

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.

Both risk management and internal controls are cornerstones of corporate governance and help provide safeguards against business risks and corporate failures. Theoretically, internal controls are an integral part of the risk management process and exist to mitigate potential risks. Risk management is an ongoing and robust process and does not end with establishment of internal controls.

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.

We agree with the proposed amendments to Principle C.2. However, it is also our view that the current proposed role for the board to be “responsible for evaluating the risks it is willing to take in achieving the issuer’s objective” could be further expanded as we believe that, more importantly, the Board has a role to determine the nature and extent of the significant risks which it is willing to take (this concept of determining the amount of risk which an issuer is willing to take is commonly known as “risk appetite”). This is the position of the UK and Singapore codes and we believe that this is an important point for issuers to articulate clearly to their investors and stakeholders their risk appetite in striving for their objectives.

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.

The proposed disclosure will bring greater transparency on the issuer's risk management and internal control systems and allow investors to obtain a better understanding of how important decisions are made which may affect their investments. The intention of the proposed wording is sufficient and clear.

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.

Risk management should be an ongoing and robust process and does not end with establishment of internal controls. The intention of the proposed wording is sufficient and clear.

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.

By providing further guidance on the matters to be considered during the board's annual review, stakeholders would be able to obtain more substantive, meaningful information about the issuers' risk management and internal control systems as well as how the issuers have performed their annual reviews.

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.

By providing disclosure requirements in the Corporate Governance Reports, stakeholders would be able to obtain more substantive, meaningful information about the issuers' risk management and internal control systems as well as how the issuers have performed their annual reviews.

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.

By amending the relevant wording of proposed CP C.2.4, stakeholders would be able to obtain more substantive, meaningful and clearer information about the issuers' risk management and internal control systems as well as how the issuers have performed their annual reviews.

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.

We are generally in agreement with the proposal. However, we consider that each individual issuer should determine what is relevant and meaningful for stakeholders in terms of such disclosure because regulatory compliance risks could be extensive and voluminous.

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.

We are generally in agreement with the proposed changes. However, under the revised Section Q., paragraph (c), the proposed changes require issuers to disclose in the annual report 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”. Whilst the first part of this proposed mandatory disclosure is consistent with the CP C.2.1 requirements, there appears to be an additional expectation within the second part of this paragraph for issuers to make a “positive” confirmation about the results of their annual review. In our analysis of disclosure statements about the results of C.2.1 amongst issuers in the past, we have noted generally three types of disclosures, being “no opinion”, “negative confirmation” and “positive confirmation”. In our view, issuers are currently issuing a “no opinion” statement may need to dedicate additional effort and resources in conducting a more thorough review of their risk management and internal control systems in order to satisfy themselves and their boards that a more robust view is warranted. As such, this may impose an unintended obligation for issuers and results in additional effort and resources.

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.

The proposal will allow no restrictions to the disclosure of significant areas of concerns “which may affect shareholders”.

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.

The proposal will ensure issuers provide meaningful information on their risk management and internal control systems.

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.

The relevant recommendations should be removed since the proposed C.2.3 and C.2.4 have clearly specified the disclosure requirements.

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.

We are generally in agreement with the proposal. However, given the general “comply or explain” requirement of code provisions, we feel that it may not be necessary to re-iterate the need for issuers to disclose the reasons for the absence of such function in the Corporate Governance Report as any deviation from code provisions would need to be explained anyway. Furthermore, by highlighting the requirement to explain any deviation may indeed influence certain issuers to indeed deviate from the CP and offer an explanation (which would have the opposite effect from the desired outcome. In addition to requiring an internal audit function, the proposed CP should also emphasise the independent nature of the role of the internal audit function and also highlight the responsibility of the audit committee or sub-committee to review (and approve) the adequacy of coverage of the internal audit plan on a periodic basis. Further guidance should also be provided to issuers to ensure the independent nature of the internal audit function (e.g. by giving the audit committee the primary responsibility to “hire and fire” the head of internal audit).

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.

We are generally in agreement with the proposal. In addition, we suggest that the Notes clarify that compliance with the proposed CP may be achieved either by way of an in-house internal audit function or an outsourced one.

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.

The board should be responsible for ensuring that the internal audit function executes the internal audit plan in a proficient and efficient manner in order to adequately and effectively appraise the issuer's risk management and internal control systems.

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.

Both risk management and internal controls are cornerstones of corporate governance and help provide safeguards against business risks and corporate failures.

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.

We believe that there is no “one size fits all” solution in determining the Audit Committee’s role and hence we agree that the matter of establishing a separate board risk committee should be left to the issuers to decide on their own.

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.

A period of nine months should be an appropriate timeframe for the issuers to better prepare themselves for the additional requirements and proposals as outlined in the Consultation Paper.

- End -