

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.

No comment.

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.

Although the board appoints and oversees management, the actual roles of the board and management vary from enterprise to enterprise and may not be necessarily distinct. In the case of small and medium enterprises (SMEs), there is a close relationship between governance and management. Indeed in the case of the smaller SMEs they are usually indistinguishable, with the executive directors of the board forming the core management. Therefore, the proposed amendments may not have any added-value in substance.

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.

Please see comments on Question 2 above.

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.

The key is to ensure that an adequate risk management and internal control system is in place to ensure the effectiveness and efficiency of operations. The current requirement for the board to conduct an annual review is sufficient for the purpose.

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.

CP s C.2.1-2 are good enough to serve their intended purposes. Along with the nature of risks faced by issuers, the extent of disclosures required of them varies. Costs aside, the proposal will only impose onerous disclosure burden on issuers and is unlikely an improvement to the current practice in terms of cost effectiveness.

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.

Please see comments on Question 5 above.

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.

No comment.

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.

Wouldn't it be a double standard to propose amending CP C.2.4 to remove ambiguous language on the one hand, and to propose including the handling of "other regulatory compliance risks" in Section S., paragraph (a)(ii) to invite ambiguity on the other hand? The expression "other regulatory compliance risks" suggests an extensive scope of risks which issuers will find baffling to identify.

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.

The existing Mandatory Disclosures Requirements are sufficient to provide transparency.

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.

No comment.

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.

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.

This may not be practical taking into account the simple business models of SMEs. As long as they have an effective internal control system, it should be sufficient for them to handle risk management issues without an internal audit function. The requirement to have an internal audit function will add onerous costs and personnel burden on these SMEs. We should leave it to individual issuers to determine if an internal audit function is practically necessary for their own needs. The existing RBP C.2.6 as a recommended best practice is already sufficient for the purpose.

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.

Please see our comments on Question 13 above. Furthermore, the term "internal audit function" is sufficiently self-explanatory.

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.

Since our answer to Question 13 above is "No", the answer to this Question is naturally in the negative. To include internal audit function in the scope of the board's annual review, along with the set up of the function, should be a RBP.

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.

The existing wording of Principle C.3 is sufficient for the current role of the audit committee.

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.