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27 October 2005

Mr. Kenneth Ng
Chairman, Legal Committee
Hong Kong General Chamber of Commerce
22/F United Centre
95 Queensway
Hong Kong

Dear Mr. Ng,

Financial Reporting Council Bill

I refer to the Chamber's letter of 7 September 2005 to the Legislative Council's Bills Committee on the Financial Reporting Council Bill.

2. The Administration is pleased to note that the Chamber fully recognizes the paramount importance of our financial reporting framework which underpins Hong Kong's global competitiveness. As the Chamber is no doubt aware, the notable corporate failures (for example, Enron and Worldcom) in other parts of the world over the past few years have highlighted the importance of upgrading the effectiveness, transparency and independence of the regulatory regime for the accountancy profession in Hong Kong.

3. As a first step, the Legislative Council has enacted in July 2004 the Professional Accountants (Amendment) Ordinance 2004, which has reformed, among other things, the composition of the Council and Disciplinary and Investigation Panels of the Hong Kong Institute of Certified Public Accountants (HKICPA), which is the statutory licensing body for certified public accountants in Hong Kong. At present, the Chief Executive may appoint four lay persons to the Council of the HKICPA, and the majority of a Disciplinary Committee and an Investigation Committee of the HKICPA now comprise lay persons respectively. This has helped bring greater transparency and independence to the regulatory regime.

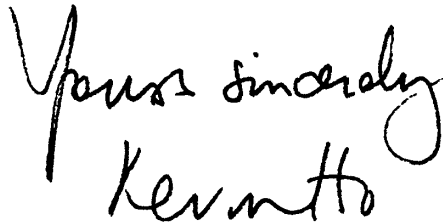
4. This notwithstanding, the HKICPA has proposed to the Administration to establish an investigatory body independent of the professional body, with a view to addressing the issue that greater degree of independence is required for investigations of auditing irregularities in relation to listed entities. It was proposed that the new statutory body, i.e. the Financial Reporting Council (FRC), should be given stronger teeth to conduct investigations and enquiries more effectively than the existing regime. We do not consider it appropriate to put the proposed FRC under the Securities and Futures Commission (SFC) or the Stock Exchange, as a certified public accountant in Hong Kong does not need to be registered with a securities regulator before becoming a company auditor. This proposal of setting up the FRC is also in line with the international trend in the oversight of auditors, and comparable bodies in other jurisdictions include the Financial Reporting Council in the United Kingdom, the Public Company Accounting Oversight Board (PCAOB) in the United States, and the Companies Auditors and Liquidators Disciplinary Board and the Financial Reporting Panel in Australia.

5. It was against the above background that the Administration formulated the Bill. We consider that the establishment of the FRC will have a significant bearing on enhancing Hong Kong's corporate governance regime and investor confidence. As similar bodies have already been set up in other leading international financial centres, Hong Kong cannot afford to lag behind.

6. Regarding the Chamber's view about the lay composition of the FRC, we wish to stress that the appointment of lay persons helps ensure the independence of the FRC. It is the Administration's intention to establish an independent FRC with a wide and balanced composition. The Chief Executive would consider appointment of candidates from different backgrounds and disciplines (such as those with experience in accounting, auditing, finance, banking, law, business administration, etc.), so that the FRC could discharge its functions effectively. Furthermore, the Bill empowers the FRC to employ persons, or assign consultants, agents or advisers, to assist the Council in the performance of its functions. The proposed lay composition is also consistent with the aforementioned reform vide the Professional Accountants (Amendment) Ordinance 2004, whereby the majority of an Investigation Committee of the HKICPA is now lay persons. Internationally, the lay majority in comparable bodies, such as the PCAOB in the United States, does not seem to be an issue either.

7. The Chamber may wish to note that the Bill was drawn up in consultation with the HKICPA, the SFC and the Hong Kong Exchanges and Clearing Limited, and in view of the strong support we received during the two public consultations in September 2003 and February 2005. The submissions recently referred to us by the Bills Committee also reveal that the Bill has received the support from many bodies.

8. In this respect, the Administration looks forward to receiving from the Chamber the support for this important Bill, as the establishment of the FRC will play a pivotal role in upgrading market quality and consolidating Hong Kong's status as an international financial centre. As always, we would continue to listen to public opinion, including any further views from the Chamber, during the scrutiny of the Bill by the Legislative Council.

A handwritten signature in black ink that reads "Yours sincerely" on the top line and "Kevin Ho" on the bottom line. The signature is fluid and cursive.

(Kevin Ho)
Permanent Secretary
for Financial Services and the Treasury
(Financial Services)

c.c.

Mr. David Eldon, GBS, JP
Chairman, Hong Kong General Chamber of Commerce
Honourable Jeffrey LAM Kin-fung, SBS, JP
Registrar of Companies
Clerk to Bills Committee on Financial Reporting Council Bill,
Legislative Council