



**The British
Chamber of Commerce
in Hong Kong**

LC Paper No. CB(1)2288/04-05(02)

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By fax and by mail
Fax no 2869 6794

22 September 2005

The Clerk to the Bills Committee
The Legislative Council Secretariat
3rd Floor Citibank Tower
3 Garden Road Central
Hong Kong

Dear Sir

Re Financial Reporting Council Bill

We welcome the opportunity to comment on this important Bill, and to make representations at the Bills Committee.

At present the Hong Kong Stock exchange is the ninth largest in the world in terms of market capitalisation. This is already the largest capitalisation per head of population worldwide, and this considerably benefits all people in Hong Kong, and especially personnel working in its financial services sector, a growing sector of the economy.

With many large China companies contemplating listing in Hong Kong it is entirely probable, in our view, that within 15 years the Hong Kong Stock Exchange may become one of the top three or four Stock Exchanges in the world in terms of market capitalisation. Therefore it is vital to have controls on the Hong Kong auditing profession, who, apart from the annual audit and interim statement audits are a key part of the Initial Public Offering process in particular. This Bill introduces a Financial Reporting Council ("FRC") in the form of a statutory body, to have regulatory oversight of auditors of Hong Kong listed companies and listed collective investment schemes.

At present the auditing profession is a self-regulating profession; and a registered auditor must apply to be recognized as such by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). The HKICPA does have disciplinary procedures but these are not in the public domain. In fact we cannot recall any accounting firms in Hong Kong being severely reprimanded in the past for errors or problems arising on the audits of listed companies or collective investment schemes.

There is now considerable and growing pressure on accounting firms handling listed clients owing to insufficient numbers of qualified staff. This pressure is likely to grow, in view of the demand for listings from Chinese companies, as mentioned above. To maintain the quality of listed company audits in Hong Kong, and to prevent accounting scandals from affecting the capital markets, it is vital therefore that checks and balances are implemented properly.

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We therefore fully support the implementation of the FRC and agree with the proposed modus operandi, in terms of having an Audit Investigation Board ("AIB") and also a Financial Reporting Review Council ("FRRC").

We understand that the AIB will handle investigations but in terms of fines or penalties, the SFC will in most cases impose penalties, should they be necessary. This process will particularly will need to be reviewed in the light of experience.

Whether reports will be published is left open to the Council. It is the checks and balances in the operation of the Council 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 are reported.

We attach a copy of our previous correspondence on this matter for the record, and our representative looks forward to attending the Bills committee itself.

Yours sincerely

Christopher Page
Chairman

cc: Brigadier Christopher Hammerbeck CB – Executive Director
Deborah Annells – Chief Financial Services Agreement
David Dodwell – Government Relations General Committee Member

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18 April 2005

Miss Emma Lau
For The Secretary for the Financial Services and the Treasury
Financial Services Branch
18th Floor
Admiralty Centre Tower 1
18 Harcourt Road
Central
Hong Kong

Dear Sir

**Consultation paper on Legislative Proposals to
Establish a Financial Reporting Council ("FRC")**

Thank you for inviting us to comment on these proposals, we apologise for the late submission but this has been due to the juxtaposition of Easter with other public holidays. Our thoughts are set out below.

In general we fully support the implementation of an FRC, that is to say an independent body having regulatory oversight of auditors of Hong Kong listed companies and listed collective investment schemes.

In essence we understand the proposals recommend that an FRC will be established, with enabling legislation to be tabled during this term of Legco, as an independent statutory body with a lay majority, comprising not more than 11 members including an ex officio member for the Administration and other members to be appointed by the Chief Executive.

There will be two parts to the FRC, the Audit Investigation Board ("AIB") which will investigate suspected irregularities concerning auditors, with reference to the powers presently afforded by the relevant sections of the Securities and Futures Ordinance ("SFO"). There will also be a Financial Reporting Review Committee ("FRRC") to enquire into suspected non compliance of accounts and financial statements. The FRC will have power to refer cases to relevant enforcement agencies, professional accountancy bodies and the Courts if necessary.

Turning to the particular questions raised in the Consultation paper, we comment as follows:

(a) In matters relating to the establishment of the FRC, its composition and operational structure.

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. We think any person nominated as a Member 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 rules area.

(b) On the proposed funding for the arrangements.

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We think an initial contribution of HK\$2.5m and then three years contributions of HK\$2.5m each is steep for the three bodies to bear, especially for the HKICPA; and also for the Registrar of Companies who will contribute the same amounts as a fourth funding body.

Whilst the proposal is that a special levy will be raised by the HKICPA only from those audit firms which handle listed companies and collective investments schemes audits, in practice we cannot see how this will work as an the investigation may take place some years after the irregularity, and the levy will fall unfairly on firms conducting such audits.

Since this is proposed to be a statutory body we believe the Government should fund the operations initially and the body should move towards creating 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.

- (c) Whether the proposed accountability measures are appropriate in ensuring that the FRC would perform its functions independently fairly properly and efficiently and with due propriety.

The choice of the FRC members is crucial; in addition there should be a Chairman who would lead the Board. Choice of this Chairperson is key; and it should not be anyone from the HKICPA, the SEHK, or the SFC.

- (d) Whether the proposed jurisdictions for the AIB's investigations, investigation powers for the AIB, and the proposed safeguards in relation to the exercise of these powers are sufficient and appropriate.

We agree that the AIB should pursue investigations and not also handle disciplinary matters. We also agree that the AIB should be staffed by employees of the FRC; although they may subcontract investigative work to suitable parties if required, but at all times controlling the matter and the secrecy aspects. We agree that investigations can cover the audit firm, its principals and staff, i.e. individuals, and may be instituted where there is reasonable cause to believe there has been an irregularity.

We are not sure what is intended to be covered by 5.11(h). Perhaps some examples could be given.

Where an irregularity is proved we agree 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.

- (e) Whether the proposed jurisdictions for a FRRC enquiry, enquiry powers for the FRRC, and the proposed safeguards in relation to the exercise of these powers, are sufficient and appropriate.

We agree with the "group" approach, that is to say the FRRC will comprise not less than 20 professionals, chosen by the Chief Executive, with five being chose to review any particular case, and chaired by a Panel Convener. We agree that where an error has been identified and the accounts amended, that costs of the FRRC can be recovered from the corporation, or the directors who approved the defective accounts. Again not all cases would mean recovery of costs.

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- (f) The proposed *modus operandi* in relation to the referral and publication of investigation/enquiry reports, as well as the proposed secrecy and immunity provisions

We agree that the FRC should have discretion as to whether reports about cases should be published; it is not appropriate that all cases should be published even on a no-names basis.

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.

We also agree that the publication of revised or amended accounts, after the filing of a "caution" with the Registrar of Companies.

If you require any further information you are most welcome to contact us or to request meeting

Yours sincerely

Brigadier Christopher Hammerbeck CB
Executive Director

Cc: Christopher Page – Chairman
Deborah Annells – Chair Financial Services Agreement
David Dodwell – Government Relations General Committee Member

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