

Comments on the Financial Reporting Council Bill

As stated in our comments on the Consultation paper on Legislative Proposals to establish Financial Reporting Council, The Law Society generally supports the proposals to establish Financial Reporting Council to oversee an Audit Investigation Board and Financial Reporting Review Committee(s).

The following are our views on the Financial Reporting Council Bill –

A Powers to investigate auditing and reporting irregularities

- 1 In relation to the powers for the purpose of investigation of relevant irregularities by the Financial Reporting Council (“Council”) or the Audit Investigation Board (“AIB”), the investigator has the power to require persons other than the auditors and the listed entity to produce records and documents relating to auditing and reporting irregularities.

Sections 25(5) and 26(5) of the Bill empower the investigator to require the production of record or document by any person who has dealt with, or has dealings with, the listed entity or is otherwise in possession of records or documents that relate to the audit of the accounts or the preparation of a report for a listing documents of the entity.

Section 28 of the Bill empowers the investigator to require, in addition to the auditor or reporting accountant of the listed entity, a person whom the investigator has reasonable cause to believe to be in possession of records or documents that contain, or are likely to contain, information relevant to the relevant irregularity or to the question whether or not there is such an irregularity, or a person whom the investigator has reasonable cause to believe to be otherwise in possession of such information.

- 2 Such powers of the Council and the AIB appear to be over extensive and are wider than the equivalent power of investigations provisions -
 - in the UK, the powers of the Financial Reporting Council (which derived its powers from the Companies Act 1985 and the Companies (Audit, Investigations and Community Enterprise) Act 2004) to require production of document and information from the company and any officer, employee or auditor of the company;
 - in the US, the powers of the Public Company Accounting Oversight Board (created

by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies) to require the accounting firm and person associated with such firm to comply with their orders.

- 3 The role of the Council is investigatory/ enquiry only, it does not have the power to impose sanctions, any further investigation or disciplinary action would be taken by other regulatory authority or professional accountancy bodies to whom the Council might refer its findings.

In our view, the power of investigation of the Council and the AIB should enable it to compel the provision of information and documents by auditors and listed companies, but not further. Such power should be adequate for investigation into suspected auditing and reporting irregularities. In particular, such power should not extent to, for instance, legal advisers whose legal professional privilege may not always be successfully claimed, for whatever reason, notwithstanding the provisions of section 55.

The Council and AIB should not have all the investigation powers of the SFC which would be overly intrusive and not justified by its objective and jurisdiction.

- 4 It is noted that, in contrast, the investigatory powers of the Council or the Financial Reporting Review Committee (“FRRC”) under section 42 of the Bill in respect of relevant non-compliances in relation to financial reports of a listed entity are not so extensive. The power to require production of records and documents and provision of information and explanation is restricted to the listed corporation, the auditor and officers or employees of the corporation. We agree that the scope of such power is appropriate.

B Provisions regarding avoidance of conflict of interest

- 1 As stated in our previous comments on the Consultation Paper, we are concerned that the provisions relating to avoidance of conflict of interests may be too harsh. Such provisions are now set out in section 52 of the Bill.
- 2 The provisions apply to members of the Council, the AIB, the FRRC, committees established by the council and persons who perform a function under the Ordinance.

The list of interest required to be declared is very extensive. In any matter to be considered by any of the above persons, such person must declare his interest if such matter relates to any of the specified parties from an extensive list, including in particular the following extracts (section 52) -

- “ another person –
- by whom he is or was a client;
 - who is or was his associate; or
 - whom he knows is or was a client of a third person
 - by whom he is or was employed; or
 - who is or was his associate.”

“associate” in relation to a person, includes any employee ...of the person...

“associate” in relation to a corporation, includes each of its directors and its related corporations and each director or employee of any of its related corporations

The consequence of any contravention, including omission, is severe. A person who, without reasonable excuse, contravenes the disclosure provisions commits an offence and is liable to a fine of \$1,000,000 and to imprisonment for 2 years.

- 3 It is noted that the provisions follow closely those in the Securities and Futures Ordinance, non-compliance of which would result in offence liable for fines and imprisonment. However, the role of the Council is investigatory/ enquiry only, it does not have the power to impose sanctions, any further investigation or disciplinary action would be taken by other regulatory authority or professional accountancy bodies to whom the Council might refer its findings.

It is also noted that, in comparison, persons appointed to serve on the governing bodies of many other statutory boards are not subject to the same onerous disclosure obligations and severe sanctions. Examples are those under [the Mandatory Provident Fund Schemes Ordinance, Town Planning Ordinance].

- 4 It would seem that most of the persons to be appointed to the Council, the AIB and the FRRC would be non public officer individuals whose appointment would be unpaid and would be undertaken as a public duty. In view of the onerous disclosure obligations the compliance of which would require extensive checking and confirmation, and the severity of the sanction, it may be difficult to persuade sufficient number of qualified and suitable candidates to take up such appointment.

We suggest that consideration should be given as to whether such onerous disclosure obligations and severe sanctions regarding disclosure obligations are necessary and appropriate under the circumstances.

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