

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.

This can help to reflect the global recognition of internal control being an integrated part of risk management.

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 to the reasons set out in the Consultation Paper.

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.

This proposal can facilitate better disclosures by issuers.

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.

However, it is impractical for the entire board to oversee the issuer's risk management and internal control systems "on an ongoing basis" given that the non-executive directors (NEDs) and independent non-executive directors (INEDs) are not involved in the day-to-day management of the issuer. Further, the newly proposed CP C.2.3 under the UK code does not contain such ongoing requirement (per Note 29 of the Consultation Paper). Accordingly, we suggest to delete the requirement of "on an ongoing basis" from the proposed CP C.2.1.

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.

We agree that this would help to focus issuers' attention to the particular matters specified therein.

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.

We agree that this proposal would help to encourage more substantive, meaningful disclosure of issuers' risk management and internal control systems and the substance of 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.

This will help to draw shareholders'/potential investors' attention to the fact that the risk management and internal control systems are used to manage rather than eliminate risks.

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 agree with the proposal to upgrade the existing recommendation that issuers should disclose, in the Corporate Governance Report, their procedures and internal controls for handling and disseminating inside information (existing Section S, paragraph (a)(ii)), but do not agree with the new disclosure requirement under the proposed CP C.2.4(e) on procedures and internal controls for handling of "other regulatory compliance risks" as such term is too general and ambiguous and it is unclear to issuers as to what the scope of the disclosure might be.

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.

This proposal can facilitate better disclosures by issuers.

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.

This proposal can facilitate better disclosures by issuers.

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 existing RBP C.2.5 is ambiguous and redundant.

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.

We agree to the reasons set out in the Consultation Paper.

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.

The adoption of the proposal to require issuers (on a "comply" or "explain" basis) to maintain an internal audit function will bring Hong Kong in par with the other jurisdictions in respect of such requirement.

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 agree to the reasons set out in the Consultation Paper.

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.

However, we do not agree to replace the word "consider" with "ensure" in the new proposed C.2.2 given that an annual review by the board can never "ensure" the "adequacy" of resources, staff qualifications and experience, etc. – "adequacy" is difficult to define and an objective decision by the board to ensure adequacy may later found to be inadequate based on unexpected factors. Accordingly, we urge the Exchange to keep the original wording, i.e. "consider".

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.

We agree that internal control is an integrated part of risk management and it is better for the audit committee to be assigned with the duty of reviewing the risk management framework of the issuer, as opposed to establishing a separate board risk 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.

Further, we suggest the Exchange to put up a note in Section C.3 to make clear its view under paragraph 103 of the Consultation Paper, i.e., the Exchange agrees that the issuer should be given an option to establish a separate board risk committee.

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.

The Exchange should allow sufficient time for small or medium sized issuers to make preparations for compliance with the proposed new amendments set out in the Consultation Paper.

- End -