

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.

It is important to recognise that effective and appropriate internal controls ONLY result from a comprehensive risk management programme and thus issuers must give this due consideration.

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.

It is appropriate that the board is provided with appropriate tools in order to ensure that their acceptance or avoidance of risk is an informed decision and that there is a consistent mechanism in place to support their decision making and the consequences of those decisions. Management must ensure that the risk management process is effectively embedded in day-to-day operations, which is beyond the ability of the board to manage.

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.

Management is implementing and monitoring and therefore it is also appropriate for them to report on the effectiveness of the risk management process and controls.

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.

As the output from the risk management function is required to make ongoing decisions it is important that the board has comfort that the information they are using to make risk based decisions is derived from an effective process at the time they are required to make the decision.

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.

It is good to have a minimum set of reporting so that comparison across issuers can be simplified, but must be careful not to unintentionally limit the disclosures being made.

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.

This will support substantiated evaluation rather than cursory compliance thus enhancing the quality of the risk management process.

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.

As it is not possible to provide an absolute guarantee that a risk is eliminated, failure to permit the disclosure to recognise this may result in inaccurate and/or misleading statements.

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.

The disclosure requirement is much too broad given that the procedures and internal controls will span very significant parts of the business and is constantly evolving, especially for issuers with multiple regulatory obligations.

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?

☒ (Qualified) Yes

☐ No

Please give reasons for your views.

Agree this is basic information necessary for informed assessment of an issuers risk appetite BUT do NOT agree that an issuer should be mandated to disclose the views/proposals of the audit committee.

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.

Provided it remains only an RBP and does not become mandatory, and it is often more appropriate to address concerns directly with the relevant stakeholder (when not a shareholder) through means other than the discloser through the exchange reporting mechanism.

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.

It may be intuitive, but it is fundamental and is more valuable to escalate to a mandatory principal rather than to remove (the very act of removal could wrongly be construed as removing the requirement).

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.

These are matters which are potentially very broad (for large issuers) and often would require excessive detail to convey meaningful information to shareholders thus there would be minimal value and remote probability that it would be complied with as a recommendation (and difficult even as a CP).

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.

Internal Audit is a key component of ensuring effectiveness of internal controls and providing management and the board with the appropriate assurances of effectiveness.

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.

These notes are key in distinguishing the separation of responsibility between the performance of the risk management function and internal audits role to review the adequacy and appropriateness of the function (i.e. internal audit SHOULD NOT be responsible for risk management).

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)?

☒ (Qualified) Yes

☐ No

Please give reasons for your views.

Although it is essential that such functions are properly resourced and not considered as a discretionary cost function, we do not believe that the board can ensure the adequacy of the above as such professionals are limited and in high demand.

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.

Such responsibilities can be included in the terms of reference of the audit committee or else handled by the board itself.

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.

Issuers generally require 12 months (or longer) to prepare for the implementation of new rules and amendments to rules.

- End -