

<u>URGENT BY FAX AND BY HAND</u> (2810 5656)

Our Ref.: C/AASC 28 March 2003

The Hon. Audrey Eu Yuet-mee, Chairman, Bills Committee on Companies (Amendment) Bill 2002, Legislative Council Secretariat, Legislative Council Building, 8 Jackson Road, Central, Hong Kong.

Dear Ms. Eu,

Companies (Amendment) Bill 2002 (the "Bill")

Further to our submission on the Bill, we are aware that as a result of deliberations at the Bills Committee, it is proposed recently that certain Committee Stage Amendments (CSAs) are to be introduced, which will have the effect of amending the existing s158(10)(a) and s161B of the Companies Ordinance. We write to draw your attention to the grave concerns that the auditing profession have on these proposed CSAs.

Background on the relevant sections of the Law

Section 158(10)(a)

- (1) S158(1) requires every company to keep a register of its directors and secretaries. S158(10)(a) states that a person in accordance with whose directions or instructions the directors of a company are accustomed to act shall be deemed to be a director of the company.
- (2) Clause 61(3) of the Bill proposes to amend the existing s158(10)(a) by substituting "person in accordance with whose directions or instructions the directors of a company are accustomed to act" with the term "shadow director".
- (3) The effect of this change is purely cosmetic as the term "shadow director" is already defined in s168C to mean any person in accordance with whose directions or instructions the directors of a company are accustomed to act.



Section 161B

- (4) S161B requires that the accounts that are required to be laid before a company in general meeting should include information relating to loans etc. made by the company to its directors. In the event that the disclosure requirement in s161B is not complied with, s161B(6) places a specific duty on the company's auditors to include in their reports, as far as they are reasonably able to do so, a statement giving the required particulars.
- (5) S161B is unclear as to whether "directors" in this section shall include "shadow directors".

In 1985, HKSA obtained an interpretation from the then Registrar General that for the purpose of practical administration, the word "director" for the purpose of s161B includes a "shadow director". On that basis, the HKSA issued an accounting bulletin to its members to provide guidance on the disclosure of loans to directors in the accounts.

The proposed CSAs and HKSA's concerns

We understand that CSAs are being drafted to repeal "shadow director" in s158(10)(a). On the other hand, other CSAs will be introduced to expressly require the disclosure under s161B to include loans to "shadow directors".

We write to express our concerns that if the above CSAs are effected, it could be interpreted that there will no longer be any requirement for the company to include the details of "shadow directors" in its register of directors and secretaries under s158.

While the company is not required to maintain a record of "shadow directors" in its register of directors and secretaries, an important source of evidence of existence of "shadow directors" and their identities will be lost. It would be very difficult, if not impossible, for the auditors to come to a conclusion by themselves as to whether the company has any "shadow directors" and who are the "shadow directors", and as a result, whether any loans have been granted by the company to the "shadow directors". In the absence of any obligation for the company to maintain such information in its books and records, it will make s161B(6) an extremely onerous duty.

It is also not up to the auditors to determine as to under whose instructions or directions the directors of the company are accustomed to act, and therefore who shall fall to be regarded as "shadow directors" as legally defined. Accordingly, the auditors could be put into a hopeless situation with their judgement being open to challenge by the company and its directors. Practically, the auditors simply would not have sufficient objective evidence to count on when challenged by the company and its directors. Therefore, it will be quite impossible for the auditors to perform the duty under s161B(6).

Regardless of the practical considerations moreover, it is extremely unfair and unreasonable to let the onus of judging whether there is or there is not the presence of shadow directors to rest with the auditors rather than the directors. Such practice is certainly not one that should be endorsed, as an important principle of good corporate governance is that it should begin with the company and its internal management rather than externally provided.

We respectfully request that the Bills Committee take into consideration our concerns when considering the CSAs to repeal s158(10)(a) and amend S161B regarding "shadow directors". It should also consider the potential implications of these proposed amendments to other sections of the Ordinance as well.

If you require any clarification or further information on our above concern, please do not hesitate to contact the undersigned at the Society.

Yours sincerely,

VinCeup

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