



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

HKEX
香港交易所

ESG Academy – Risk Management and Internal Controls: From Awareness to Action

Observations and Lessons from Enforcement Action

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Part I – Lessons from Enforcement Action

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Agenda

1

Importance of risk management and internal controls

2

Enforcement case studies

3

Common internal control weaknesses

Why are risk management and internal controls important?

The importance of risk management and internal controls



Regulatory breaches and corporate misconduct often stem from **inadequate or poorly implemented internal controls**

Enforcement case studies

Case Study (1)

Money lending transactions

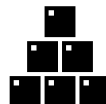
IPO

Listed company



\$

Wealth management product



>40% of IPO proceeds

A listed company subscribed for wealth management products a few days after its IPO



Contrary to intended uses



No disclosure to the public

Post-listing



\$

Borrowers



Granted loans of substantial amount

It granted interest-free and unsecured loans, almost all of which were impaired.



No guarantees or pledges provided by borrowers



No board oversight over loan business



No oversight over fund recipients

Case Study (2)

Corporate transactions

Listed company

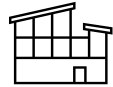


Acquired 50% interest
in a joint venture

JV partner



Substantial
amount owed
by JV partner



Lawsuit against the JV
but the listed company
was not aware of it



No protective measures to
monitor JV's business



No recovery of amounts due
from JV partner



No check and balance for JV's
cash flow



Failed to make disclosures

Case Study

Possible enforcement actions



- Suspend share trading of the listed company under Section 8(1) of the Securities and Futures (Stock Market Listing) Rules
- Take legal action under s.214 of the SFO to seek court orders, e.g. disqualification orders and compensation orders



- Take disciplinary sanctions, including public censure, prejudice to investors' interests statement and director unsuitability statement against relevant directors

Common internal control weaknesses

Common internal control weaknesses

Undefined authorisation and approval process



No check and balance



Poor documentation and recordkeeping



Insufficient due diligence and credit assessment



Insufficient post-transaction monitoring



Weak control environment



Part II

Practical Application for Risk Management and Internal Control Systems

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Agenda

- 1. Who?** Responsibility for risk management and internal control systems.
- 2. What?** Components / scope of risk management and internal control systems.
- 3. How?** Application of internal controls in practice.
- 4. Key Takeaways**



Who?

**Responsibility for risk management and
internal controls**



Who? Responsibility for risk management and internal controls

- **The Board** is ultimately responsible for risk management and internal controls.
- **The Audit Committee** oversees the effectiveness of risk management and internal control systems, and, through its independence, is best placed to critically assess the systems' effectiveness.
- **The Management** executes the board's vision for the design of the internal controls and reports back to the board.
- **The Company Secretary** assists the board in maintaining a sound corporate governance framework and keeps the board informed of developments in laws, rules and regulations.



What?

Components of risk management and internal control systems



What? Components of risk management and internal controls

No “one-size-fits-all”

Risk management and internal control systems need to be tailored to the unique risk profile of each issuer, covering (among other things) the following components¹:

1 – Corporate Culture and Control environment

Designated procedures governing the issuer’s compliance culture and establishing the overall control environment.

2 – Risk Assessment

Procedures for ongoing risk assessment (including for fraud risks) and to periodically ascertain whether any changes to risk profile occurred.

3 – Internal Controls

Internal controls and control activities designed to manage and mitigate risks to the issuer, including activities, processes, policies, communications and technological infrastructure.

4 – Information and Communication

Procedures to gather and communicate appropriate and up-to-date information and data to support operation of risk management and internal controls.

5 – Monitoring

Procedures for continuous monitoring to ensure risk management and internal control systems remain fit for purpose and deficiencies are reported in a timely manner.

1. *Internal Control—Integrated Framework (ICIF-2013)* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)



How?

Application of internal controls in practice



How? Considerations for money lending operations

Internal controls operationally ready from the outset?

Before Operations Commence

Have all relevant licenses and relevant internal controls been put in place, is qualified staff in charge, and are procedures for ongoing monitoring and risk management effectively implemented?

Proper due diligence conducted?

Before Loan Approval

Is there a system of robust pre-loan due diligence, including know-your-client procedures focused on client's identity and creditworthiness, and ensuring recoverability in cases of default?

Effective monitoring of loan status and ability to repay?

Post-Loan Monitoring

Is there regular and constant monitoring of loan status, borrowers and whether collateral remains secure? Are procedures in place to escalate concerns?

Is there proper documentation?

Throughout Operations

Is there proper documentation of due diligence steps and approvals? Are supporting documents (e.g. on client identity, creditworthiness, collateral) properly retained and kept up-to-date?



How? Considerations for corporate transactions (e.g. acquisitions, disposals, financial assistance)

To manage risks, the Board needs to ensure and ascertain (among other things):

Does the proposed transaction follow a proper commercial rationale with terms that are fair and reasonable?

Commercial Rationale

Due Diligence

Is the scope of due diligence wide enough to cover financial, legal, operational and human resources aspects, tailored to the transactional nature and risks, and the involved counterparties?

Prior to approval, have relevant internal controls and regulatory requirements been complied with?

Compliance

Independent Judgment

Has each director applied independent judgment when considering information for the approval of the transaction? If there are comments or concerns, have such been properly raised and documented?



Key Takeaways



Key Takeaways

Effective internal controls key for robust corporate governance

- Effective risk management and internal controls are key requirements for achieving healthy corporate governance.
- The board leads, setting the tone from the top, with all stakeholders and departments playing an important role in the day-to-day implementation.

No one-size-fits-all

- Risk management and internal control systems have to be tailored to the unique requirements of each issuer and need to be continuously evaluated to confirm they remain fit for purpose.

High risk transactions require particular attention

- The board has to be mindful when approving high risk transactions or business ventures to ensure internal controls remain effective and regulatory requirements have been complied with.





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Many Thanks!

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