

30 August 2014

BY HAND AND BY EMAIL

Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

Attn: Corporate and Investor Communications Department

Dear Sirs,

**Consultation Paper on Risk Management and Internal Control:
Review of the Corporate Governance Code and Corporate Governance Report**

Ernst & Young is pleased to respond in this letter to the request of Hong Kong Exchanges and Clearing Limited ("HKEx") for comments regarding the proposals set out in the captioned consultation paper.

We welcome the HKEx's ongoing initiative to promote good corporate governance. We are supportive of the proposals to narrow the gap with the requirements in other jurisdictions and enhance the disclosure quality of and facilitate comparability across issuers' corporate governance reports. We would like to share with you the following observations and comments:

Management's assurance on the effectiveness of the issuer's risk management and internal control systems

HKEx's proposed amendments to Principle C.2:

"The board ~~should ensure~~ is responsible for evaluating the nature and extent of the risks it is willing to take in achieving the issuer's strategic objectives, and ensuring that the issuer establishes and maintains sound appropriate and effective risk management and internal controls systems to safeguard shareholders' investment and the issuer's assets. The board should oversee management in the design, implementation and monitoring of the risk management and internal control systems, and management should provide assurance to the board on the effectiveness of these systems."

HKEx's proposed new Recommended Best Practice C.2.6:

"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."

We note that it is proposed that, as a matter of principle, management should provide assurance to the board on the effectiveness of the issuer's risk management and internal control systems and that the board is recommended to disclose that it has received such assurance from management. However, there is no elaboration as to whether the management assurance should include additional information such as the basis for the assurance. If the HKEx is of the view that the need for such additional information and/or the basis for the management assurance can be left to the board to decide, the HKEx may consider making it clear by way of a frequently asked question.

Internal audit function

Reporting line

HKEx's proposed new Note 1 to Code Provision C.2.5:

"An internal audit function generally carries out the analysis and independent appraisal of the adequacy and effectiveness of the issuer's risk management and internal control systems."

The internal audit function is expected to carry out an independent appraisal of the risk management and internal control systems. However, the proposal does not specify the reporting line of the internal audit function. We note that the existing Corporate Governance Code ("Code") contains a Code Provision specifying the reporting line of the company secretary. We suggest that the revised Code should specify the reporting line of the internal audit function.

Outsourcing option

It is stated in paragraph 89 of the consultation paper that "we understand that in practice it is common for issuers to engage external service providers to perform the internal audit function. Discussions with practitioners indicate that in most overseas jurisdictions (including the UK, Australia, Singapore and the US) issuers are considered to be in compliance with the relevant code provision or rule if they opt to outsource their internal audit functions. As such, we are of the view that compliance with the proposed CP may be achieved either by way of an in-house internal audit function or an outsourced one". However, the suggested amendments to the Code do not address the outsourcing option.

We note that the existing Code contains a Code Provision acknowledging that an issuer may engage an external service provider as its company secretary. We suggest that the outsourcing option for the internal audit function should be specified in the revised Code or the relevant frequently asked questions, whichever is deemed more appropriate by the HKEx.

Implementation date

We consider that issuers should be allowed sufficient time to prepare for the compliance with the revised Code, in particular, the new Code Provision on internal audit function. In this regard, we suggest that an appropriate period of time between the publication of the consultation conclusions and the implementation of the amendments would be at least 12 months. Furthermore, it would be helpful if the HKEx continues its practice of issuing frequently asked questions setting out clearly the implementation schedule with reference to financial reporting periods.

Should you have any questions on the above comments, please do not hesitate to contact our Professional Practice Partner in Hong Kong, [REDACTED].

Yours faithfully,

