

Comments on the drafting of the provisions of the Code

Appendix 14 Code on Corporate Governance Practices

- (1) 3rd paragraph of the preamble, last line – “*Any such failure to disclose will be regarded as a breach of the Exchange Listing Rules.*”

There seems to be some ambiguity in this statement. Presumably, failure to comply either is or is not a breach of the Listing Rules. If it is a breach, it would be more appropriate to make a clear and firm statement to the effect that any failure to disclose any deviation from the Code Provisions, and the reasons for such deviations, in the Corporate Governance Report *will be a breach of the Listing Rules.*

A. DIRECTORS

A.1 The Board

- (2) A.1.2 & A.1.3

We believe that the expression “exceptional circumstances” is capable of a wide interpretation. As such, for the sake of transparency, upon which the “comply or explain” approach is premised, we propose that a listed issuer should be required to disclose any non-compliance and to indicate the nature of the exceptional circumstances resulting in non-compliance.

- (3) A.1.1 and following

We suggest that provisions similar to those applicable to board meeting procedures or arrangements, should be included as Recommended Best Practices for board committees.

A.2 Chairman and Chief Executive Officer

- (4) A.2.7

We propose that the purpose of the chairman holding private meetings with the non-executive directors should be specified, e.g. to ensure a free and frank exchange; listen to any concerns that non-executive directors might have about the operation of the company, or their role, etc.

A.4 Appointments, re-election and removal

- (5) A.4.6

Note 1 states that “*This requirement would be met by making it available on request and by including the information on the issuer’s website.*” Is it intended that the nomination committee’s terms of reference, role and authority should be made available to any shareholder upon request? This could be onerous in practice. We are not convinced that a “belt and braces” approach is needed here, rather than, say, allowing an issuer to choose one channel or the other, provided that the issuer makes it known where the information can be obtained.

A.5 Responsibilities of directors

(6) A.5.1

This Provision states that “*This code provision also applies to directors of new listing applicant*” [sic]. It is not clear whether this means all directors of a new listing applicant or only newly-appointed directors. If it is the former, which seems likely, this should be made clearer in the opening statement of the Provision, which currently states: “Every newly appointed director of an issuer should receive a comprehensive, formal and tailored induction...”. If, on the other hand, the intention in respect of new listing applicants, is only to include newly-appointed directors, it needs to be clarified how “newly-appointed directors of a new listing applicant” is to be defined; e.g., is it those directors appointed within a certain period before the date of submission of the listing application?

(7) A.5.4

In addition to reminding directors that they must comply with their obligations under the Model Code set out in Appendix 10 to the Listing Rules, we are of the view that directors should also be reminded that they must also abide by the Code on Corporate Governance Practices, as appropriate.

(8) A.5.6

We consider that a director should notify the issuer whenever there are any changes in the number and nature of offices he holds in other public companies or organisations and his other significant commitments, rather than doing so only “at the time of his appointment, and on a periodic basis”.

A.6 Supply of and access to information

(9) A.6.1 to A.6.3

We suggest that these Provisions should be applied to board committees as Recommended Best Practices.

(10) A.6.1

Please see our comments in relation to (2) above. An issuer should be required to disclose any non-compliance and to indicate the nature of the exceptional circumstances resulting in non-compliance.

(11) A.6.3

Consideration should be given to suggesting, either in the Code or Recommended Best Practices, that an issuer should designate an officer (e.g., the company secretary) to be responsible for responding to directors’ queries.

B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

B.1 The level and make-up of remuneration and disclosure

(12) B.1.4, Note 1

Please see our comments under item (5) above. If an issuer is required to make such information available upon request as well as through the website this could be onerous in practice. These should perhaps be alternatives provided that the issuer makes it clear how the information can be obtained.

(13) B.1.7

As regards disclosure of remuneration payable to members of senior management, it is preferable to specify the details to be disclosed, e.g. to adopt a similar analysis to directors' emoluments specified in paragraph 24 of Appendix 16 to the Listing Rules.

C. ACCOUNTABILITY AND AUDIT

C.1 Financial reporting

(14) C.1.2

It is noted that *"The directors should acknowledge their responsibility for preparing the accounts, and there should be a statement by the auditors about their reporting responsibilities."*

(i) It is not entirely clear in what form the directors should acknowledge their responsibility for preparing the accounts.

We note that paragraph 3(a) of Appendix 17 requires disclosure of an acknowledgement from the directors of their responsibilities for preparing the accounts and we suggest that it be specified in Appendix 14, C.1.2, that the following disclosures should be made in the Corporate Governance Report:

- An acknowledgement from the directors of their responsibilities for preparing the accounts; and
- any material uncertainties relating to events or conditions that may cast significant doubt upon the issuer's ability to continue as a going concern.

(ii) As regards a statement by the auditors about their reporting responsibilities, it is not clear what kind of statement is envisaged here. The Statement of Auditing Standards (SAS) 600 *"Auditors' Reports on Financial Statements"* already requires a statement to be contained in the auditors' report, that:

"Auditors should distinguish between their responsibilities and those of the directors by including in their report:

a. ...; and

b. a statement that the auditors' responsibility is to express an opinion on the financial statements. (SAS 600.3)"

We consider that the existing SAS 600.3 requiring a statement of auditors' responsibility to be contained in the auditors' report should suffice, and cannot see any particular benefit to including a separate statement by the auditors about their reporting responsibilities in the Corporate Governance Report, which is to be prepared by the board of directors.

- (iii) The Provision states that "*The directors should prepare the accounts on a going concern basis ...*"

We suggest prefacing this with "*Unless it is not appropriate to presume that the company will continue in business...*".

C.3 Audit Committee

(15) C.3.2

- (k) Note, 8th line – "the reference to "that guide" may not be clear enough as reference is made in the Note to two different sources of guidance.

(16) C.3.3, Note 1

Please see our comments under items (5) and (12) above. The same point applies.

D. DELEGATION BY THE BOARD

D.1 Management functions

- (17) This Provision makes reference to delegation to the "management" generally. Elsewhere, however, the Note to D.1.1 appears to further subdivide the management, where it refers to delegating matters to "*executive directors or management*". We would suggest that, if distinctions of this kind are being made, these terms may need to be defined, so that it is clear to whom different functions may be delegated, and so that those affected by the corporate decisions are able to understand the respective accountabilities and contributions of the board and those exercising delegated authority.
- (18) Where the board has delegated the management and administration functions to the management, it is important that the board should also maintain effective oversight and monitoring of the management. The need for the board to ensure that an appropriate oversight and monitoring structure and arrangements are in place should be brought to the attention of the board.

Appendix 17 Corporate Governance Report

GENERAL

- (19) Paragraph 1, 14th line – “*Any failure to disclose ... in their Corporate Governance Report will be regarded as a breach of the Exchange Listing Rules.*”

Please see our comments under item (1) above. The same point applies here.

MANDATORY DISCLOSURE REQUIREMENTS

- (20) 2(c)(vii)

We would suggest that it might be clearer if the issue of a relationship between the chairman and the chief executive officer, specifically, is covered under 2(d).

- (21) 2(h)

The Corporate Governance Report requires the following information to be included amongst the disclosures: “An analysis of [auditors’] remuneration in respect of audit, audit-related and non-audit services provided by the auditors ...”

The HKSA’s Professional Ethics Statement 1.203A “*Independence for Assurance Engagements*” contains a definition of “audit engagement” (paragraph 3(e)), as follows:

“An assurance engagement to provide a high level of assurance that financial statements are free of material misstatement, such as an engagement in accordance with SASs and Auditing Guidelines issued by the HKSA or International Standards on Auditing. This includes a Statutory Audit which is an audit required by legislation or other regulation.”

We believe that it would be appropriate to make reference to the above for a definition of “audit service”. Accordingly, any other services provided by the auditors that do not fall within the above definition should collectively be categorised as “non-audit services”.

Under the circumstances, we are not clear how (i) audit-related and (ii) non-audit services can be further distinguished. In order to avoid confusion and increase the comparability of the financial statements, we would like to know how the Stock Exchange intends to define or distinguish audit-related services and non-audit services.

Other Matters

- (22) We have noticed several minor typographical errors in the draft Code and Corporate Governance Report, which will no doubt be identified and remedied in a further review of the drafting.