

CONSULTATION CONCLUSIONS

ON RISK MANAGEMENT AND INTERNAL CONTROL:
REVIEW OF THE CORPORATE GOVERNANCE CODE
AND CORPORATE GOVERNANCE REPORT

December 2014



Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

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CHAPTER I: INTRODUCTION

1. In June 2014, The Stock Exchange of Hong Kong Limited (the “**Exchange**”), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (“**HKEx**”) published a “Consultation Paper on Risk Management and Internal Control: Review of the Corporate Governance Code and Corporate Governance Report” (“**Consultation Paper**”). The Consultation Paper sought comments on proposed changes to the Corporate Governance Code and Corporate Governance Report (“**Code**”) relating to internal controls (Sections C.2 and C.3).
2. This paper presents the results of the consultation.
3. The consultation period ended on 31 August 2014. The Exchange received a total of 57 submissions from respondents including issuers, market practitioners, professional bodies, institutional investors and individuals.
4. All submissions are available on the HKEx website¹ and a list of respondents (other than those who requested anonymity) is set out in **Appendix I**.
5. With a few exceptions, the proposals received substantial majority support. We conclude that most of the proposals outlined in the Consultation Paper should be adopted, with certain modifications or clarifications set out in this paper. We also received valuable comments in respect of the Code generally which while, not on this occasion specifically sought in the consultation, will be considered at future reviews.
6. Chapter II of this paper summarises the key points made by respondents on the proposals, and our conclusions. This paper should be read in conjunction with the Consultation Paper, which is posted on the HKEx website.
7. The Code amendments are set out in **Appendix II** and are available on the HKEx website². They have been approved by the Board of the Exchange and the Securities and Futures Commission, and will become effective for accounting periods beginning on or after 1 January 2016. Code references in this paper are to the Main Board Listing Rules, while corresponding amendments will be made to the GEM Rules.
8. We would like to thank all respondents for their time and efforts in reviewing the Consultation Paper and sharing with us their detailed and thoughtful suggestions.

Main changes adopted

9. In summary, the main changes include:
 - incorporating risk management into the Code where appropriate;

¹ <http://www.hkex.com.hk/eng/newsconsul/mktconsul/responses/cp201406r.htm>.

² http://www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/mb_ruleupdate.htm and http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/gemrule_update.htm.

- revising Principle C.2 to define the roles and responsibilities of the board and management;
- clarifying that the board has an ongoing responsibility to oversee the issuer's risk management and internal control systems;
- upgrading to Code Provisions (“CPs”) the recommendations in relation to the annual review and disclosures in the Corporate Governance Report; and
- upgrading to a CP the recommendation that issuers should have an internal audit function, and those without to review the need for one on an annual basis.

CHAPTER II: MARKET FEEDBACK AND CONCLUSIONS

10. This chapter contains our proposals for Code amendments, a summary of the comments we received, together with our responses and conclusions.
11. The Main Board and GEM Rule amendments are available at the HKEx website.³
12. The 57 respondents can be grouped into broad categories as follows:

Category	No. of respondents
Issuers	33
Professional bodies	9
Market practitioners	6
Individuals	7
Institutional investors	1
Others	1
Total	57

13. A list of the respondents forms Appendix I. The full text of all the submissions is available on the HKEx website.⁴

1. Risk management and internal control

(Consultation Question 1)

The proposal

14. We proposed amending the title of Section C.2 of our Code to “Risk management and internal control”.

Comments received

15. A substantial majority of respondents supported this proposal. Many respondents commented that the proposed title amendment aptly emphasises the integration of risk management and internal controls. They also in general agree that the proposal is in line with international practices.
16. Two individuals opposed the amendments on the ground that the phrase “risk management” encompasses the meaning of “internal control”.

³ http://www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/mb_ruleupdate.htm and http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/gemrule_update.htm.

⁴ <http://www.hkex.com.hk/eng/newsconsul/mktconsul/responses/cp201406r.htm>.

The Exchange's response

17. We welcome the broad support for our proposed title amendment and consider it appropriate to amend the title to place equal emphasis on risk management and internal controls.

Consultation conclusion

18. We have adopted the proposed title amendment.

2. Responsibilities of the board and management

(Consultation Questions 2 and 3)

The proposals

19. We proposed amending Principle C.2 to define the roles of the board and the management, and to state that the management should provide assurance to the board on the effectiveness of the risk management systems.
20. We also proposed introducing an amended Recommended Best Practice (“**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.

Comments received

Roles of the board and management

21. Most respondents supported amending the Principle as proposed. In addition to the rationale in the Consultation Paper, many supporters believed that a clear delineation of the duties of the board and the management would enhance the effectiveness of the internal control and risk management systems and promote accountability.
22. Two respondents were of the view that the board’s role should not just be to evaluate, but also to determine the nature and extent of the risks.
23. Opponents to the proposal mainly argued that for smaller issuers it is not practicable to separate the roles of the board and management. Some respondents considered that the term “management” should be defined in the Rules.

Assurance

24. The proposal to introduce an RBP C.2.6 received strong support. Many respondents supporting the proposal believed that it would emphasise the management’s responsibility for designing, implementing and monitoring the systems. A number of respondents, mainly market practitioners and professional bodies, submitted that the proposal should be a CP (i.e. subject to “comply or explain”), rather than a RBP, so as to align with the direction set by the revised Principle.

25. However, a number of respondents raised issues with the term “assurance” in the proposed Principle C.2 and RBP C.2.6. Some pointed out that assurance is usually something given by an independent party, whilst others asked for more concrete guidelines on the forms and content of the assurance. There was concern that using the term assurance could encourage management to over-rely on internal and/or external audit.

The Exchange’s response

Roles of the board and management

26. Given the significant support and the reasons expressed by the respondents, we consider it appropriate to revise the Principle to define the roles of the board and management.
27. The amendments to the Principle, as proposed, would provide direction/guidance to the company. As there is no requirement for disclosure, the proposed amendments would not impose an undue administrative burden on issuers.
28. We agree with the respondents’ comments in relation to the board’s responsibility (paragraph 22), in that it should include “determining” as well as evaluating the nature and extent of the risks it is willing to take in achieving the issuer’s strategic objectives.
29. The Rules do not define “management”. As well as the fact that it is a commonly understood term, each company may also have its own definition of “management”. The Exchange has explained “senior management” in a note under CP A.7.2 of the Code,⁵ we consider that the “management” of an issuer should be determined by the issuer itself.

Assurance

30. We intended the term to mean that the management should inspire confidence to the board on the effectiveness of the systems, as opposed to requiring assurance given by independent third parties. Given the possible misinterpretation of the term “assurance”, we consider the word “confirmation” an appropriate substitution.

Consultation conclusion

31. We have adopted the proposed amendments to Principle C.2 with minor amendments to take into account the discussions in paragraphs 28 and 30.
32. We have adopted the proposed RBP C.2.6 with minor amendments as discussed in paragraph 30.

⁵ Note under A.7.2: “In this Code, ‘senior management’ refers to the same persons referred to in the issuer’s annual report and required to be disclosed under paragraph 12 of Appendix 16.”

3. Annual review and disclosure in the Corporate Governance Report

A. Ongoing process as opposed to one-off review

(Consultation Question 4)

The proposal

33. We proposed to amend CP C.2.1 to add that the board should oversee the issuer's risk management and internal control systems on an ongoing basis.

Comments received

34. The proposal received strong support. Supporters agreed with the rationale set out in the Consultation Paper. A number of respondents shared the view that risk management should be an ongoing process which does not end with the establishment of internal control systems.
35. Some opponents to the proposal were concerned that the phrase "*on an ongoing basis*" could be interpreted as a "day-to-day" responsibility for the board, which it might not have the capacity to handle. Also, they expressed the view that the word "oversee" already indicates a continual process.
36. Some respondents considered that the current requirement was for the board to review the risk management and internal control systems once a year and that was sufficient.

The Exchange's response

37. We agree with the majority view that the Code should emphasise the board's ongoing responsibility to oversee the issuer's risk management and internal control systems. In particular, we concur with the respondents' comments including: "*risk management and internal control systems are integrated into the daily operation of the issuer*" and "*risk management should be an ongoing and robust process and does not end with establishment of internal control systems*".
38. Whilst it may not be possible for the board to supervise the risk management and internal control systems on a day-to-day basis, we would however expect the board to seek and receive regular reports on the operation of these systems, which should include knowing how key risks are being managed and any changes in the major risks facing the issuer.
39. We believe the proposed amendment clarifies rather than adds to the board's responsibility.
40. The proposal is also in line with international practices.⁶

⁶ For instance, C.2.3 of the new UK code (published in September 2014) contains similar wording to the Code's C.2.1 except that it uses the word "monitoring" which suggests an ongoing process. See also

Consultation conclusion

41. We have adopted the proposed amendments to CP C.2.1.

B. Disclosure relating to annual review and matters to be considered

(Consultation Questions 5 to 9)

The proposals

42. We proposed upgrading to a CP the existing RBP C.2.3, which sets out the matters that the board's annual review should consider.
43. We proposed upgrading 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. Apart from upgrading C.2.4, we also proposed to:
- (a) amend the wording of 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; and
 - (b) upgrade to CP C.2.4 (e) the existing recommendation that issuers disclose their procedures and internal controls for handling and disseminating inside information (from Section S., paragraph (a) (ii)), and amending it to include "*other regulatory compliance risks*".
44. We proposed upgrading to Mandatory Disclosures most of the existing Recommended Disclosures in relation to internal controls (Section S) and amending the title of this section to incorporate "risk management".

Comments received

Upgrading the existing RBPs C.2.3 and C.2.4 to CPs

45. A significant majority of respondents supported our proposals to upgrade the existing RBPs C.2.3 and C.2.4 to CPs. Supporters recognised that the proposed upgrade would provide more guidance to issuers on the particular matters on which they should focus during the review and that it would facilitate comparability across issuers. Respondents agreed that CP C.2.4 should include the statement that the risk management and internal systems are designed to manage rather than eliminate risks.
46. A small minority of respondents opposing the proposals thought that the upgrade was burdensome to smaller issuers.

paragraph 11 of "*Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*" published in September 2014 by the UK's Financial Reporting Council. Also see Principle 16 of "*COSO Internal Control-Integrated Framework*" published in May 2013.

47. A majority of respondents expressed concerns about the disclosure of the handling of “*other regulatory compliance risks*” in CP C.2.4(e). Several professional bodies and market practitioners pointed out that the proposed requirement is too vague and extensive.

Upgrading some existing Recommended Disclosures to Mandatory Disclosures in Section S

48. The proposal to upgrade most of the existing Recommended Disclosures in relation to internal controls (Section S) to Mandatory Disclosures gained strong support. Supporting respondents mostly agreed with paragraphs (a) to (c) but have concerns over the proposed paragraph (d).
49. A majority of respondents expressed reservations towards the proposed upgrade of paragraph (d) (“*significant views or proposals put forward by the audit committee*”) from Recommended to Mandatory Disclosure, stating that it may discourage the audit committee to share views with the rest of the board, particularly on proposals which may contain confidential and sensitive information.

The Exchange’s response

Upgrading the existing RBPs C.2.3 and C.2.4 to CPs

50. We consider there is substantial support for upgrading to CPs the existing RBPs C.2.3 and C.2.4, as discussed in the Consultation Paper and the responses.
51. We agree that the proposed disclosure requirement covered by the wording “*other regulatory compliance risks*” is too broad and may be difficult to comply with, and have therefore decided to remove it.

Upgrading some existing Recommended Disclosures to Mandatory Disclosures in Section S

52. The upgrade of most of the Recommended Disclosures in relation to internal controls (i.e. Section S paragraphs (a) to (c)) is consequential to the proposed upgrade of RBP C.2.4 to a CP.
53. We note and understand the concerns that the proposed disclosure requirement in paragraph (d) may discourage free exchange of views between the audit committee and the board. We also appreciate the issue with regard to confidentiality.

Consultation conclusion

54. We have adopted the proposal of upgrading to a CP the existing RBP C.2.3.
55. We have also adopted the proposal of upgrading to a CP and revising the wording of the existing RBP C.2.4. We have removed the wording “*other regulatory compliance risks*” from paragraph (e).

56. We have adopted the proposal to upgrade the Recommended Disclosures in Section S paragraphs (a) to (c) to Mandatory Disclosures, and removed the proposed paragraph (d).

C. Other amendments

(Consultation Questions 10 to 12)

The proposals

57. We proposed 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*”.
58. We proposed removing RBP C.2.5, which states that issuers should ensure their disclosures provide meaningful information and do not give a misleading impression.
59. We proposed 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)).

Comments received

60. A significant majority of respondents supported the proposal to move the existing recommendation that issuers disclose details of any significant areas of concern to a new RBP C.2.7. In addition to agreeing with the rationale stated in the Consultation Paper, respondents also commented that the proposal would impose no restrictions on the disclosure of significant concerns “*which may affect shareholders*”. Supporters also thought that disclosure of significant areas of concern which may affect other stakeholders of a company is equally important. A number of supporting issuers believed this proposal can provide clearer guidance on the disclosure requirements.
61. A number of respondents disagreed with the removal of the wording “*which may affect shareholders*” on the ground that issuers have the primary responsibility to their shareholders. One respondent preferred that only those concerns that become material enough to have an impact on financial performance and share value should be disclosed.
62. Nearly all respondents concurred with our proposal to remove RBP C.2.5, agreeing that it is redundant.
63. An overwhelming majority of respondents supported the proposals to remove the existing recommendations set out in paragraph 59. A number of supporting issuers pointed out that the removal of the recommendations would bring clarity to the Code.

The Exchange's response

64. We believe it is important for issuers to disclose details of any significant areas of concern. Removal of the wording “*which may affect shareholders*” is intended to reflect the fact that issuers are not only responsible to their shareholders, but also to other stakeholders.
65. We also welcome the market's broad support towards our proposed removal, for the sake of clarity, of RBP C.2.5 and the existing recommendations as set out in paragraph 59.

Consultation conclusion

66. We have adopted the 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 remove the reference to areas of concern “*which may affect shareholders*”.
67. We have adopted the proposal to remove RBP C.2.5 and paragraphs (a)(i) and (a)(vii), of Section S of the Code.
68. We have also adopted the proposal to remove the existing recommendations as set out in Section S, paragraphs (a)(i) and (a)(vii) of the Code.

4. Internal audit

(Consultation Questions 13 to 15)

The proposals

69. We proposed 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 those 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.
70. We proposed the following new Notes 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.
71. We proposed 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).

Comments received

Reviewing the need for an internal audit function

72. The proposal of requiring issuers, on a “comply or explain” basis, to annually review the need for an internal audit function was supported by a significant majority of respondents. They mostly agreed with the rationale set out in the Consultation Paper.
73. Many supporters recognised the importance of an internal audit function and submitted that upgrading RBP C.2.6 to a CP aligns with global practices.
74. Opponents were concerned about the practicality and the potential cost burden for small sized issuers to establish an internal audit function.

Introducing Notes regarding internal audit function

75. A significant majority of respondents agreed with the proposal to introduce the new Notes, stating that they provide clarity.
76. Some respondents suggested introducing a note or an FAQ, clarifying that either in-house internal audit function or outsourcing the function to competent persons can achieve compliance with the proposed CP.
77. One respondent recommended that in respect of Note 2 (paragraph 70(b)) under the proposed CP C.2.5, the sharing of resources should not be restricted to resources of the holding company. A group should have the flexibility to decide which of its group companies, holding or subsidiaries, is best to carry out the internal audit functions for other member companies, based on expertise and resources planning and allocation.
78. A small number of respondents opposed the introduction of the Notes, maintaining that the proposed CP C.2.5 is self-sufficient.

Amendments to the existing CP C.2.2

79. The proposal received broad support, including unanimous approval from individuals and market practitioners. Most respondents considered that the proposals were logical consequential amendments following the proposals in relation to internal audit.
80. One respondent approving the proposal in relation to CP C.2.2 commented that management often faces an intrinsic conflict in allocating sufficient resources to internal audit. However, in the company that the respondent serves, there are specific provisions in their board policy that in case of disagreement, the board should step in and intervene. The proposed CP would provide greater power to issuers’ boards to allocate sufficient resources to internal audit functions amongst other items set out in the CP.
81. One respondent did not agree with replacing the original word “consider” to “ensure”, stating that an annual review by the board can never “ensure” the adequacy of resources, staff qualifications and experience. Another respondent suggested

replacing the word “ensure” with “evaluate” or “assess” to reflect the fact that the board’s annual review is a process, the outcome of which can be assessed separately.

82. A small number of opponents considered the upgrade unnecessary and thought that the requirement should remain as a RBP.

The Exchange’s response

83. We note that a majority of the respondents recognise the importance of an internal audit function in ensuring the effectiveness of an issuer’s risk management and internal control systems. We consider “ensure” a more appropriate word than “consider” as it would promote greater accountability of the board.
84. We agree with the respondent (paragraph 77) that the sharing of resources in relation to internal audit function should not be limited to the resources of the holding company. We note respondents’ call for an additional note or FAQ to clarify that outsourcing the internal audit function would not be considered a deviation from the CP. We intend to publish an FAQ to clarify this point.

Consultation conclusion

85. We have adopted the proposal of upgrading RBP C.2.6 to a CP (re-numbered C.2.5), together with the new Notes set out in the Consultation Paper. We have removed the wording “of the holding company” from Note 2.
86. We have also adopted the proposal of amending the existing C.2.2.

5. Audit Committee’s role

(Consultation Questions 16 and 17)

The proposals

87. We proposed amending 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.
88. We sought market views on whether the matter of establishing a separate board risk committee should be left to issuers to decide in accordance with their own circumstances.

Comments received

89. A substantial majority of respondents supported the proposal of amending Principle C.3, and most agreed with the rationale in the Consultation Paper.
90. A number of respondents suggested adding clarifications that where an issuer has a board risk committee, the audit committee’s duties in respect of risk management and internal controls could be effectively discharged if they are expressly addressed by a separate board risk committee.

91. A small number of issuers commented that the existing wording in Principle C.3 is already sufficient and that the proposed amendments would impose an onerous burden on the audit committee.
92. Nearly all respondents supported the view that the establishment of a separate board committee should be left to issuers to decide for themselves. Most of them favoured flexibility to issuers and acknowledged that there is no “*one size fits all*” solution.

The Exchange’s response

93. We agree that where oversight and other risk management and internal control responsibilities are carried out by a risk committee (instead of the audit committee), it should not be treated as deviation from the CP.
94. We note the overwhelming support for leaving the question of the establishment of a separate board committee to issuers to decide for themselves.

Consultation conclusion

95. We have adopted the proposal to amend Principle C.3 and CP C.3.3 in respect of audit committees and their terms of reference to incorporate “risk management” where appropriate.
96. We have also concluded that the matter of establishing a separate board risk committee should be left to issuers to decide.
97. We have revised the wording of Section C of the Code so that where a risk committee carries out oversight and other risk management and internal control responsibilities it should not be treated as a deviation from the Code.

6. Implementation Date

(Consultation Question 18)

The proposal

98. We sought market views on an appropriate period of time between the publication of the consultation conclusions and the implementation of the amendments set out in the Consultation Paper.

Comments received

99. Over two-thirds of the respondents favoured 12 months. They commented that a 12-month period can allow sufficient time for issuers to prepare for new requirements. Some of them find this period particularly necessary for small and medium sized issuers in view of their resources.

The Exchange's response

100. Given the respondents' strong support, we believe 12 months is an appropriate period of time between the publication of this consultation conclusions and the implementation of the amendments set out in the Consultation Paper.

Consultation conclusion

101. Implementation of the Code amendments as set out in Appendix II will apply to accounting periods beginning on or after 1 January 2016.

APPENDIX I: LIST OF RESPONDENTS

Issuers (33 in total)

1	Integrated Waste Solutions Group Holdings Limited
2	Swire Pacific Limited A & B
3	Swire Properties Limited
4	Cathay Pacific Airways Limited
5	Hong Kong Aircraft Engineering Company Limited
6	PCCW Limited
7	HKT Trust and HKT Limited
8	China COSCO Holdings Company Limited
9	Hutchison Whampoa Limited
10	Kaisun Energy Group Limited
11	AIA Group Limited
12	MTR Corporation Limited
13	Standard Chartered PLC
14	Cheung Kong (Holdings) Limited
15	Sa Sa International Holdings Limited
16	HSBC Holdings PLC
17	Hysan Development Company Limited
18	CLP Holdings Limited
19	Henderson Land Development Company Limited
20	Hong Kong Ferry (Holdings) Company Limited
21-33	13 issuers requested anonymity

Market Practitioners (6 in total)

34	KPMG
35	PricewaterhouseCoopers Limited
36	Ernst & Young
37	Deloitte Touche Tohmatsu
38	CT Partners Consultants Limited
39	SHINEWING Risk Services Limited

Individuals (7 in total)

40	Suen Chi Wai
41	KC Wong
42	Chu Wai Lim
43	Eric Kan
44-46	3 individuals requested anonymity

Professional Bodies (9 in total)

47	The Hong Kong Association of Banks
48	The Law Society of Hong Kong
49	The Chamber of Hong Kong Listed Companies
50	The Hong Kong Institute of Chartered Secretaries

51	ACCA Hong Kong
52	The Information Systems Audit and Control Association (China HK Chapter)
53	The Institute of Internal Auditors Hong Kong Limited
54	Hong Kong Institute of Certified Public Accountants
55	The Hong Kong Institute of Directors

Institutional investors (1 in total)

56	BlackRock
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Others Entities (1 in total)

57	Independent Commission Against Corruption
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Remarks:

1. *One submission is counted as one response.*
2. *The total number of responses is calculated according to the number of submissions received and not the underlying members that they represent.*

APPENDIX II: LISTING RULE AMENDMENTS

(Unless otherwise specified, set out below are the draft Main Board Rule amendments. The Exchange will 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

...

PRINCIPLES OF GOOD GOVERNANCE, CODE PROVISIONS AND RECOMMENDED BEST PRACTICES

...

C.ACCOUNTABILITY AND AUDIT

...

C.2 Risk management and internal controls

Principle

The board ~~should ensure~~ is responsible for evaluating and determining 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 a confirmation 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~~ 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.

~~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:

1 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.

2 A group with multiple listed issuers may share group resources to carry out the internal audit function for members of the group.

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.~~

C.2.6 The board may disclose in the Corporate Governance Report that it has received a confirmation 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.

C.3 Audit Committee

Principle

The board should establish formal and transparent arrangements to consider how it will apply financial reporting, risk management and internal control principles and maintain an appropriate relationship with the issuer's auditors. The audit committee established under the Listing Rules should have clear terms of reference.

Code Provisions

...

C.3.3 The audit committee's terms of reference should include at least:

Relationship with the issuer's auditors

- (a) ...
- ...
- (e) ...
- ...

Oversight of the issuer's financial reporting system, risk management and internal control systems ~~procedures~~

- (f) to review the issuer's financial controls, and unless expressly addressed by a separate board risk committee, or by the board itself, to review the issuer's risk management and internal control and risk management systems;
- (g) to discuss the risk management and internal control systems with management to ensure that management has performed its duty to have ~~an effective internal control~~ systems. This discussion should include the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's accounting and financial reporting function;
- (h) to consider major investigation findings on risk management and internal control matters as delegated by the board or on its own initiative and management's response to these findings;
- (i) where an internal audit function exists, to ensure co-ordination between the internal and external auditors, and to ensure that the internal audit function is adequately resourced and has appropriate standing within the issuer, and to review and monitor its effectiveness;

...

CORPORATE GOVERNANCE REPORT
MANDATORY DISCLOSURE REQUIREMENTS

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...

L. BOARD COMMITTEES

The following information for each of the remuneration committee, nomination committee, ~~and~~ audit committee, risk committee, and corporate governance functions:

(a) ...

...

(d) a summary of the work during the year, including:

(i) ...

...

(iv) for the audit committee, a report on how it met its responsibilities in its review of the quarterly (if relevant), half-yearly and annual results, and unless expressly addressed by a separate risk committee, or the board itself, its review of the risk management and internal control systems, the effectiveness of the issuer's internal audit function, and its other duties under the Code....; and

(v) for the risk committee (if any), a report on how it met its responsibilities in its review of the risk management and internal control systems and the effectiveness of the issuer's internal audit function.

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P. INVESTOR RELATIONS

Any significant changes in the issuer's constitutional documents during the year.

RECOMMENDED DISCLOSURES

S-Q. RISK MANAGEMENT AND INTERNAL CONTROLS

~~(a) — Where an issuer includes a directors' the board's statement that they have it has conducted a review of its risk management and internal control systems in the annual report under paragraph code provision C.2.1, it is encouraged to must disclose the following:~~

~~(a) (i) — an explanation of how the internal control system has been defined for the issuer;~~

~~(ii) — procedures and internal controls for the handling and dissemination of inside information;~~

- (iii) whether the issuer has an internal audit function;
- ~~(iv) the outcome of the review of the need for an internal audit function conducted, on an annual basis, by an issuer without one (C.2.6 of the Code);~~
- (b) ~~(v) how often the risk management and internal controls systems are reviewed; the period covered, and where an issuer has not conducted a review during the year, an explanation why not; and~~
- (c) ~~(vi) a statement that a the directors have reviewed review of the effectiveness of the risk management and internal control systems has been conducted and whether they the issuer considers them effective and adequate;~~
 - ~~(vii) directors' criteria for assessing the effectiveness of the internal control system;~~
 - ~~(viii) the period covered by the review;~~
 - ~~(ix) details of any significant areas of concern which may affect shareholders;~~
 - ~~(x) significant views or proposals put forward by the audit committee;~~
 - ~~(xi) where an issuer has not conducted a review of its internal control system during the year, an explanation why not; and~~
- ~~(b) a narrative statement explaining how the issuer has complied with the code provisions on internal control during the reporting period.~~

RECOMMENDED DISCLOSURES

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Q.R. SHARE INTERESTS OF SENIOR MANAGEMENT

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R.S. INVESTOR RELATIONS

...

S. INTERNAL CONTROLS

...

T. MANAGEMENT FUNCTIONS

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