

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.

Although I do not believe that there are universally agreed definitions for the terms “internal controls” and “risk management” (the COSO framework definition may be widely quoted but it is never regarded as the one and only one definition), “risk management” does points to a wider and more forward looking perspective in viewing the risks faced by a corporation. The amendment can do no harm.

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.

The amendments are clearly an improvement over the existing version. Correctly emphasise the important role of the Board to determine the “risk appetite”. Risk and control systems and processes are not without costs (monetary costs, lowering of operating efficiencies, loss of business opportunities, etc.), and it is ultimately the Board’s responsibility to find the correct balance.

In my view, the UK code (described in paragraph 42) best delineates the different roles of the Board and the management. In reality, management is most qualified to identify and evaluate risks faced by the corporation. However, their judgment may be impaired by other considerations such as short term performance, lack of resources, work efficiencies, etc. In this regard, the Board is instrumental in acting as a monitoring body to ensure that the risks identified by management is appropriate, and that suitable levels of controls are installed and implemented to address those risks.

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.

Generally I dislike the use of statement such as “..received assurance from...” The new CP 2.1 to 2.5 already outline the basic requirement for the Board to ensure the effectiveness of the risk management systems. These requirement cannot be fulfilled without the active support and participation of the management. The assurance from the management is thus given in action rather than in words. The suggested RBP (C 2.6) does not appear to add anything, except perhaps the adverse effect that some boards may simply do the minimum and rely on a statement from the management (Just to cover its back! See what the Board of MTR said? “We asked whether there would be any delay. The management said no. They “assured” us that there would be none!).

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.

No further comments.

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.

I have no objection to turning C2.3 from a RBP into a CP. However, it is acknowledged that due to the wide variation of circumstances (the size of the corporation, the complexity of the operations, the governance structure, etc.), the way that a board reviews the risk management systems may be very different. It is therefore important that this CP should be brief, focusing on the “must do’s” and allows sufficient flexibility for the Board to determine what the review should or should not include.

On this basis, my view is that:

- (1) The first half of (b): “the scope and quality of management’s ongoing monitoring of risks and of the internal control systems” should be taken out. The statement is vague and redundant. An assessment cannot be done without looking at the scope and the quality.*
- (2) The second statement of (d): “Also, the extent to which they have.....on the issuer’s financial performance or condition,” should be taken out. This adds nothing to the CP. The starting words “significant” describe the requirement already.*
- (3) (e) should be taken out. “Accuracy of financial reporting” is no doubt an important risk. I am not sure “Listing Rule compliance” is (the Stock Exchange may have a biased view on this one, but for most corporations, there are certainly many risks that they face which are much more important than Listing Rule compliance!). It is odd to specifically highlight these2 risks in this CP. Are other risks not as important as these 2?*

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.

I agree with the idea of specifying certain disclosure requirements. But see my comments on Q.7 below.

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.

My suggestions on the amendments to the proposed C2.4:

(1) (a) and (b) can be combined into one. “The process used to identify, evaluate and manage significant risks” can be exceedingly detail and complex and I wonder how a complete process can be included in the CGR. The requirement should be only for “a summary of the main features of the risk management and internal control systems”.

(2) Again, I do not see sufficient reason to highlight “inside information disclosure” and “regulatory compliance” as 2 risks that justify specific highlight. (e) should be taken out.

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.

See my comments on Q.7 above.

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.

No further comment.

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.

If the Board decides to disclose certain “areas of concern”, I think it should at the same time discloses control systems implemented or proposed to be implemented to address those “areas of concern”, or that none has been put in place or proposed (I doubt they would say that!), otherwise it is only showing half of the picture.

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.

Obvious. No further comment.

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.

No further comment.

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.

No further comment.

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.

I am not entirely sure why (b) is needed. You states in paragraph 88 that you accept an outsourced IA function as compliance. I suggest that you either add this into (b) above or delete (b) all together, if this sub-paragraph is meant to allow corporations with limited resources (or cost concern) to use "outside" people to do IA work.

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.

Fully support this proposal. Management often faces an intrinsic conflict in allocating sufficient resources to IA. In the company which I serve as the Chairman of the Audit Committee, we are in constant struggle with the management to put additional resources into IA function. We do have specific provisions in our relevant Board Policy that in case of disagreement, the Board should step in and intervene. It would be nice to have it as a CP.

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.

No further comment.

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.

*Agree with your view that for most corporations, the members of these 2 committees may end up to be the same persons.
Having said that, my personal view (having served on many Audit Committees for over 20 years) is that the 2 existing major functions of an Audit Committee, namely review of financial information (including monitoring the relationship between the issuer and its external auditors) and risk management and internal control systems, demand very different expertise. The former function is clearly accounting and finance related, more suitably discharged by members with accounting and finance background. The latter may require the knowledge of a wide range of operational activities and members with general management expertise, preferably with experience in related fields (to the issuer) are better able to contribute. This is clearly reflected in the different involvement in the issues being discussed in our Audit Committee meetings.
So my “out-of-the-box” proposal, perhaps for the next round of review, is the take away the duties towards risk management and internal control from the Audit Committee, allowing it to focus on the financial reporting function (and thus encouraging issuers to select members with appropriate accounting and finance background to sit in that committee). At the same time, make mandatory the Risk Committee and allow the Board to delegate its “Risk” functions to this committee. In practice, such a committee, smaller in size and more focused, can have a much closer interaction with management and save the Board a lot of valuable Board resources.*

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.

Cannot see reason for delay.

- End -