

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEx website at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201406.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with our proposal to amend the title of Section C.2 of the Code to “Risk management and internal control”?

Yes

No

Please give reasons for your views.

Acknowledging that internal controls are an integrated part of risk management, why not just call it “Risk Management”?

At any rate, I think that the following should also be clarified:

- 1. Exactly what do we mean by risk management, e.g., compliance risk, financial reporting risk, operational risks? How about strategic risks, liquidity risks, market risks and natural disasters, etc.?***
- 2. Is the COSO definition of internal controls, (i.e., “A process ... provide reasonable assurance ... achievement of objectives relating to operations, reporting and compliance.”) adequate and appropriate?***
- 3. In addition to internal controls, what else are there in risk management? Should they also be given the same significance as internal control?***

2. Do you agree with the proposed amendments to Principle C.2 to define the roles of the board and the management, and state that the management should provide assurance to the board on the effectiveness of the risk management systems? Is the intention of the proposed wording sufficiently clear?

Yes

No

Please give reasons for your views.

Management, directed by the Board, should have the responsibility to maintain an effective and efficient risk management system. However, for credibility, like external auditor's provision of independent assurance on the true and fair of financial statements, there should be another independent party providing this assurance.

Also, it is questionable if any professional can provide reliable, objective assurance without a generally accepted framework. For example, that of Hong Kong Financial Reporting Standards used by the external audit profession for external audit purposes.

3. Do you agree with our proposal to introduce an amended RBP (C.2.6) to provide that the board may disclose in the Corporate Governance Report that it has received assurance from management on the effectiveness of the issuer's risk management and internal control systems? Is the intention of the proposed wording sufficiently clear?

Yes

No

Please give reasons for your views.

See my comment to Pt. 2 above. Management is not independent and should not be relied on to give assurance.

4. Do you agree with the proposed amendments to CP C.2.1 to state that the board should oversee the issuer's risk management and internal control systems on an ongoing basis? Is the intention of the proposed wording sufficiently clear?

Yes

No

Please give reasons for your views.

See my comment to Pt. 1 above. I think we need to first clarify the exact meaning of risk management, definition of internal controls, and what else are there in risk management, if any.

5. Do you agree with our proposal to upgrade to a CP the existing RBP C.2.3, which sets out the matters that the board's annual review should consider?

Yes

No

Please give reasons for your views.

I think the list of matters to consider cannot be proper unless and until we have clarified the exact meaning of risk management.

As is, the list appears to be arbitrary and no proof of their significance. Upgrading to CP can be counterproductive.

6. Do you agree with our proposal to upgrade to a CP the existing RBP C.2.4, which sets out the particular disclosures that issuers should make in their Corporate Governance Reports in relation to how they have complied with the internal control CPs during the reporting period?

Yes

No

Please give reasons for your views.

Basically YES, but a lot of terminologies should be better defined. For example:

- *significant risks;*
- *effectiveness;*
- *material internal control defects, etc.*

7. Do you agree with our proposal to amend the wording of proposed CP C.2.4 to simplify the requirements and remove ambiguous language, and to make clear that the risk management and internal control systems are designed to manage rather than eliminate risks? Is the intention of the proposed wording sufficiently clear?

Yes

No

Please give reasons for your views.

8. In relation to proposed CP C.2.4, do you agree with our proposal to upgrade the existing recommendation that issuers disclose their procedures and internal controls for handling and disseminating inside information (Section S., paragraph (a)(ii)), and amend it to include the handling of “other regulatory compliance risks”?

Yes

No

Please give reasons for your views.

9. Do you agree with our proposal to upgrade to Mandatory Disclosures the following existing Recommended Disclosures in relation to internal controls (Section S.):

- (a) whether the issuer has an internal audit function;
- (b) how often the risk management and internal control systems are reviewed, the period covered, and where an issuer has not conducted a review during the year, an explanation why not;
- (c) a statement that a review of the effectiveness of the risk management and internal control systems has been conducted and whether the issuer considers them effective and adequate; and
- (d) significant views or proposals put forward by the audit committee?

Yes

No

Please give reasons for your views.

10. Do you agree with our proposal to move the existing recommendation that issuers disclose details of any significant areas of concern (Section S., paragraph (a)(ix)) to a new RBP C.2.7, and to amend the provision to widen its application by removing the reference to areas of concern “which may affect shareholders”?

Yes

No

Please give reasons for your views.

11. Do you agree with our proposal to remove RBP C.2.5, which states that issuers should ensure their disclosures provide meaningful information and do not give a misleading impression?

Yes

No

Please give reasons for your views.

12. Do you agree with our proposals to remove the recommendations that issuers include in their Corporate Governance Reports:

(a) an explanation of how the internal control system has been defined for them (Section S., paragraph (a)(i)); and

(b) the directors' criteria for assessing the effectiveness of the internal control system (Section S., paragraph (a)(vii))?

Yes

No

Please give reasons for your views.

Without a proper benchmark, it is questionable if a system can be objectively measured. Unless HKEx is preparing to also dictate the proper benchmark to use, the directors' criteria is probably the most economical way to achieve this.

Nevertheless, internal control should be replaced by risk management.

13. Do you agree with our proposal to upgrade RBP C.2.6 to a CP (re-numbered C.2.5) and amend it to state that an issuer should have an internal audit function, and issuers without an internal audit function should review the need for one on an annual basis and disclose the reasons for the absence of such function in the Corporate Governance Report? Is the intention of the proposed wording sufficiently clear?

Yes

No

Please give reasons for your views.

14. Do you agree with our proposal to introduce new Notes to the proposed CP C.2.5 to clarify that:

- (a) the role of the internal audit function is to carry out the analysis and independent appraisal of the adequacy and effectiveness of an issuer's risk management and internal control systems; and
- (b) a group with multiple listed issuers may share group resources of the holding company to carry out the internal audit function for members of the group?

Yes

No

Is the intention of the proposed wording sufficiently clear? Please give reasons for your views.

Given HKEx's proposal of a "comply or explain" approach to internal audit, instead of management, it makes more sense for internal audit to provide assurance to the board on the effectiveness of the risk management systems.

15. Do you agree with our proposal to amend the existing CP C.2.2 to state that the board's annual review should ensure the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's internal audit function (in addition to its accounting and financial reporting functions)?

Yes

No

Please give reasons for your views.

16. Do you agree with our proposal to amend Principle C.3 in respect of audit committees and CP C.3.3 in respect of their terms of reference to incorporate “risk management” where appropriate?

Yes

No

Please give reasons for your views.

17. Do you agree that the matter of establishing a separate board risk committee should be left to issuers to decide in accordance with their own circumstances?

Yes

No

Please give reasons for your views.

18. What would be an appropriate period of time between the publication of the consultation conclusions and the implementation of the amendments set out in the Consultation Paper?

Six months

Nine months

12 months

Others (please specify:)

Please give reasons for your views.

- End -