Bills Committee on Financial Reporting Council Bill

Summary of outstanding issues of concern and proposed amendments to individual clauses of the Bill
(Position as at 22 March 2006)

Abbreviations:

Audit Investigation Board (AIB)

Chief Executive (CE)

Chief Executive Officer (CEO)

Committee Stage amendment (CSA)

Deloitte Touche Tohmatsu (Deloitte)

Ernst and Young (E&Y)

Financial Reporting Council (FRC)

Financial Reporting Review Committee (FRRC)

Financial Reporting Review Panel (FRRP)

Hong Kong Institute of Certified Public Accountants (HKICPA)

International Federation of Accountants (IFAC)

Mandatory Provident Fund Schemes Authority (MPFA)

Prevention of Bribery Ordinance (PBO)

Professional Accountants Ordinance (PAO)

Securities and Futures Commission (SFC)

Securities and Futures Ordinance (SFO)

The Association of Chartered Certified Accountants (Hong Kong) (ACCA(HK))

The Association of International Accountants – Hong Kong Branch (AIA(HK))

The Chamber of Hong Kong Listed Companies (CHKLC)

The Chartered Institute of Management Accountants – Hong Kong Division (CIMA(HK))

Clause no.	Issues of concern	Administration's responses/ proposed amendments
Clause 2	<u>Definition of "public officer"</u> AIA(HK) notes that a "public officer" is referred to in clause 7(3) and in other parts of the Bill. It may be sensible for certainty to insert a definition of this term. (Item 3.9 of LC Paper No. CB(1)166/05-06(03))	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 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 CSA to put our intent beyond doubt.
Clause 2	<u>Definition of "specified authority"</u> ACCA(HK) notes that the FRC may refer a case or complaint to a "specified body", being a "specified authority" or "specified enforcement agency". The interpretation of a "specified authority" (clause 2) includes an accountancy body that is a member of IFAC. In view of the different categories of IFAC membership possible (including affiliate membership), this requirement should refer to current full membership of IFAC. (Item 3.36 of LC Paper No. CB(1)166/05-06(03))	The definition of "*lay person*" under section 2(1) of the PAO (Cap. 50) also makes reference to "*a member of the International Federation of* Accountants". We do not think it necessary to further narrow down the scope concerning the membership of the IFAC, insofar as the definitions of "*specified authority*" and "*lay persons*" 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.
Clause 4	<u>"Relevant irregularity"</u> At the Bills Committee meeting on 6 December 2005, members noted the Administration's advice that the Bill did	The Bills Committee might examine the relevant issues during the clause-by-clause examination of the

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	not propose to create new types of irregularities in relation to auditors/reporting accountants, with a view to ensuring that the relevant irregularities investigated by the AIB could fall within the jurisdiction of the disciplinary proceedings under the PAO, and therefore ensuring that there would be smooth interface between the AIB's investigation and the HKICPA's disciplinary proceedings. Members stressed the need for the Administration to ensure the smooth interface mentioned above. The legal adviser to the Bills Committee pointed out that in the absence of the actual operational procedures, it was not clear how the interface could be effected. (Pages 13 and 14 (English version) of the Appendix of the minutes of the meeting on 6 December 2005)	Bill.
Clause 4	<u>Drafting comment</u> HKICPA is concerned whether it should be "or" instead of "and" at the end of clause 4(2)(a). (Item 3.52 of LC Paper No. CB(1)166/05-06(03))	The word "*and*" is just to join two separate definitions of "*auditing irregularity*" and "*reporting irregularity*". The use of the word "*and*" does not necessarily mean the two definitions could not function without the other.
Clause 7	<u>Appointment of members to the FRC</u> (a) Members consider it necessary to set out explicitly in clause 7(1)(c)(iv) the backgrounds and disciplines that the CE shall consider in the appointment of the four to six other members of the FRC; and (b) On the draft proposed CSA to clause 7(1)(c)(iv), the	To consider proposing a CSA to clause 7(1)(c)(iv) as shown below - "not fewer than 4, and not more than 6, other members appointed by the Chief Executive ***from among persons who, either because of their***

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	Administration is requested to take into account a member's view that some of the words in the Chinese text of the draft proposed CSA appear to be superfluous (e.g. "因而行政長官覺得適合獲委任"). (Item 1 of LC Paper No. CB(1)420/05-06(01))	***experience in accounting, auditing, finance, banking, law, administration, management, or because of their professional or occupational experience, appear to the Chief Executive to be suitable for the appointment***." (Paragraph 4 of LC Paper No. CB(1)286/05-06(02))
Clauses 7, 22 and 41	<u>Change in membership of FRRC</u> According to the Administration, a change in the membership of a FRRC during the course of an enquiry will not by itself constitute a breach of the principles of natural justice, and will not affect a FRRC's legal status and thus, the legality of evidence collected by it. The Administration is requested to examine whether the drafting of the relevant provisions in the Bill is clear enough to ensure that a FRRC's legal status, or the legality of its evidence, would not otherwise be subject to grounded legal challenge in the event of a change in its membership. (Item 4 of LC Paper No. CB(1)866/05-06(01))	To review the drafting of the relevant provisions and revert to the Bills Committee during the clause-by-clause examination of the Bill. (Item 4 of LC Paper No. CB(1)963/05-06(01))
Clause 10	<u>"Employ" and "appoint"</u> HKICPA considers that there may be contradiction between subclauses (2)(a) and 2(b) of clause 10. The word "employ" is used in subclause (2)(a), whereas "appoint" is used in subclause (2)(b). (Item 3.52 of LC Paper No. CB(1)166/05-06(03))	We consider that the above drafting is in order. A person "*employed*" under clause 10(2)(a) is an employee, while a person "appointed" 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).

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Clause 13	Drafting comment HKICPA is concerned whether the word "perform" instead of "performs" should be used in clause 13(1)(a). (Item 3.52 of LC Paper No. CB(1)166/05-06(03))	Agreed.
Clause 14	Written directions of the CE The Secretary for Financial Services and the Treasury is requested to incorporate in his speech resuming the Second Reading debate on the Bill the gist of paragraphs 13 and 14 of the paper on "Appointment to and Checks and Balances on the Proposed Financial Reporting Council" (LC Paper No. CB(1)166/05-06(02)), including the following points: (a) Clause 14 is a tool of last resort for the Administration, through the CE, to implement necessary remedial measures in the most pressing and extreme circumstances; (b) CE will take into account all prevailing circumstances, including whether there is any major malfunction on the part of the FRC, whether the reputation of Hong Kong as an international financial centre is at stake, the urgency of remedial actions required of the FRC, and whether other checks and balances are performed effectively at the time; and (c) No direction has ever been given by the CE in the past in accordance with relevant provisions in other	Agrees to consider the request. (Item 2 of LC Paper No. CB(1)420/05-06(01))

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	ordinances, as this reserve power is not intended to be used lightly. (Item 3(c) of LC Paper No. CB(1)286/05-06(01)) (Item 2 of LC Paper No. CB(1)420/05-06(01))	
Clauses 25 and 26	<u>"Relevant undertaking" and "associated undertaking"</u> AIA(HK) notes that clauses 25 and 26 provide that the investigator may require the auditor of the listed entity, or of a "relevant undertaking" of the listed entity, to produce records and documents. There are two suggestions: (a) The meanings of "relevant undertaking" and "associated undertaking" are similar. It is clearer to include "associated undertaking" in clauses 25 and 26; and	The definition of the term "*associated undertaking*", which appears in clause 54, extends the definition of "*relevant undertaking*" (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 "*associated undertaking*" is modelled on section 381(5) of SFO which is also an immunity clause in relation to the "whistle-blowing" by auditors.

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	(b) It is necessary to specifically extend the statutory obligation to produce records and documents to officers of the listed entity, a relevant undertaking, or an associated undertaking. (Item 4.9 of LC Paper No. CB(1)166/05-06(03))	For the investigation powers under clauses 25(2)(c) and 26(2)(c), we consider it sufficient and prudent to provide that the investigator may require the "*relevant undertaking*" 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. 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, ***or where the person is a corporation, an existing, or past, officer or employee of that person,*** to give an explanation, or make a statement, or matters relating to the document.
Clause 28	<u>Assistance given to the investigator</u> Deloitte considers that clause 28(1)(d) is too vague and too	The requirement of giving the investigator all

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	wide. It provides the requirement for the auditor or reporting accountant of the listed entity or the relevant person to "give the investigator all other assistance in connection with the investigation that he is reasonably able to give". Other sub-paragraphs of clause 28(1) have clearly set out all the requirements which an investigator could reasonably make of a person. (Item 4.16 of LC Paper No. CB(1)166/05-06(03))	assistance in connection with the investigation that a person is ***reasonably*** 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 provides for the investigation powers of SFC). This is a sweep-up clause which enables the investigator to conduct an investigation effectively.
Clause 28	<u>Reference to an "authorized officer"</u> AIA(HK) notes that a reference to an authorized officer assisting the investigator appears in clause 28(1)(b) and 28(6). It is clearly set out in clause 28(6) that the appointment of such a person is to assist the investigator for the purposes of clause 28(1)(b). It is not clear from clauses 25, 26 and 27 whether an authorized officer can assist the investigator for the purposes of those clauses, although clause 30 seems to suggest this can be the case in relation to clause 27. For clarity, and if this is the Administration's intention, clauses 25, 26 and 27 should contain similar references to an authorized officer as are found in clause 28. (Item 4.17 of LC Paper No. CB(1)166/05-06(03))	Clause 28(1)(b) makes a specific reference to an "*authorized officer*", 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 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 "*an authorized officer*" 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.

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Clause 31	<u>Offences relating to the requirements under clauses 25, 26, 27 or 28</u> Mr Simon YOUNG considers that: (a) there is no apparent reason why the offence in clause 31(1) should be one of strict liability. (b) the mens rea requirement of "knowledge or recklessly" should be expressly added to the provision. (Item 4.22 of LC Paper No. CB(1)166/05-06(03))	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".
Clause 31	<u>Level of fine under clause 31(13)</u> AIA(HK) notes that the proposed fine under clause 31(12) is the same as that under clause 31(13) (i.e. $1,000,000), even though the offences under subclause (13) are of a more serious nature, being "with intent to defraud". AIA(HK) suggests that the proposed fine under clause 31(13) be raised to give more deterring effect. (Item 4.23 of LC Paper No. CB(1)166/05-06(03))	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

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		period of imprisonment in relation to an offence under sub-clause (2), (3), (6) and (7) which encompasses the element of "intent to defraud". The Department of Justice has been consulted on the appropriateness of the proposed penalty levels.
Clause 34	<u>Retention of records</u> (a) Members are concerned that if no criminal proceedings are involved, the six-month retention period provided under clause 34(4)(a) will apply. Given the need to keep the records or documents for investigation and drafting of the investigation report, the six-month retention period may not be sufficient for the purpose. Moreover, such records or documents may be useful evidence supporting the AIB's investigation report, and may be used in the disciplinary proceedings of the HKICPA if the cases concerned are subsequently referred to the Institute; and (b) In connection with item (a) above, it is suggested that a provision be added to allow the FRC and AIB to apply for the extension of the record retention period when necessary. (Item 4 of LC Paper No. CB(1)866/05-06(03))	The Administration undertakes to propose a CSA to clause 34(4) to the effect that the records or documents removed under a magistrate's warrant may also be retained for such longer period as may be necessary for the purpose of the disciplinary proceedings under the PAO. (Item 10 of the list of follow-up actions for the meeting on 24 February 2006)
Clauses 35 and 47	<u>Reasonable opportunity of being heard</u> Members, E&Y, CIMA(HK) and Mr Oscar WONG are concerned whether the persons concerned will be given a	(a) To consider proposing a CSA to the effect that the AIB shall, before submitting a written report

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	reasonable opportunity of being heard before the publization of an investigation/enquiry report.	to the FRC on the findings of an investigation, give any person, who may be the subject of any criticism in the AIB's report, a reasonable opportunity of being heard. In this connection, the Administration is requested to consider a member's view that the proposed CSA should have the effect of providing the person with the right to have legal representation. (b) To consider proposing a CSA to the effect that any person who may be the subject of any criticism in a FRRC's enquiry report shall be given a reasonable opportunity of being heard. (Item 4(b) of LC Paper No. CB(1)548/05-06(01)) (Item 8 of LC Paper No. CB(1)866/05-06(01)
Clauses 35 and 47	<u>Use of hearsay evidence in criminal proceedings</u> Mr Simon YOUNG, E&Y and Deloitte consider that it is inappropriate to make the AIB's investigation report admissible as evidence in any court or disciplinary proceedings (clause 35(5)). *(Remarks: The same concern has been raised on FRRC's enquiry report (clause 47(5)).)* (Items 4.26, 4.27 and 4.28 of LC Paper No. CB(1)166/05-06(03))	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.

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Clause 39	<u>Appointment of members to the FRRP</u> *(Please refer to clause 7 mentioned above)*	To consider proposing a CSA to clause 39(1) to set out explicitly the backgrounds and disciplines that the CE shall consider in the appointment of members of the FRRP. (Item 2 of LC Paper No. CB(1)665/05-06(06))
Clause 49	<u>Post-enquiry actions of a FRRC</u> The Administration is requested to improve the drafting of the proposed CSA to clause 49(1) (Annex B to LC Paper No. CB(1)963/05-06(02)), taking into consideration members' suggestions, as follows: (a) To replace the proposed formulation "… there is or may be a question whether or not ..." in the English text of the draft proposed CSA by the formulation "… there is, or may be, a question whether or not ..."; and (b) To recast the Chinese text of the draft proposed CSA so as to facilitate readers' understanding and to start the first sentence with "如財務滙報局覺得就某上市實體 …….". (Item 3 of the list of follow-up actions for the meeting on 24 February 2006)	*(Response awaited)*

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Clause 51	<u>Preservation of secrecy</u> Members note the Administration's draft proposed CSAs to clause 51(3)(b)(ix) and (3)(c) (Annex C to LC Paper No. CB(1)963/05-06(02)) to address the concerns about the disclosure of information to the Official Receiver (OR) for him to perform the statutory duties of his two roles, i.e. the statutory duties as OR other than in the capacity of a liquidator/provisional liquidator under the Companies Ordinance (Cap. 32), and the statutory duties as OR in the capacity of a liquidator/provisional liquidator. The Administration is requested to consider and respond to some members' further views and suggestions, as follows: (a) There are two major considerations for deciding the parties to which the FRC may disclose information: Information should only be disclosed on a "need-to-know" basis, and the disclosure would not give the parties receiving the information an unfair advantage over others; (b) It is unclear why it is necessary for the FRC to disclose information to a liquidator/provisional liquidator of a listed entity which is the subject of its investigation or enquiry. The disclosure of information, particularly during the investigation or enquiry stage, may give the liquidator/provisional liquidator an unfair advantage over others and jeopardize the interest of the entity concerned;	*(Response awaited)*

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	(c) It is unclear from the draft proposed CSAs to clause 51(3)(c) whether the FRC may, apart from disclosing information to the liquidator/provisional liquidator of a listed entity which is the subject of its investigation or enquiry (Company A), also disclose information to other liquidators/provisional liquidators. If the FRC may do so, it may disclose information about the investigation or enquiry to the liquidator/provisional liquidator of a creditor of Company A (Company B). The information may enable the liquidator/provisional liquidator of Company B to take swift action to recover assets from Company A, thus giving the liquidator/provisional liquidator an unfair advantage over other creditors of Company A. The policy intent in this regard is unclear and should be clarified; and (d) From the drafting of the proposed CSAs to clause 51(3)(b) and (3)(c), it seems that the FRC may disclose any information to the OR or liquidators/provisional liquidators. There should be some restrictions on the scope of disclosure. (Item 5 of the list of follow-up actions for the meeting on 24 February 2006)	
Clause 52	<u>Avoidance of conflict of interests</u> (a) The scope of the term "interest" in clause 52(3)(a) is not clear.	(a) To propose a CSA to clarify that the term "interest" in clause 52(3)(a) means interest in securities or a collective investment

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	(b) Members stress the importance of putting in place a stringent interest disclosure regime to avoid conflict of interests. In this connection, the Administration is requested to consider and respond to the views and suggestions expressed by some members, as follows: (i) Details about the FRC's interest disclosure regime, such as the kinds of interests that required to be disclosed and the circumstances under which disclosure should be made, should be clearly set out in writing, such as in the form of a code of conduct or guideline; and (ii) Clause 52 seems to imply that a member of the FRC/AIB/FRRC should not participate in the FRC/AIB/FRRC's investigation or enquiry if conflict of interests is involved. This policy intent should be expressly stated in the Bill. While clause 52(5) provides that a member who has disclosed the nature of any interest in a matter shall not participate in the FRC/AIB/FRRC's deliberations and take part in any of its decision with respect to the matter, such a provision could only be invoked after the member has disclosed his interest. If the member does not disclose his interest, clause 52(5) could not serve its purpose. (c) Some members are concerned about the impact of non-disclosure of interests if it is found in the course of	scheme. (b) to (d) *(Response awaited)*

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	an investigation or enquiry that a member of AIB or FRRC has not disclosed his interest in the matter which is the subject of the investigation or enquiry. The Administration points out that under clause 52(8), a contravention of clause 52 does not invalidate a decision of the FRC, AIB, FRRC, or a committee established by the FRC. In members' view, clause 52(8) could not address the concern that non-disclosure of interests of members of AIB or FRRC, whether intentional or unintentional, is unfair to the parties under investigation or enquiry, and may subject the investigation or enquiry report to legal challenge. In this connection, the Administration is requested to consider and respond to the views and suggestions expressed by some members, as follows: (i) A mechanism should be provided in the Bill to deal with the situation mentioned above. A suggested option is that if it is found in the course of an investigation or enquiry that a member of AIB or FRRC has not disclosed his interest in the matter which is the subject of the investigation or enquiry, the FRC is required to review whether the same AIB or FRRC should continue with its work or the AIB or FRRC should be dissolved and reconstituted, and the review undertaken by the FRC in this regard should be recorded in the report of the AIB or FRRC; and	

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	(ii) It is not appropriate to rely on the general provisions in section 42(b) of the Interpretation and General Clauses Ordinance (Cap.1) to deal with issues relating to vacancy in the membership and dissolution of the AIB or FRRC arising from the situation mentioned above. (d) Clause 52(4) provides that the FRC shall keep a record of the particulars of the interests disclosed under the clause. There is no provision in the Bill requiring the disclosure of the record. In this connection, the Administration is requested to consider and respond to the views and suggestions expressed by members, as follows: (i) In principle, the interest disclosure record should be made available for public inspection to enhance the transparency of the operation of the FRC. However, some members are concerned that making public the interest disclosure record may have negative impact on the market and jeopardize the interests of the listed entities under investigation or enquiry. Consideration may be given to disclose in the investigation or enquiry report the interests declared and conflict of interests involved, if any. Such record will then be made public if it is decided by the FRC that the report should be made public; and	

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	(ii) If a member of the FRC, AIB, or FRRC has disclosed interest in a matter which is the subject of an investigation or enquiry but the FRC considers that: ● there is no conflict of interests involved and the member should be allowed to participate in the investigation or enquiry; or ● despite there is conflict of interests involved, the member should be allowed to participate in the investigation or enquiry, the parties under investigation or enquiry should be informed of such disclosure of interests and the FRC's decision. (Items 6 to 9 of the list of follow-up actions for the meeting on 24 February 2006)	
Clause 52	<u>Avoidance of conflict of interests</u> ACCA(HK) notes that clause 52 sets out the provisions in respect of the avoidance of conflict of interests. It 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 trust of which a member is a trustee, or any other person included in subclause (3)(b). (Item 7.4 of LC Paper No. CB(1)166/05-06(03))	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

Clause no.	Issues of concern	Administration's responses/ proposed amendments
		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.
Clause 52	<u>Avoidance of conflict of interests</u> The Law Society of Hong Kong considers that the proposed provisions in clause 52 may be too harsh. There are three points of concern: (a) The list of interest to be declared is very extensive; (b) The consequence of contravention of the provision, including omission, is severe (i.e. a fine of $1,000,000 and imprisonment for two years) (clause 52(7)). Persons appointed to serve on the governing bodies of many other statutory boards are not subject to the same onerous disclosure obligations and severe sanctions, e.g. MPFA and Town Planning Board; and (c) Given the onerous disclosure obligations and severity of the sanction, it may be difficult to persuade sufficient number of qualified and suitable candidates to take up the appointment as members of the FRC, the AIB and the FRRC. Suggests that the Administration should review the disclosure	*(Same as above)*

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	obligations and sanctions in clause 52. (Item 7.5 of LC Paper No. CB(1)166/05-06(03))	
Clause 52	<u>Avoidance of conflict of interests</u> HKICPA and Mr Peter WONG consider that consideration should be given to enunciating the general principle of avoiding bias and then providing examples of conflicts in clause 52. (Items 7.6 and 7.7 of LC Paper No. CB(1)166/05-06(03))	*(Same as above)*
Clause 52	<u>Avoidance of conflict of interests</u> Deloitte considers that several subclauses of clause 52 are exceptionally wide and confusing. Examples are: (a) Subclause (2) provides that if a person (i.e. a member of the FRC, the AIB, the FRRC or a committee established by the FRC, or a person who performs a function under the FRC Ordinance) is required to consider a matter in which he has an interest, he shall immediately disclose the nature of the interest to the FRC. However, when a matter first comes before the FRC, a member might not appreciate that there is a conflict of interest until further facts are disclosed. Hence, a member should only be required to disclose an interest immediately when he becomes aware of it; and (b) Under subclause (3)(b)(iv), a person has an interest in a	*(Same as above)*

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	matter if it relates to another person whom he knows is or was a client of a third person by whom he is or was employed; or who is or was his associate. This potentially could involve a huge range of persons. The problem is further compounded when one is taken to the definition of "associate" in subclause (9) which is also very wide. In this connection, subclause (9)(k) 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 range of conflict of interests should be more tightly drawn. (Item 7.8 of LC Paper No. CB(1)166/05-06(03))	
Clause 52	<u>Avoidance of conflict of interests</u> E&Y points out that given the nature of the type of investigations undertaken by the FRC, which may be complex, or involve an ongoing widening of focus and ongoing clarification of the situations and relationships being investigated, it may not immediately be apparent to an FRC member that a conflict of interest exists which requires disclosure under clause 52(2). E&Y suggests that the wording of clause 52(2) should be extended to include wording along the lines of "when the FRC member becomes aware, or reasonable grounds exist for him to become aware" that he is required to consider a matter in which he has an interest.	*(Same as above)*

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	(Item 7.9 of LC Paper No. CB(1)166/05-06(03))	
Clauses 43, 45 and 53	Immunity Clause 43 provides that the enquirer may require persons from the specified classes to produce any record or document, or any information or explanation, relevant to the non-compliance. Clause 45 further empowers the enquirer to apply to the court for an inquiry of any unreasonable refusal or failure to comply with the requirement under clause 43. Members are concerned that in the event that the relevant records or documents do not belong to the persons concerned, or the persons concerned are forbidden to disclose the records or documents by statutory or contractual requirements, it would be difficult for them to comply with clause 43. There should be provisions in the Bill specifying how such situations are to be dealt with. (Item 5 of LC Paper No. CB(1)665/05-06(06))	To consider proposing a CSA to clause 53 to include an additional immunity clause to the effect that a person who complies with a requirement under any provision of the Financial Reporting Council Ordinance shall not incur any civil liability to any person by reason only of that compliance. (Item 6 of LC Paper No. CB(1)866/05-06(01))
New clause 70A	Consequential amendments to the PAO Members are of the view that: (a) given that the HKICPA may initiate disciplinary proceedings against a certified public accountant who has failed to comply with a requirement of its Investigation Committee under section 34(1)(a)(vii) of the PAO, and that it is the Administration's policy intent that the AIB be set up to take over the investigation	(a) To propose CSAs to the relevant provisions of the PAO to empower the HKICPA to discipline its members who have failed to comply with an information-gathering requirement imposed by AIB or a FRRC in the investigations or enquiries. (b) To convey to the HKICPA and the future FRC

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	functions of the HKICPA in respect of suspected irregularities of the accountancy profession in relation to the audit of accounts for listed entities, it is justified to provide explicitly in the PAO that a certified public accountant failing to comply with a requirement of the AIB or a FRRC should be subject to disciplinary proceedings of the HKICPA; (b) in connection with item (a) above, it should also be noted that failure to comply with an information-gathering requirement imposed by the AIB without reasonable excuse is a criminal offence under clause 31. This forms a justifiable ground for the HKICPA to initiate disciplinary proceedings against the certified public accountant concerned; and (c) section 34(1)(a)(x) of the PAO is concerned with serious misconduct and may only be invoked for conduct which could be reasonably regarded as bringing discredit upon the HKICPA or the accountancy profession. It appears that the provision may not be readily invoked for every matter relating to accountants' non-compliance with information-gathering requirements of the AIB or a FRRC. The Administration is requested to consider members' view that administrative arrangements should be put in place for the FRC to inform the HKICPA of non-compliance of accountants with the information-gathering requirement of	members' suggestion of putting in place administrative arrangements for the FRC to inform the HKICPA of non-compliance of accountants with the information-gathering requirement of the AIB or a FRRC so as to facilitate the Institute to initiate appropriate disciplinary actions. (Items 1 and 2 of the list of follow-up actions for the meeting on 24 February 2006)

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	the AIB or a FRRC so as to facilitate the Institute to initiate appropriate disciplinary actions. (Items 6 and 7 of LC Paper No. CB(1)963/05-06(01))	
Clause 75	<u>Consequential amendments to the PBO</u> The legal adviser to the Bills Committee suggests that the reference to "Audit Investigation Board" and "Financial Reporting Review Committee" be added to Schedule 1 to the PBO. (Item 11 of the list of follow-up actions for the meeting on 24 February 2006)	Agrees to consider the suggestion.
Schedule 2	<u>Maximum period of appointment for FRC members</u> ACCA(HK) notes that clause 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. (Item 3.8 of LC Paper No. CB(1)166/05-06(03))	There is already a *general* 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.
Schedule 2	<u>Remuneration of FRC members</u> HKICPA is concerned that clause 7(1) has not specified whether the FRC members should be paid. (Item 3.52 of LC Paper No. CB(1)166/05-06(03))	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 *pro bono* basis for this

Clause no.	Issues of concern	Administration's responses/ proposed amendments
		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.
Schedule 2	<u>Meetings and proceedings of FRC</u> AIA(HK) notes that resolutions at FRC's meeting are passed by a majority vote of the members present (clause 6(8) and (9) of Schedule 2 to the Bill). However, written resolutions must be passed unanimously by all the members present in Hong Kong (clause 7 of Schedule 2 to the Bill). It is not clear why a written resolution should not be passed by a majority of the members present in Hong Kong at the time, with the same proviso as clause 6(9) of Schedule 2 to the Bill (i.e. the number of the votes that constitutes the majority, apart from the casting vote (if any), is to be 4 or more.) (Item 3.53 of LC Paper No. CB(1)166/05-06(03))	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 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. The key difference is whether there is an opportunity for discussion. We consider that, without such an opportunity, it will be more appropriate to require a unanimous vote. Section 7 of Schedule 2 to the Bill is modelled on section 7 of Schedule 2 to the Deposit Protection

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		Scheme Ordinance (Cap. 581).
Schedule 2 (FRC) Schedule 4 (AIB) Schedule 6 (FRRC)	<u>Quorum requirement for AIB and FRRC</u> Members raise the following suggestions: (a) To provide in the Bill a quorum requirement for the AIB and FRRC; and (b) To set out clearly in the Bill that a member of the FRC, AIB and FRRC, who has disclosed the nature of any interest in any matter and shall not be present during any deliberation of the FRC, AIB, or FRRC with respect to the matter, is not counted towards the quorum for the FRC, AIB and FRRC. (Item 3(b) & (d) of LC Paper No. CB(1)866/05-06(03))	(a) To propose a CSA to expressly provide that the quorum for any meeting of the AIB is to be two members, or half of its members, whichever is the greater. (b) To propose a CSA to expressly provide that the quorum for any meeting of a FRRC is to be half of its members. (c) To propose a CSA to the effect that if a member of the FRC, the AIB, or a FRRC has disclosed an interest in the matter being investigated or enquired, the member will not be counted for the purpose of forming a quorum at the relevant meeting of the FRC, the AIB, or a FRRC. (Items 1 to 3 of LC Paper No. CB(1)963/05-06(01))
Schedule 3	<u>Maximum period of appointment for the CEO</u> CHKLC notes that clause 1 of Schedule 3 to the Bill provides that the term of office of the CEO is three years and he is eligible for re-appointment. There is a loophole that a particular person may take up this position for an exceedingly long period of time if he is eligible for re-appointment every time his tenure of office is due for renewal. There is a need to impose a maximum time limit, say, not more than two	Clause 8(4) provides that the CEO of the FRC is the administrative head of the FRC. As his post is an executive post, we consider that re-appointments should be allowed. Therefore, we do not propose any limits on the number of terms a person could be appointed as the CEO of the FRC.

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	terms, to avoid this from happening. (Item 3.10 of LC Paper No. CB(1)166/05-06(03))	As for other members of the FRC, there is already a general 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.
Schedule 3	<u>Remuneration of the CEO</u> CHKLC points out that the remuneration of the CEO is not mentioned in the Bill. Consideration should be given to specify that the remuneration of the CEO be referable to a certain pay level of a civil servant of a comparable rank. (Item 3.10 of LC Paper No. CB(1)166/05-06(03))	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 clause 20.
Schedule 3	<u>Notice period for resignation and policy governing post-termination employment of CEO</u> CHKLC considers that as the CEO is a key figure of the FRC, there should be mandatory provisions on the notice period in respect of his resignation (e.g. at least three to six months) to ensure a smooth transition. To avoid actual or	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

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	possible conflict of interests and to safeguard impartiality in discharging his duties, the CEO should not be permitted to take up any position in conflict with his position as CEO within a period of 12 months after termination. (Item 3.10 of LC Paper No. CB(1)166/05-06(03))	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.
Schedule 3	<u>Removal of CEO</u> HKICPA is of the view that consideration should be given to whether the provisions in clause 4(1)(d) of Schedule 3 to the Bill (about removal of the CEO) are sufficiently stringent. (Item 3.11 of LC Paper No. CB(1)166/05-06(03))	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 punishable 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.
Schedule 6	<u>Change in membership of FRRC</u> Members are concerned whether the parties concerned would be informed of the change in membership of the FRRC. (Item 3(d) of LC Paper No. CB(1)665/05-06(06))	To consider proposing a CSA requiring the FRC or a FRRC to inform the parties concerned of the change in the membership of the FRRC. (Item 3 of LC Paper No. CB(1)866/05-06(01))

Clause no.	Issues of concern	Administration's responses/ proposed amendments
—	Protection of informers' identity Members stress the need to protect the identity of the persons who lodge complaints about relevant irregularities and relevant non-compliances in relation to listed entities to the FRC. In this connection, the Administration should make reference to section 30A of the PBO and relevant provisions in other ordinances to provide in the Bill separate provisions on "Protection of informers". (Item 2 of LC Paper No. CB(1)866/05-06(03)) (Item 10(b) of LC Paper No. CB(1)963/05-06(01))	To revert to the Bills Committee as soon as practicable. (Item 4 of the list of follow-up actions for the meeting on 24 February 2006)
—	Funding of the FRC To address the concerns raised by members of the Bills Committee and deputations about the proposed funding arrangements for the FRC, the Administration is requested to take the following actions and provide written response: (a) To further consider whether the proposed annual budget of $10 million and reserve fund of $10 million will be sufficient for the effective operation of the FRC, having regard to the following points: (i) The costs involved in— ● employing quality staff and experts, who have relevant experience and expertise but no conflict of interests, to undertake the investigation or enquiry work; ● undertaking investigations into large	To revert to the Bills Committee as soon as practicable. (Item 2 of LC Paper No. CB(1)166/05-06(01))

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	corporate scandals involving a number of listed entities; and ● any judicial review against the FRC's decisions. (ii) The future workload of the AIB and FRRCs, including increase in workload arising from the surge in the number of cases; (iii) Given the complexity of the issues involved, it may be necessary for FRC members to spend considerable time and efforts on FRC's work. Consideration should therefore be given to providing FRC members with remuneration. One of the possible options is to provide remuneration for a certain number of hours spent on FRC's work per month; and (iv) Given the Administration's advice that the proposed annual budget for the FRC has been worked out with reference to the annual expenses incurred by the HKICPA in undertaking investigations in 2003 and 2004, members highlight that some of the investigations of the HKICPA are conducted by retired audit professionals free of charge. In working out the budget for the FRC, consideration should be given to whether and how far the assistance of retired audit professionals could be solicited to take up	

Clause no.	Issues of concern	Administration's responses/ proposed amendments
	FRC's work free of charge. (b) To report to the Bills Committee as early as practicable on the outcome of the Administration's liaison with HKICPA, SFC, and the Hong Kong Exchanges and Clearing Limited on whether additional resources should be injected to the FRC. (Item 1(b) of LC Paper No. CB(1)2368/04-05(01)) (Item 2(a) and (c) of LC Paper No. CB(1)166/05-06(01)) (Item 1(b) of LC Paper No. CB(1)866/05-06(01))	

Council Business Division 1
Legislative Council Secretariat
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