12 September 2005

The Clerk to the Bills Committee
The Bills Committee on the
Financial Reporting Council Bill
Legislative Council Building
8 Jackson Road
Central

Dear Sir / Madam,

Re: Financial Reporting Council ("FRC") Bill

Thank you for your letter of 28 July 2005. We make the following submissions on the Bill: -

1. Clause 4 generally – In our submission the FRC should be restricted to launching investigations only in respect of material irregularities in the accounts of listed companies and the matter raises or appears to raise important issues affecting the public interest in the HKSAR. This latter requirement is part of the Scheme adopted by the Accountancy Investigation and Disciplinary Board in the U.K. (part of the U.K. Financial Reporting Council) on 13 May 2004. Thus the machinery of the FRC should not be used except where there are important issues which need to be examined in the public interest. Other matters should be left to normal processes of self regulation if it is deemed necessary to pursue them;

   Clause 4(3)(c) – it is our submission that this sub-paragraph is inappropriate. We know that it is included in the relevant section of the Professional Accountants Ordinance (Cap 50) ("PAO") (section 34) but in our view it is inappropriate because Clause 4 (3) also contains sub-paragraph (d) which is sufficient to encompass any negligence which would legally constitute professional misconduct. In our submission to include this sub-paragraph in the context in which it appears here will only cause complications in the conduct of enquiries and investigations because professional accountants will be more inclined to take all legal steps to oppose such an enquiry because of the obvious possible impact on any future liability in a civil action. We would go so far as to say that given that an occurrence of an act of negligence by itself is not necessarily professional misconduct we query its appropriateness even in the PAO.

2. Clause 25 – this relates to requiring an accountant to produce documents in his possession relating to a listed entity or of a relevant undertaking of that entity. We wish to draw attention to the fact that there may be problems in this regard because of the highly developed cross border nature of Hong Kong listings. There are different laws in the mainland of the People's

Republic of China relating to commercial secrets, States secrets, etc. which may inhibit Hong Kong based auditors from producing documents which are held by their associated practices there, which practices are separate independent legal entities constituted under and subject to the laws of the mainland of the People's Republic of China.

3. Clause 28(1)(d) – this sub-paragraph in our submission is too vague and too wide. The other sub-paragraphs of Clause 28(1) clearly set out all the requirements which an investigator could reasonably make of a person. What could be encompassed by the expression in sub-paragraph (d) "all other assistance in connection with the investigation that he is reasonably able to give"? Does this mean that the investigator can instruct the person to go and make photocopies of documents on his behalf or to deliver letters or documents on his behalf?

4. Clause 34 – this clause potentially applies to the premises of anybody whether they have anything to do with the listed company or the auditors or not. It has the potential to be most intrusive on innocent third parties. There is no exception in this clause for domestic premises. In our submission, domestic premises should be excluded from this power, however were the Bills Committee to consider that that would not be reasonable, we would alternatively submit that if there is to be a warrant for domestic premises then that has to be approved by a High Court judge rather than by a magistrate.

5. Clause 35(5) – in our submission this provision which seeks to make the report of an Investigation Board ("IB") admissible as evidence in any court or disciplinary proceedings is quite inappropriate. The report of the IB will no doubt contain large amounts of hearsay and expressions of opinion put forward as matters of fact. It is fundamentally inappropriate for that material to be submitted to any court or magistrate in any criminal proceedings. In our submission it is equally inappropriate to make such a report evidence in any civil proceedings. The problem is that the machinery of the FRC and the IB will be potentially misused by would be civil litigants and their lawyers in order to promote the prospect of success in later litigation. On the other hand it will have the potential to prolong and bog down the procedures of the IB because accountants, directors, other officers and their insurers will be forced to defend the investigation as if it was a rehearsal for subsequent court proceedings. This would not be in the public interest. In our submission sub-clause 5 should be limited to enabling facts stated in the report to be only prima facie evidence in the Market Misconduct Tribunal or in disciplinary proceedings under the PAO but it would not otherwise be admissible in proceedings in any court.

Whilst on the subject of prosecuting disciplinary proceedings under the PAO we note that the Bill is silent on who is to take responsibility for such a prosecution. Where a matter is of sufficient public interest for the FRC to have taken action it appears logical, practical and expedient for the FRC to fill the role of prosecutor. It is also unfair to expect the HKICPA to bear the cost of a prosecution in respect of which it has had no role.

6. Clause 36(2) – we see no reason why merely because a matter has been placed in the hand of an IB that this should deprive the FRC of the power to cease any investigation or suspend same. There appears no good policy reason why it should be so.

7. Clause 47(5) – we have the same comment as under Clause 35(5).

8. Clause 48(2) – again we have the same comment as we made in respect of Clause 36(2).

9. Clause 52 – this clause relates to avoidance of conflicts of interest of members of the FRC, the IB, a Review Committee or any other committee established by the FRC or someone who is performing functions under the proposed Ordinance. In our view these provisions, for the most part, have sought to bring some certainty to this concept. However, there are several paragraphs that we believe are exceptionally wide and confusing of interpretation and will only have the affect of discouraging people with knowledge and experience of business and the markets from wanting to be involved in the FRC's work. Our first submission is that in sub-clause (2) a person should only be required to disclose an interest immediately he becomes aware of it. We are sure members of the Bills Committee can well appreciated that when a matter might first come before the FRC a member might not appreciate that there is a conflict until further facts are disclosed and the identities of further players in the drama come to his/her attention.

   Developing our earlier point regarding the width of some of the terms of Clause 52 we draw special attention to sub-paragraph (3)(b)(iv) and we query why this sub-paragraph needs to be there. More importantly we are concerned about the potential breadth of it as it refers to a person having an interest in a matter if it relates to someone who he knows is or <u>was</u> a client of a third person by whom he is or <u>was</u> employed or who is or <u>was</u> his associate (our underlining). This potentially could involve a huge range of persons and, especially when considering the past tense, we wonder why this is necessary as it could cover very remote interests and associations that had ceased long ago and lead to needless difficulties for members of the various bodies earlier referred to. The problem is further compounded when one is taken to the definition of "associate" in sub-clause (9) which again is very wide.

   Next we would refer to sub-paragraph (k) and again make the point that this is far too wide because it relates not only to directors of a corporation and its related corporations but, in respect of the related corporations, even extends to employees. The same reference is made to a pension or provident fund or an employee share scheme of the corporation or the related corporation of that corporation. These could be very remote relationships indeed and in fact have no real impact on the matter under investigation. In our submission, the range of conflicts of interest should be more tightly drawn, otherwise, as we submitted earlier, persons of business acumen and/or lengthy experience in business and capital markets

in Hong Kong will be effectively excluded from the workings of the FRC, the IB and the Review Committee.

10. We note that there is no provision in the Bill to prevent duplicate investigations against the same auditor or accountant. In respect of an auditor, in our submission, a provision should be inserted in the Bill that, if the FRC has already commenced or decided to commence an investigation in respect of an auditor, the HKICPA should be precluded from commencing any investigation or continuing any investigation already commenced which relates to the same issue. This prevents both waste of resources by the HKICPA and prevents harassment and the oppression of the auditor who has to expend time, resources and legal expenses on fighting on two different fronts relating to the same issues. The justice of this is even more apparent when one considers that the thrust of the Bill is to really make the result of any investigation by the FRC or the IB the basis for disciplinary proceedings under the Professional Accountants Ordinance. Therefore it would be quite inappropriate for the HKICPA to be doing the same thing at the same time as the FRC or an IB is considering it.

    We also would submit on behalf of accountants who are financial controllers or finance directors of listed companies that they also have the potential to be seriously prejudiced and oppressed by multiple investigations because they may at the same time as being investigated by the FRC or an IB be also under investigation potentially by the HKICPA and the Securities and Futures Commission. This is surely not a desirable state of affairs not only because of the waste of resources but also the prejudice and an oppression of the accountant. In our submission proper regulation does not mean that a professional loses his/her rights to fair treatment.

    For the interest of members of the Bills Committee and to illustrate how in the global market in which we find ourselves this whole issue of duplicate investigations can be oppressive let us point out that if a listed company happens to have a dual listing in e.g. the United States an auditor in Hong Kong could find himself or herself subject to concurrent investigations by the FRC/IB, the HKICPA, the Unites States Securities and Exchange Commission and the Unites States Public Company Accounting Oversight Board.

We trust that the Bills Committee will find our submission persuasive and we would like to accept the invitation in your letter to attend before the Committee and further explain or expand upon the issues identified in this submission.

Yours faithfully,

Deloitte Touche Tohmatsu