

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, I agree that internal controls is an integral part of risk management. I believe internal control is a subset of risk management. The term "risk management" is wide enough to cover the meaning of "internal control". However, the requirement for setting up "internal audit function" is proposed to be upgraded to CP, I think it would be more appropriate to amend the title of Section C.2 of the Code to "Risk management and internal audit function". The purpose of this is to highlight the importance of the three-tier system in risk management, namely the board, management and internal audit. Please see my mark up in Appendix 1 to this questionnaire.

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.

I agree with the amendments and consider that the proposed wording is sufficiently clear.

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.

I agree with the introduction of the amended RBP C.2.6 and consider the proposed wording is sufficiently 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.

Yes, the proposed amendment is acceptable.

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.

Yes, I agree with the proposed upgrade to a CP except that as the Principle C.2 defines the role of the Board as "...evaluating the nature and extent of the **risk** it is willing...", it is desirable to remove the word "significant" from the proposed CP C.2.3(a). This word "significant" is not consistent with the Principle and that is subjective in nature where there is no guidance as to what is meant by "significant" in Section C of the Code. Please also see my mark up in Appendix 1 to this questionnaire.

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.

Yes, I agree with the proposed upgrade to a CP except that as the Principle C.2 defines the role of the Board as "...evaluating the nature and extent of the **risk** it is...", it is desirable to remove the word "significant" from the proposed CP C.2.4(a). This word "significant" is not consistent with the Principle and that is subjective in nature where there is no guidance as to what is meant by "significant" in Section C of the Code. Please also see my mark up in Appendix 1 to this questionnaire.

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.

Yes, the proposed wording is sufficiently clear.

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.

Yes, I agree with the proposal.

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.

Yes, I agree with the proposal.

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.

Yes, agree.

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.

Yes, agree.

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.

Yes, agree.

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.

Yes, agree.

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.

No, I do not agree with the addition of the new Notes to the proposed CP C.2.5. I personally do not fancy the use of notes. A note under a CP is normally to clarify the meaning or illustrate the practical application of the CP. Generally, I believe a CP should be self-sufficient in terms of meaning. Unless under special circumstances where clarification is necessary, we should avoid using notes. For the proposed CP C.2.5, I consider that the meaning of "internal audit function" should be built into the proposed CP C.2.5 itself. Please see my mark up on the proposed CP C.2.5 in Appendix 1 to this questionnaire.

As regards Note 2 to the proposed CP C.2.5, I believe an independent and effective internal audit function is a part of sound corporate governance. The internal audit function must be able to perform its assignments on its own initiative in all areas and functions of the issuer. It must be free to report its findings and assessments internally through clear reporting lines. Therefore, an issuer should have its own internal audit function, which should be accountable to the board of the issuer. I worry that independence and objectivity of the internal audit function may be undermined if the internal audit function is shared by members of a group of listed companies. Nevertheless, regardless whether the internal audit activities are outsourced, the board of the issuer remains ultimately responsible for the internal audit function.

In addition, sharing of parent company's resources to carry out the internal audit function for members of the same group may, in certain circumstances, give rise to uneven dissemination of inside information.

In summary, I suggest that the proposed Note 2 should be removed. Sharing of internal audit function among listed companies of the same group should not be encouraged. Please also see my mark up on the proposed CP C.2.5 in Appendix 1 to this questionnaire.

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.

Yes. However, as accounting and financial reporting functions are closely related, drafting of the proposed C.2.2 should be modified so as to make it consistent with the wording of the Q15. Please see my mark up on the proposed C.2.2 in Appendix 1 to this questionnaire.

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.

Yes, agree.

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.

Yes, agree.

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.

I believe 12 months should be an appropriate period of time for implementation of the proposals in this consultation paper.

- End -

16/18

APPENDIX I: PROPOSED AMENDMENTS TO THE CORPORATE GOVERNANCE CODE AND CORPORATE GOVERNANCE REPORT

(Unless otherwise specified, set out below are the draft Main Board Rule amendments. The Exchange proposes to make equivalent amendments to the GEM Rules.)

The marked-up parts represent the proposed amendments to the Main Board Rules.

Appendix 14

CORPORATE GOVERNANCE CODE AND CORPORATE GOVERNANCE REPORT

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PRINCIPLES OF GOOD GOVERNANCE, CODE PROVISIONS AND RECOMMENDED BEST PRACTICES

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C. ACCOUNTABILITY AND AUDIT

...

C.2 Risk management and internal controls

audit function

Principle

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.

Code Provisions

C.2.1 The ~~directors~~ board should oversee the issuer's risk management and internal control systems on an ongoing basis, ensure that at least annually conduct a review of the effectiveness of the issuers' issuer's and its subsidiaries' risk management and internal control systems has been conducted at least annually and report to shareholders that they it

have has done so in their its Corporate Governance Report. The review should cover all material controls, including financial, operational and compliance controls ~~and risk management functions~~.

- C.2.2 The board's annual review should, in particular, ~~consider~~ ensure the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's ~~accounting~~ internal audit and financial reporting functions.

Recommended Best Practices

- C.2.3 The board's annual review should, in particular, consider:

- (a) the changes, since the last annual review, in the nature and extent of significant risks, and the issuer's ability to respond to changes in its business and the external environment;
- (b) the scope and quality of management's ongoing monitoring of risks and of the internal control systems, and where applicable, the work of its internal audit function and other assurance providers;
- (c) the extent and frequency of communication of monitoring results to the board (or board committee(s)) which enables it to assess control of the issuer and the effectiveness of risk management;
- (d) significant control failings or weaknesses that have been identified during the period. Also, the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the issuer's financial performance or condition; and
- (e) the effectiveness of the issuer's processes for financial reporting and Listing Rule compliance.

- C.2.4 Issuers should disclose, in the Corporate Governance Report, a narrative statement on how they have complied with the risk management and internal control code provisions during the reporting period. ~~The disclosures should also include~~ In particular, they should disclose:

- (a) the process used to identify, evaluate and manage significant risks;
- (b) ~~additional information to explain the main features of its~~ the risk management ~~processes~~ and internal control systems;
- (c) an acknowledgement by the board that it is responsible for the risk management and internal control systems and reviewing its

function in addition to its accounting

their effectiveness. It should also explain that such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss;

- (d) the process used to review the effectiveness of the risk management and internal control systems; and
- (e) ~~the process used to resolve material internal control defects for any significant problems disclosed in its annual reports and accounts; and~~
- (e) the procedures and internal controls for the handling and dissemination of inside information, and for the handling of other regulatory compliance risks. [Moved from Recommended Disclosures Section S., paragraph (a)(ii).]

C.2.5 ~~Issuers should ensure that their disclosures provide meaningful information and do not give a misleading impression. The issuer should have an internal audit function. Issuers without an internal audit function should review the need for one on an annual basis and should disclose the reasons for the absence of such a function in the Corporate Governance Report.~~

Notes:

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.

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.

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unclarified
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Recommended Best Practices

- C.2.6 ~~Issuers without an internal audit function should review the need for one on an annual basis and should disclose the outcome of this review in the Corporate Governance Report. [Moved to proposed CP C.2.5.]~~
- 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.
- C.2.7 The board may disclose in the Corporate Governance Report details of any significant areas of concern. [Moved from Recommended Disclosures Section S., paragraph (a)(ix).]