

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.

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 note that the terms ‘management’ and ‘senior management’ appear regularly in the Listing Rules but are not defined. In most cases, the issuer’s board will overlap with its management. In this respect, it will be helpful if the Stock Exchange will provide guidance as to what constitutes the management of an issuer vis-à-vis its board.

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.

Please see question 2 as regards our comment on the definition of management (which is not defined) vis-à-vis the board.

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.

In principle, we agree that the board should oversee the issuer's risk management and internal control system. However we are concerned about the phrase "on an ongoing basis" and whether this would be interpreted as a "day-to-day" responsibility for the board, in case of which the board would not have the capacity to handle. In light of this, and since we feel that the word "oversee" already indicates a continual process, the phrase "on an ongoing basis" should be taken out to eliminate the redundancy and possibility of confusion in interpretation.

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.

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.

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.

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 disclosing the procedures and internal controls for handling and disseminating inside information. Having such procedures and internal controls is a key compliance element for Part XIVA of the SFO regarding inside information disclosure. There should be no difficulty for issuers to disclose such procedures.

However, as for the inclusion of “other regulatory compliance risks”, we feel that the term is too vague and overly encompassing. A corporation is obliged to comply with a great many regulatory requirements in various aspects of their operation. Having to disclose procedures for handling all regulatory compliance risks would be too burdensome- and indeed impracticable- for companies, and even for shareholders’ consumption. As an alternative, and at most, the board should only be required to disclose that there are procedures and internal controls for handling of other regulatory compliance risks, but not to disclose the actual procedures nor details thereof.

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 disagree with points (b) and (d).

Point (b) requires disclosing “how often the risk management and internal control systems are reviewed”. This requirement is redundant. CP C.2.1 already mandates at least an annual review, failing of which needs to be explained. There is no need to state the same requirement twice.

Point (d) requires disclosure of “significant views or proposals put forward by the audit committee”. Our concern is that views or proposals might be commercially sensitive and are expressed or made in confidence. To enforce a mandatory disclosure of them is not practical. It may also be counter-productive as it may discourage views or proposals to be expressed or made knowing that they would be made public somehow.

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.

We disagree to removing the reference to “which may affect shareholders”. Ultimately, a company is responsible to its shareholders, and they should be the primary audience of the CG Code and Report. Areas of concerns affecting other stakeholders can be dealt with in the ESG Report. This will define the focus and contents of the two reports better.

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.

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.

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.

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 recommend adding a third Note here to spell out clearly an outsourced internal audit function is accepted for the purpose of compliance with this CP.

With regard to point (b) above, we welcome the provision that group resources can be shared among member companies in carrying out of the internal audit function. However this needs not be limited to resources from the holding company. A group should have the flexibility to decide which of its group company, holding or subsidiary, is best to carry out the internal audit functions for other member companies, based on expertise and resources planning and allocation. We recommend simply taking out the phrase "of the holding company".

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.

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.

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.

Although 51% of issuers had reported they had an internal audit function, there is still 49% or some 850 companies that don't. These companies would need to start to hire or train people or look for third party service providers. What we don't want is for these companies to scramble for people or service providers in a short space of time, only to settle for sub-standard set up or pay high prices due to a sudden surge of demand for limited available expertise. We therefore recommend a 12-months lead time for implementation.

- End -