

**For Discussion  
8 April 2008**

**Legislative Council  
Panel on Financial Affairs**

**Progress Report on  
the Work of the Financial Reporting Council**

**PURPOSE**

The Financial Reporting Council (“FRC”), a new statutory body to investigate audit irregularities and enquire into non-compliances of financial reporting of listed entities, became fully operational on 16 July 2007. The FRC briefed Members on its preparatory work for full operations on 5 July 2007. This paper serves to update Members on the work progress of the FRC since 16 July 2007.

**WORK PROGRESS**

2. The FRC was established to uphold the quality of financial reporting in Hong Kong, enhance the protection for investors and increase investors’ confidence, thereby reinforcing Hong Kong’s status as an international financial center. The FRC has been faithfully carrying out its functions in accordance with the FRC Ordinance (Cap. 588) since it began full operation on 16 July 2007. Below is a brief account of our progress –

***Discharge of Statutory Functions***

3. The key function of the FRC is to investigate or enquire into suspected cases of audit irregularities and non-compliances of financial reporting. In this regard, the Council receives complaints from the public or referrals from other regulators. To assist the Council in discharging its key function, two subsidiary organs, the Audit Investigation Board (“AIB”) and Financial Reporting Review Committee (“FRRC”), have been set up. The AIB, which is tasked to investigate into complaints on audit irregularities, is chaired by the Chief Executive

Officer of the FRC with three professional Secretariat staff as members. In this regard, the Council has invited three highly experienced certified public accountants to serve on an Advisory Panel as its honorary advisers on audit investigations. On the other hand, the Council would appoint a FRRC for enquiry into each complaint on non-compliance in financial reporting. Each FRRC would comprise 5 members drawn from the Financial Reporting Review Panel (“FRRP”). The FRRP comprises over 20 professionals with a wide range of expertise<sup>1</sup> who were appointed by the Chief Executive in consultation with the FRC. Annex A illustrates the above set-up for Members’ easy reference.

### ***Preliminary Assessment of Complaints***

4. As of 29 February 2008, the Council had received 20 complaints from investors and regulators, with the majority related to non-compliance. The FRC handled the complaints according to its established procedures. For each of the complaints, the FRC Secretariat first conducted a preliminary internal assessment to determine whether the allegation was within the jurisdiction of the FRC and if so, proceeded to review the allegation in detail.

5. The FRC Secretariat would review the information provided by the complainant(s), information available in the public domain and where necessary, seek additional information from the party being complained. A preliminary assessment report would then be prepared by the FRC Secretariat for presentation to the Council. The Council would decide whether an investigation or enquiry was required.

6. For the majority of the complaints received, the preliminary assessments were completed within six weeks. Listed entities and auditors, by and large, have been very co-operative in replying to informal enquiries from the FRC. On average, their substantive replies would reach the FRC within about three weeks.

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<sup>1</sup> Section 39 of the FRC Ordinance provides that the Chief Executive shall appoint, in consultation with the FRC, at least 20 persons with experience in accounting, auditing, finance, banking, law, administration or management, or because of their professional or occupational experience, to the FRRP.

7. In view of public expectation for the FRC to handle complaints in an efficient manner and to optimize the use of resources, the FRC took a pragmatic approach in handling complaints and a fair solution could be reached at a fairly early stage. Formal procedures of investigation or enquiry would not be instituted, unless there were significant issues that warranted a full-blown assessment. Of the complaints received, the Council has completed the review of nine cases and decided to initiate one enquiry and one investigation.

### ***Enquiry and Investigation***

8. Both enquiry and investigation approved by the Council have been proceeded with according to the provisions of the FRC Ordinance. A FRRC has been appointed by the Council to conduct the enquiry. The FRRC has met twice and the enquiry is approaching completion.

9. The Council has also directed the AIB to conduct the investigation. The AIB met to set requirements for the auditor and listed entity concerned to provide records, documents, explanation etc., and to review and consider such information when available. The investigation being undertaken is also near completion.

10. The Council has an oversight role in the enquires conducted by the FRRCs and investigations carried out by the AIB. Upon completion of the enquiry and investigation, written reports would be submitted to the Council for consideration.

11. To maintain transparency of the FRC operations, operations statistics are published on the website of the FRC and updated on a monthly basis. Please refer to Annex B for the operations statistics up to 29 February 2008.

### ***Co-operation with Other Regulators***

12. The FRC does not work alone as a regulator but is an integral part of the financial regulatory framework in Hong Kong. Hence, since beginning full operations, the FRC has been working closely with its fellow financial regulators in Hong Kong. It has signed Memoranda of

Understanding with Hong Kong Institute of Certified Public Accountants (“HKICPA”), Hong Kong Monetary Authority, Insurance Authority, Stock Exchange of Hong Kong Limited and the Securities and Futures Commission (“SFC”). Given the close relationship between Hong Kong and the Mainland, and the fact that many Hong Kong listed entities are based in the Mainland or have substantial investments/business interests in the Mainland, the FRC is also establishing co-operation channels with the Mainland authorities.

## **CORPORATE GOVERNANCE**

13. As a statutory body tasked to strengthen the corporate governance of listed entities, the FRC strives to maintain the highest standard of corporate governance through checks and balances provided in the FRC Ordinance as well as through other internal control systems and accountability measures.

### ***Policies and procedure***

14. To strengthen internal control, policies and guidelines for personnel administration, procurement, authorisation of transactions and safeguarding of assets have been set down. An entire set of operations guidelines and procedures have also been developed. Policies and procedures will be subject to continuous enhancement. The operations procedures have been reviewed by the ICAC from the point of view of prevention of corruption.

### ***The Council and its Committees***

15. In the discharge of its duties, the Council met 8 times up to end February 2008. Four committees, namely the Operations Committee, the Corporate Communications Committee, the Remuneration Committee and the Tender Committee, have been set up to advise the Council on relevant areas of its work. These committees have met 8 times in total up to end February 2008. Members of the Council actively participate in the affairs of the FRC through meetings and frequent contacts with the Secretariat.

### ***Budget***

16. As required by the FRC Ordinance, the FRC has to submit to the Secretary for Financial Services and the Treasury (“SFST”) estimates of income and expenditure for each financial year for approval. The FRC has complied with the requirement and its 2007 and 2008 budgets have been approved by the SFST.

### ***Audited Accounts and Annual Report***

17. The FRC also has to submit its accounts at the end of each financial year to the Director of Audit for auditing. Furthermore, the FRC is required to submit a report on its activities, together with its accounts and the audit report for that financial year to the SFST for tabling at the Legislative Council (“LegCo”). FRC’s first annual report, which contains the aforesaid reports, was published on 19 March 2008 and will be tabled at LegCo on 9 April 2008. Copies of the annual report were distributed to all LegCo Members on 19 March 2008.

### ***Process Review Panel***

18. As an additional safeguard to ensure that the operations of the FRC are fair and reasonable, a Process Review Panel for the FRC would be established in the latter half of 2008 to begin work in 2009. The Process Review Panel would review a selection of cases to determine whether the FRC has followed its internal procedures and advise the FRC on the adequacy of its procedures.

## **FINANCIAL AND HUMAN RESOURCES MANAGEMENT**

19. The operations of the FRC is jointly funded by the Companies Registry Trading Fund, the Hong Kong Exchanges and Clearing Limited, the HKICPA, and the SFC. The four parties each contributes an annual amount of HK\$2.5 million as recurrent funding for the first three years of operation (i.e. 2007 to 2009), amounting to an annual budget of HK\$10 million. The four parties have also each contributed a lump-sum amount

of HK\$5 million to make up a Reserve Fund of HK\$20 million for meeting any inadequacies of the recurrent funding and other exigencies of circumstances.

20. For the period from 1 December 2006 to 31 December 2007<sup>2</sup>, because the FRC only became fully operational since July 2007, the total expenditure was HK\$5.46 million, with the majority of the expenditure being staff cost. The FRC Secretariat maintained a lean and efficient human resources structure with a total headcount of eleven, including the CEO, for the first financial year. For the year 2008, the FRC expects that the annual contribution of HK\$10 million should be adequate to cover the expenditure.

21. As for the funding model beyond 2009, the FRC would liaise with the Government and the four funding parties having regard to the actual operational experience gained by the FRC.

## **LOOKING AHEAD**

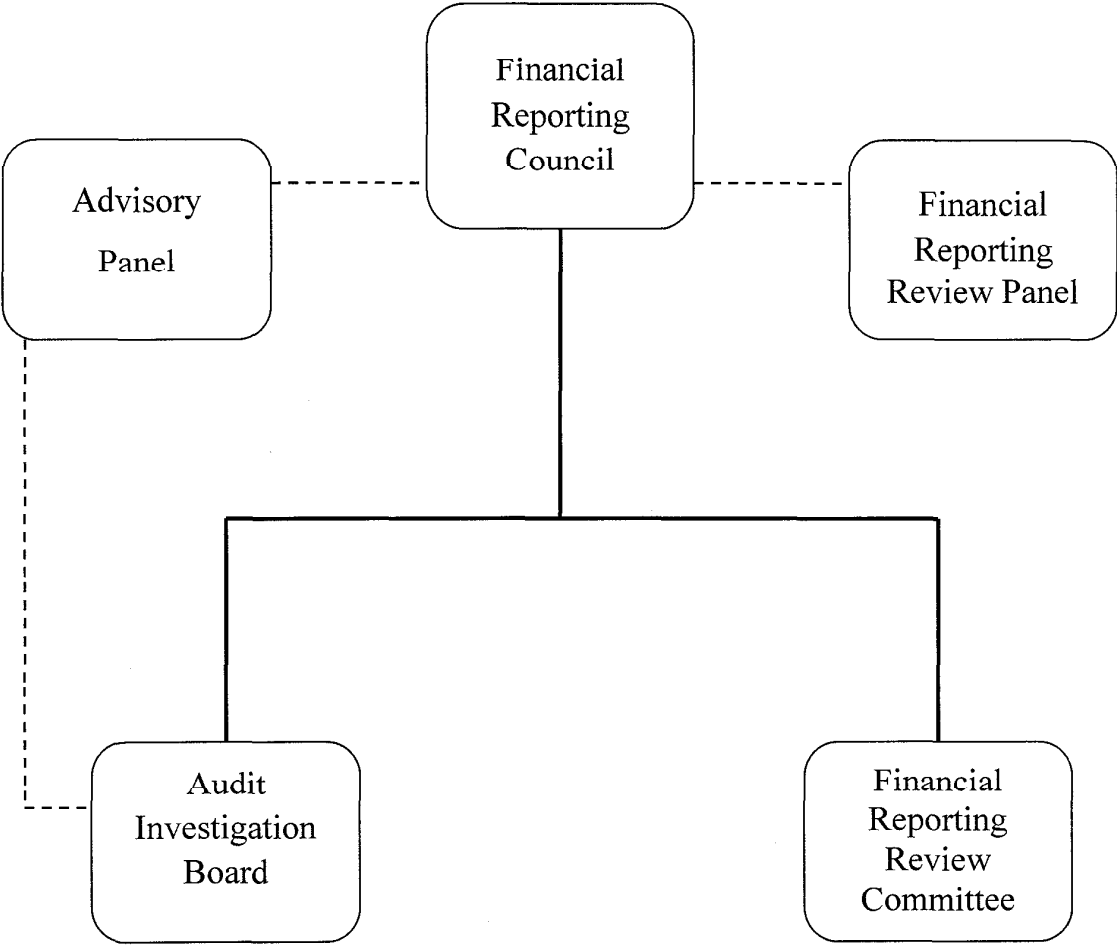
22. The FRC strives to fulfill its statutory duties effectively and efficiently and in accordance with the law. The FRC will continue to work closely with other regulators and do its best in the review of complaints, the conduct of investigations and enquiries to maintain impartiality and transparency and to upgrade corporate reporting in Hong Kong.

## **Financial Reporting Council March 2008**

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<sup>2</sup> The first financial period of the FRC was from 1 December 2006 to 31 December 2007 as the FRC was established on 1 December 2006. The FRC then proceeded with preparatory work including staff recruitment, office setting up and drafting of operational procedures etc. before becoming fully operational on 16 July 2007.

**Illustration of set-up to conduct investigations and enquiries**



## OPERATIONS STATISTICS - 2008

for the period from 1 January 2008 to 29 February 2008

## REVIEW OF COMPLAINTS

Complaint	Current Period	Since commencement	Note
No. of cases under review at the beginning of the period	9	-	
Complaints received	3	20	
Reviews completed:			
- No. of cases with no follow-up action	(1)	(4)	1
- No. of cases with follow-up actions (see below)		(5)	
Withdrawn by complainants	-	-	
Under review as at 29 February 2008	11	11	

## Follow-up actions taken:

- Resolved without initiating an investigation or enquiry	-	1	2
- Referred to specified enforcement agencies	-	2	3
- Enquiries initiated (see table below)	-	1	
- Investigations initiated (see table below)	-	1	

## Remark:

A complaint may contain multiple allegations. Each allegation may lead to different courses of action. On the other hand, more than one complaint may relate to the same entity and similar issues. These complaints will be consolidated for follow up purpose.

## PROGRESS OF ENQUIRIES

Enquiry	Current Period	Since commencement	Note
No. of cases in progress at the beginning of the period	1	-	
Initiated	-	1	
Completed	-	-	4
In progress as at 29 February 2008	1	1	

## For completed enquiries, the following actions were taken:

- No further action recommended	-	-	5
- Notice to secure removal of non-compliance	-	-	6
- Application to Court to secure removal	-	-	
- Referred to specified enforcement agencies	-	-	3



## PROGRESS OF INVESTIGATIONS

Investigation	Current Period	Since commencement	
No. of cases in progress at the beginning of the period	1	-	
Initiated	-	1	
Completed	-	-	4
In progress as at 29 February 2008	1	1	

For completed investigations, the following actions were taken:

- No further action recommended	-	-	5
- Referred to specified enforcement agencies	-	-	3

## Notes :

1. No follow-up action is required. After the Council has reviewed the complaint by reference to the material provided by the complainant and additional information obtained from the party concerned, the Council considers that the complaint has no merit or the party concerned has provided a satisfactory explanation.

2. The FRC has invited the party concerned to comment on the allegation. With the co-operation of the party concerned, the matter has been resolved satisfactorily without initiating an investigation or enquiry.

3. Specified enforcement agencies are defined in the FRC Ordinance, e.g. HK Police, ICAC, HKICPA, SFC, HKEx, etc.

4. Upon completion of an enquiry or investigation, it may lead to multiple courses of action.

5. After the completion of an investigation or enquiry, the Council concludes that there is no audit irregularity or non-compliance. Hence, no further action is required.

6. Notice issued to listed entities to secure removal of non-compliance identified.