

JUNE 2011 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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Introduction

This Supplement has been produced for those candidates preparing for the June 2011 examination session of the HKICPA Qualification Programme.

It is designed to be used in conjunction with the 2010 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 29 December 2010, the cut-off date for examinable standards and legislation for the June 2011 examination.

The supplement contains two sections:

Part A contains a list of any notified errors in the material in the current edition of the Learning Pack. These are identified in chapter order, therefore as you start a new chapter in the Learning Pack you are advised to refer to the list to see whether there is anything relevant. If there is no reference to a chapter, there is no error within it.

Part B comprises a technical update on developments that will be examinable in June 2011 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.

Careful study of both the Learning Pack and this supplement should ensure that you are fully prepared for the June 2011 examination session.

Good luck with your studies!

Part A: Identified Errata

At the time of writing there are no identified errata in the Module B Learning Pack or Flashcards.

Part B: Technical Update

Chapter 15 Regulatory environment

1 The regulatory environment

This section provides additional notes about the regulatory environment in Hong Kong, to supplement the information already contained in Chapter 15 of the Learning Pack.

The purpose of these notes is to explain the different but inter-connecting roles of the various bodies and the laws, rules or codes that they administer. They do not cover the role of the Hong Kong Monetary Authority, the Hong Kong Insurance Authority (which regulates and supervises the insurance industry in Hong Kong) or the Hong Kong Securities Institute (the professional body for securities and finance professionals in Hong Kong).

1.1 The Securities and Futures Ordinance

The Securities and Futures Ordinance (SFO) is the main body of law relating to the securities and futures industry and markets. The powers and authority of the Securities and Futures Commission (SFC) are derived from the SFO, which empowers the SFC to make rules with respect to participants in the markets, including rules regarding applications for listing.

1.2 Securities and Futures Commission

The Securities and Futures Commission (SFC) is the main regulator of the securities and futures markets in Hong Kong, including the stock exchange. It is an independent non-government statutory body, which is funded by levies on transactions conducted on the Stock Exchange of Hong Kong (SEHK) and the Hong Kong Futures Exchange (HKFE), and by fees charged to market participants.

The SFC was created in 1989 in response to the stock market crash of October 1987. Its powers are now derived from the Securities and Futures Ordinance (SFO) which was implemented in 2003.

The SFC's objectives are to:

- set and enforce market regulations for the securities and futures markets;
- license market participants such as brokers and investment advisers and to supervise them after licensing;
- supervise market operators such as exchanges, automated trading systems and clearing houses;
- authorise offer documents for securities and other investment products to be offered to the public (including prospectuses for new share issues in collaboration with the Listing Division of the stock exchange);
- supervise the activities of listed companies under the Codes on Takeovers and Mergers and Share Repurchases; and

- educate investors about markets, investment products and their risks.

Supervision of mergers and takeovers

The SFC has responsibility for supervision of merger and takeover activity involving listed companies.

The department of the Executive Director of the Corporate Finance Division of the SFC ('the Executive') deals with any matters referred to it concerning a takeover or merger, or repurchase of shares by a company, and makes rulings on the matter in accordance with the Codes on Takeovers and Mergers and Share Repurchases ('the Codes'). Under the provisions of the Securities and Futures Ordinance, the SFC has established the Takeovers and Mergers Panel ('the Panel') and appoints its members.

The role of the Executive and the Panel and the main features of the Takeovers Code are explained in more detail in Chapter 18 of the Learning Pack and in Section 3 of this supplement.

1.3 Hong Kong Exchanges and Clearing Limited (HKEx)

Hong Kong Exchanges and Clearing Limited (HKEx) operates a securities market and a derivatives market in Hong Kong and the clearing houses for these markets. (The clearing houses are Hong Kong Securities Clearing Company Limited (HKSCC), HKFE Clearing Corporation Limited (HKCC) and The SEHK Options Clearing House Limited (SECH).)

HKEx was established in 2000 as a holding company for the merger of the Stock Exchange of Hong Kong Limited (SEHK), Hong Kong Futures Exchange Limited (HKFE) and Hong Kong Securities Clearing Company Limited (HKSCC). It is a recognised exchange controller under the Securities and Futures Ordinance. HKEx is a listed company on the Stock Exchange of Hong Kong.

The Stock Exchange of Hong Kong Limited (SEHK)

The Stock Exchange, a wholly-owned subsidiary of HKEx, is a recognised exchange company under the Securities and Futures Ordinance. It operates the stock market in Hong Kong and is the primary regulator of stock exchange participants on trading matters and of companies whose securities are listed on the Main Board and Growth Enterprise Market (GEM) of the Stock Exchange. Companies wishing to become listed companies must apply to the Listing Division of the Stock Exchange and must comply with the Listing Rules of the Exchange.

Hong Kong Futures Exchange Limited

The Hong Kong Futures Exchange, a wholly-owned subsidiary of HKEx, is also a recognised exchange company under the Securities and Futures Ordinance. It operates a futures market in Hong Kong and is the primary regulator of futures exchange participants with regard to trading matters.

1.4 The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the 'Listing Rules')

The Listing Rules are the responsibility of SEHK (and HKEx). Companies wishing to obtain a listing on the Main Board of the Exchange or GEM must comply with the rules on applications for listing. After obtaining a listing, listed companies must then comply with the continuing obligations in the Listing Rules.

The Exchange monitors compliance with the Listing Rules. Some of the rules relating to the application for a listing by companies are described in section 2 of this supplement.

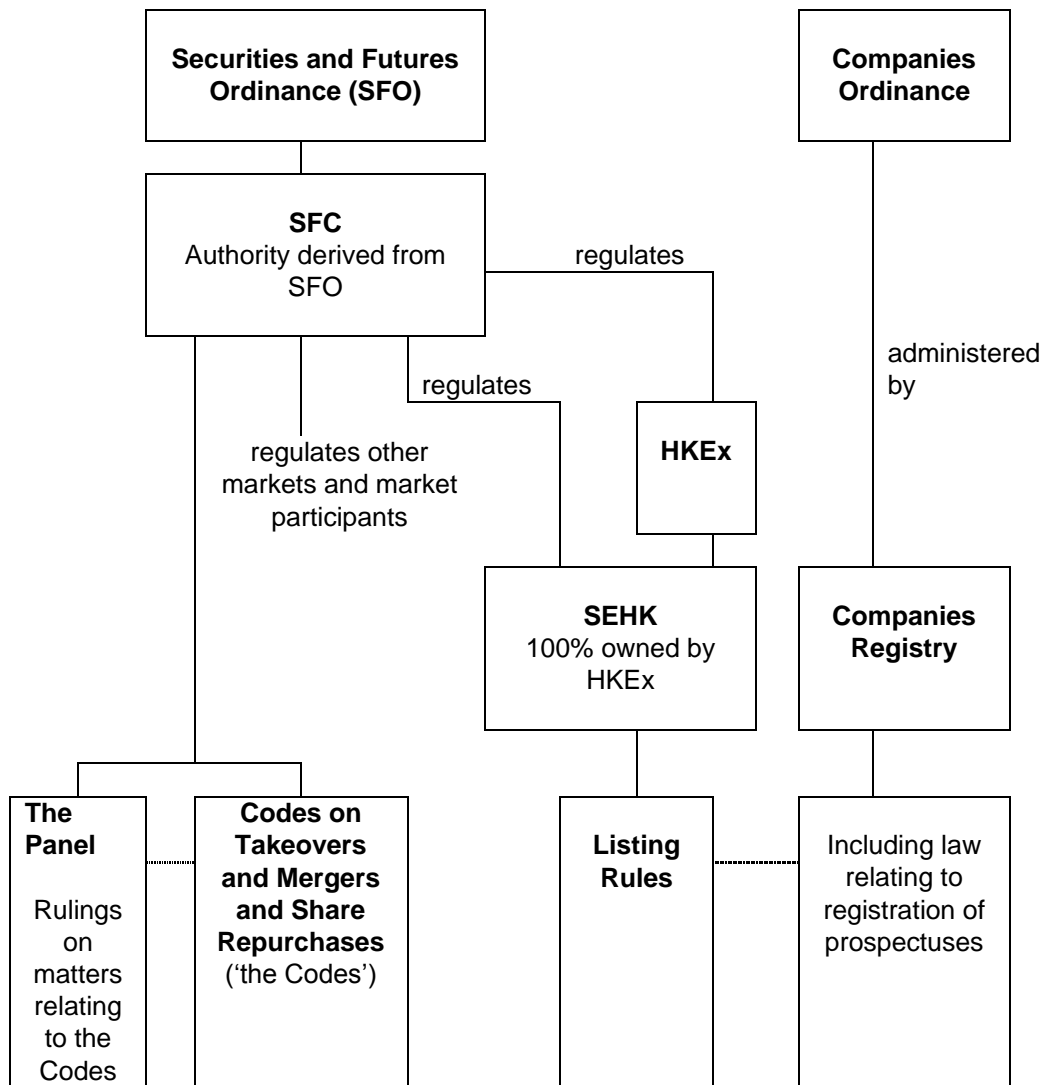
1.5

Companies Registry and the Companies Ordinance

The responsibilities of the Companies Registry include registering documentation provided by companies under the requirements of the Companies Ordinance. These responsibilities include the registering of prospectuses by companies that are accepted for listing by the Stock Exchange and which will be issuing shares for sale when trading in the shares begins on the Exchange.

The Companies Registry enforces the Hong Kong Companies Ordinance, which is the main law that applies to companies registered in Hong Kong. One of the requirements of the Companies Ordinance is that companies that intend to offer shares for sale to the public must produce a prospectus. Companies that apply for a listing for these shares must submit their prospectus to the Listing Division of the Stock Exchange, and the Listing Committee of the Exchange approves the prospectus for registration with the Companies Registry.

Summary of relationships



2 Applications for listing

This section explains the rules and procedures that apply to a company wishing to have shares listed on the Main Board or the Growth Enterprise Market.

2.1 Outline of the system for admission to listing

The Stock Exchange of Hong Kong (SEHK or the Exchange) has two boards, the Main Board and the Growth Enterprise Market (GEM). The Main Board is for established companies that can meet certain minimum requirements for listing, and GEM is a market for smaller growth companies with lower entry requirements than for the Main Board. A company whose shares are listed on GEM may subsequently apply for admission to listing on the Main Board, provided it meets the necessary entry requirements.

Applications for listing can be made by Hong Kong companies (which must not be a private company), companies incorporated in the PRC, companies incorporated in Bermuda and the Cayman Islands and other foreign companies (usually companies whose shares are already listed on a stock exchange in another country).

The requirements for listing are specified in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the 'Listing Rules').

The Listing Rules differ in some ways for:

- companies applying for a listing on the Main Board and for a listing on GEM;
- new applicants that do not yet have any shares listed ('non-listed companies'), and existing listed companies that are applying for a listing for new shares;
- companies incorporated in the PRC;
- companies incorporated in Bermuda or the Cayman Islands; and
- other foreign companies.

However, the rules for all companies are broadly similar.

An application for listing is made by the company and its advisers to the Listing Committee of the stock exchange. The company must prepare a listing document for submission to the Listing Committee, containing information specified by the Listing Rules.

When the company intends to offer the shares for sale, the listing document will also be a prospectus. A prospectus is a document that offers securities in a company for sale to investors. It must comply with the requirements of the Companies Ordinance, and:

- must contain information specified by the Ordinance; and
- must be available in both an English and Chinese language version.

The Listing Division of the Exchange checks that the listing document/prospectus complies with the requirements of both the Listing Rules and the Companies Ordinance. The application is considered by a meeting of the Listing Committee, and if the Committee is satisfied:

- it approves the listing of the company's shares and also; and
- authorises the registration of the prospectus by the Companies Registry.

Under the 'dual-filing' system the Exchange also provides the Securities and Futures Commission with a copy of the prospectus. The SFC may object to a

listing application if the prospectus appears to contain false or misleading information, but any comments that it makes about the prospectus are communicated to the company through the Listing Division of the Exchange.

After the approval of the listing application, the shares are admitted to listing, and trading in those shares begins.

2.2 Contents of a prospectus

A prospectus must contain information about the company that will enable investors to decide whether to subscribe for shares in the issue. It must therefore contain details about:

- the share issue and the company's capital;
- the business activities of the company and its group;
- financial information about the company, including a statement about trading and financial prospects for at least the current financial year; there may be a profit forecast;
- an accountant's report, prepared by independent accountants; and
- details of how the company intends to use the money obtained from the share issue.

A new applicant for listing must make a statement in the prospectus that it will have **sufficient working capital** for at least 12 months from the date of publication of the prospectus. The sponsor must confirm that this working capital sufficiency statement has been made after due and careful enquiry by the company and that institutions (such as banks) providing finance for working capital have stated in writing that the relevant financing facilities have been agreed and will be available.

2.3 Minimum requirements for listing on the Main Board

New applicants for a Main Board listing must meet several requirements.

- In the opinion of the Exchange, the applicant and its business must be suitable for listing. For example, the Exchange will not normally consider a new applicant suitable if it has recently changed the period of its financial year.
- The company must (usually) have a trading record of not less than three financial years.
- It must (usually) also be able to demonstrate continuity of management for at least the three preceding financial years and continuity of ownership and control for at least the most recent audited financial year.
- The company must have a sufficient management presence in Hong Kong. Usually, this means that at least two directors of the company should be resident in Hong Kong.
- At the time of the expected date for admission to listing, the expected market value of the securities of the company which are held by the public must be at least HK\$50,000,000. (At least 25% of the company's total issued share capital must be held by the public at all times. Not more than 50% of the shares held by the public at the time of listing can be beneficially owned by the three largest public shareholders.)

A new applicant for listing to the Main Board must also pass one of three financial tests:

- a profits test;
- a market capitalisation/revenue/cash flow test; or
- a market capitalisation/revenue test.

Profits test

To pass the profits test, the applicant (or its group) must have reported a profit of at least HK\$20,000,000 in its most recent financial year and total reported profits of at least HK\$30,000,000 in the two preceding years combined. These profits should exclude profits or losses that arise from activities outside the company's ordinary business.

Market capitalisation of at least HK\$200,000,000 at the time of listing.

Market capitalisation/revenue/cash flow test

To pass the market capitalisation/revenue/cash flow test, the company must have:

- market capitalisation of at least HK\$2,000,000,000 at the time of listing;
- revenue of at least HK\$500,000,000 from its main business operations for the most recent audited financial year; and
- positive cash flow from its operating activities of at least HK\$100,000,000 in total for the most recent three financial years combined.

Market capitalisation/revenue test

To pass the market capitalisation/revenue test, the company must have:

- market capitalisation of at least HK\$4,000,000,000 at the time of listing;
- revenue of at least HK\$500,000,000 from its main business operations for the most recent audited financial year; and
- at least 1,000 shareholders at the time of the listing.

This market capitalisation/revenue test is most suitable for large companies that will attract substantial interest in its shares from investors.

2.4

Professional advisers

Sponsors

A company that applies for a listing for the first time must appoint one or more sponsors to help with its application. The sponsor must be licensed by the SFC to act as a sponsor. The sponsor acts as the channel of communication between the company and the Listing Division of the Exchange. It is closely involved in the preparation of the listing document/prospectus and on behalf of the company submits all the documentation for the application for listing. The sponsor is responsible for the accuracy and completeness of the information in the listing document/prospectus and for the compliance of the company's directors with the requirements of the Listing Rules.

Compliance advisers

A newly-listed company must appoint a compliance adviser for the period beginning on the date of the listing of its shares and ending on the publication of its results for the first full financial year that begins after listing. A compliance adviser must be licensed by the SFC to be a sponsor, but need not be the same firm that acted as the company's sponsor for the application for listing. Companies are required to consult with their compliance adviser during this period in four situations:

- before publication of any regulatory announcement, circular or financial report;
- where a significant transaction is planned, such as a major acquisition or a major disposal;
- where the company intends to use the money raised from its share issue for a different purpose than specified in the prospectus or where its business development or financial results differ from any profit forecast or other information provided in the prospectus; and
- where the Exchange makes an enquiry about unusual price movements or trading volumes in the company's shares.

Existing listed companies who are making an application for new shares to be listed (in a rights issue or placing) do not need a sponsor or compliance adviser. Instead they are assisted by their financial advisers or auditors.

Underwriters

New issues of shares must usually be fully underwritten. This means that there are investors who have formally agreed to buy any of the shares of the company that are not purchased by other investors. The reason for this rule is that if the share issue is fully underwritten, the company is able to plan on the basis that it will receive the amount of funds it is expecting (and will not raise insufficient money because investors decide not to buy the shares).

2.5

The process for admission to listing on the Main Board

The process for admission to listing on the Main Board for shares of a new applicant company is as follows.

- The company decides to make an application for listing. This will include an assessment of how much capital it wants to raise from the share issue and how any of its existing shares will be made available for sale to the public.
- The company appoints a sponsor (and reporting accountants and legal advisers).
- The prospectus is prepared and checked for accuracy and completeness. It includes an accountant's report and may also include a profit forecast. Several drafts of the prospectus are prepared until the final version is completed.
- Other documentation is prepared, including a formal application for listing.
- An underwriting agreement is prepared and underwriting is negotiated with underwriters.
- All documentation and agreements are reviewed and approved by the company's board of directors.
- The application for listing is made to the Listing Committee of the Exchange (by the sponsor on behalf of the company).
- The Listing Committee approves the application and the admission of the shares to listing. It also approves the prospectus, and the company must then file a copy with the Companies Registry.
- The prospectus is published, together with application forms for investors to apply to buy shares in the issue.
- The applications from investors are processed and shares are allocated to the applicants.

- Dealing in the shares begins on the Exchange.

For a new applicant this process usually takes about six to twelve months.

2.6 Applications for a listing on GEM

The minimum requirements for listing on GEM are less than for a listing on the Main Board, but the requirements are similar in nature. The table below provides a comparison.

	Minimum requirements for listing	
	Main Board	GEM
Type of company	Large and well-established companies that meet the Main Board's requirements.	Companies that do not meet the requirements for a Main Board listing but meet the requirements for a GEM listing.
Minimum trading record	At least 3 financial years.	At least 2 financial years.
Financial requirement	<p>Must pass one of three tests</p> <p>Profits test</p> <p>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. Market capitalisation of at least HK\$200 million.</p> <p>Market capitalisation/revenue/cash flow test</p> <ul style="list-style-type: none"> – Market capitalisation of at least HK\$2 billion. – Revenue of at least HK\$500 million for the most recent audited financial year. – Positive cash flow from its operating activities of at least HK\$100 million in total for the most recent three financial years. <p>Market capitalisation/revenue test</p> <ul style="list-style-type: none"> – Market capitalisation of at least HK\$4 billion. – Revenue of at least HK\$500 million for the most recent audited financial year. – At least 1,000 shareholders. 	<p>Must pass a financial test</p> <ul style="list-style-type: none"> – No profit requirement – Market capitalisation of at least HK\$100 million at the time of listing. – Positive cash flow from operating activities of at least HK\$20 million in aggregate for the two preceding financial years.

	Minimum requirements for listing	
	Main Board	GEM
Minimum continuity of management	At least the three preceding financial years.	At least the two preceding financial years.
Minimum continuity of ownership	For at least the most recent audited financial year.	For at least the preceding full financial year.
Minimum market capitalisation for shares	See financial requirements – at least HK\$200 million at the time of listing. At least HK\$50 million (25%) to be held by the public.	At least HK\$100 million at the time of listing. At least 25% (subject to a minimum of HK\$30 million) to be held by the public.
Underwriting requirement	Issue should be fully underwritten.	No underwriting requirement.
Method of offering shares for a new listed company	Company may not list by means of a placing only.	May be by a placing
Minimum number of shareholders at time of listing who are regarded as the 'public'	300, or 1,000 if the market capitalisation /revenue test is used.	100

2.7 Transfers from GEM to the Main Board

GEM companies may apply for a transfer of their shares from GEM to the Main Board, provided they have grown and now meet the requirements for a Main Board listing. The company should be assisted by its financial advisers or auditors in making the application, which is made to the Listing Committee. The documents submitted must include a working capital sufficiency statement for the next 12 months, supported by written confirmation from the financial advisers or auditors that the statement has been prepared by the company after due and careful consideration.

3 The Takeovers Code

This section describes the functions of the Executive and of the Takeovers and Mergers Panel, and explains the main rules in the Codes on Takeovers and Mergers and Share Repurchases that apply to takeovers and mergers. The section of the Codes dealing with takeovers and mergers is referred to in these notes as the Takeovers Code.

3.1 The purpose and application of the Codes

The purpose of the Codes is to protect shareholders from unfair treatment in a takeover or merger involving their company, or when a company repurchases some of its shares. In a takeover, there could be a risk that some shareholders will not be informed about a bid for their company, so that they cannot make an informed decision about whether or not to accept the offer. There is also a risk that some shareholders might be treated more favourably than others, for example by receiving a better price for their shares than others. The Codes set out standards of conduct and behaviour for everyone involved in a takeover or merger, including the directors of the companies concerned, their professional advisers and other participants in the financial markets.

The introduction to the Codes explains that their purpose is to ensure fair treatment for shareholders who are affected by a takeover, merger or share repurchase offer and:

- require equality of treatment for shareholders;
- require disclosure of timely and adequate information to enable shareholders to make a decision as to the merit of an offer; and
- ensure that there is a fair and informed market in the shares of the companies affected.

The Codes do not have the force of law, but their general principles and rules are applied by the Executive and Takeovers Panel when making rulings about a takeover or merger, and the Listing Rules require compliance with the Codes. Anyone who breaches the Codes risks having the facilities of the Hong Kong financial markets withheld from them.

The Codes apply to the directors of companies that are subject to the Codes, their professional advisers and market participants. Companies subject to the Codes are public companies in Hong Kong and companies with a primary listing for their equity shares in Hong Kong. As a general rule, it is the nature of the company that is the target of a takeover bid (the ‘offeree company’) that determines whether the Takeovers Code applies. This means that the Code applies to a takeover bid for a public company in Hong Kong or a company with a primary listing in Hong Kong, but not to a takeover bid for non-public or non-listed companies.

3.2 The Executive and the Panel

The Codes contain **ten** General Principles, which are set out in the Learning Pack. The Takeovers Code also includes a set of rules that should be followed in a takeover or merger, and the Executive and Takeovers and Mergers Panel make rulings in specific cases by applying and interpreting these rules.

- The Codes are administered by the Executive. This is the Executive Director of the Corporate Finance Division of the SFC and his staff. The Executive monitors takeovers and mergers to which the Codes apply, and anyone involved in a takeover or merger can consult with the Executive about anything on which they need clarification or guidance. The Executive may also be asked to give rulings on matters to which the Takeovers Code applies.
- The Takeovers and Mergers Panel is a committee of the SFC. The Panel may be asked to review a ruling that has been made by the Executive in a particular case, or may be asked to give a ruling in cases that are referred to it by the Executive. The Panel publishes its rulings and the reasons for them on the SFC web site. The Panel also deals with disciplinary hearings in the first instance, in cases where someone is accused of breaching the Code. (Disciplinary hearings are different from rulings about compliance with the Code.)
- A Takeovers Appeal Committee, which is another committee of the SFC, deals with appeals against disciplinary judgements by the Panel.

3.3 Rules of the Takeovers Code

The Takeover Rules are a long and complex document, dealing with many different aspects of conduct during a takeover or merger. The main rules are explained below, but there are exceptions to the rules and the description here is not comprehensive.

A takeover or merger begins with an offer to the board of the offeree company (although it might also begin when there are rumours about the possibility of a takeover or merger offer). The offer should be made to the board of the offeree company (or its advisers) before it is announced to the public. The board of the offeree company has a right to be satisfied that the bidder (offeror) will be in a position to implement its bid in full. It is then usually the responsibility of the offeree company to make the public announcement about the offer and its details.

On receiving the offer, the board of the offeree company is required, in the interests of the shareholders, to set up a committee of independent non-executive directors which should make a recommendation about whether the offer appears to be fair and reasonable and a recommendation about acceptance. The company should also appoint an independent financial adviser. The recommendation of the independent committee and the written advice of the financial adviser should be included in a circular that the board of the offeree company is required to send to shareholders about the bid.

After receiving a bid, the board of the offeree company must not take any measures that may frustrate the bid, such as issue more shares in the company or sell some of the company's assets, without the approval of the shareholders of the offeree company.

During the course of the offer, information about the companies involved must be made equally available to all shareholders, as nearly as possible at the same time.

The offeror is required to post an offer document to the shareholders in the offeree company within 21 days of the announcement of the offer. Within the next 14 days, the directors of the offeree company must send a circular to the shareholders, containing information to help them reach a decision (and containing the recommendations of the independent committee and the advice of the financial adviser). If the takeover is 'friendly' the offeror's offer document and the circular of the board of the offeree company should be combined into a single document. All documents must be in English or Chinese, with a translation into Chinese or English. Documents must also be filed with the Executive before they are released or published, and cannot be released or published until the Executive states that it has no further comments to make.

An offer is often conditional, which means that the offeror will only buy shares in the target company if certain conditions are met. A condition as to acceptances is that the offer will not proceed unless acceptances of the offer are received from holders of over 50% of the shares.

The offer must be kept open for 21 or 28 days, during which time shareholders in the offeree company can send in their acceptances. If the offer is then declared unconditional as to acceptances, it must then be kept open for a further 14 days to give the other shareholders time to submit acceptances.

Except with the consent of the Executive, the board of the offeree company cannot announce any material new information (such as trading results, a profit forecast or a proposal to make a dividend payment) after the 39th day following the posting of the offer document to the offeree company shareholders. This is called the 39-day rule.

Dealings in shares of the offeree company may take place during the offer period. Details of any shares purchased in the market by the offeror must be publicly disclosed. If the offeror buys shares in the offeree company after the public announcement of the offer at a price that is higher than the offer price, it must raise its offer price to not less than the highest price paid for any of the shares it has acquired.

In addition, the offeror cannot buy shares in the offeree company from some shareholders on more favourable terms than it has offered to other shareholders. These rules are designed to prevent an offeror from offering a better deal to some shareholders than to others.

The offer period cannot last longer than 7.00 pm on the 60th day after the offer document was posted. The results of the bid are announced and if acceptances are sufficient, the offer is declared unconditional and the offeror buys the shares of the shareholders who have accepted the offer. If the offeror acquires at least 90%

of the shares it is trying to acquire, it has a right of compulsory purchase of the remaining minority still held by other shareholders.

3.4 Mandatory offer

The mandatory offer rule in the Takeovers Code is a rule that applies when someone (an individual or a company) acquires 30% or more of the shares in a company subject to the Code. The 30% may be acquired over a period of time, or in a single transaction. When this situation arises, the holder of the shares is required by the Code to make a bid for all the other equity shares in the company. This is because within the meaning of the Code, someone gains control of a company by acquiring 30% (rather than more than 50%) of the equity shares.

3.5 Conclusion

Without a Takeovers Code, there would be many ways in which an offeror or some of the shareholders in an offeree company might benefit at the expense of many shareholders in the offeree company. Ethical issues and concerns about misconduct can arise, which is why the role of the Executive and Panel can be important.