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Report of the Bills Committee on Financial Reporting Council Bill

Purpose

This paper reports on the deliberations of the Bills Committee on Financial Reporting Council Bill.

Background

2. Quality and reliable financial reporting is of paramount importance for upgrading market quality and maintaining investors' confidence. The auditing profession is the first line of defence against defective financial reporting and in upholding corporate governance. Since 1973, the auditing profession has been subject to a self-regulatory regime under the Professional Accountants Ordinance (PAO) (Cap. 50). However, the corporate scandals in the United States (US) and suspected cases involving false financial reports of listed companies in Hong Kong in recent years have aroused considerable public concern about the integrity of the auditing profession and accuracy of financial reporting. In this connection, two parallel proposals for reform were raised, the first by the Hong Kong Institute of Certified Public Accountants (HKICPA) for the establishment of an Independent Investigation Board (IIB) and the second by the Standing Committee on Company Law Reform (SCCLR) for the establishment of a Financial Reporting Review Panel (FRRP).

3. The proposal to establish an IIB was one of the four major reform proposals put forward by the then Hong Kong Society of Accountants (HKSA) [1] in January 2003 to open up its governance structure and improve the regulatory regime. The aim of the proposal was to deal with alleged accounting, auditing and/or ethics irregularities related to listed companies. As regards the proposal to establish a FRRP, it was put forward against the background that no mechanism was in place in Hong Kong's regulatory regime to provide for the making of enquiries into compliance of companies' financial statements with the accounting requirements of the Companies Ordinance (CO) (Cap. 32), nor was there any requirement for directors to revise and re-issue financial statements. The SCCLR, in its Consultation Paper on Phase I of the

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[1] The three other reform proposals were subsequently incorporated into the Professional Accountants (Amendment) Bill 2004 sponsored by Dr Hon Eric LI, and the Bill was passed by the Legislative Council in July 2004. The title of HKSA was changed to the "Hong Kong Institute of Certified Public Accountants" under that Bill.

Corporate Governance Review issued in July 2001, proposed the setting up of a body with authority to investigate financial statements and enforce any necessary changes to companies' financial statements.

4. In September 2003, the Administration issued a consultation paper to seek public views on the two proposals. A majority of the respondents supported the establishment of the IIB and the establishment of the FRRP. When the Panel on Financial Affairs (FA Panel) was briefed on 2 April 2004 on the outcome of the public consultation on the two reform proposals, members noted the Administration's proposal to establish an independent governing board to oversee both the IIB and FRRP so that there would be one independent entity overseeing auditors and financial statements preparers. The Administration indicated that it would continue the discussion with the parties concerned on the details of the proposals and funding arrangements, and prepare the legislative amendments for implementing the proposals.

5. In early 2005, the Administration, in consultation with HKICPA, Hong Kong Exchanges and Clearing Limited (HKEx), and Securities and Futures Commission (SFC), proposed to establish a new statutory body to be called the Financial Reporting Council (FRC). The FRC would oversee both the Audit Investigation Board (AIB) (i.e. IIB in HKICPA's original proposal) and the Financial Reporting Review Committee(s) (FRRC) (i.e. FRRP in the SCCLR's original proposal). The Administration conducted a second round of public consultation on the detailed proposals about the FRC, and then briefed the FA Panel on the detailed proposals and the outcome of the consultation on 7 March and 6 May 2005 respectively. A great majority of members of the Panel indicated support in principle for the proposal to establish the FRC to enhance the oversight of the public interest activities of auditors and the transparency of the self-regulatory regime of the accounting profession. A number of concerns were, however, raised on the proposal, including whether the function of the FRC should be purely investigatory; whether a review mechanism on the actions of the FRC should be set up; and the funding arrangements for the FRC.

6. On 29 June 2005, the Administration introduced the Financial Reporting Council Bill (the Bill) into the Legislative Council (LegCo).

The Bill

7. The principal objects of the Bill are to provide for —

(a) the establishment of a FRC:

(i) to investigate irregularities committed by auditors of listed entities in the audit of accounts; and irregularities committed by reporting accountants of listed entities in the preparation of financial reports for prospectuses or other listing documents; and

(ii) to enquire into non-compliances with legal, accounting or regulatory requirements in the financial reports of listed entities;

(b) the establishment of an AIB to conduct the investigations mentioned in item (a)(i) above; and

(c) the appointment by the FRC of a FRRC to conduct the enquiries mentioned in item (a)(ii) above.

The Bills Committee

8. The House Committee agreed at its meeting on 8 July 2005 to form a Bills Committee to study the Bill. The Bills Committee first met on 19 July 2005 and Hon TAM Heung-man was elected Chairman. The membership list of the Bills Committee is in **Appendix I**.

9. Given that the Bill is a new piece of legislation containing 81 clauses and six schedules, the Bills Committee has invited the Administration to propose a work plan to facilitate the scrutiny of the Bill. According to the work plan proposed by the Administration in September 2005, it was estimated that, in addition to the first two meetings already held, 14 more meetings were required to examine the policy and drafting issues involved in the Bill. The Administration's tentative target was that the scrutiny of the Bill would be completed by June 2006 with a view to resuming the Second Reading debate on the Bill in July 2006 (i.e. before the close of the 2005-06 session). The Bills Committee endorsed the proposed work plan and scheduled a series of meetings up to June 2006. The Bills Committee completed its scrutiny work at its 20th meeting on 16 June 2006.

10. The Bills Committee has also invited the public to give views on the Bill. It received oral representation or written submissions from 37 organizations/individuals/academic. The list of the organizations/individuals/academic concerned is in **Appendix II**.

Deliberations of the Bills Committee

11. While the proposed establishment of the FRC has received support from a number of accountancy professional bodies and other bodies, the Bills Committee is aware of a few submissions expressing reservations on the need to establish this new statutory body. There were also suggestions on whether it would be more appropriate to house the relevant functions of the proposed FRC in the HKICPA or the SFC instead. Hence, the first and foremost task of the Bills Committee is to examine the need for the establishment of the FRC.

12. The Bills Committee notes that the proposal to establish an investigatory body independent of the professional accountancy bodies was initiated by the then HKSA in 2003, with a view to addressing the issue that a greater degree of independence is required to investigate auditing irregularities in relation to listed entities. The proposal was made in the context of the notable corporate failures (for example, Enron and Worldcom) in other parts of the world over the past years which highlighted the need to enhance public confidence in the auditing profession and the effectiveness, transparency and accountability of the regulatory regime. Given the wide support received during the two public consultations conducted in 2003 and 2005, the Administration considers it justified to establish the FRC as a new statutory body. The Administration also considers it not appropriate to put the proposed FRC under the SFC. Unlike the situation in Australia and the US but similar to that in the United Kingdom (UK), a certified public accountant in Hong Kong does not need to be registered with a securities regulator before becoming a company auditor. In this connection, although the SFC possesses powers to investigate market misconduct and licensed securities and futures intermediaries, the HKICPA has pointed out that it is not within the functions of the SFC under section 5 of the Securities and Futures Ordinance (SFO) (Cap. 571) to investigate the conduct of certified public accountants in respect of suspected breaches of accounting and/or professional standards.

13. The Bills Committee supports the Administration's proposal to establish the FRC to enhance the regulation of auditors and the quality of financial reporting of listed entities. The proposal is necessary as it has a significant bearing on enhancing Hong Kong's corporate governance regime and investor confidence. In this connection, the Bills Committee has examined the Bill in detail to ensure that the new statutory body will achieve its intended purposes. In particular, the Bills Committee has examined the following major issues and drawn reference to the practices of some other jurisdictions:

(a) Organizational structure and composition.

(b) Terms and conditions of appointment of members and the CEO, and related issues, including:
- Tenure of appointed members of the FRC;
- Remuneration for members of the FRC;
- Remuneration for the CEO;
- Recruitment arrangement for the CEO;
- Policy governing post-termination employment of the CEO; and
- Removal of members of FRC, AIB and FRRC, and the CEO.

(c) Functions and powers, including:
- Functions of the FRC;
- Jurisdiction and investigatory powers of the AIB;
- Enquiry powers of the FRRC; and
- Information-gathering requirements of the AIB and FRRC.

(d) Operational issues, including:

- Meetings and proceedings of the FRC;
- Change in membership of the FRC, AIB and FRRC;
- Reasonable opportunity of being heard;
- Preservation of secrecy;
- Protection of informers' identity; and
- Avoidance of conflict of interests.

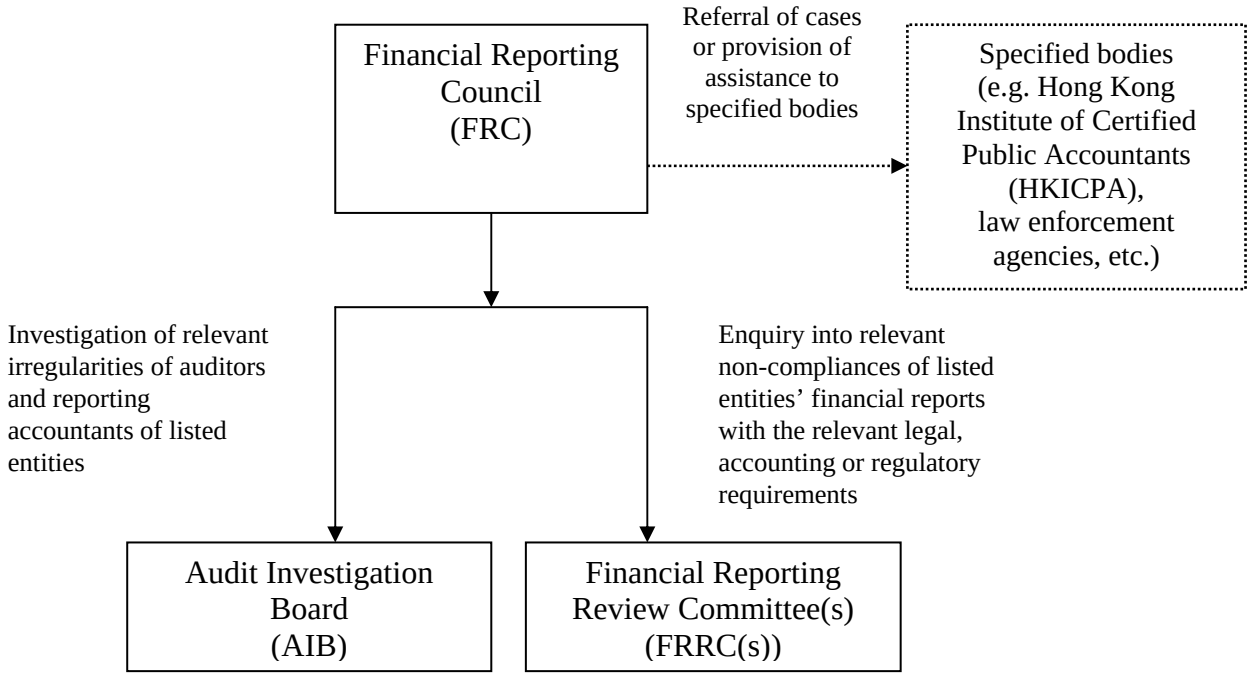
(e) Post-investigation or post-enquiry actions, including:
- Revision of financial reports; and
- Investigation reports.

(f) Checks and balances, including:
- Proposal to empower the Chief Executive (CE) to give written directions to the FRC;
- Need for introducing the "public interest" threshold;
- Need for a separate appeal tribunal; and
- Setting up of a Process Review Panel (PRP).

(g) Funding arrangement for and financial estimates of the FRC.

Organizational structure

14. The FRC will oversee both the AIB and the FRRC. Its organizational structure and relationship with the HKICPA and other specified bodies are illustrated in the following diagram:



Composition

Composition of the FRC

15. It is proposed under the Bill that the FRC comprises not more than 11 members (clause 7), namely:

(a) one ex officio member from Government, i.e. the Registrar of Companies or his representative;

(b) the Chief Executive Officer (CEO) of the FRC, as an ex officio member;

(c) three members, each nominated by the SFC, the HKEx and the HKICPA; and

(d) at least four and not more than six other appointed members.

16. The Bills Committee notes that members of the FRC assume an overseeing role in respect of the investigations carried out by the AIB and enquiries by the FRRC. It is proposed under the Bill that the majority of FRC members must be "lay persons" (i.e. non-accountants)[2], and that the CE shall appoint the Chairman of the FRC from amongst the appointed members of the FRC who are lay persons (clause 7). The Bills Committee also notes the Administration's proposal that the Chairman, who will be non-executive, shall be supported by a CEO who is the administrative head of the FRC.

17. Given that all members of the FRC (save the ex officio member from Government) will be appointed by the CE and that the members' qualification requirements are not set out in the Bill, some members of the Bills Committee are concerned that the FRC may not be able to maintain independence and there will be a lack of transparency in the appointment process. The Bills Committee considers it essential for the Administration to ensure that membership of the FRC will include a wide and balanced composition and that its members will have relevant experience and expertise but free from conflict of interests. The Administration confirms that this is its intention and that the CE will 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 can discharge its functions and oversee the work of the AIB and FRRC effectively. However, the Administration does not propose to set out in detail the qualification requirements in the Bill so as to facilitate the CE in appointing the best available candidates in the light of the actual circumstances. The proposed arrangement is consistent with the Professional Accountants (Amendment) Ordinance 2004 which prescribes no detailed

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[2] Clause 2(1) defines a "lay person" to mean a person who is not a certified public accountant within the meaning of the PAO or a member of an accountancy body that is a member of the International Federation of Accountants. This definition is modelled on section 2(1) of the PAO.

qualification requirements regarding the appointment of lay members to the Council, Disciplinary and Investigation Panels of the HKICPA. It is also consistent with the approach adopted by other local statutory bodies under the relevant ordinances, such as the SFO, the Broadcasting Authority Ordinance (Cap. 391), and the Consumer Council Ordinance (Cap. 216). Moreover, no detailed qualification requirements are set out in the legislation regarding the appointment of directors of the UK's FRC, which is a company limited by guarantee. The Sarbanes-Oxley Act of the US does not specify that the appointees to the Public Company Accounting Oversight Board should represent certain stakeholder groups, although the Act provides for a lay majority.

18. As regards the concern about the independence of the FRC, the Bills Committee is advised by the Administration that, save the ex officio members, all other members (including the Chairman) of the FRC are to be appointed by the CE to serve the Council on an ad personam basis. They do not represent the Administration, nor are they obliged to follow the wishes or instructions of any person in performing their duties as FRC members. Furthermore, clause 6(3) expressly provides that the FRC is not a servant or agent of Government. The Administration therefore does not see how the CE's power to appoint members to the FRC might impair the Council's independence. Internationally, similar bodies are also appointed by either the government or the regulator of the securities markets.

19. Given the Administration's policy intent mentioned in paragraph 17 above, some members of the Bills Committee consider that it should be set out clearly in the Bill the backgrounds and disciplines from which the CE shall consider in the appointment of the four to six other members of the FRC, and that the appointment of such members shall be made on the basis of the nominations made by the relevant bodies and stakeholders (such as associations of listed companies and legal professional bodies). In this connection, some members suggest that reference be made to the Committee Stage amendments (CSAs) moved by the Administration to the Construction Industry Council (CIC) (No. 2) Bill which prescribe in detail the composition of the new CIC and the related nomination arrangement.

20. The Bills Committee notes the Administration's view that the context of the CIC is entirely different, as the use of a "sectoral approach" in the appointment process may enable stakeholder groups (including employers; trade unions representing workers employed in the construction industry; professionals and consultants connected with construction industry; contractors, subcontractors, material suppliers, equipment suppliers in the construction industry) to be represented at the CIC with a view to forging consensus on strategic issues connected with the construction industry. However, there is no apparent need to follow such an approach regarding the appointments to the FRC, as a wide and balanced composition for the FRC is fundamental to bringing in expertise and experience to the operation of the Council rather than balancing the influence of different stakeholder groups. The Administration also points out that the CE shall appoint three members, each nominated by the SFC, the HKEx and HKICPA respectively (clause 7(1)(c)). This proposed nomination arrangement is already sufficient to help ensure that the FRC comprises appointees nominated by the relevant parties with backgrounds in securities

regulation, listing and professional accountancy. The Administration does not consider it necessary and desirable to build in additional nomination channels for the appointments.

21. The Administration remains of the view that setting out mandatory qualification requirements of individual appointees rigidly in statute is unnecessary and undesirable and that to do so may only undermine the ability of the CE to appoint the best available candidates in the light of the actual circumstances. Nevertheless, in view of the concerns of some members of the Bills Committee, the Administration agrees, to the extent that such ability will not be duly hampered, that further guidance as to how the CE will exercise the appointment power may be provided in the Bill more explicitly. Taking reference from section 4(1) of the Deposit Protection Scheme Ordinance (Cap. 581), the Administration agrees to propose a CSA to clause 7(1)(c)(iv) to the effect that the four to six lay members of the FRC will be appointed by the CE from amongst persons who, either because of their experience in accounting, auditing, finance, banking, law, administration or management, or because of their professional or occupational experience, appear to the CE to be suitable for such appointment.

Composition of the AIB

22. The AIB is to consist of the CEO of the FRC, as an ex officio member and chairman of the board; and at least one other member appointed by the FRC (clause 22). The AIB shall operate as per the direction of the FRC (clause 23), and its policies and activities shall be overseen by the FRC (clause 9(e)). Moreover, the investigation findings of the AIB shall be reported to the FRC for consideration (clause 35). It is the Administration's intention that the AIB shall be regarded as the FRC's executive arm which works on a day-to-day basis to undertake the ground investigation work. The AIB is to be headed by the CEO of the FRC who will be supported by full-time employees of the FRC and any other consultants, agents and advisers appointed by the FRC. There is no upper limit to the number of members. In the Administration's view, this arrangement enables the FRC to have the flexibility to decide on the size of the AIB in the light of caseload and resources available.

23. On the concern of some members of the Bills Committee about the selection criteria of AIB members, the Administration envisages that the FRC may appoint full-time senior investigation officers of the FRC, or other consultants, agents and advisers, to the AIB, who will assist the CEO to undertake the investigation work. Where situation warrants, the FRC may appoint members of the Council as members of the AIB.

24. The Bills Committee is concerned whether the Chairman of the AIB will be able to oversee the investigation work of all cases. The Administration advises that, while it is difficult to forecast the future workload of the AIB, reference could be made to the experience of the HKICPA where a total of 14 cases (concerning listed entities) were instigated by its Investigation Committees from 1998 to 2005 with an annual expenditure of about $3 million. In this light, the Administration does not consider

that there will be difficulties for the CEO of the FRC, who will work full time and will be supported by other members of the AIB and other employees or consultants of the FRC, to effectively discharge his duties as the Chairman of the AIB effectively. The Administration also points out that, although there will be only one AIB, it will have the ability, if necessary, to undertake several investigations concurrently as it will comprise largely, if not solely, full time employees of the FRC.

Composition of the FRRP

25. It is proposed under the Bill that the CE shall, in consultation with the FRC, appoint a FRRP of at least 20 persons (clause 39(1)). With reference to the membership base of the UK FRRP, the Administration envisages 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 of the Bills Committee, 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. In line with the proposed CSA to clause 7(1) on the appointment of members of the FRC, the Administration will propose 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.

Composition of the FRRC

26. The Bills Committee notes 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 40), and that a FRRC is to consist of at least five members of the FRRP (clause 41). One of the members is to be a Panel Convenor, who is to be the Chairman of that FRRC. Moreover, the policies and activities of a FRRC shall be overseen by the FRC (clause 9(e)), and its enquiry findings shall be reported to the FRC (clause 47).

27. Given that the arrangements for the appointment of a FRRC and its members are not stipulated in the Bill, members of the Bills Committee have raised a number of concerns. On the concern about the arrangement and criteria under which the FRC may appoint members of a FRRC, the Administration advises that in exercising the power to appoint a FRRC, the FRC must act reasonably and in good faith and on lawful and relevant grounds of public interests. The Administration envisages that the FRC will have to consider, among other things, the background and expertise of FRRP members, who shall not face a conflict of interest situation in that particular case, in making the appointment. In this light, the Administration considers that there is no need to provide for the appointment arrangements (including the administrative procedures) and the criteria in the Bill. As a point of reference, section 182 of the SFO does not contain any detailed requirements governing the arrangements or criteria under which the SFC appoints one or more persons to investigate cases concerning market misconduct.

28. Regarding the concern on whether it is necessary to provide for an upper limit to the number of members of a FRRC, the Administration advises that while the appointment of FRRC members is a matter for the FRC to decide, the Administration considers that the FRC may, where the situation warrants, appoint more than five members to a FRRC. In making the appointment, the FRC must act lawfully, reasonably and for proper purposes. The Administration sees no particular reason to propose an upper limit to the number of members of a FRRC.

Terms and conditions of appointment of members and the CEO, and related issues

29. The Bills Committee notes that the terms and conditions of appointment of the appointed members and the CEO of the FRC are to be determined by the CE (section 4 of Schedule 2 and section 3 of Schedule 3 to the Bill). Given that no details in this regard are set out in the Bill, the Bills Committee has examined the relevant issues, in particular, the tenure of appointed members; remuneration arrangement for members and the CEO; recruitment arrangement for the CEO; policy governing post-termination employment of the CEO; and removal of members of the FRC, AIB and FRRC, and the CEO.

Tenure of appointed members of the FRC

30. The appointed members of the FRC are to be appointed for a term not exceeding three years, and are eligible for reappointment (section 2 of Schedule 2 to the Bill). Some members of the Bills Committee share the concern of the Association of Chartered Certified Accountants (Hong Kong) that, as a good governance practice, there should be a maximum term for any member reappointed. Given the current policy guideline that non-official members of statutory bodies should not hold office for more than six consecutive years, some members of the Bills Committee consider that such policy guideline should be clearly set out in the Bill. They request the Administration to propose a CSA to this effect modelling on the relevant CSAs moved by the Administration to the CIC (No. 2) Bill on 24 May 2006.

31. The Administration points out that the context of the CIC is entirely different and there is no apparent need to follow the approach adopted for the CIC. While the Administration will follow the prevailing policy guideline on tenure of appointed members of statutory bodies, the Administration does not consider it necessary to prescribe in the Bill rigidly the maximum number of terms an appointed member may serve so as to allow flexibility for reappointment under the exigency of circumstances, such as where there is a need for reappointing a member of the FRC to enable him to continue to oversee an investigation or enquiry beyond his six years' service. Some members of the Bills Committee are concerned that in the absence of express provisions in the Bill in this regard, what constitutes the "exigency of circumstances" would be subject to the interpretation of the Administration. They stress the importance for the Administration to observe the policy guideline so as to enhance good governance of statutory bodies. Given that the Administration has

already amended the CIC (No. 2) Bill to set out clearly that an appointed member of the CIC may not serve continuously for more than six years, the members of the Bills Committee could not see why the same policy guideline should not be set out in this Bill. However, some other members support the Administration's view. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move a CSA to section 2 of Schedule 2 to the Bill to the effect that an appointed member of the FRC may not serve continuously for more than six years. The Administration indicates that it does not support the proposed CSA.

Remuneration for members of the FRC

32. The Administration proposes that, save the CEO of the FRC, all other members (including the Chairman) of the FRC are expected to serve on a pro bono basis. Some members of the Bills Committee consider it unreasonable for the FRC not to provide remuneration for members of the FRC/AIB/FRRC as it may be necessary for them to spend considerable time and efforts on FRC's work given the complexity of the issues involved in its investigations or enquiries.

33. The Bills Committee is advised by the Administration that the proposed arrangement is in line with the practice adopted by the HKICPA. While investigations currently undertaken by the HKICPA are done by full-time paid staff, members of its Investigation Committees, who are responsible for adjudication and oversight duties, work on a pro bono basis and receive no remuneration. The FRC would also engage full-time paid staff for conducting investigations or enquiries. As there is no provision in the Bill specifying that no remuneration would be provided for members of the FRC/AIB/FRRC, the FRC would have the flexibility to decide on the need to remunerate the members as and when necessary. A member of the Bills Committee urges that the Administration should review, in the light of the operation of the FRC, whether members of the FRC, AIB and FRRC should be offered remuneration commensurate with their work. The Bills Committee requests the Administration to consider the member's view.

Remuneration for the CEO

34. Some members of the Bills Committee consider that given the public concern that senior executives of some statutory public bodies are overpaid and objective criteria are not in place for determining pay increases for and the grant of bonuses to the senior executives, a mechanism should be provided in the Bill for determining the remuneration for the CEO. In this connection, they support the view of the Chamber of Hong Kong Listed Companies that it should be specified that the remuneration of the CEO be referable to a certain pay level of a civil servant of a comparable rank. The Administration does not consider it appropriate to prescribe rigidly the pay level of the CEO in the legislation, so as to allow flexibility for the CE in deciding the remuneration packages of individuals after taking into account, among other things, their background, capability and performance, together with the pay trends and levels in comparable bodies. The Administration envisages 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 LegCo under clause 20.

35. Some members of the Bills Committee stress the need to ensure that the CEO of the FRC is remunerated at a reasonable level. They suggest that a CSA be proposed to section 3 of Schedule 3 to the Bill to the effect that the remuneration of the CEO is to be determined with reference to the remuneration of public officers of comparable level by an independent committee appointed by the FRC for such purpose. However, some other members and the Administration do not consider the proposed CSA necessary. The Administration points out that the FRC may, like the SFC, set up a Remuneration Committee to make recommendations on the remuneration packages of its senior executives. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move the proposed CSA mentioned above. The Administration indicates that it does not support the proposed CSA. On drafting, the Administration considers it unclear what the expressions "public officers of comparable level" and "independent committee" refer to. Some members consider that the expressions are sufficiently clear.

Recruitment arrangement for the CEO

36. The Bills Committee notes the Administration's intention that an open recruitment will likely be conducted in relation to the appointment of the CEO. While some members of the Bills Committee consider it necessary to add an express provision in the Bill to make it clear that the CEO is to be recruited openly, some other members and the Administration do not see the need to do so. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move a CSA to section 1 of Schedule 3 to the Bill to set out clearly that the CEO is to be recruited openly. The Administration indicates that it does not support the proposed CSA. On drafting, the Administration considers the expression "recruited openly" unclear and that it may give rise to the question of whether open recruitment needs to be conducted upon the expiry of the CEO's three years' term. Given that the expression "recruited openly" is commonly used, some members consider that its meaning should be well understood. They share the view of the legal adviser to the Bills Committee that the proposed CSA imposes a requirement for the CEO to be recruited openly and such a requirement should apply to the first appointment but not necessarily to subsequent reappointment of the same person to the post.

Policy governing post-termination employment of the CEO

37. Referring to the improvement measures introduced by the Administration in January 2006 to tighten control on the applications for post-service employment of former directorate civil servants, some members of the Bills Committee consider that arrangements should also be made to govern the post-termination employment of the CEO of the FRC so as to avoid conflict of interest. In this connection, they note that all directorate civil servants, irrespective of their terms of appointment and

circumstances under which they leave the Government, are required to seek prior permission if they wish to take up outside work during their final leave period and/or within a specified control period[3] after they have left the Government. The members therefore suggest that a CSA be proposed to section 3 of Schedule 3 to the Bill to the effect that the FRC should set comprehensive arrangements for the post-termination employment of the CEO, including a control period of not less than 12 months commencing from the date of termination during which the CEO shall not take up any remunerative employment without the prior written approval of the FRC. However, some other members do not consider the proposed CSA necessary.

38. The Bills Committee notes the Administration's view that the arrangements governing post-termination employment should be set out in the appointment letter and not in the Bill. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move the proposed CSA mentioned above. The Administration indicates that it does not support the proposed CSA. On drafting, the Administration considers it unclear what the expressions "any remunerative employment" and "control period" refer to. The Bills Committee notes its legal adviser's view that both expressions are sufficiently clear as the provision is meant to set out the principles to be followed by the FRC which could fill out the details. As regards the expression "control period", the same expression is used by the Administration in its papers[4] presented to the Panel on Public Service (PS Panel) on its policy governing the post-service employment of former directorate civil servants.

Removal of members of FRC, AIB and FRRC, and the CEO

39. The Bill provides for the removal of the appointed members of the FRC and FRRP, and the CEO for reasons such as bankruptcy, incapacity caused by physical or mental illness, or conviction of an offence, which render them unable or unfit to perform their functions. The Administration agrees that similar provisions should be added to the Bill to provide for the removal of the appointed members of the AIB. It will propose a CSA to add the new section 1B in Schedule 4 to the Bill for this purpose.

40. As regards a FRRC, some members of the Bills Committee are concerned whether and how the appointment of a member of a FRRC could be revoked, and the circumstances under which such a power could be exercised. The Administration advises that section 42(a) of the Interpretation and General Clauses Ordinance (Cap. 1) provides that, where any Ordinance confers a power upon any person to make any appointment, then the person is also empowered to remove any person appointed in exercise of such power. In exercising the power of removal, the FRC must act

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[3] For directorate officers below D8 level or equivalent, the control period is one year for those who have left the Government after less than six years of continuous service and two years for those who have left the Government after six or more years of continuous service.

[4] Relevant papers provided by the Administration include:
(a) Paper discussed at the PS Panel meeting on 21 March 2005 (LC Paper No. CB(1)1112/04-05(05)); and
(b) Paper discussed at the PS Panel meeting on 21 November 2005 (LC Paper No. CB(1)295/05-06(03)).

reasonably and in good faith and on lawful and relevant grounds of public interests. The application of section 42(a) of Cap. 1 to the appointment of the FRRC members has not been excluded by any contrary intention appearing from the Bill[5]. As such, the Bill needs not expressly provide for the removal of a FRRC member.

41. Given that the Bill provides that the notice of appointment of members of the FRC, AIB and FRRP, and the CEO should be published in the Gazette (clauses 7, 22, 39 and 8), the Bills Committee considers that notice of removal of the members and the CEO should also be published in the Gazette as soon as practicable after the removal has been made. The Administration accepts the Bills Committee's view and agrees to include such a provision in the new section 1B in Schedule 4 to the Bill in respect of the removal of members of the AIB, and to move CSAs to the following relevant provisions accordingly:

(a) Section 5 of Schedule 2 – Removal of appointed members of the FRC;

(b) Section 4 of Schedule 3 – Removal of the CEO; and

(c) Section 2 of Schedule 5 – Removal of members of the FRRP.

Functions and powers

Functions of the FRC

42. The main function of the FRC is to investigate or enquire into, in response to a complaint or otherwise, "relevant irregularities" [6] and "relevant non-compliances"[7] in relation to listed entities (clause 9). The Bills Committee notes that, as the FRC may initiate an investigation or enquiry in response to complaints or otherwise, a complaint is not a precondition for the FRC to initiate an investigation or enquiry.

Whether the FRC's function should be purely investigatory

43. Regarding some members' concern on whether the FRC's function should be purely investigatory, the Bills Committee is advised by the Administration that during the public consultation in September 2003, the majority of respondents opined that the proposed independent investigation board (i.e. the AIB) should carry out only investigatory functions while the HKICPA should retain the disciplinary function. The

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[5] Section 2(1) of Cap. 1 provides that, save where the contrary intention appears either from Cap. 1 or from the context of any other Ordinance or instrument, the provisions of Cap. 1 shall apply to any other Ordinance in force.

[6] "Relevant irregularities" are defined in clause 4 to cover irregularities of (a) auditors in respect of the audit of accounts of a listed entity or (b) reporting accountants in respect of the preparation of financial reports for the purposes of a listing document.

[7] "Relevant non-compliances" are defined in clause 5 to cover non-compliances of financial reports of a listed entity with relevant legal, accounting or regulatory requirements.

Administration has built on this premise in developing the Bill. This proposal has the benefit of preserving the status quo of the "self-regulatory" regime of the profession, while at the same time giving stronger teeth and greater degree of independence to the "investigatory" function.

44. The Bills Committee has examined the question of whether the FRC should be empowered to "prosecute" and "sanction" an auditor after investigation of a relevant irregularity of the auditor so as to ensure a smooth interface between the investigation and disciplinary proceedings, and a timely and effective sanction of an auditor responsible for the irregularity. The Administration is of the view that the FRC should not play the role of a "prosecutor" (i.e. to present a case) against HKICPA's members in the disciplinary proceedings under the PAO and should not perform a disciplinary function. As the establishment of the FRC is to provide for an independent investigation of auditors' irregularities in relation to listed entities, the FRC should be an impartial and effective "fact-finder" to assist, instead of becoming a party to, subsequent disciplinary proceedings. However, the fact that the "investigation" and "prosecution" functions are not combined does not mean that the HKICPA needs to investigate a complaint all over again. The Administration envisages that, through the accumulation of experience and effective communication between the FRC and the HKICPA, the FRC will be able to assist the Registrar of the HKICPA to present a case against the auditor concerned in the disciplinary proceedings. Moreover, the Bill has installed the necessary framework to ensure a smooth interface between the investigations of the FRC and the disciplinary regime of the HKICPA. The Administration therefore does not consider that there will be operational difficulties in relation to the referral of cases from the FRC to the HKICPA.

45. On the disciplinary function, the Bills Committee notes the Administration's view that the ultimate decision as to whether or not an accountant should be punished for professional misconduct should lie with the HKICPA as the registration and deregistration of certified public accountants are two sides of the same coin. If the HKICPA does not have the power to discipline its members, there is little point in laying down criteria for membership of the HKICPA (i.e. registration), and the whole rationale of having a separate professional body will fall away. Since the establishment of the FRC is driven essentially by the need to enhance the effectiveness and independence of the 'investigatory" function, the Administration does not consider it desirable for the FRC to take over the disciplinary function from the HKICPA altogether.

Smooth interface between the investigation and disciplinary proceedings

46. Noting that the Administration maintains its proposal that FRC's function should be purely investigatory, the Bills Committee stresses that there should be a smooth interface between the investigations of the FRC and the disciplinary proceedings of the HKICPA and proceedings of other law enforcement agencies. As the FRC would be empowered to refer cases or complaints to the HKICPA, administrative arrangements should be put in place for the HKICPA to inform the FRC

of the follow-up action taken on the cases and their outcome. The Administration points out that the hearings of a Disciplinary Committee constituted by the HKICPA are generally held in public pursuant to section 36(1A) of the PAO (Cap. 50). In this light, the public (including the future FRC) is able to keep track of the outcome of the cases in respect of which disciplinary proceedings have commenced. Nevertheless, the Administration agrees to convey members' suggestion to the HKICPA and the future FRC for their consideration when they discuss the administrative arrangements governing the activities of the two bodies.

47. Regarding cases referred by the FRC after investigation to the HKICPA for instituting disciplinary proceedings, some members of the Bills Committee are concerned whether the Bill should provide that the HKICPA should be required to refer any fresh evidence obtained or new complaints revealed in the course of the disciplinary proceedings back to the FRC for review or further investigation. The Administration points out that, where evidence not revealed in preceding investigation is uncovered during the disciplinary proceedings, the Disciplinary Committee has powers to receive and consider the evidence, as well as to examine the witness regarding the weight of such evidence during the proceedings. Moreover, where the situation warrants, it is possible for the FRC to assist the HKICPA in considering the newly-revealed evidence. In this respect, it is within the functions of the FRC to provide assistance to a specified body on the body's dealing with the case or complaint concerned (clause 9(g)). In addition, if the evidence reveals a suspected irregularity which likely constitutes a separate case or complaint, the HKICPA may refer the new case or complaint to the FRC for any necessary investigation. The Administration considers that the Bill and the PAO already contain provisions to deal with the above-mentioned situations.

48. The Bills Committee is also advised by the Administration that clause 10(2)(d) provides that the FRC may enter into any memorandum of understanding (MoU) with other parties. It is envisaged that the FRC will, where necessary, enter into such memoranda with the HKICPA or other law enforcement agencies in relation to matters about provision of assistance and referral of cases at various stages of FRC's investigation. Moreover, the arrangement under which the HKICPA would refer cases or complaints to the FRC for investigation may also be provided in the MoU. In view of the importance of this arrangement, the Bills Committee considers that the PAO should contain an express provision to require the HKICPA to, upon receipt of a complaint concerning a "relevant irregularity" of a listed entity, refer such a complaint to the FRC. Having consulted the HKICPA, the Administration agrees to propose a CSA to add the new clause 72A for amending the PAO to this effect.

Jurisdiction of the AIB

49. The Bills Committee notes the Administration's proposal that the AIB should investigate a relevant irregularity in relation to a listed entity as it involves a wider public interest. An auditor or reporting accountant has committed an "irregularity" if he, among other things, falsified or caused to be falsified a document (clause 4(3)(a)); has been negligent in the conduct of his profession (clause 4(3)(c)); or

has been guilty of professional misconduct (clause 4(3)(d)). The Bills Committee notes some accountancy bodies' view that clause 4(3)(c) should be deleted because clause 4(3)(d) (guilty of professional misconduct) is sufficient to encompass any negligence which would legally constitute professional misconduct.

50. The Bills Committee is advised by the Administration that clause 4 is modelled on sections 34 and 41A of the PAO which set out the types of irregularities currently subject to investigations by an Investigation Committee constituted by the HKICPA. The Bill does not propose the creation of new types of "irregularities" in relation to auditors/reporting accountants, with a view to ensuring that the relevant irregularities investigated by the AIB can fall within the jurisdiction of the disciplinary proceedings under the PAO. Having considered the interest of the profession and the public, the Administration maintains its view that "negligent conduct" should retain its status as a separate "relevant irregularity" as defined in clause 4.

Investigatory powers of the AIB

51. The Bill Committee notes that the AIB's powers of investigation are modelled on those currently possessed by the SFC in relation to an investigation of a listed corporation under sections 179, 182(1) and 183 of the SFO. In this connection, a preliminary investigation may be initiated if it appears to the FRC that there are circumstances suggesting that there is a relevant irregularity in relation to a listed entity (clause 23(1) and (2)), and a more extensive investigation may be initiated if the FRC has reasonable cause to believe that there is or may be a relevant irregularity in relation to a listed entity (clause 23(3)). While the FRC may direct the AIB to investigate the relevant irregularities of auditors and reporting accountants in relation to listed entities, it also preserves the powers to investigate an irregularity by itself.

52. Noting that the FRC may, after having directed the AIB to conduct an investigation, direct the AIB to cease the investigation (clause 23(4)), some members of the Bills Committee are concerned under what circumstances the FRC may do so. The Administration advises that one of the possible situations where the FRC may direct the AIB to cease an investigation is when the investigation reveals evidence of possible commission of a criminal offence. Moreover, when the circumstances no longer suggest that there is a relevant irregularity or when the FRC no longer has reasonable cause to believe in the occurrence of an irregularity, the AIB should not continue its investigation. In this case, clause 23(4) will come into play so that the FRC may direct the AIB to cease the investigation.

53. The Bills Committee notes that the investigator (i.e. FRC or AIB) may require a relevant person to attend before the investigator and answer any relevant question (clause 28(1)(b)). In response to some members' concern about the right to legal representation entitled by the relevant person, the Administration advises that in essence, Article 35 of the Basic Law provides, among other things, that "Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies". Following this, in the course of an

investigation undertaken by the FRC, any person who is requested to attend before the investigator or to give explanation or produce documents, shall always be entitled to seek his own legal advice and to have choice of lawyers for timely protection of his lawful rights and interests. Apart from the protection guaranteed under the Basic Law, the common law rules of procedural fairness and proportionality will apply to investigation procedures of the FRC. Given that the Bill contains no provision which has the effect of abrogating or restricting such rights, the Administration does not consider it necessary to repeat in the Bill the rights guaranteed under the Basic Law.

Enquiry powers of the FRRC

54. Under the Bill, 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 (clause 40(1)). For the purpose of the enquiry, the enquirer (i.e. FRC or FRRC) may require persons from the specified classes[8] to produce any record or document, or any information or explanation, relevant to the non-compliance (clause 43). The Bills Committee notes that the proposed powers for a FRRC in Hong Kong are largely similar to those possessed by the UK FRRP.

Information-gathering requirements of the AIB and FRRC

55. The Bills Committee notes that an investigator and an enquirer are empowered under clauses 32 and 45 to apply to the court for an inquiry of any failure to comply, without reasonable excuse, with an information-gathering requirement imposed under clauses 25, 26, 27 or 28, and clause 43 respectively. On such application, the court may order the person to comply with such a requirement and punish him as if he had been guilty of contempt of court[9]. On some members' suggestion that the criteria which may constitute a "reasonable excuse" referred to in clauses 32 and 45 be set out in the Bill, the Administration considers that it should be best for the court to decide whether the failure is justified by a reasonable ground and whether the compliance should be enforced, and that it is neither necessary nor desirable to attempt to define what constitutes a "reasonable excuse" in the Bill.

56. The Bills Committee is concerned that if 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 the information-gathering requirement imposed under the relevant clauses. The Administration agrees with members that difficulties may arise where a person may run the risk of breaching the obligations under any contractual or statutory requirements and incur liability only because of compliance

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[8] The specified classes include: (a) a listed corporation; (b) a responsible person of a listed collective investment scheme; (c) a relevant undertaking (i.e. a subsidiary) of a listed entity; or (d) the past or present auditor, officer or employee of a listed entity or the entity's relevant undertaking.

[9] 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.

with a requirement given by the AIB or a FRRC. In this regard, the Administration agrees to propose a CSA to include an additional immunity clause under clause 53 to the effect that a person who complies with a requirement under any relevant provision of the FRC Ordinance shall not incur any civil liability to any person by reason only of the compliance. A similar provision is found in section 380(3) of the SFO.

57. 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 functions of the HKICPA in respect of suspected irregularities of the accountancy profession in relation to the audit of accounts for listed entities, the Bills Committee requests the Administration to consider, in consultation with the HKICPA, whether it is necessary to amend the PAO to provide that a certified public accountant who fails to comply with an information-gathering requirement imposed by the FRC should be subject to disciplinary action. The HKICPA has no in-principle objection to the Administration proposing amendments to the relevant provisions of the PAO to empower the Institute to discipline its members who have failed to comply with an information-gathering requirement imposed by the FRC in the investigations and enquiries. In this connection, the Administration agrees to propose a CSA to add the new clause 70A for the purpose. It also undertakes to convey to the HKICPA and the future FRC 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 FRRC so as to facilitate the Institute to initiate appropriate disciplinary action.

58. The Bills Committee notes that clause 31(9)[10] provides that a person is not excused from complying with an information-gathering requirement under clause 25, 26, 27 or 28 only on the ground that to do so might tend to incriminate him. Regarding some members' concern that the common law privilege against self-incriminating evidence is abrogated by clause 31(9), the Administration advises that the common law privilege against self-incriminating evidence is replaced with a statutory prohibition provided under clause 30(2) [11] against the admissibility of self-incriminating evidence in criminal proceedings in a court of law other than those in which the person is charged with an offence under clause 31 (i.e. the failure to comply with the requirements imposed on the person under clause 25, 26, 27 or 28), or under Part V of the Crimes Ordinance (Cap. 200), or for perjury, in respect of the explanation, particulars or statement, or the answer or response given. Clause 30(2) requires the person giving the information to claim the use of the statutory prohibition with a view to assisting both parties to the proceedings to quickly identify evidence that might be self-incriminating and ensuring that that such evidence will not be admitted against the person who has given the information in the first place. The person will first be reminded or informed of this limitation by the investigator before giving information or answering questions in an investigation. This claim-based requirement is modelled on section 187 of the SFO and section 145(3A) of the CO.

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[10] A similar provision is set out in clause 43(3).

[11] A similar provision is set out in clause 44(2).

59. A member of the Bills Committee is concerned whether clause 30(2) is consistent with Article 14(3)(g) of the International Covenant on Civil and Political Rights (ICCPR); and whether the statutory prohibition against the use of incriminating evidence under clause 30(2) should be extended to cover disciplinary proceedings of accountants. The Bills Committee is advised by the Administration that the Department of Justice (DoJ) is of the view that clause 30(2) is capable of being given effect to in a manner which is consistent with Article 14(3)(g) of the ICCPR (which is replicated in Article 11(2)(g) of the Hong Kong Bill of Rights), which guarantees that a person is not to be compelled to testify against himself or to confess guilt in the determination of any criminal charge against him. Clause 30(2) is modelled on section 187(2) of the SFO, section 145(3A) of the CO and section 42D(4) of the PAO. DoJ is also of the view that disciplinary proceedings under Part V of the PAO do not involve any determination of a criminal charge for the purposes of Article 11(2) of the Hong Kong Bill of Rights. Accordingly, the fact that self-incriminating evidence are not inadmissible in evidence against the person in disciplinary proceedings under clause 30(2) will not render the clause inconsistent with Article 14(3)(g) of the ICCPR.

Operational issues

Meetings and proceedings of the FRC

Enhancing transparency of the FRC

60. The Bills Committee considers that there is a need to enhance the transparency of the FRC so as to enable the public to scrutinize the performance of the Council's functions. However, given the very nature of the FRC's investigatory work, the Bills Committee is equally mindful that the effectiveness of the investigation in progress should not be undesirably hampered and that relevant persons may be adversely affected due to any premature or inappropriate disclosure of case details. Referring to the relevant CSA moved by the Administration to the CIC (No. 2) Bill on 24 May 2006 which proposes that the meetings of the CIC shall be open to the public save in certain prescribed circumstances, some members suggest that it should be set out clearly in this Bill that meetings of the FRC shall be held in public unless in some specified circumstances, such as those involving discussions on the details of investigation of an individual case.

61. The Administration considers that in overall terms the framework provided in the Bill should be sufficient to serve the need to help ensure the transparency of the FRC. The Administration does not consider it appropriate to mandate the holding of the FRC meetings in public, given that, in most circumstances, the meetings of the FRC will focus on the progress, findings and follow-up actions of an investigation or enquiry. It is also not appropriate to follow the example of the CSA to the CIC (No. 2) Bill. One of the key functions of the CIC is to advise and make recommendations to the Government on strategic matters, major policies and legislative proposals that may affect or are connected with the construction industry, whereas the FRC is primarily an

investigatory body and hence most of its meeting discussion will be on case-specific matters. Although clause 9(e) provides that one of the functions of the FRC is to approve and oversee the policies and activities of the AIB, a FRRC or any committee established by the Council, such policies and activities may likely concern either individual cases under investigation or overall investigation techniques, tactics and strategies. Hence, the holding of meetings in public may run the risk of undermining the effectiveness of the FRC's investigations and enquiries and providing further room for relevant persons engaging in irregularities to disguise the true nature of their activities. In any case, there is no provision in the Bill prohibiting the FRC from holding its meetings in public if the FRC sees fit in the light of the actual circumstances and subject to the secrecy provisions in clause 51.

62. Some members of the Bills Committee suggest that it should be set out in the Bill the requirement for the FRC to make public the major discussions and decisions made at its closed meetings, including FRC's decisions on not initiating an investigation or enquiry into a suspected auditing irregularity or financial non-compliance and the relevant reasons. The Administration considers it unnecessary and undesirable to provide such a requirement in the Bill. The Administration is particularly mindful of any suggestion mandating the disclosure of information concerning "non-pursuable" cases, as this may affect adversely relevant persons in connection with such cases. In particular, in respect of those cases carrying suspected criminal elements, it is highly undesirable for the FRC to disclose any details after the Council has ceased investigation but referred the case to the Police or other relevant agencies, as such disclosure may probably affect the subsequent investigation. The Administration considers that the proposal to convene a PRP, which will be tasked to verify whether those decisions concerning cases (including "non-pursuable" cases) have been made in accordance with the proper procedures, is already sufficient as an additional "checks and balances" measure. Furthermore, the Administration envisages that, in line with the experience of its overseas counterparts, the proposed FRC may consider maintaining a website, or publishing press releases or enforcement newsletters, to keep the public informed of its work.

Regulating the transaction of business by circulation of papers

63. The Bills Committee notes that pursuant to section 7 of Schedule 2 to the Bill, the FRC may transact business by circulation of papers, vide a written resolution 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). To prevent abuse of this provision, some members of the Bills Committee consider that new provisions should be added modelling on the CSA moved by the Administration to the CIC (No. 2) Bill on 24 May 2006 for regulating the transaction of business by circulation of papers. The effect of the relevant CSA to the CIC (No. 2) Bill is that any member of the CIC may, upon receipt of a paper issued to him by circulation, give notice in writing to the chairman requiring that the business to which the paper relates be transacted at a meeting, and the chairman shall convene the meeting accordingly. They consider that a similar CSA should be moved to this Bill. However, the Administration does not consider the proposed CSA necessary. It points out that

section 7(2) of Schedule 2 already requires a written resolution to be approved by all the members of the FRC present in Hong Kong. Notwithstanding section 7(2) of Schedule 2, a member of the FRC may, upon receipt of a paper issued to him by circulation, request that the business in question be transacted at a meeting. Some other members support the Administration's view. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move the proposed CSA mentioned above. The Administration indicates that it does not support the proposed CSA.

Rules of procedures

64. To ensure the smooth operation of the FRC, the Bills Committee also requests the Administration to consider a member's view that the FRC should make a set of rules of procedures covering the procedures of its meetings and proceedings.

Change in membership of the FRC, AIB and FRRC

65. Regarding the Bills Committee's concern on whether the turnover of members of the AIB will result in the persons under investigation being denied of a fair investigation, the Administration points out that according to the advice given by DoJ, a change in the membership of the AIB (due to, for instance, the resignation, replacement, or staggered appointments of AIB members) during the course of an investigation will not of itself constitute unfairness to the persons being investigated nor can it be considered inherently unjust.

66. However, the Bills Committee remains concerned about the impact of change in membership on the actual operation of the FRC, AIB and FRRC. For example, if one of the five members of a FRRC has been removed or has resigned during the enquiry stage, whether a new member would be appointed to the FRRC or a new FRRC would be formed to handle the same matter. In this connection, if a new member would be appointed to the FRRC to handle the same matter, it would give rise to the questions of whether the change in membership of the FRRC during the enquiry stage may be against the principle of natural justice and may subject the legal status of the FRRC and the report it made to legal challenge.

67. The Bills Committee is advised by the Administration that section 3 of Schedule 6 to the Bill provides that, if a vacancy occurs among the members of a FRRC, the FRC may appoint another member of the FRRP to fill the vacancy. Alternatively, in the very unlikely situation where most or all of the members cannot or should not continue to serve, section 42(b) of Cap. 1 empowers the FRC to dissolve the FRRC. When considering whether or not to fill the vacant membership or dissolve the FRRC entirely, the FRC must act lawfully, reasonably and for proper purposes. In situations where the FRC considers in the light of circumstances that a vacancy does not need to be filled, section 51(a) of Cap. 1 [12] will ensure that the powers of a FRRC shall not be affected by such vacancy. However, some members of the Bills

[12] Section 51(a) of Cap. 1 provides that, where any committee is established by or under any Ordinance, the powers of such committee shall not be affected by any vacancy in the membership thereof.

Committee are of the view that instead of relying on section 51 of Cap. 1, it should be set out clearly in the Bill that the powers of a FRRC shall not be affected by any vacancy in its membership.

68. Noting the Administration's position that a change in the membership of a FRRC during an enquiry will neither of itself constitute a breach of the principles of natural justice nor affect the Committee's legal status and the legality of evidence collected by it, the Bills Committee requests the Administration to review whether the drafting of the relevant provisions in the Bill may give rise to any doubts concerning this position. After review, the Administration agrees to propose a CSA to clause 41 to put it beyond doubt that a FRRC may perform any of its functions, and its proceedings are valid, despite a vacancy in its membership; a defect in the appointment or qualification of a person purporting to be a member of the FRRP or a FRRC; or a minor irregularity in the convening of any meeting of a FRRC. The Administration also agrees to propose similar CSAs to clauses 7 and 22 in respect of the FRC and AIB respectively.

69. As regards the question of whether the concerned parties will be informed of the change in the membership of a FRRC, the Bills Committee is advised by the Administration that the Bill does not prohibit the FRC or a FRRC from informing the concerned parties if it sees fit. However, to enhance the transparency of the operations of a FRRC, the Administration proposes a CSA to clause 40 to the effect that the FRC shall notify the listed entity concerned in writing of the names of the members of a FRRC upon appointment.

Reasonable opportunity of being heard

70. The Bills Committee shares the concern of some organizations which have given views on the Bill on whether a reasonable opportunity of being heard will be allowed during an investigation undertaken by the AIB, in view of the absence of an express provision to this effect in the Bill. The Administration points out that as advised by DoJ, 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. However, the Administration agrees to state its intent explicitly and to propose a CSA to clause 35 to the effect that the AIB shall, before submission of a written report to the FRC on the findings of an investigation, give any person who may be the subject of any criticism in the report a reasonable opportunity of being heard. The Administration also agrees to propose a CSA to clause 47 to provide the same requirement for the FRRC.

Preservation of secrecy

71. Clause 51(1) requires specified persons [13] to preserve the secrecy of information obtained in the course of performing their functions. However, to enable

[13] By virtue of clause 51(13), a "specified person", in essence, means the FRC and any person who performs any function under the Ordinance (including the employees of the FRC, and members of the FRC, the AIB and a FRRC).

the FRC to properly perform its functions, certain exceptions are proposed under clause 51(2) and (3) so that the prohibition in clause 51(1) does not apply to the disclosure of information in specified circumstances. For example, clause 51(3)(b)(ix) permits the disclosure of information to the Official Receiver (OR) and clause 51(3)(c)(i) permits the disclosure of information to a person who is a liquidator or provisional liquidator appointed under the CO.

72. Some members of the Bills Committee are concerned about the policy intent of, and justification for, empowering the FRC to disclose information to a liquidator and the OR. The Administration considers it justifiable to open a disclosure gateway to enable the FRC to disclose information to a liquidator to enable the liquidator to perform his functions, given that administration of the insolvent estate is not only a concern of the insolvent company and its creditors, but also carries public interest considerations concerning the protection of shareholders, employees and the investing public. In particular, investigations instituted by a liquidator during liquidation proceedings may lead to, for example, the disqualification of directors or officers under section 168H of the CO or prosecution of delinquent officers and members of the company under section 277 of the CO. The Administration also considers it justifiable to create a disclosure gateway to enable the FRC to disclose information to the OR to facilitate him to perform his numerous statutory functions as a regulator in the insolvency regime.

73. Regarding the disclosure of information to liquidators, members are concerned that if the FRC is empowered to disclose information to a liquidator of any company, it may be possible that the liquidator of "Company B" (being a creditor of "Company A" which is under investigation by the FRC) may receive information concerning the solvency of "Company A" in advance and recover assets from "Company A" ahead of other creditors. To avoid such an anomaly, the Administration agrees to propose a CSA to clause 51(3)(c) to restrict the scope of the FRC's disclosure so that the FRC may only disclose information on a listed corporation under investigation or enquiry to the liquidator of that corporation.

74. Regarding the disclosure of information to the OR, the Bills Committee notes that as the OR may act as the liquidator or provisional liquidator of a company under liquidation, he will be able to receive information from the FRC under the two disclosure gateways provided under clause 51(3)(b)(ix) and 51(3)(c)(i). This may put the OR in a more advantageous position than other liquidators. In this connection, the Bills Committee requests the Administration to review the drafting of these two subclauses, and consider the need to set out clearly that the purpose of disclosing information to OR under clause 51(3)(b)(ix) is for him to perform the statutory duties of the OR in his capacity as the OR but not for other purposes, such as the performance of the functions of a liquidator.

75. After review, the Administration agrees to propose CSAs to clause 51 to address members' concern. Having noted the draft proposed CSAs, some members are concerned that the draft may not be able to address the problem that the OR may, through the disclosure gateway under subclause (3)(b)(ix), obtain information from the

FRC about the solvency situation of a company which is under investigation by the FRC ("Company C") and then use the information to facilitate the performance of his duties as the liquidator of another company ("Company D"), which is one of the creditors of "Company C", thus gaining an unfair advantage over other creditors of "Company C". The Administration is requested to make it clear in clause 51 that the OR should not use the information disclosed to him by the FRC under subclause (3)(b)(ix) to facilitate the performance of his statutory duties as the OR in the capacity of a liquidator/provisional liquidator under the CO.

76. The legal adviser to the Bills Committee also points out that although the draft proposed CSAs to clause 51 may achieve preservation of secrecy in most of the situations, there is still the potential risk of use by the OR of the information provided by the FRC when performing his functions in a different capacity. Moreover, different officers in the OR's Office may, in assisting the OR in acting as a liquidator of a company, have access to the information provided by the FRC on a listed entity. It is not clear whether any flow of information within the OR's Office would contravene the secrecy provisions in clause 51 as there may be no disclosure to a third party.

77. The Bills Committee notes the Administration's view that, when disclosing information to the OR, the FRC would prescribe clearly the purpose of the disclosure and the relevant capacity in which the OR is given the information. To ensure proper use of information, clause 51(1) provides that a specified person should not suffer or permit any person to have access to any matter relating to the affairs of any person that comes to the specified person's knowledge in the performance of any function under the FRC Ordinance, and should not communicate any such matter to any person other than the person to whom such matter related. The Administration also points out that in recent years, the OR has outsourced most of the liquidation cases and has rarely been appointed to act as the liquidator or provisional liquidator of a company under the CO[14].

78. Regarding the scope of disclosure of information, members are concerned that 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. They consider that there should be some restrictions on the scope of disclosure. The Administration agrees to propose a CSA to the effect that any disclosure to the relevant liquidator (including the OR in the capacity of a liquidator) under clause 51(3)(c) will be subject to the same safeguards under clause 51(4)[15].

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[14] The number of cases in which the OR was appointed as a liquidator of a company in the past three years is: seven cases in 2003-04; four cases in 2004-05; and zero case in 2005-06.

[15] Clause 51(4) provides that the FRC shall not disclose information under clause 51(3)(a) or (b) unless the FRC is of the opinion that -

(a) the disclosure will enable or assist the recipient of the information to perform his functions; and

(b) it is not contrary to the interest of the investing public or to the public interest that the information should be so disclosed.

Protection of informers' identity

79. Despite the secrecy provision in clause 51, some members stress that the Bill should contain express provisions to protect the anonymity of informers who have given information to the FRC or of other persons who have assisted the FRC in an investigation or enquiry. In this connection, they suggest that the Administration should make reference to section 30A of the Prevention of Bribery Ordinance (PBO) (Cap. 201) and relevant provisions in other ordinances to provide in the Bill separate provisions on "Protection of informers". The Administration advises that the common law provides a degree of protection for informers generally and that this protection arguably extends to "informers" or "whistle-blowers" providing information to the FRC, irrespective of the existence of a specific statutory provision. Notwithstanding this, the Administration agrees to propose a CSA to add the new clause 51A to encode in statute this aspect of protection.

80. In order to achieve the purpose of protecting the identity of informers, a member considers that a witness should be forbidden to disclose the name or address of an informer. He is concerned that the expression "is not obliged to disclose" in the proposed new clause 51A(2) may carry the meaning that a witness may or may not disclose the name or address of an informer in the relevant proceedings. He therefore suggests as a matter of principle and the Administration proposes accordingly that the expression "is not obliged to" be substituted with "shall not". The Bills Committee notes its legal adviser's view that given that the new clause 51A(2) is no more than stating the position at common law, the proposed change may not ensure the protection of the identity of an informer as it has no sanction for any breach, but may affect the completeness of the evidence a witness might give in court due to the prohibition on disclosing the identity and particulars of relevant persons and in view of the wide scope of the definition of "relevant person" in the new clause 51A(6)(a) and (b). Further, the new clause 51A is an adaptation of section 30A of the PBO which was drafted purely to prevent the identity and particulars of an informer from being elicited in cross-examinations. The proposed amendment may not provide any comprehensive protection. The legal adviser considers that balancing the pros and cons of the effect of the proposed amendment, it may be preferable to retain the original wording of the new clause 51A(2) for this Bill, and that the Administration should consider, outside the context of this Bill and from a policy perspective, how, in the context of good corporate governance, the system for the protection of whistle blowers could be enhanced. The Bills Committee accepts the legal adviser's views and requests the Administration to consider these views.

Avoidance of conflict of interests

81. Given the proposed powers of the FRC, the Bills Committee agrees with the Administration about the importance of putting in place an appropriate system to ensure that members or employees of the FRC, or other persons performing a function under the Ordinance, are not involved in any conflicts of interest, as such conflicts (whether genuine or perceived) will undermine the credibility of the FRC and the effectiveness of the whole set-up. In this connection, the Bills Committee notes the

views of some organizations which have given views on the Bill about the extensiveness of the interests subject to the disclosure requirement and the consequences of non-compliance. For example, the Law Society of Hong Kong considers that, given the onerous disclosure obligations and severity of the sanctions, it may be difficult to find a sufficient number of qualified and suitable candidates to accept appointments to the FRC. The HKICPA considers that the preferred approach is to enunciate the general principles of avoiding bias rather than to define the scope of potential conflicts in such detail. The Bills Committee has therefore examined the proposed system for the disclosure of interests.

82. On the circumstances under which disclosure of an interest should be made, the Bills Committee is advised by the Administration that clause 52(2) provides that if, in the course of performing a function under this Ordinance, a person is required to consider a matter in which he has an interest, he shall immediately disclose the nature of the interest to the FRC. On the scope of the interests that are required to be disclosed, clause 52(3) provides that a person has an interest in a matter if the matter relates to a listed entity (in which he has an interest); or his, past or present, employers, clients or associates; or another person whom he knows is or was a client of his, past or present, employers or associates. Clause 52(9) defines the term "associate" to mean a close family member of a person, any corporation of which the person is a director or with which the person has a close business relationship, any employee or partner of the person, or any other related party. As regards the offence provision, clause 52(7) provides that a person who, without reasonable excuse, contravenes clause 52(2), commits an offence and is liable to a fine or an imprisonment. The Administration considers that this proposed arrangement has provided the necessary safeguards to ensure compliance with the "disclosure of interests" requirement.

83. The Bills Committee notes that in formulating clause 52, the Administration has been guided by the principle that it is necessary to put in place proper disclosure requirements that are proportionate to the proposed functions and powers of the FRC. Clause 52(3), 52(7) and 52(9) are modelled on the relevant provisions of the SFO. Having regard to the need to put in place a stringent interest disclosure regime to avoid conflict of interests, members have no objection in principle to these three subclauses.

84. Members of the Bills Committee however have raised some concerns about the provision in clause 52(5). This subclause provides that, after a member of the FRC, AIB or a FRRC has disclosed the nature of any interest in any matter, he shall not be present during any deliberation of the FRC, AIB, or a FRRC with respect to the matter, unless the FRC otherwise determines. However, in the absence of a quorum requirement[16] for the AIB and a FRRC, if some members of the AIB and a FRRC have disclosed their interest in a matter and could not participate in the deliberation with respect to that matter, it is not clear as to whether the AIB and a FRRC with the participation of very limited number of members, say, only one member, would meet the requirements on the minimum number of members set out in clauses 22(2) and

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[16] The quorum requirement for a meeting of the FRC, which is provided in section 6(4) of Schedule 2 to the Bill, is two thirds of the members of the Council.

41(1) (i.e. the AIB and a FRRC are to consist of at least two and five members respectively); and if they would, then the AIB and a FRRC with the participation of only one member may conduct enquiries and make decisions. Such an arrangement is unfair to the parties concerned and may subject the legality of the decisions made to legal challenge. The Administration agrees to propose CSAs to Schedules 4 and 6 to the Bill to respectively provide that the quorum for any meeting of the AIB is to be two members, or half of its members, whichever is the greater, and the quorum for any meeting of a FRRC is to be half of its members.

85. Regarding the concern on whether any member of the FRC, the AIB or a FRRC who has disclosed an interest in any matter will constitute the quorum required for convening the relevant meeting, the Bills Committee is advised by the Administration that, unless the FRC determines otherwise, the member is required not to be present during the deliberation of the FRC, the AIB or a FRRC (as the case may be) in respect of the matter. Thus, that relevant member will, of course, not be counted, alongside other members present, for the purpose of forming a quorum at the relevant meeting. To put this beyond doubt, the Administration agrees to propose CSAs to Schedules 2, 4 and 6 to the Bill to expressly state this position.

86. Regarding the suggestion that it should be provided expressly in clause 52(5) that a person having disclosed the nature of interest in any matter shall not be given any document relating to the matter, the Administration agrees to propose a CSA to expressly provide that the person excluded under clause 52(5) or (6) shall not be given any document, or the relevant part of it, that contains a record of, or is issued for the purpose of, the relevant deliberation, decision or determination.

87. Regarding the concern on whether particulars of the interests disclosed should be published or made known to the relevant parties who/which are the subjects of the investigation or enquiry, the Bills Committee notes the Administration's view that the publication of the disclosure particulars of a FRC/AIB/FRRC member may prematurely prejudice investigation or enquiry and the relevant parties concerned and jeopardize the operation of financial markets. As clause 52(4) already requires the FRC to keep a record of the particulars of any disclosures made, the Administration considers that latitude should be given to the FRC concerning whether to record the particulars separately in the investigation or enquiry reports, and whether, and if so to what extent, such reports should be published in accordance with the considerations set out in clauses 35 and 47.

88. However, given that the relevant auditor or listed entity will be aware of the composition of the AIB or the FRRC, the Administration agrees to propose a CSA to expressly require the FRC to notify such relevant auditor/entity of the FRC's determination under clause 52(5) that the relevant FRC/AIB/FRRC member is not to be excluded from participating in the investigation or enquiry notwithstanding his disclosure of certain interests.

Post-investigation or post-enquiry actions

Revision of financial reports

89. It is proposed under the Bill that following an enquiry into the non-compliance of a relevant financial report with the relevant accounting requirements, the FRC may specify, in a written notice issued to the listed entity concerned, why in the FRC's opinion there is a relevant non-compliance, and request the listed entity to cause the relevant financial report to be revised (clause 49). If a listed corporation does not comply with the request, the FRC may apply to the court for a declaration that there is a relevant non-compliance in the relevant financial report and an order requiring the directors of the listed corporation to revise the financial report as necessary (clause 50).

90. Some members of the Bills Committee are concerned that as the FRC is tasked to enquire into financial non-compliances of listed entities and does not have sanctioning powers, it seems not justified to empower the FRC to request listed entities to revise their defective financial reports. Such a request may imply that there is a relevant non-compliance in relation to the listed entity concerned and the reporting accountant concerned has failed to prepare the reports in accordance with the relevant financial standards. It is doubtful as to whether the FRC should make a positive assertion that there is a relevant non-compliance in relation to a listed entity without giving the parties concerned an opportunity to respond to the FRC's findings. Such an assertion is against the principles of law and principles of natural justice. The question of whether there is a relevant non-compliance in relation to a listed entity and the reporting accountant concerned should be determined by the court or the relevant disciplinary body.

91. The Bills Committee notes the Administration's advice that the proposals enshrined in clauses 49 and 50 seek to implement the recommendations made by the SCCLR in the context of Phase I of the Corporate Governance Review. The Administration envisages that, during an enquiry into the relevant non-compliances of a financial report of a listed entity, a FRRC may form an opinion on whether and why there are non-compliances with respect to the financial report and how these non-compliances should be rectified. The Administration considers it appropriate to empower the FRC, having considered the findings of a FRRC, to request the listed entity to revise the defective financial report as prompt remedial actions in this respect will enable the investing public to have the more reliable financial report in order to appraise the financial position of the listed entity concerned. That said, if the listed entity does not agree with the FRC's opinion and does not voluntarily revise its financial report, the FRC has no authority to impose a sanction under clause 49. However, the FRC may apply to the court for mandatory revision of the report under clause 50 or, if the situation warrants, the FRC may refer the case to the HKICPA, HKEx or SFC for any follow-up actions with respect to the non-compliances found.

92. Some members of the Bills Committee are concerned that as listed entities' compliance with the FRC's request under clause 49 is voluntary and that non-

compliances with such request will not amount to an offence or other sanctions, the listed entities concerned may not comply with the FRC's request. While the FRC may apply to the court for an order under clause 50, the court's decisions in this regard are appeallable. As a result, the FRC may be involved in lengthy legal proceedings, thus incurring substantial legal costs. In this connection, the Administration advises that, since the proposed framework for a FRRC under the Bill is modelled on that of the UK FRRP under the Companies Act 1985, the UK's experience is relevant. While the UK FRRP also possesses the power to apply to the court for mandatory revision of financial reports under section 245B of the Companies Act, compliance following the enquiry has been voluntary and, to date, the UK FRRP has succeeded in resolving all cases without any recourse to court. The Administration envisages that the UK's experience may shed light on the future operation of clauses 49 (concerning voluntary revision) and 50 (mandatory revision under a court order).

93. Some members of the Bills Committee consider that sections 245A and 245B of the UK Companies Act 1985, on which clauses 49 and 50 are modelled, are much carefully worded to avoid giving a positive assertion that the financial report of the company concerned has failed to comply with the requirements of the Act. In this connection, the Bills Committee requests the Administration to review the drafting of clauses 49 and 50 with reference to relevant provisions in the UK Companies Act 1985. In particular, consideration should be given to revise the drafting of clause 49(1) to the effect that the positive assertion "there is a relevant non-compliance …" in that subclause be replaced by the formulation used in section 245A(1) of the UK Companies Act 1985, i.e. "there is, or may be, a question whether….''; and the FRC is required to issue a notice to the listed entity concerned indicating the respects in which it appears to the FRC that a question of a relevant non-compliance arises or may arise and specifying a period for the listed entity and the persons concerned to give an explanation (section 245A(1) and (2) of the UK Companies Act 1985). After review, the Administration agrees to propose CSAs to clauses 49 and 50 to closely align the two clauses with the relevant provisions in the UK Companies Act 1985.

Investigation reports

94. Clause 35 requires the AIB to submit to the FRC written reports on the findings of the investigation. Clause 35(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 investigation report is admissible as evidence of the facts stated in the report. The intent of this provision is to ensure that there should be a smooth interface between the investigations of the FRC and the disciplinary proceedings of the HKICPA and proceedings arising from the actions of the law enforcement agencies to which the cases are referred by the FRC. However, the Bills Committee shares the concern of some organizations which have given views on the Bill that written reports, which would most likely contain hearsay evidence, are normally not admissible in a criminal trial. After review, the Administration accepts that statutory exceptions to the rule against hearsay in criminal proceedings should not be easily created. The Administration agrees to propose a CSA to clause 35 to carve out the admissibility of the investigation reports in criminal proceedings as evidence of

the facts stated therein. It also agrees to propose a CSA to clause 47 to the same effect in respect of the enquiry reports of the FRRC.

Checks and balances

95. To enable the FRC to function independently and with due propriety, the Bills Committee considers that there should be an effective mechanism whereby the FRC is accountable for its work and is subject to adequate checks and balances. In this connection, the Bills Committee notes that the Administration, after making reference to the arrangements of other statutory bodies such as the SFC and the Hong Kong Deposit Protection Board, proposes to put in place in the Bill checks and balances measures, including clause 14 which provides that the CE may, after consultation with the Chairman of the FRC, and on being satisfied that it is in the public interest to do so, give the FRC written directions as he thinks fit with respect to the performance of any of its functions. The Bills Committee has examined in great detail the need for empowering the CE to give written directions to the FRC. It has also examined the need for introducing the "public interest" threshold for the FRC to launch its investigations or enquiries; the need for setting up an appeal tribunal to hear appeals against the FRC's decisions; and the need to set up a PRP.

Proposal to empower the CE to give written directions to the FRC

96. Given some members' concern that clause 14 may undermine the independence of the FRC, the Bills Committee requests the Administration to reconsider the need for such a provision. The Administration considers clause 14 necessary to enable it to continue to account to LegCo and the public for effective regulation of the accountancy profession. The Administration stresses that the power of giving directions under clause 14 can only be exercised by the CE subject to three restrictions: the direction must be in the public interest; the CE must first consult the Chairman of the FRC; and the directions must be with respect to the performance of the FRC's function as stipulated in clause 9. These three restrictions are included in the Bill in order to strike a reasonable balance between protecting the public interest and ensuring the FRC's independence in performing its day-to-day functions.

97. The Administration also stresses that 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. The CE will not give directions to the FRC unless it is necessary in the public interest and that, in doing so, he will have taken into account all circumstances prevailing at the time. These circumstances may include 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, etc.

98. The Administration further points out that the reserve power for the CE to take remedial and other necessary action is not unique to the FRC and is, in fact, fairly

common in the case of comparable statutory bodies. Similar provisions providing for the CE's reserve power are found in, for example, sections 11 of the SFO and section 10 of Clearing and Settlement Systems Ordinance (CSSO) (Cap. 584). No direction has ever been given by the CE in the past in accordance with the aforementioned Ordinances, as this reserve power is not intended to be used lightly.

99. While some members of the Bills Committee support the Administration's proposal to empower the CE to give written directions to the FRC, some other members express great reservations on the need to do so. The latter members consider that if the CE is given such power, it is essential to ensure that the CE would exercise the power under clause 14 in an appropriate manner. In this connection, they suggest that the circumstances under which the CE may exercise the power under clause 14 should be set out clearly in the Bill. Moreover, for the purpose of enhancing transparency, it should be set out clearly in the Bill that the CE's written directions to the FRC should be made public, though not immediately when the directions are given but at an appropriate time, so as to enable the public to know what directions have been given by the CE to the FRC and the circumstances involved. The members also request the Administration to clarify whether the CE's written directions to the FRC are subject to judicial review.

100. The Administration reiterates that clause 14(1) has already provided that the power of giving directions can only be exercised by the CE subject to three restrictions. In this light, the Administration considers that the clause as it is drafted have already prescribed the necessary checks and balances on the CE's reserve power, which is not intended to be used lightly. The Administration considers that the present drafting of clause 14 is appropriate and does not require amendment. The Administration also points out that there is no provision in the Bill prohibiting the disclosure of the written directions given by the CE to the FRC. The CE will decide whether to make public such written directions, and if so, in what manner, in light of actual circumstances. Given that the nature and content of the written directions could not be anticipated at the present stage, it is not appropriate to mandate the disclosure of the directions. There are also no similar requirements in other Ordinances (for example, section 11 of the SFO and section 10 of CSSO) to mandate the CE to make such disclosure.

101. The Administration confirms that the CE's power under clause 14, being a statutory power, would be regarded by the court as being of a public nature and amenable to judicial review.

102. In response to some members' suggestion, the Administration agrees that the Secretary for Financial Services and the Treasury (SFST) would incorporate in his speech resuming the Second Reading debate on the Bill the gist of paragraphs 97 and 98 above, 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 ordinances, as this reserve power is not intended to be used lightly.

103. Whilst appreciating that the SFST would incorporate the above points in his speech resuming the Second Reading debate on the Bill, some members consider that as the speech does not form part of the Bill, the preferred approach is for the Administration to incorporate those points in clause 14. Moreover, they remain concerned about the need to enhance the transparency of the written directions given by the CE to the FRC. A suggested option is that it should be set out in the annual report of the FRC whether the CE has exercised his power under clause 14. The Administration advises that under clause 35, the FRC may cause an investigation report, or any part of the report, to be published. There is no provision in the Bill prohibiting the disclosure of the CE's written directions in the report. In this connection, in deciding whether or not to cause an investigation report, or any part of the report, to be published, the FRC should take into account the factors set out in the proposed new subclause (6) of clause 35, including whether or not the publication may adversely affect any criminal proceedings before a court or any proceedings under Part V of the PAO that have been or are likely to be instituted; whether or not the publication may adversely affect any person named in the report; and whether or not the report, or that part of the report, should be published in the interest of the investing public or in the public interest.

104. A member suggests that the conditions set out in the proposed new subclause (6) of clause 35 be adopted for clause 14 to the effect that the CE's written directions should be disclosed if the disclosure would not adversely affect any relevant proceedings that have been or are likely to be instituted and any person concerned, and the disclosure would be in the interest of the investing public or in the public interest. The Administration advises that clause 14 is modelled on the relevant provisions of the SFO. Given that the current arrangement under SFO has been working well, it is appropriate to adopt the same arrangement for the FRC. The Administration's stance is that the CE's written directions may be disclosed if circumstances permitted. However, given that the nature and content of the written directions could not be anticipated at the present stage, it is not appropriate to mandate the disclosure of the directions.

105. Some members accept the Administration's stance and express reservations on the proposal to mandate the disclosure of the CE's written directions, as the disclosure may have adverse impacts on the market and the parties concerned.

106. However, some other members are of the view that as the functions and powers of the FRC are different from those of the SFC, it is not appropriate for the Administration to model clause 14 on the relevant provisions of the SFO. While the SFC, which is a regulator of the securities and futures industry, has a wide range of functions, the FRC mainly performs an investigatory or enquiry function. The members are also concerned whether the arrangement for the executive bodies to give directions to statutory bodies is in line with the arrangement in other jurisdictions. The Administration advises that the arrangement for empowering the CE to give written directions to some statutory bodies in the financial services sector is made to cater for the circumstances in Hong Kong and the same arrangement is not particularly found in other jurisdictions. However, the Administration believes that such an arrangement has not affected Hong Kong's status as an international financial centre.

107. Hon Emily LAU is of the view that no adverse impact of the arrangement has been identified because the CE has so far not exercised his power under the SFO and other relevant ordinances to give written directions. However, if the same arrangement is adopted for the FRC, when the CE decides to exercise his power to give written directions but not to disclose the directions, the public would never know that the CE has given the directions and the impact of such directions. If there are rumours spreading around that the CE has given written directions to the FRC and yet the directions are not disclosed, it may also have an adverse impact on the market and the parties concerned. Hon Emily LAU is very much concerned that the proposed arrangement under clause 14 is not in line with international practices and is therefore not conducive to the development of a good business environment in Hong Kong. She requests that these points be set out in the report of the Bills Committee.

108. The Administration points out that different jurisdictions have different frameworks governing the operation of market regulators. The different frameworks adopted by other jurisdictions may enable them to use other means of control or influences over the market regulators. Nevertheless, the proposed arrangement under clause 14 is the same as that under the SFO and other relevant ordinances, which has been working well in Hong Kong for some years. The Administration reiterates that clause 14 is a tool of last resort for the Administration, and the CE would not use the power under the clause lightly. In this connection, some members expect that the CE would act in accordance with the requirements in clause 14 and ensure that the three conditions set out in clause 14(1) are met before exercising his power.

109. Hon Ronny TONG considers that the CE should not be empowered to give written directions to the FRC. However, if the Administration maintains its view that the CE should be given such power, the power should be restricted. It is envisaged that the scope of the written directions to be given by the CE to the FRC may be confined to three aspects, i.e. to direct the FRC: to undertake an investigation; to discontinue or not to undertake an investigation; and to vary its decisions. In Mr TONG's view, the second and third aspects are the areas of concern. He therefore proposes that the following CSAs be moved to clause 14 by the Bills Committee:

(a) To stipulate that the CE may, on being satisfied that the FRC, in the performance of its functions, has committed a serious and apparent error in failing to investigate a relevant irregularity or relevant non-compliance and it is in the public interest to do so, give the FRC such written directions as he thinks fit directing the same to correct the said error and to properly investigate the said relevant irregularity or relevant non-compliance in accordance with the requirements of this Ordinance; and

(b) To delete clause 14(3).

110. Members have diverse views on Hon Ronny TONG's proposal. Given that the proposal is not supported by a majority of the members present, it is not endorsed by the Bills Committee. Mr TONG indicates that he will move the proposed CSAs. The Administration indicates that it does not support the proposed CSAs.

Need for introducing the "public interest" threshold

111. The Bills Committee notes that some accountancy professional bodies consider that FRC investigations and enquiries should be launched only when significant public interests are involved. In this connection, the Administration considers it not necessary to introduce the additional "public interest" threshold. First of all, the FRC will investigate auditors' irregularities and enquire into non-compliances of financial reports only in relation to listed entities. Cases concerning listed entities should be of sufficient public interest *per se*, as such irregularities and non-compliances have a bearing on the quality of listed entities' financial reporting which underpins the market quality and investor confidence in Hong Kong as an international financial centre. There is no need to further require those cases involving listed entities to satisfy any "public interest" test, as there is already a demonstrably far greater degree of "public interest" in "listed entities" than "unlisted entities".

Need for a separate appeal tribunal

112. On the need to set up an appeal tribunal to hear appeals against the FRC's decisions, the Bills Committee notes the Administration's position that it is not necessary to establish such an appeal tribunal, as the FRC's role is mainly confined to investigatory and enquiry work and the FRC is not vested with any disciplinary power to sanction any person or impose a penalty on its own. The investigation or enquiry and the referral of cases to a specified body by the FRC are too remote from the determination of a civil right or obligation of the person to which the case or complaint relates. As a benchmark comparison, there is no particular appeal mechanism against an investigation by the Investigation Committee of the HKICPA and the HKICPA Council's decision to refer a case to a Disciplinary Committee. The Administration also points out that any party aggrieved by the action of the FRC may apply to the court for a judicial review of the action concerned. Moreover, both the disciplinary decisions under the PAO and the court's decisions regarding the revision of accounts under clause 50 of the Bill are appeallable.

Setting up of a Process Review Panel

113. On some members' concerns about the transparency of the FRC's operations, particularly in respect of its decisions to initiate an investigation or otherwise, the Bills Committee invites the Administration to put in place a mechanism to review the operations of the FRC.

114. Whilst appreciating that it is important for the FRC to earn pubic confidence and trust, the Administration points out that part of its work, together with its investigatory decisions, is necessarily subject to the secrecy requirements under clause 51. However, given that some members of the public may wish to know whether or not the FRC is taking or has taken appropriate action in response to a complaint, the Administration proposes to convene a non-statutory PRP, which is independent of the FRC. This proposed PRP is essentially aimed to conduct reviews of the FRC's operational procedures to ensure that they are fair and reasonable, and to determine whether, in handling cases or taking actions or decisions, the FRC has followed its internal due process procedures (including procedures for ensuring consistency). The concept of a PRP is modelled on a similar non-statutory Panel for the SFC, in which case the Panel focuses on process rather than reviewing the merits of any case. The Administration proposes that the PRP shall make regular reports to SFST on its findings. Through the publication of such reports, to the extent permitted within the statutory constraints of secrecy and confidentiality, the public will be better able to know FRC's activities. The Administration will make reference to the existing PRP for the SFC in devising the detailed framework (including the terms of reference and membership) for the convening of the PRP for the FRC, after the Bill has been passed and prior to the establishment of the FRC.

115. The Bills Committee welcomes the Administration's proposal to set up an independent PRP. However, some members consider that the proposed ambit of the PRP should be expanded to cover the review of the FRC's decision on not initiating investigations or enquiries into "non-pursuable" cases. The Administration points out that the PRP will receive and consider periodic reports from the FRC on all completed and "non-pursuable" cases. The proposed PRP may call for and review the FRC's files to verify whether the decisions made and the actions taken in relation to certain cases or complaints (including any "non-pursuable" ones) have been adhered to and are consistent with the relevant procedures and guidelines, and advise the FRC accordingly. Although the proposed PRP for the FRC will focus on process rather than reviewing the merits of any cases, the experience of the PRP for the SFC which adopts a similar approach has proved to be effective in helping ensure that the SFC exercises its powers in a fair and consistent manner.

116. On the composition of the proposed PRP, the Bills Committee notes the Administration's preliminary view that the Panel may comprise members from, for example, the accounting, auditing, academic, legal, other financial services sectors, as well as some ex-officio members representing the FRC and the Administration.

Funding arrangement for the FRC

117. The Bills Committee notes that the Government, HKEx, HKICPA and SFC have agreed to contribute to the funding of the FRC on an equal share basis. The Government's contribution would be funded by the Companies Registry Trading Fund (CRTF). The CRTF would also provide free office accommodation for the FRC. Under the original proposal, each of the four parties would contribute $2.5 million per annum for the first three years, plus a one-off contribution of up to $2.5 million as contingency funding. The funding arrangement from the fourth year onwards would be reviewed later on, in the light of actual operational experience. The detailed funding agreement would be effected through a MoU among the four parties.

118. Given that the funding arrangement for the FRC is not incorporated in the Bill, a member is concerned whether this approach is consistent with those adopted by other regulators, such as the SFC. In this connection, section 14 of the SFO provides that for each financial year of the Commission, the Government shall pay to the Commission out of the general revenue the moneys appropriated by LegCo for that purpose. The Bills Committee is advised by the Administration that in general, if the funding of a statutory body comes from the moneys appropriated by LegCo, such an arrangement is normally set out in the relevant ordinance. As the funding of the FRC is to come from four parties, it is appropriate to set out the arrangement in a MoU among the four parties.

119. The Bills Committee stresses that sufficient funding should be made available to the FRC for the effective performance of its functions. In this connection, members share the concern of some organizations which have given views on the Bill that the proposed annual budget and contingency fund may not be sufficient for the effective operation of the FRC. The Administration is therefore requested to consider, in consultation with the other three funding parties, whether additional resources should be injected to the FRC, having regard to the estimated workload of the FRC, including possible increase in workload arising from the surge in the number of cases; estimated costs involved in undertaking investigations and enquiries, in particular large corporate scandals involving a number of listed entities (e.g. costs for appointing competent staff and experts, who have relevant experience and expertise); and the need for the FRC to meet substantial legal costs arising from litigations against its decisions.

120. On the caseload of the FRC, the Administration considers that the caseload may fluctuate from time to time depending on many factors, such as the business cycle and the enhancement of the regulatory framework. Nevertheless, in working out the funding arrangement for the FRC, reference has been made to the number of investigations, in relation to listed entities, instigated by HKSA/HKICPA's

Investigation Committees since 1998[17]. According to HKICPA, a total of 14 cases were instigated by its Investigation Committees from 1998 to 2005 with an annual expenditure of about $3 million.

121. On resource requirements, the Bills Committee is assured that the Administration will be guided by the principles that it is necessary to maintain a lean structure for the FRC but that, at the same time, the resources available to the FRC should be adequate for it to discharge its functions effectively.

122. As regards investigation costs, the Administration points out that the FRC is empowered to recover investigation costs from cases where the complaints are proven (clauses 37, 71 and 80). Moreover, contingency funding shall be available for the FRC to cover any shortfall in the recurrent funding and meet the exigencies of circumstances (for instance, an unexpected heavier caseload, the need to recruit additional employees to deal with certain complex cases, legal fees, etc.).

123. The Bills Committee, however, considers it prudent for the Administration and the other three funding parties to review the funding arrangement. After review, the Administration advises that the four funding parties consider that the proposed recurrent funding of $10 million per annum should be sufficient to cover the operating expenses of the FRC in the first three years and cater for some future fluctuations in price levels and occasional rise of investigation costs as a result of any upsurge of caseload and complexity of individual cases. However, the four parties have agreed to double the amount of the contingency funding for the FRC. In other words, each party will contribute an amount of $5 million (i.e. a total of $20 million) as the contingency funding for the FRC for the first three-year period.

124. The Bills Committee has no objection to the revised funding arrangement. Some members are concerned that while the caseload of HKICPA's Investigation Committees remains small, the number of relevant cases may increase after the establishment of the independent FRC. They consider that, where necessary, additional funding beyond the agreed commitments should be sought from the four funding parties so that the FRC's investigation or enquiry work would not be hindered by the lack of funds. In this connection, members are assured by the Administration that there is a strong wish on the part of the four funding parties for the successful operation of the FRC. The four parties have agreed that they will seriously consider any justified request made by the FRC for additional funding beyond the current commitments.

Financial estimates of the FRC

125. The Bills Committee notes that the FRC is required under clause 17 to submit to SFST for his approval estimates of the income and expenditure of the Council for the next financial year. Given that the Government is one of the funding

[17] Since the introduction of investigatory powers in the PAO in 1994, no cases were filed for investigation until 1998.

parties of the FRC, some members stress the need to enhance the transparency of the FRC's expenditure so as to enable the public to know how the public moneys involved are to be used. They support a member's suggestion that, along the lines of section 13 of the SFO, provisions should be added to clause 17 requiring the Administration to cause the estimates of the FRC's income and expenditure to be laid on the table of LegCo. The Administration, however, considers the original provision in clause 17 to be appropriate, taking into account the fact that no funding approval by LegCo is proposed for the FRC. At the request of the Bills Committee, the Administration has sought the views of the other three funding parties of the FRC on the proposed amendment. According to the Administration, the three parties concerned do not support the proposed amendment.

126. Members have diversified views on the proposed amendment mentioned above. After deliberation, the Bills Committee decides by a majority of the members present that the Chairman will, on behalf of the Bills Committee, move a CSA to clause 17 to effect the proposed amendment. The Administration indicates that it does not support the proposed CSA.

Committee Stage amendments

127. The Bills Committee supports the CSAs proposed by the Administration.

128. On behalf of the Bills Committee, the Chairman will move the CSAs mentioned in the following paragraphs of this report:

(a) Tenure of appointed members of the FRC (paragraphs 30 and 31);

(b) Remuneration for the CEO (paragraphs 34 and 35);

(c) Recruitment arrangement for the CEO (paragraph 36);

(d) Policy governing post-termination employment of the CEO (paragraphs 37 and 38);

(e) Regulating the transaction of business by circulation of papers (paragraph 63); and

(f) Financial estimates of the FRC (paragraphs 125 and 126).

129. Hon Ronny TONG will move CSAs to clause 14 in his personal capacity. Relevant discussions are set out in paragraphs 109 and 110 of this report.

Recommendation

130. The Bills Committee supports the Administration's proposal that the Second Reading debate on the Bill be resumed on 12 July 2006.

Consultation with the House Committee

131. The House Committee, at its meeting on 23 June 2006, supported the recommendation of the Bills Committee in paragraph 130 above.

Council Business Division 1
Legislative Council Secretariat
7 July 2006

附錄I
Appendix I

《財務匯報局條例草案》委員會
Bills Committee on
Financial Reporting Council Bill

委員名單
Membership List

主席 **Chairman**	譚香文議員	Hon TAM Heung-man
委員 **Members**	何俊仁議員	Hon Albert HO Chun-yan
	呂明華議員, SBS, JP	Dr Hon LUI Ming-wah, SBS, JP
	陳智思議員, GBS, JP	Hon Bernard CHAN, GBS, JP
	陳鑑林議員, SBS, JP	Hon CHAN Kam-lam, SBS, JP
	單仲偕議員, JP	Hon SIN Chung-kai, JP
	黃宜弘議員, GBS	Dr Hon Philip WONG Yu-hong, GBS
	劉慧卿議員, JP	Hon Emily LAU Wai-hing, JP
	林健鋒議員, SBS, JP	Hon Jeffrey LAM Kin-fung, SBS, JP
	梁君彥議員, SBS, JP	Hon Andrew LEUNG Kwan-yuen, SBS, JP
	湯家驊議員, SC	Hon Ronny TONG Ka-wah, SC
	(總數：11位委員) (Total : 11 members)	
秘書 **Clerk**	陳美卿小姐	Miss Salumi CHAN
法律顧問 **Legal Adviser**	顧建華先生	Mr KAU Kin-wah
日期 **Date**	2005年7月19日 19 July 2005	

Appendix II

Bills Committee on
Financial Reporting Council Bill

List of organizations, individuals and academic submitted/presented views on the Bill

Organizations

* 1. Hong Kong Stockbrokers Association Limited
* 2. The Association of International Accountants – Hong Kong Branch
* 3. British Chamber of Commerce in Hong Kong
* 4. Deloitte Touche Tohmatsu
* 5. The Chamber of Hong Kong Listed Companies
* 6. The Hong Kong Society of Financial Analysts Limited
* 7. Hong Kong Institute of Certified Public Accountants
* 8. CPA Australia – Hong Kong China Division
* 9. The Chartered Institute of Management Accountants – Hong Kong Division
10. The Chinese General Chamber of Commerce
11. Mandatory Provident Fund Schemes Authority
12. Office of the Privacy Commissioner for Personal Data, Hong Kong
13. The Office of The Ombudsman
14. KPMG Tax Limited
15. Standing Committee on Company Law Reform
16. Hong Kong General Chamber of Commerce
17. Hong Kong Trustees Association Ltd
18. The Association of Chartered Certified Accountants (Hong Kong)
19. The Law Society of Hong Kong (Companies and Financial Law Committee and Securities Law Committee)
20. The Hong Kong Chinese Enterprises Association
21. Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies
22. Securities and Futures Commission
23. The Hong Kong Institute of Chartered Secretaries
24. National Institute of Accountants of Australia – China Branch

25. Ernst and Young

26. Hong Kong Bar Association

Member of Hong Kong Institute of Certified Public Accountants' Disciplinary Panels or Investigation Panels

* 27. Mr CHAN Sai-hoi

* 28. Mr Benny KWOK Kai-bun

* 29. Miss Peggy LIAO Zi-yin

* 30. Mr Anthony WU Ting-yuk

* 31. Mr Charles CHOW Chan-lum

* 32. Mr Peter H Y WONG

33. Mr Oscar WONG Sai-hung

Individuals and academic

* 34. Mr YUEN Shu Tong

35. Mr Simon YOUNG, Associate Professor, Faculty of Law, The University of Hong Kong

36. Mr David GUNSON

37. Dr Peter P F CHAN

Remark:

"*" denotes those organizations the representatives of which or individual who have attended Bills Committee meeting(s).