



Comments on the Consultation Paper on Legislative Proposals to establish Financial Reporting Council

The Law Society generally supports the proposals to establish Financial Reporting Council to oversee an Audit Investigation Board and Financial Reporting Review Committee(s).

The following are our views on the matters on which public comments are invited –

Q(a) The matters in relation to the establishment of the FRC, its composition and operational structure (c.f. Chapter 2)

A We agree with the proposed composition of the FRC and its operational structure.

In relation to quorum and voting of the FRC, we note in paragraph 2.9 that it is proposed that at least two-third of the members are required to constitute the quorum of any meetings of the FRC, and that every question for decision shall be determined by a majority of votes of the members present at the meetings, subject to a minimum threshold of four votes.

We suggest considering reducing the quorum to a simple majority of the members, that quorum should count and votes may be given by members in telephone conferences, and that matters may be determined by circulation of papers. This may facilitate the decision making process in view of the fact that

- nearly all of the members will be unpaid and have other commitments;*
- some of the members may be required to exclude themselves due to conflict of interests in certain cases; and*
- members of the FRC may have to make decisions frequently as it is intended that the AIB and each FRRC shall only carry out investigations and an enquiry respectively as directed by the FRC.*

Q(b) The proposed financial arrangements for the FRC (c.f. Chapter 3)

A We agree that the arrangement for the Administration, HKEx, HKICPA and SFC

to contribute to the funding of the FRC on an equal share basis is an appropriate arrangement.

Q(c) Whether the proposed accountability measures are appropriate in ensuring that the FRC would perform its functions independently, fairly, properly, efficiently and with due propriety (c.f. Chapter 4)

A Other than referred to below, we agree that the measures are generally appropriate.

We note the provisions in respect of the avoidance of conflict of interest in paragraph 4.10 which -

- (1) require disclosure of interest in “any matter relating to...his past or present employers, employees, clients, associates, and other related parties;” and*
- (2) provide that a person failing to disclose would commit an offence and will be liable to a fine and/or imprisonment.*

It appears that the provision in (2) follows closely those in sections 379(3) and (4) of the Securities and Futures Ordinance, non-compliance of which would result in offence liable for fines and imprisonment. However, the wordings in (1) were not included in such sections. We also note that the provisions of sections 7(4), (5) and (6) of Schedule 1A to the Mandatory Provident Fund Schemes Ordinance (Cap.485) are much less severe and do not provide for sanction or offence for non-compliance.

Since it is intended that the function of the FRC should remain purely investigatory and that the any legal and/or disciplinary action would be decided by a relevant enforcement agency or a professional accountancy body to whom the FRC might refer its findings, we feel that the sanctions outlined in paragraph 4(10)(c) are too severe. In addition, the scope of the wordings in (1) above (contained in paragraph 4(10)(a)(ii)) appears to be too wide and should be clarified to provide for more certainty.

Q(d) Whether the proposed jurisdictions for the AIB’s investigations, investigation powers for the AIB, and the proposed safeguards in relation to the exercise of these powers, are sufficient and appropriate (c.f. Chapter 5)

A We think that the AIB’s power of investigation should enable it to compel the provision of information and documents by members of HKSA and listed companies, but not further, which is already an enhancement over the powers of the HKICPA under the PAO. Such power should be adequate for investigation

into suspected irregularities concerning auditors. The AIB does not need to have all the investigation powers of the SFC which would be overly intrusive and not justified by its objective and jurisdiction.

In relation to “public interest activities” which the AIB may deal with as listed in paragraph 5.9, the Listing Rules (Note 10) only referred to the “Red Book” which contained the listing rules for the Main Board. They should also refer to the GEM Board listing rules.

Q(e) Whether the proposed jurisdictions for a FRRC’s enquiry, enquiry powers for a FRRC, and the proposed safeguards in relation to the exercise of these powers, are sufficient and appropriate (c.f. Chapter 6)

A We think the proposed jurisdictions are appropriate. Our comment on Listing Rules in Q(d) above also applies here.

Q(f) The proposed *modus operandi* in relation to the referral and publication of investigation / enquiry reports, as well as the proposed secrecy and immunity provisions (c.f. Chapter 7)

A We share the concerns mentioned in paragraph 7.6 regarding publication of the investigation / enquiry reports, in particular, that publication may be prejudicial to any proceedings subsequent to the referral by the FRC to a relevant body. Paragraph 7.7 refers to modeling the publication provisions on section 146(3)(b) of the CO. However, inspectors are appointed by the Financial Secretary under that section whereas the investigation / enquiry proposed are directed by the FRC.

We agree with the secrecy and the immunity provisions.

**The Law Society of Hong Kong
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