

**For Discussion**

**Bills Committee on  
Financial Reporting Council Bill**

**Component Three  
Financial Reporting Review Panel and  
Financial Reporting Review Committees**

**PURPOSE**

In relation to Component Three<sup>1</sup> of the Financial Reporting Council Bill (the Bill), this paper aims to –

- (a) outline the major proposals contained in **Parts 1 and 4** of and **Schedules 1, 5 and 6** to the Bill regarding the establishment of the Financial Reporting Review Panel (FRRP) and Financial Reporting Review Committee(s) (FRRC). The relevant provisions seek to provide for the (i) **organizational structure**; (ii) **jurisdiction**; (iii) **enquiry powers**; (iv) **checks and balances**; and (v) **post-enquiry actions** concerning the FRRP and FRRC; and
- (b) set out the responses of the Administration to the salient comments on these issues as discussed at the second Bills Committee’s meeting held on 27 September 2005 or as reflected in deputations’ comments<sup>2</sup>.

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<sup>1</sup> For the grouping of components, please refer to the Administration’s paper entitled “Proposed work plan” (LC Paper No. CB(1)2288/04-05(35)) as discussed by the Bills Committee at its meeting held on 27 September 2005.

<sup>2</sup> For details of the responses, please refer to the Administration’s note entitled “Summary of submissions and Administration’s responses” (LC Paper No. CB(1)166/05-06(03)).

## **BACKGROUND**

2. Quality and reliable financial reporting is of paramount importance for upholding the corporate governance regime and maintaining investor confidence. The proposal to establish a statutory mechanism to enquire into suspected non-compliances of financial reports dated back to July 2001 when the Standing Committee on Company Law Reform issued its Consultation Paper on Phase I of the Corporate Governance Review. Submissions received then indicated support for the establishment of a panel to review financial reports of companies and enforce any necessary changes to such reports. The Administration further consulted the public on the proposal, which was modelled on a similar set-up in the United Kingdom (UK), in September 2003 and February 2005. With the firm support we received during these consultations, we propose to establish, under the overall structure of the Financial Reporting Council (FRC), the **FRRP**. Members of the FRRP will be appointed to form an individual FRRC, with a view to enquiring into any non-compliance of a listed entity's financial reports with the relevant legal, accounting and regulatory requirements.

## **ORGANIZATIONAL STRUCTURE OF THE FRRP AND FRRC**

### ***Financial Reporting Review Panel***

3. **Clause 39(1)** provides that the Chief Executive (CE) shall, in consultation with the FRC, appoint the FRRP of at least 20 persons. 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 business administration field. In response to the views of some Members and deputations, the Administration agrees, to the extent that the ability of the CE to appoint the best available candidates in the light of circumstances will not be unduly hampered, that further guidance as to how the CE may exercise the appointment power can be provided in the Bill more explicitly. A similar approach in the proposed Committee Stage Amendment (CSA), modelled on section 4(1) of the Deposit Protection Scheme Ordinance (Cap. 581), was discussed by the Bills

Committee concerning the CE's appointment power to the FRC under **clause 7(1)**<sup>3</sup>.

4. In addition, **clause 39(2)** provides that the CE shall appoint, from amongst the members of the FRRP, three Panel Convenors.

### ***Financial Reporting Review Committees***

5. We have modelled our proposals on the UK's approach of constituting a "group"<sup>4</sup> to enquire into an individual case. **Clause 40** provides that the FRC may appoint a FRRC for the purpose of enquiring into non-compliances of financial reports *in relation to a listed entity*. **Clause 41** provides that a FRRC is to consist of at least 5 members of the FRRP. One of the members is to be a Panel Convenor, who is to be the Chairman of that FRRC. The arrangement for convenorship helps ensure consistency in the *modus operandi* of enquiries across the committees. Moreover, the policies and activities of a FRRC shall be overseen by the FRC pursuant to **clause 9(e)**. The enquiry findings of a FRRC shall be reported to the FRC by virtue of **clause 47**.

6. **Schedules 5 and 6** to the Bill set out the supplementary provisions relating to the FRRP and a FRRC, as well as their members. **Section 1 of Schedule 5** states that any member of the FRRP is to be appointed for a term not exceeding three years and is eligible for reappointment. **Section 1 of Schedule 6** provides that the procedures for meetings and proceedings of a FRRC are to be determined by the FRRC itself, subject to any direction of the FRC.

## **JURISDICTION OF THE FRRC**

7. **Clause 9(c)** provides that one of the functions of the FRC is to enquire, in response to a complaint or otherwise, into (i) relevant

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<sup>3</sup> Please refer to paragraph 4 of the Administration's paper entitled "Follow-up actions arising from the meeting held on 31 October 2005" (LC Paper No. [CB\(1\)286/05-06\(02\)](#)) as discussed by the Bills Committee at its meeting on 17 November 2005.

<sup>4</sup> Please refer to Annex A of the Administration's paper entitled "International Experience" (LC Paper No. [CB\(1\)2288/04-05\(33\)](#)) as discussed by the Bills Committee at its meeting on 27 September 2005.

non-compliances in relation to listed entities; and (ii) the question whether or not there are any relevant non-compliances in relation to listed entities. As set out in **clause 5**, there is a “*relevant non-compliance*” if a “*relevant financial report*” of the entity has not complied with a “*relevant requirement*”.

### “*Relevant Financial Reports*”

8. **Part 1 of Schedule 1** sets out the scope of “*relevant financial reports*”. In essence, the definition covers the following reports -

- (a) any published accounts of a listed corporation (which is incorporated in Hong Kong) for the purposes of section 129C of the Companies Ordinance (CO, Cap. 32);
- (b) any published accounts of a listed corporation (which is a non-Hong Kong company) – where a copy of such accounts is registered with the Registrar of Companies under section 336 of the CO;
- (c) a published summary financial report of a listed corporation referred to in section 141CA of the CO<sup>5</sup>;
- (d) any quarterly, interim or annual financial statements of a listed entity for the purposes of the relevant code issued by the Securities and Futures Commission (SFC)<sup>6</sup> or Listing Rules<sup>7</sup>; and

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<sup>5</sup> Section 141CA of the CO enables a listed company incorporated in Hong Kong to send to an entitled person of the company a summary financial report in place of the full set of financial documents for the purpose of a general meeting of the company if the entitled person so agrees.

<sup>6</sup> As defined in **clause 2(1)**, “*relevant code*” means “a code or guideline published under section 399 of the Securities and Futures Ordinance (SFO, Cap. 571) for providing guidance in relation to the operation of section 104 of the Ordinance, as in force at the material time”. Section 104 of the SFO concerns the authorization of collective investment schemes by the SFC. The SFC has published certain codes and guidelines to stipulate the authorization requirements of such schemes, including, among other things, the accounting requirements as to the matters or information to be included in the financial reports of a scheme.

<sup>7</sup> Listing Rules are, at present, non-statutory rules made by the Stock Exchange of Hong Kong (SEHK) governing the listing of securities on the Main Board and the Growth Enterprise Market. These rules are subject to the approval by the SFC under the SFO.

- (e) a “*specified report*”<sup>8</sup> required for a “*listing document*”<sup>9</sup> issued by or on behalf of a listed entity.

### “*Relevant Requirements*”

9. The corresponding “*relevant requirement*” in relation to a “*relevant financial report*” is also set out in **Part 1 of Schedule 1**. A “*relevant requirement*” refers to an **accounting requirement** as to the matters or information to be included in a “*relevant financial report*” as provided in (a) the CO; (b) the Hong Kong Financial Reporting Standards<sup>10</sup>; (c) the International Financial Reporting Standards<sup>11</sup>; (d) the Listing Rules; (e) the relevant code published by the SFC; or (f) any generally acceptable accounting principles allowed to be used under the Listing Rules.

10. To sum up, as the investing public relies on the above-mentioned financial reports to appraise the results or prospect of listed entities<sup>12</sup>, we consider that these reports have a significant public interest dimension and should thus be subject to enquiries by a FRRC. The scope of “*relevant financial reports*” and “*relevant requirements*”

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<sup>8</sup> In **clause 2(1)**, “*specified report*” refers to any financial report specified in Part II of the Third Schedule to the CO that is required under section 38 or 342 of the CO to be set out in a prospectus of a company; or in relation to a listing document other than a prospectus, any report on the financial information on the entity, or a business or undertaking to be acquired or disposed of by the entity, that is required for inclusion in the listing document issued for the purposes of the relevant code published by the SFC or the Listing Rules.

<sup>9</sup> In **clause 2(1)**, “*listing document*”, in essence, means a prospectus within the meaning of the CO, or a document issued for the purposes of the Listing Rules, that offers any securities issued by a corporation or interests in a collective investment scheme to the public for subscription or acquisition.

<sup>10</sup> In essence, the Hong Kong Financial Reporting Standards (HKFRS) are the standards of accounting practices issued by the Council of the Hong Kong Institute of Certified Public Accountants under the Professional Accountants Ordinance (PAO, Cap. 50).

<sup>11</sup> The International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board, which is the most widely recognized accounting standards setting body in the world. The Listing Rules require that, where accounts of corporations primarily listed on the SEHK are required to be prepared, audited, or reported upon under the Rules, they shall conform to either the HKFRS or IFRS. Since 1 January 2005, the HKFRS are in virtually all material aspects converged with the IFRS.

<sup>12</sup> **Clause 3** defines a “*listed entity*” to mean a “*listed corporation*” or a “*listed collective investment scheme*”. The definition will cover all corporations (be they incorporated in Hong Kong or otherwise), together with collective investment schemes, listed on the SEHK.

may be reviewed from time to time in the light of market developments. Where any change to the scope is warranted, **clause 60(1)** provides that the Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend **Schedule 1** to effect the change.

## ENQUIRY POWERS OF A FRRC

11. **Clause 40(1)** provides that the FRC may initiate its enquiry powers or appoint a FRRC to enquire into a case, if it appears to the FRC that **there is or may be a question whether or not there is a relevant non-compliance** in relation to a listed entity<sup>13</sup>. For the purpose of the enquiry, **clause 43** proposes that the enquirer<sup>14</sup> may require persons from the specified classes (viz. (a) a listed corporation; (b) a responsible person<sup>15</sup> of a listed collective investment scheme; (c) a relevant undertaking<sup>16</sup> of a listed entity; or (d) the past or present auditor, officer or employee of a listed entity or the entity's relevant undertaking) to **produce any record or document, or any information or explanation**, relevant to the non-compliance<sup>17</sup>.

12. Furthermore, **clause 45** empowers the enquirer to apply to the Court for an inquiry of any unreasonable refusal or failure to comply with a requirement imposed on a person under **clause 43**. On such application, the Court may order the person to comply with such a

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<sup>13</sup> This threshold is modelled on section 245F(1) of the UK Companies Act 1985 (see **Annex**).

<sup>14</sup> Pursuant to **clause 38**, the term “*enquirer*”, whenever appearing in Part 4 of the Bill, means the “FRC” or a “FRRC” appointed by the FRC to make an enquiry concerning a relevant non-compliance.

<sup>15</sup> **Clause 2(1)** defines a “*responsible person*”, in relation to a listed collective investment scheme, to mean (i) the manager of the scheme; or (ii) the person appointed as the trustee, or custodian, of the property of the scheme.

<sup>16</sup> “*Relevant undertaking*” is defined in **clause 2(1)**. In essence, it means a subsidiary of a listed entity.

<sup>17</sup> **Clauses 40(1) and 43(1)** are modelled on section 245F of the UK Companies Act 1985. The proposed powers for a FRRC in Hong Kong are largely similar to those possessed by the UK FRRP. However, it should be noted that the UK Companies Act 1985 does not empower the UK FRRP to require a *subsidiary* (i.e. a relevant undertaking) of the company in question, or any officer, employee or auditor of that *subsidiary*, to produce documents or give information.

requirement or punish him as if he had been guilty of contempt of court<sup>18</sup>.

## CHECKS AND BALANCES

13. In proposing the powers set out in paragraphs 11 and 12 above, care has been taken to ensure that they are proportionate. We are also mindful of the need to ensure that the exercise of such powers is subject to proper checks and balances. In addition to the general accountability measures covering the FRC, we have put in place, for the exercise of the proposed enquiry powers, a set of specific checks and balances as set out below -

- (a) **Statutory thresholds** - As mentioned in paragraph 11 above, the Bill proposes that the enquirer may only initiate an enquiry upon the passage of the statutory threshold in **clause 40(1)** (that is, **when there is or may be a question whether or not there is a relevant non-compliance**). Where any document, record or information is sought under **clause 43**, the enquirer must demonstrate that it has “*reasonable cause to believe*” that such document, record or information as required is relevant to the non-compliance. The enquirer must certify in writing that the requirements of the statutory thresholds have been satisfied;
- (b) **Notification and Consultation with Other Regulatory Bodies - Clauses 42 and 43(2)** stipulate a notification and consultation arrangement (similar to **clauses 24 and 29** in the case of the AIB) which helps ensure that the planned enquiry of the FRC will be coordinated with the enforcement action of other financial service regulators where the situation warrants<sup>19</sup>; and
- (c) **Prohibition of the Use of Incriminating Evidence in Criminal Proceedings – Clause 43(3)** provides that a person is

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<sup>18</sup> There is a similar power referred to in sections 245F(4) to (5) of the UK Companies Act 1985, which empower the UK FRRP to apply to the Court for an order to mandate a person to take such steps as the court directs for securing the production of any document requested.

<sup>19</sup> Please refer to paragraph 18(b) of the Administration’s paper entitled “Component Two – Audit Investigation Board” (LC Paper No. CB(1) 286/05-06(03)).

not excused from complying with a requirement of providing information under **clause 43(1)** only on the ground that to do so might tend to incriminate him. However, for human rights reasons, **clause 44** expressly provides that such incriminating evidence is not admissible in evidence against the person in criminal proceedings<sup>20</sup>. The two provisions are similar to **clauses 31(9) and 30(2)** (in the case of the AIB)<sup>21</sup> and are modelled on sections 184(4) and 187 of the SFO respectively.

### ***Reasonable Opportunity of Being Heard***

14. We note from some depositions' submissions that there are concerns on whether a reasonable opportunity of being heard will be allowed during an enquiry undertaken by a FRRC, in view of the absence of an express provision to this effect in the Bill. We are advised by the Department of Justice that the fact that the Bill does not expressly provide for a reasonable opportunity of being heard does not mean that the common law rules of natural justice do not apply<sup>22</sup>. However, in view of the deputation's comments and to state our intent explicitly, we will consider proposing a CSA to the effect that any person who may be the subject of any criticism in the enquiry report shall be given a reasonable opportunity of being heard.

## **POST-ENQUIRY ACTIONS**

### ***Enquiry Reports***

15. **Clause 47** requires a FRRC to submit to the FRC written reports on the findings of the enquiry. **Clause 48** provides that, upon consideration of the enquiry report, the FRC may (a) close or suspend the

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<sup>20</sup> These refer to criminal proceedings in a court of law other than those in which the person is charged with an offence under Part V of the Crimes Ordinance (Cap. 200), or for perjury, in respect of the information or explanation.

<sup>21</sup> Please refer to paragraph 18(c) of the Administration's paper entitled "Component Two – Audit Investigation Board" (LC Paper No. [CB\(1\) 286/05-06\(03\)](#)).

<sup>22</sup> For the details about the common law rules in *Re. Pergamon Press Ltd.* [1971] 1 Ch. 388, please refer to paragraphs 19 and 20 of the Administration's paper entitled "Component Two – Audit Investigation Board" (LC Paper No. [CB\(1\) 286/05-06\(03\)](#)).

case; (b) secure the removal of the non-compliance in accordance with Division 4 of Part 4 of the Bill (i.e. to seek (i) the voluntary revision of accounts under **clause 49** and, if necessary, (ii) mandatory revision of accounts under **clause 50**); or (c) carry out such other follow-up action as the FRC thinks fit. **Clause 48(3)** provides that the FRC shall notify the listed entity concerned of the decision about the follow-up action upon the completion of the enquiry, unless the FRC is satisfied itself that the notification may prejudice the enquiry or any other action by the FRC or a specified body.

16. **Clause 47(5)** provides that, in any proceedings before a court or magistrate or the Market Misconduct Tribunal or any disciplinary proceedings under the PAO, a copy of the enquiry report is admissible as evidence of the facts stated in the report. Having considered the comments of some deputations regarding the use of hearsay evidence, we have reviewed with the Department of Justice the admissibility of evidence in relevant proceedings. We accept that we should not create statutory exceptions to the rule against hearsay in **criminal** proceedings in the Bill. We will consider proposing a CSA to carve out the admissibility of enquiry reports in **criminal** proceedings<sup>23</sup>.

### *Voluntary Revision of Accounts*

17. **Clause 49**, which is modelled on section 245A of the UK Companies Act 1985<sup>24</sup>, empowers the FRC to issue a written notice to the directors of a listed corporation or the manager of a listed collective investment scheme to -

- (a) specify why, in the FRC's opinion, there is a relevant non-compliance in relation to the listed entity; and
- (b) request the directors or manager to (i) cause the relevant financial report to be revised in such manner as the FRC

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<sup>23</sup> A similar CSA will be proposed to **clause 35(5)** regarding the admissibility of an AIB's investigation report in **criminal** proceedings. Please refer to paragraph 22 of the Administration's paper entitled "Component Two – Audit Investigation Board" (LC Paper No. [CB\(1\) 286/05-06\(03\)](#)).

<sup>24</sup> See **Annex**.

considers necessary or (ii) take such other remedial action as necessary<sup>25</sup>.

### ***Mandatory Revision of Accounts***

18. It should be noted that compliance with the request referred to in **clause 49** is voluntary and that failure to comply will not amount to an offence or other sanctions. That said, **clause 50**, which is modelled on section 245B of the UK Companies Act 1985<sup>26</sup>, will come into play if the FRC has made a request to the directors of a listed corporation to voluntarily revise the accounts and they **do not comply** with the request. **Clause 50(2)** empowers the FRC to apply to the Court for (a) a declaration that there is a relevant non-compliance in relation to the listed corporation<sup>27</sup>; and (b) an order requiring the directors of the corporation to cause the relevant financial report to be revised in such manner as the Court considers necessary or take such other remedial action concerning the report as necessary. It is useful to clarify that the Court's decisions in this regard are appealable. **Clause 50(5)** further empowers the Court to give directions with respect to the audit of the revised financial reports, the consequential revision of the directors' report or the summary financial report, the notification of the relevant stakeholders, or such

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<sup>25</sup> The Bill also proposes, in **clauses 61 to 64**, consequential amendments to the CO regarding voluntary revision of accounts, filing of a warning statement in respect of any forthcoming revision, filing of revised accounts, and other related matters. The relevant clauses may be discussed when the Bills Committee proceeds to deliberate Component Five of the Bill which concerns the consequential amendments.

<sup>26</sup> See **Annex**.

<sup>27</sup> We note that some deputations are concerned that the scope of **clause 50** is only limited to *listed corporations*. 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, or any specified reports 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 *per se*, would arguably give statutory effect to such standards, rules or codes, and hence converting non-compliances with the non-statutory standards, rules or codes into legal wrongs that are subject to legal sanctions by way of a Court order. 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 *under the CO* with the accounting requirements as to the matters or information to be included in the report *as provided in the CO*. The relevant arrangements in the UK are similar.

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 "*relevant financial reports*" and "*relevant requirements*" for the purposes of **clause 50** in due course.

other matters as the Court thinks fit. Pursuant to **clauses 50(4) and (8)**, the FRC's application, as well as the Court's order and declaration, shall be sent to the SFC and to the Registrar of Companies for registration. This arrangement helps ensure the necessary disclosure of information relating to the actions in connection with the relevant non-compliances to the investing public.

19. **Clauses 50(6) to (8)** propose to empower the Court, in making the declaration of non-compliance and the order for mandatory revision of the relevant financial reports, to order that all or part of the costs and expenses incurred by the FRC in making the enquiry and application to the Court, and those incurred by the listed corporation in connection with or in consequence of revising the financial report or carrying out remedies to the report, shall be borne by the directors who were party to the approval of the relevant financial report. In so ordering, the Court shall have regard to whether each of the directors who were party to the approval of the report knew, or ought to have known, that the report did not comply with any relevant requirement, and may exclude one or more directors from the order or order the payment of different amounts by different directors. For this purpose, **clause 50(10)** states that the directors who were party to the approval of a financial report exclude any of those who shows that he took all reasonable steps to prevent the report from being so approved. As the duty of preparing accounts has all along rested primarily with the directors of the corporation, and given that the Court will have the discretion to exclude certain directors from the order in the light of circumstances, we consider **clauses 50(6), (7), (8) and (10)**, which are similar to sections 245B(4) and (5) of the UK Companies Act 1985, to be appropriate.

### ***Publication of Enquiry Reports***

20. Having regard to the public interest and the need to ensure the transparency of the FRC, we consider that there is a case for the FRC to publish enquiry reports as it sees fit. However, we are mindful of any prejudicial effect arising from such publication. In this light, **clause 47(3)** provides that the FRC *may* cause to be published an enquiry report or a part thereof. **Clause 47(4)** requires the FRC to take into account, when deciding whether or not to publish an enquiry report, the following

considerations -

- (a) whether or not the publication may adversely affect any criminal proceedings before a court or magistrate, any proceedings before the Market Misconduct Tribunal, or any disciplinary proceedings under the PAO, that have been or are 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.

21. We consider that, coupled with the proposed statutory safeguard of a “reasonable opportunity of being heard” as referred to in paragraph 14 above, the provisions have struck a reasonable balance between the need to enhance the transparency of the FRC enquiry and any prejudicial effect that may arise in respect of any publication of an enquiry report.

## **COMPARISON WITH THE INVESTIGATORY POWERS OF THE AIB**

22. The above summary sets out the overall framework of the FRRP and FRRC under the Bill. It may be useful to note that the proposed powers for a FRRC are less extensive when compared with those for the AIB. The main differences are as follows -

- (a) An investigation by the AIB may cover any persons whom the AIB has reasonable cause to believe to be in possession of information relevant to the investigation, whereas the enquiry powers by a FRRC would only be exercisable over a listed entity and its relevant undertakings, as well as any present or past officers, employees or auditors of the entity or undertakings. Moreover, a FRRC may only require the relevant persons to produce documents or records, or provide information or explanation, it is not empowered, as is the AIB,

to require any person to attend before the committee to answer questions or give reasonable assistance in connection with the enquiry; and

- (b) Failure to comply with an information-gathering requirement without reasonable excuse imposed by the AIB is an offence (c.f. **clause 31**) or may result in an application by the AIB for a Court order compelling compliance or sanctioning the failure (c.f. **clause 32**). However, a failure to co-operate with a FRRC with respect to an enquiry is not an offence, but a FRRC may apply to the Court under **clause 45** for an order that the person shall comply with the information-gathering requirement imposed by the FRRC.

23. We consider it proportionate for the enquiry powers of a FRRC to be less extensive than the investigation powers of the AIB. The issues for a FRRC to consider will more likely involve different interpretations of accounting standards or requirements, which can be contrasted with the misconduct of an auditor to be investigated by the AIB. In view of the differences, we consider the present proposed powers for a FRRC sufficient for the purpose. Our current proposal for the FRRC is also similar to the *modus operandi* of the UK FRRP under the UK Companies Act 1985.

**Financial Services and the Treasury Bureau**  
**December 2005**

## **UK Companies Act 1985**

Current through 19 October 2005

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

(1) Where--

(a) copies of a company's annual accounts, directors' report or operating and financial review have been sent out under section 238, or

(b) a copy of a company's annual accounts, directors' report or operating and financial review has been laid before the company in general meeting or delivered to the registrar,

and it appears to the Secretary of State that there is, or may be, a question whether the accounts, report or review comply with the requirements of this Act, he may give notice to the directors of the company indicating the respects in which it appears to him that such a question arises or may arise.

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

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

(a) given a satisfactory explanation of the accounts, report or review, or

(b) revised the accounts, report or review so as to comply with the requirements of this Act,

he may if he thinks fit apply to the court.

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

### **245B Application to court in respect of defective accounts**

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

(a) by the Secretary of State, after having complied with section 245A, or

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

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

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

(a) the auditing of the accounts,

(b) the revision of any directors' report, directors' remuneration report or summary financial statement, and

(c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous accounts, and such other matters as the court thinks fit.

**(3A)** If the court orders the preparation of a revised directors' report or a revised operating and financial review it may give directions with respect to--

(a) the review of the directors' report or operating and financial review by the auditors,

(b) the revision of any directors' report, directors' remuneration report, operating and financial review or summary financial statement,

(c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous report or review, and

(d) such other matters as the court thinks fit.

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

(a) the costs (or in Scotland expenses) of and incidental to the application, and

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

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

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

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

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

#### **245F Power of authorised persons to require documents, information and explanations**

**(1)** This section applies where it appears to a person who is authorised under section 245C of this Act that there is, or may be, a question whether the a company's annual accounts, directors' report or operating and financial review comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation).

**(2)** The authorised person may require any of the persons mentioned in subsection (3) to produce any document, or to provide him with any information or explanations, that he may reasonably require for the purpose of--

(a) discovering whether there are grounds for an application to the court under section 245B; or

(b) determining whether or not to make such an application.

(3) Those persons are--

(a) the company;

(b) any officer, employee, or auditor of the company;

(c) any persons who fell within paragraph (b) at a time to which the document or information required by the authorised person relates.

(4) If a person fails to comply with a requirement under subsection (2), the authorised person may apply to the court for an order under subsection (5).

(5) If on such an application the court decides that the person has failed to comply with the requirement under subsection (2), it may order the person to take such steps as it directs for securing that the documents are produced or the information or explanations are provided.

(6) A statement made by a person in response to a requirement under subsection (2) or an order under subsection (5) may not be used in evidence against him in any criminal proceedings.

(7) Nothing in this section compels any person to disclose documents or information in respect of which in an action in the High Court a claim to legal professional privilege, or in an action in the Court of Session a claim to confidentiality of communications, could be maintained.

(8) In this section "document" includes information recorded in any form.