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SUPPLEMENT

Qualification Programme

Module B

Corporate Financing



Hong Kong Institute of  
Certified Public Accountants  
香港會計師公會

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## Changes at a glance

Amended on Learning Pack and Flashcards Supplement

**Chapter Name** **Page**

### Part A: Technical Updates

#### Learning Pack

1	Ethics in business	1
7	Treasury management	3
15	Regulatory environment	9

## Introduction

This Supplement is to be used in conjunction with the sixth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack and 31 May 2018, the cut-off date for examinable standards and legislation for the December 2018 and June 2019 examinations.

The Supplement comprises a technical update on developments that will be examinable in December 2018 and June 2019 examination sessions that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

## Technical Updates – Learning Pack

### Chapter 1 Ethics in business

Updated  
section 7.6  
Page 29

## 7.6 The Environmental, Social and Governance Reporting Guide

Globally, there has been a marked increase in the amount of policy and regulation calling for environmental, social and governance (ESG) reporting. Most countries with policies in this area adopt a combination of laws, listing rules, 'comply or explain' and/or voluntary guidelines to regulate the disclosure of ESG information.

### 7.6.1 HKEx requirements for ESG reporting

In 2012, the Hong Kong Stock Exchange announced an amendment to its Main Board Listing Rules to include a rule (Rule 13.91) whereby companies were 'encouraged' to produce an ESG report annually, either as a separate report or as part of the annual report.

An Appendix to the Listing Rules included an **Environmental, Social and Governance Reporting Guide**.

On 21 December 2015, HKEx published new requirements for ESG reporting in the 'Consultation Conclusions on Review of the Environmental, Social and Governance (ESG) Reporting Guide'. All companies listed on the HKEx were affected, and the new requirements apply to financial years commencing on or after January 2016.

HKEx believes that the long-term benefits that ESG reporting can bring to issuers, as well as to the quality, sustainability and reputation of the Hong Kong market, outweigh any cost or other disadvantages. It is also seen as important for Hong Kong to align itself with international best practice in this area.

The main changes to the ESG Guide included that issuers are now required to state in their annual reports or ESG reports whether they have complied with the 'comply or explain' requirement, and if not, to give reasons.

The Guide was also re-arranged into two subject areas – (A) Environmental and (B) Social as follows.

#### Environmental

- Emissions
- Use of resources
- The environment and natural resources

#### Social

- Employment
- Labour standards
- Supply chain management
- Anti-corruption
- Health and safety
- Development and training
- Product responsibility
- Community investment

The original Guide introduced in 2012 was intended to be the first step in an evolutionary process, with the longer term goal of achieving better and more comprehensive ESG reporting by issuers. The emphasis of the new 2015 requirements is to raise the level of general obligation in ESG reporting, given that there was evidence that many issuers were waiting for the recommended disclosures of the ESG Guide to be upgraded to 'comply or explain' before they began to report.

The 2012 version of the Guide recommended in general terms what the report disclosures should cover, and presented a list of suggested key performance indicators (KPIs). These recommended General Disclosures were upgraded in 2015 to 'comply or explain' with effect from 1 January 2016. It is intended that the requirement for companies to disclose information on their policies in respect of ESG issues, as well as their compliance records with relevant laws and regulations on a 'comply or explain' basis should enhance transparency and raise the overall level of communication.

The KPIs in the Environmental subject area were also upgraded to 'comply or explain', effective for financial years commencing on or after 1 January 2017. The aim of this was to prompt companies to consider how their performance in respect of emissions, waste production and disposal, and use of resources impacts the environment, and how to minimise these impacts and communicate this information to stakeholders.

### **ESG reporting guidelines**

The boards are charged with the responsibility for overseeing ESG risks, so there must be a suitable governance structure in place to keep the board informed of these risks. Effective management systems should be established, including robust systems that can capture data on relevant areas so that management can decide how to deal with the risks that are present.

The following Reporting Principles should be applied in the preparation of an ESG report, concerning both the content of the report and how that content is presented:

- (a) **Materiality** All companies face a range of ESG issues, with varying impacts on the business and its stakeholders. The most significant issues should be given priority.
- (b) **Quantitative**: KPIs will be used for analysis and decision-making by ESG report users. Companies should therefore establish measurable KPIs and targets wherever possible in their reports, and support them with explanation.
- (c) **Balance**: The ESG report should provide an unbiased assessment.
- (d) **Consistency**: The issuer should use consistent methodologies to allow for meaningful comparisons of ESG performance over time.

Whilst many issuers publish their ESG information as a part of the annual report, some opt for publishing this information on their websites or in standalone reports. A substantial number of issuers publish ESG information in more than one format. HKEx proposes to continue to allow multiple formats of ESG reporting so as to give issuers the flexibility to issue ESG reports in the form that best suits their circumstances.

From the Hong Kong perspective, it is important to maintain appropriate ESG reporting and quality disclosures, so as to match international standards and continue to attract global investors and maintain the city's status.

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## Chapter 7 Treasury management



**Added to  
section 1.2  
Page 265**

### Case study: 'One Belt, One Road'

In 2015, the Chinese Government launched the 'One Belt, One Road' (OBOR) initiative, which will involve significant infrastructure investment in over 60 countries in the next decade along the land and sea route of the Medieval Silk Road. Setting up a Corporate Treasury Centre (CTC) overseas has become a priority for companies who are investing in this initiative, in order to manage cash pools, offshore financing, foreign exchange and other key treasury risks. The launch of the OBOR initiative is expected to further enhance international trade and investments across economies in Asia, Europe and Africa, and strengthen the position of Hong Kong as a regional hub for corporate treasury activities.

The initiative aims to further the country's influence and trade links, mainly in Asia and Europe. It proposes the creation of new economic corridors, spanning countries that contain almost two-thirds of the world's population and account for one-third of the world's wealth. OBOR is intended to enable closer connections and new opportunities for trade, investment, economic activities, technological innovation, and the movement of people.

Under OBOR, over the next few decades China plans to build a land-based 'Silk Road Economic Belt' and a 'Maritime Silk Road'. The initiative will involve massive use of concrete, steel, chemicals and metals. Hundreds of thousands of workers and huge use of transport will be also needed to build new power stations, mines, energy projects, roads, railways, airports and container ports.

**New sections  
1.3–1.5  
Page 265**

## 1.3 Technology and the treasury function

There is a variety of technological tools available today to improve the efficiency of treasury operations in such areas as cash management, investment and debt management, and foreign exchange capabilities. Many systems are now integrated with trading platforms and bank portals, and include customised reporting tools.

Inefficiencies and weaknesses that may expose the treasury function to greater risk include the following:

- Duplication of effort, such as the re-input of information
- Tasks which take too long to complete, or are frequently delayed
- Poorly functioning links with older ('legacy') systems or those of other departments
- Management reports incomplete, inaccurate, late or in the wrong format
- Inaccurate cash flow forecasts
- Credit risk not properly identified
- Difficulty in complying with accounting standards

When applied to addressing such difficulties, technology can bring benefits in many areas of treasury management.

- Cash and liquidity management – with improved visibility of cash flows around the business, a greater understanding of pooled cash positions and improved cash flow forecasts can be achieved
- Transactions – speedier settlements, confirmation of deals and timely reporting will result from improved interfaces between trading systems

- Debt management – understanding of the company's debt position in terms of its outstanding loans, mortgages and lease finance
- Greater control over financial risk management – foreign exchange risk, interest rate risk and the management of specific instruments for associated hedging strategies can be more tightly controlled
- General risk management – understanding of exposure limits, credit limits, authorisation levels and the undertaking of scenario and sensitivity analysis should help to reduce risk exposure and ensure compliance with company procedures
- Access controls – resulting in improved security, clear audit trails and tracking of transactions

## 1.4 Software as a service

In addition to employing technology in-house, there is growing use of software as a service (SaaS). SaaS solutions employ internet technology and remote servers, enabling users to access software online from anywhere, using a device with an internet connection. The software does not need to be installed on hardware in the company's offices. There are several advantages to this for a treasury function:

- It could remove the need for an internal IT capability
- The supplier is responsible for all updates and maintenance, so the user gets access to these as part of its subscription fee
- Costs can be adjusted according to the company's own requirements (for example, number of transactions or number licensed users).

## 1.5 Cyber security

In general, cyber attacks will target money, or information (such as credit card details). A firm's systems may also be targeted as an entry to another firm that it has dealings with. It is therefore critical that all firms are aware of the potential cyber risk, and to put appropriate measures in place.

As the use of technology increases exponentially, new weaknesses are identified and the overall level of cyber threat increases. Cyber threats can include the following:

- Stealing of confidential data/information
- Fraudulent payments
- Denial of service attacks – flooding a server with information requests so that it crashes
- Ransomware – malware that blocks system access, or disrupts it until a ransom fee is paid

It is important to identify the most critical company information, data and processes that may come under attack, so that cybersecurity efforts can be prioritised and appropriate policies developed. Companies need to ensure that processes that attract cybercrime, such as payment processing, are reviewed and controls embedded including segregation of duties, enforcement of approval limits and daily reconciliations. As well as appropriate technical measures (such as encryption and anti-virus software), cybersecurity policies should take account of human factors:

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- Directors must understand the effects that a cybersecurity breach could have – strong corporate governance and clear policies must be in place
- The Board should be aware of the guidance issued by government agencies, and all employees trained in cyber and information security
- There should be appropriate restrictions around sensitive data, and the company should have clear computer use policies
- Insurance policies should cover the effects of a cyber breach
- Incident response plans should be in place, well-rehearsed and understood

Updated  
section 2  
Page 265

## 2 Hong Kong as a centre for treasury operations

### 2.1 Locating corporate treasury activities

International companies operate in an environment of multiple currencies, regulatory and interest rate regimes, in areas such as obtaining capital, managing liquidity, managing risk and processing transactions. An increasing number are using corporate treasury centres (CTC) to simplify and centralise their treasury activities. As discussed in Section 1 above, the functions of a centralised CTC can include carrying out intra-group financing activities and providing other corporate treasury services and transactions. The CTC thus plays an important role in supporting the cash management and funding of international business activity.

There are many factors to consider when deciding where to locate a CTC.

- Tax rates
- Bilateral tax treaties
- Quality and availability of staff
- Language abilities
- Government incentives
- Market liquidity
- Proximity to support staff (bankers, lawyers, consultants, accountants)
- Jurisdiction stability
- Rule of law

Having been undermined in the past by existing tax rules, the attractiveness of Hong Kong as a regional hub was addressed with the amendment of its Inland Revenue Ordinance in the 2015/16 Budget. The objective of this amendment was to attract multinational and Mainland corporations to centralise their treasury functions in Hong Kong and make it more competitive with other regional financial centres such as Singapore.

Under the amended Ordinance, in order to be a qualifying corporate treasury centre it must be a separate legal entity solely dedicated to the conduct of one or more of the following corporate treasury activities:

- Carrying on an intra-group financing business
- Providing corporate treasury services
- Entering into corporate treasury transactions

The Ordinance contained two key tax concessions for qualifying corporate treasury centres which came into effect from 1 April 2016:

- Interest expenses related to intercompany borrowings are tax deductible, (provided that the corresponding interest income is taxed outside Hong Kong at the same or a higher rate). Companies making intercompany transfers within the same group through Hong Kong will not suffer a tax penalty for doing so.
- Additionally, profits tax for qualifying treasury activities undertaken by corporate treasury centres were halved, from the regular Hong Kong corporate tax rate of 16.5% down to 8.25%. Companies need to set up a separate legal entity to encompass all their treasury activities in order to benefit from this new 8.25% tax rate, but unlike in Singapore there is no need to apply to get approval for corporate treasury centre status. The 8.25% tax rate applies automatically when the tax return is submitted.

Qualifying corporate treasury services include the following:

- Managing cash and liquidity
- Processing payments to vendors or suppliers
- Managing relationships with financial institutions
- Providing corporate finance advisory services
- Advising on the investment of funds
- Managing investor relations
- Providing guarantees, performance bonds and other credit risk instruments
- Providing advice on the management of interest rate risk
- Providing assistance in mergers and acquisitions
- Providing advice in regard to accounting policies, treasury policies and regulatory requirements
- Providing operational advice on the treasury management system
- Undertaking economic or investment research and analysis

Qualifying corporate treasury transactions include the following:

- Transactions related to the provision of guarantees, performance bonds, standby letters of credit or other credit risk instruments
  - Transactions investing the funds of the corporation in deposits, certificates of deposit, bonds, notes, debentures, money market funds and other financial instruments
  - Transactions entered into for the purpose of hedging interest rate risk, foreign exchange risk, liquidity risk, credit risk and commodity risk – including foreign exchange contracts, forward or futures contracts, swaps and options
  - Transactions involving factoring or forfaiting activities
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### Case study: COSCO Shipping

China COSCO Shipping Corporation Ltd (COSCO) is a large state-owned enterprise involved in a range of shipping-related activities, including the maintenance and management of container terminals, transport solutions, financing and ship building and repairs.

Hong Kong is its most significant location outside China, as it is an important centre for obtaining additional capital for the investment activities generated by the Chinese government's 'One Belt, One Road' initiative.

Hong Kong is a vital centre for COSCO's cash management and financing activities as it represents a mature financial market with a good local understanding of Chinese companies.

COSCO's treasury centre in Hong Kong undertakes a range of activities.

- International payments – global treasury management and supplier payments
- Cash management – cash pools set up in various countries, with excess cash centralised in Hong Kong
- Foreign exchange management – to manage and reduce foreign exchange risk
- Debt financing – bonds, syndicated loans and ship leasing
- Equity financing – several subsidiaries of COSCO have listed in Hong Kong

The network of prominent banks in Hong Kong, with access to their suite of products, services and technology, is another key factor in the attractiveness of Hong Kong as a corporate treasury centre for international companies such as COSCO.

(Source: *'Corporate Treasury Centres in Hong Kong – Case Studies'*, Invest Hong Kong and Hong Kong Monetary Authority, October 2016)

## 2.2 Cybersecurity in Hong Kong

Hong Kong has not introduced stand-alone cybercrime or cybersecurity legislation, but the Telecommunications Ordinance, Crimes Ordinance and Theft Ordinance were amended to include computer-related criminal offences. These include:

- unauthorised access to any computer;
- misuse of a computer program or data;
- making false entries in banks' books of accounts by electronic means;
- obtaining access to a computer with the intent to commit an offence or with dishonest intent; and
- unlawfully altering, adding or erasing the function or records of a computer.

In addition, the Hong Kong Government supports a number of organisations dedicated to responding to cyber threats. The Hong Kong Police Force established the Cyber Security and Technology Crime Bureau, responsible for handling cybersecurity issues and incidents of computer crime.

As regulators, both the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) have issued circulars on cybersecurity risk. In 2016, the HKMA announced the 'Cybersecurity Fortification Initiative', undertaken in collaboration with the banking industry. This includes a Cyber Resilience Assessment Framework which comprises three stages:

- (a) Inherent risk assessment – an assessment of the level of inherent cybersecurity risk and categorising it into 'low', 'medium' or 'high';
- (b) Maturity assessment – an assessment determining whether the actual level of cyber resilience matches the level of inherent risk; and
- (c) Intelligence-led Cyber Attack Simulation Testing – a test of cyber resilience by simulating real-life cyber attacks. Institutions with an inherent risk level assessed to be 'medium' or 'high' are expected to conduct this testing.

In May 2017, the SFC issued a circular alert on ransomware threats in the securities industry. In such attacks, files are maliciously encrypted and a ransom is requested in order to recover them. In its circular, the SFC emphasised that all licensed corporations should be alert to cybersecurity threats, and implement measures to address the risk of cyber attack. The following preventive measures are listed:

- Apply the latest security update to computers and network devices
- Install and properly set up a firewall for connecting devices to the internet
- Perform offline backup
- Do not open links and attachment in suspicious emails
- Do not connect any device to the office network before proper verification of the security
- Ensure that anti-virus software is installed and kept updated

Licensed corporations are expected to take actions to critically review and assess the effectiveness of their cybersecurity controls, and they are expected to report any major cybersecurity incident to the SFC.

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**Chapter 15 Regulatory environment**
**Update to section 1.1 Page 575**

To highlight its new role as a standalone market for small and medium sized companies, the Growth Enterprise Market was renamed “GEM” with effect from 15 February 2018.

**Update to section 6.3.2 Page 594 para (e)**
**Minimum requirements for listing on the Main Board**

- (e) With effect from 15 February 2018, at the time of the expected date for admission to listing, the minimum expected market capitalisation was increased to HK\$500,000,000 from HK\$200,000,000 and the expected market value of the securities held by the public must be at least HK\$125,000,000. (At least 25% of the company's total number of issued shares must be held by the public at all times. Not more than 50% of the number of shares held by the public at the time of listing can be beneficially owned by the three largest public shareholders.)

**Update to section 6.3.5 Page 595**
**Applications for a listing on GEM**

With effect from 15 February 2018, the GEM Listing Rules were amended as follows:

- (a) An increase to the minimum expected market capitalisation of a new applicant at the time of listing from HK\$100 million to HK\$150 million
- (b) An increase to the minimum public float value of a new applicant at the time of listing from HK\$30 million to HK\$45 million
- (c) An increase to the minimum cash flow requirement for a new applicant from HK\$20 million to HK\$30 million

Accordingly, the table on page 596 has been updated in the following areas:

	Minimum requirements for listing	
	Main Board	GEM
<b>Type of company</b>	Large and well-established companies that meet the Main Board's requirements.	Small and medium sized companies that meet the GEM's requirements.
<b>Financial requirement</b>	Must pass one of three tests	Must pass a financial test
	Profits test: Profit of at least HK\$20 million in its most recent financial year and at least HK\$30 million in aggregate in the two preceding years.	<ul style="list-style-type: none"> <li>• No profit requirement</li> <li>• Market capitalisation of at least HK\$150 million at the time of listing.</li> <li>• Positive cash flow from operating activities of at least HK\$30 million in aggregate for the two preceding financial years.</li> </ul>

	Market capitalisation/ revenue/cash flow test	
	<ul style="list-style-type: none"> <li>• Market capitalisation of at least HK\$2 billion</li> <li>• Revenue of at least HK\$500 million for the most recent audited financial year</li> <li>• Positive cash flow from its operating activities of at least HK\$100 million in total for the most recent three financial years.</li> </ul>	
	Market capitalisation/revenue test	
	<ul style="list-style-type: none"> <li>• Market capitalisation of at least HK\$4 billion</li> <li>• Revenue of at least HK\$500 million for the most recent audited financial year</li> </ul>	
<b>Minimum market capitalisation for shares</b>	See financial requirements – at least HK\$500 million at the time of listing. At least HK\$125 million (25%) to be held by the public.	At least HK\$150 million at the time of listing. At least 25% (subject to a minimum of HK\$45 million) to be held by the public.
<b>Methods of offering shares for a new listed company</b>	Company may not list by means of a placing only.	A mandatory public offering requirement of at least 10% of the total offer size.

**Update to  
section 6.3.6  
Page 597**

#### **Transfers from GEM to the Main Board**

The amendments to Listing Rules also include new arrangements for transfers from GEM to the Main Board.

- The removal of the streamlined process for a transfer of listing from GEM to the Main Board
- The mandatory sponsor requirement, where a sponsor must be appointed at least two months before the submission of a listing application
- The requirement of the issuance of a 'prospectus-standard' listing document

**New section  
6.3.7  
Page 597**

#### **6.3.7 Listing regime for companies from emerging and innovative sectors**

The HKEx has changed its Listing Rules to allow for weighted voting rights (WVR) structures and the listing of pre-profit/pre-revenue companies in the biotech industry. This comes in response to concern that the HKEx was not

sufficiently open to new economy companies, illustrated by the decision of Chinese company Alibaba to choose the New York Stock Exchange for its listing in 2014. The aim is to create a listing regime that will boost Hong Kong's attractiveness and competitiveness versus other major global listing venues, particularly in respect of attracting new economy companies.

With effect from 30 April 2018, amendments have been made to the Listing Rules to implement the proposals of the '*Consultation Conclusions Paper on a Listing Regime for Companies from Emerging and Innovative Sectors*' (published on 24 April 2018).

The HKEx has also proposed appropriate investor safeguards, recognising the potential risks associated with pre-profit/pre-revenue firms and those with WVR structures. The amendments are summarised below.

(a) **Permit listings of biotech companies that do not meet any of the Main Board financial eligibility tests**

The HKEx offers guidance on the listing eligibility for pre-profit/pre-revenue biotech companies that produce pharmaceuticals, biologics, and medical devices. Manufacturers of other biotech products will be considered on a case by case basis.

Since such issuers will not meet any of the financial eligibility tests of the Main Board, they potentially carry additional risks to investors. These issuers will therefore be subject to high standards, in line with the Main Board requirements. Accordingly, there are detailed eligibility and suitability criteria for determining appropriate applicants, a higher market capitalisation requirement, enhanced disclosure requirements and restrictions on fundamental changes of business.

(b) **Permit listings of companies with WVR structures**

For WVR issuers, safeguards include limits on WVR power and rules to protect non-WVR holders' right to vote, in addition to enhanced corporate governance requirements. An applicant will be required to demonstrate that it is eligible and suitable for listing with a WVR structure, by reference to a number of characteristics, including the nature of the company and the contribution of the proposed WVR beneficiaries.

(c) **Establish a new secondary listing route for China and international companies that wish to secondary list in Hong Kong**

The HKEx aims to strike a balance between facilitating listings of innovative companies that are primarily subject to regulation overseas, and providing appropriate investor protection.

