularity”): Why do we not just refer to the relevant parts of the PAO so that they are one and the same?</p>	<p>Please refer to item (6) of the Administration’s responses to the comments of the HKICPA (at page 30).</p>

	Summary of Comments ²	Administration's Responses
3	<p>Clause 50 (FRC may apply to the Court of First Instance to secure removal of relevant non-compliance): The FRC will not be empowered to seek a court order to mandate rectification of annual financial statements of listed entities generally. I appreciate that there are legal difficulties to legislate for listed companies which are constituted overseas.</p>	<p>Please refer to item (4) of the Administration's responses to the comments of the HKICPA (at page 28).</p>
4	<p>Clause 52 (Avoidance of conflict of interests): In clause 52, there has been an attempt to be all inclusive in defining what the conflicts are. Such attempt is doomed to failure because it is impossible to foresee all circumstances, particularly in the future.</p>	<p>Please refer to item (11) of the Administration's responses to the comments of Deloitte Touche Tohmatsu (at page 18).</p>

(31) Hong Kong Stockbrokers Association Limited (CB(1)2331/04-05(01))

	Summary of Comments ²	Administration's Responses
1	General: In order for Hong Kong to maintain our status as the capital raising centre for China, it is necessary to set higher standards and thresholds for listed entities. Quality financial reporting promotes good corporate governance, transparency, and accountability which are all prerequisites for investor confidence and increased market liquidity.	Noted.
2	General (The role of the FRC): The proposals appear to be a sensible mix of statutory powers of investigation, coupled with self-regulation by the HKICPA where disciplinary action is required. We fully support this concept, and concur that the FRC should avoid being police, prosecutor, judge, jury and executioner.	Noted.
3	Schedule 1 (Definition of "relevant financial reports") Currently, the proposals appear to be applicable only to annual accounts and interim financial statements. We would suggest that "published accounts and financial statements" should be extended to cover all financial reports prepared by auditors of listed companies published and used by the investing public such as those included in disclosure on major transactions, etc.	Please refer to item (2) of the Administration's responses to the comments of the Standing Committee on Company Law Reform (at page 55).

	Summary of Comments ²	Administration's Responses
4	<p>Clauses 25 and 26 (Power of investigations): We understand the need to give the AIB powers to carry out investigations. However, we are concerned that the powers as proposed are very wide-ranging and extend to “any other person” who has had dealings with or in possession of documents “relating to the affairs of the corporation”.</p>	<p>According to the HKICPA’s <i>Proposals to Strengthen the Regulatory Framework of the Accountancy Profession</i> in January 2003, one of the difficulties regarding the investigation regime under the PAO is the lack of adequate powers under the PAO to compel non-HKICPA members to provide information. To address this, clauses 25(5) and 26(5) of the Bill propose to enable an investigator to require a person, who (a) has directly or indirectly dealt with, or has had dealings directly or indirectly with, the listed entity or a relevant undertaking of the entity; or (b) is otherwise in possession of records or documents that relate to the audit of the accounts of the entity or undertaking or to the preparation of a specified report required for a listing document, to produce records or documents. Clauses 25(5) and 26(5) are modelled on section 179(8) of the SFO.</p>
5	<p>Clause 50 (FRC may apply to the Court of First Instance to secure removal of relevant non-compliance): While there should be a mechanism for recovery of expenses incurred by the FRRC, directors should be entitled to rely on the advice of professional advisors in the preparation of financial statements. Therefore, directors should not be made to bear the costs of the enquiry and any rectifications unless it is proved beyond reasonable doubt that they were party to deliberate falsification.</p>	<p>By virtue of clause 50(8), we propose that the Court shall have regard to whether each of the directors who were party to the approval of the relevant financial report <i>knew, or ought to have known</i>, that the report did not comply with any relevant requirement, where the Court orders pursuant to clause 50(6) that the costs and expenses referred to in clause 50(7) shall be borne by such directors. Clause 50(10) provides that, for the purposes of clause 50, the directors of a listed corporation at the time when the relevant financial report of the corporation was approved by them, <i>except any director who shows that he took all reasonable steps to prevent the report</i></p>

	Summary of Comments ²	Administration's Responses
		<p><i>from being so approved</i>, would be taken to be the party to the approval of that report.</p> <p>Clauses 50(6), (7), (8) and (10) are modelled on sections 245B(4) and (5) of the UK Companies Act 1985.</p>
6	<p>General (The role of the FRRC): As a FRRC is to enquire into compliance with “relevant accounting requirements”, it may result in the FRRC interpreting accounting standards and becoming a “rule-making” body by default.</p>	<p>Please refer to item (3) of the Administration's responses to the comments of Standing Committee on Company Law Reform (at page 56).</p>

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