ANNEX

HONG KONG SOCIETY OF ACCOUNTANTS

RESPONSES TO CONSULTATION PAPER ON PROPOSED AMENDMENTS TO THE LISTING RULES RELATING TO CORPORATE GOVERNANCE ISSUES

PART B PROTECTION OF SHAREHOLDERS' RIGHTS

VOTING BY SHAREHOLDERS

Voting by poll

Q1 **Agree**. While we have some concerns that voting by poll may impose an additional cost and administrative burden on issuers, we consider that it could be kept to an acceptable level if the due process is carried out efficiently (e.g. if the preparation for polls are undertaken in advance of the meeting). We also have some concern that if polls are automatically required to be conducted, this may discourage prior debate on the relevant issues. Consideration should be given as to how this might be addressed.

Q2 **Agree**. We agree provided that the results of the poll are announced during the meeting. We would also suggest that consideration be given to extending this to the results of voting on all polls.

Q3 **Agree**.

Voting of "interested shareholders" in relation to very substantial acquisitions, very substantial disposals and major transactions

Q4 **Disagree**. We consider that the term "interest" needs to be defined properly. We are not sure as to whether the concept of interest is defined in terms of shareholdings in an acquiree or benefits to be received from the transactions or other definitions and whether it refers to legal or beneficial interest. If a shareholding of, say, five shares in an acquiree were to constitute an "interest", we consider that the proposal is too restrictive. Furthermore, it should defined in such a way that it equates to some form of advantage.

Q5 We consider that once the term "interest" is defined and the Rules are amended in accordance with the proposal in paragraph 2.4 of Part B, it would then be unnecessary to define "material". Before defining what constitutes "interest", we consider it necessary for the Exchange to elaborate further as to what is intended to be included.

Voting of controlling shareholders

Q6 **Disagree**. Controlling shareholders should be allowed to vote in all matters in which their interests are the same as other shareholders.

We consider that unless the controlling shareholders have a separate interest in the transaction, the majority rule should prevail. We are concerned that disallowing controlling shareholders to vote "for the approval of certain matters that have

significant impact on issuers and shareholders and there were significant previous cases of abuse of minority interests" as proposed in paragraph 3.9, could be problematic from a definitional point of view and in relation to determining who should be the "judge" in respect of allowing or disallowing controlling shareholders to vote. The rules ought to be as transparent and self-explanatory as possible in stipulating circumstances in which controlling shareholders may not vote.

Q7 **Agree**. A minority shareholder or dissident director may propose resolutions in relation to which it would be unfair to disenfranchise the controlling shareholder.

Q8 **Disagree**. We do not think that this should necessarily be the case in all circumstances. We presume that the rationale for aggregating the shareholding interests of the chief executive, directors (except independent non-executive directors) and their associates, as proposed, is that they are assumed to be acting in concert in relation to control of the issuer and are thus equivalent to a single controlling shareholder. If this is so, then the Rules should provide the opportunity for them to be able to rebut the presumption. Under the Takeovers Code, directors are presumed to be acting in concert with each other only when the issuer is subject to an offer or where the directors have reason to believe a bona fide offer for the company may be imminent.

Q9 **Disagree**. Re paragraph 3.11(a), independent shareholders and controlling shareholders are not necessarily mutually exclusive. The test of an independent shareholder should be whether or not a shareholder has an interest different from that of the other shareholders in relation to the transaction in question.

As regards paragraph 3.11(b), see our response to Q8 above.

Waiver of requirement to hold general meetings

Q10 **Agree**. While written approvals tend to reduce transparency, permitting them in some circumstances can assist efficiency. Therefore while we agree in principle, consideration could be given to requiring a mandate to be obtained from shareholders as a precondition for allowing written approvals. As regards the details of the proposal, the term a "closely allied group of shareholders", in paragraph 4.7(c) of Part B, is not defined under the Rules. The wording is different from the "acting in concert" concept stipulated under the Takeovers Code and therefore the relevant term should be further clarified to avoid confusion.

Q11 **Agree**.

Q12 **Agree**.

DILUTION OF SHAREHOLDERS' INTERESTS

Placing of shares using the general mandate

Q13 **Disagree**. Issuers should be allowed to issue securities under a general mandate up to a limit of 10% of issued share capital.

Q14 **2 times**. Assuming that issuers are allowed to issue securities under a general mandate up to a limit of 10% of issued share capital. (See our reply to Q13 above).

We believe that there have been cases of abuses of a general mandate, with multiple refreshments during a year and placements being made to persons who are closely associated with the controlling shareholder. We suggest that guidelines should be issued to prevent such abuses under a general mandate.

Q15 **Disagree**. Independent shareholders' approval should be required for the issuer's refreshment(s) of general mandates.

We consider that the real problem lies in abuses of the general mandate rather than the principle of what approval is required for refreshment(s).

Q16 **Agree**. 30% of issued share capital as at the date of commencement of any rolling 3-year period.

Q17 **Disagree**. We are not clear how "severe financial difficulties" is to be defined. Furthermore, difficulties do not happen overnight and there could be concern that the facility will be issued for abusive purposes. It could also be argued that if a substantial discount is permitted, why should existing shareholders not be allowed to participate. Arguably the price should be determined by market demand.

Q18 **Disagree**. The trigger discount level should be set at a discount of no more than 10% to the benchmarked price. This may help protect minority shareholders from the potential dilution effect of a placement.

Q19 **Disagree**. We perceive practical problems in ascertaining what constitutes "severe financial difficulties" and "exceptional circumstances". How would a temporary cash flow problem be regard compared with, say, a net deficiency of assets? We do not consider that imposing such a pricing restriction on the issue of securities under a general mandate would help to safeguard shareholders' interest from being diluted unfairly. For a company to go into "severe" financial difficulties, normally it would have gone through a period during which the share price would have gone down significantly. In that case, a large placing at a price that is within the 20% limit could potentially cause shareholders' interests to be diluted significantly. Generally, we believe that the "carve out" needs to be more clearly defined and made more transparent.

Q20 **Agree**. We agree, provided that the proposed requirement is <u>in addition</u> to the current practice of disclosing the placees if the number of placees is less than 6.

Placing and top-up subscription

Q21 **Agree**.

Q22 **Agree**. We suggest that consideration be given to including a guidance note in the Listing Rules alerting the practitioners to promptly prepare detailed information about the background of the places, independence confirmations and other placing details which are required by the Exchange and, or the SFC if the placing and top-up transaction falls under the Takeovers Code so that the regulators may grant the necessary approval within the 14-day limit. It is noted that there have been placings and top-up transactions in the past that have extended for much longer

than a 14-day period, as approval from the regulators had not been readily obtained during the period. This defeats the purpose of placing and top-up arrangements which are meant to be quick capital raising exercises. As a matter of practice therefore consideration could also be given to extending the 14-day deadline if the delay is due to regulatory action.

Rights issues and open offers

Q23 **Agree**.

Q24 **Not applicable** (we agree with Q23).

Q25 **Agree**. Any shares which have been specially approved by shareholders previously should not be included in the rolling calculation. However, we note that the Exchange's "Consultation Paper on the 1998/1999 Review of Certain Chapters of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited" (May 1999) ("The 1999 Consultation Paper") proposed to aggregate any issue of new shares or other securities (other than capitalisation issues) with other issues made in the previous twelve months, for the purpose of calculating whether the 50% threshold had been exceeded. This means that, under the 1999 Consultation Paper, placing and issue of convertible securities etc. would need to be included in the calculation. We understand that the proposal in the current consultation paper is to retain the existing Rules, i.e. only rights issues and open offers are to be included in the calculation. We would therefore welcome some clarification as to the reason for the apparent change in the Exchange's position.

Q26 **Agree**.

Q27 **Agree**.

Exclusion of overseas shareholders from share offers

Q28 **Agree**. In principle, however, there needs a mechanism to ensure that overseas shareholders' rights are not swept aside completely given Hong Kong's status as an international financial centre. One possibility is first to require that issuers endeavour to sell overseas shareholders' nil paid rights in the market, and if they succeed, to pay the proceeds to those overseas shareholders.

OTHER MATTERS AFFECTING SHAREHOLDERS

Material changes in nature of business

Q29 **Agree**. We would like to know what "material change" means. We suggest that it may be useful to consider requiring companies listed on the Main Board to submit a business plan and business implementation report, as are currently required of companies listed on GEM, and to report periodically on their adherence to it.

Share repurchases

Q30 **Disagree**. We agree with the concept of a cap but consider that the pricing restriction should be set against the latest market price, rather than the average closing market price over the preceding 5 trading days.

Q31 **Disagree**. We consider that the pricing restriction should be set against the latest market price, rather than the average closing market price over the preceding 5 trading days.

Dealing restrictions

Q32 **Agree**.

25% monthly share repurchase restriction

Q33 **Agree**.

Withdrawal of primary listing on the Exchange

Q34 **Agree**.

Withdrawal of secondary listing on the Exchange

Q35 **Disagree**. We welcome the Exchange taking the initiative to amend the Rules to clarify on the procedures for issuers to withdraw their secondary listing status. However, we are of the view that the shareholders of issuers with a secondary listing status should be given the same rights as those shareholders of issuers with primary listing status. Shareholders in Hong Kong may have invested in companies with a secondary listing in Hong Kong because of that secondary listing. The reason companies seek a secondary listing in Hong Kong is to attract local investors. We suggest that withdrawal of secondary listing status should be made conditional upon approval of independent shareholders and that the directors, chief executive and any controlling shareholder or their respective associates, should abstain from voting at general meeting in respect of such resolution.

In addition, the definition of "independent shareholder" in this context needs to be made clear. Presumably it should include independent overseas shareholders.

NOTIFIABLE TRANSACTIONS OTHER THAN CONNECTED TRANSACTIONS

Very substantial acquisitions

Q36 **Disagree**. While the Consultation Paper states that there is considerable confusion and argument as to what constitutes "assets substantially all of which are not listed", we consider that the current proposal would also have a problem in relation to the definition of "listed assets", and could result in the situation whereby the acquisition of listed assets by a listed issuer will be treated as a new listing. This could be problematic where, for example, the acquirer could not fulfil all the requirements of Chapter 8 of the Listing Rules.

We understand that the purposed of imposing the current requirements for very substantial transactions originated from the intention to prevent backdoor listing. This was stated explicitly in the 1999 Consultation Paper. So, we consider that acquisition of "listed assets" should not be subject to the requirements for very substantial transactions, but rather the opportunity should be taken to clarify the meaning of the term "assets substantially all of which are not listed".

Q37 **Agree**, in principle, but we would like to know under what circumstances the Exchange would consider an acquisition as a "hostile or contested takeover" and to be given more details as to the nature of the proposed waiver.

Q38 **Agree**. We suggest that it is necessary to define what is meant by "different interest". See our response to Q4 above.

Q39 **Agree**.

Introduction of "very substantial disposals"

Q40 **Disagree**. We are concerned about the practical problems faced by loss-making companies.

The proposal seems to imply (amongst other things) that a company must be able to comply with the requirements of Chapter 8 post disposal (see Rule 14.07(3)). This could be a commercial disaster for listed companies. A company may be loss-making and wish to dispose of a loss-making business which comprises 75% of its assets. However, to do so would result in the company being treated as a new listing applicant in circumstances where it cannot fulfil the Chapter 8 requirements. Presumably, the Company would remain suspended until it could satisfy the Chapter 8 requirements – perhaps indefinitely, possibly resulting eventually in delisting. This would not seem to be in the interests of minority shareholders.

Q41 **Not applicable** (we disagree with Q40).

Q42 **Not applicable** (we disagree with Q40).

Reverse takeovers

Q43 **Agree**.

Q44 **Agree**.

Q45 **Agree**.

Q46 **Agree**.

Introduction of "total assets test" and "turnover test"

Q47 **Disagree**. While we do not disagree entirely with the principle of the proposal, we have reservations about the way in which it would work in practice. There is a perception that this proposed change is to facilitate certain issuers with large total assets as well as large total liabilities to make acquisitions and disposals without being burdened by the disclosure and shareholders' approval requirements that

would have applied had the size of the transactions been determined by reference to the existing "assets test".

Corporate governance should be about greater transparency, not less. We are of the view that if the proposed changes will result in fewer transactions being notifiable transactions, they will tend to result in a decrease in transparency – i.e. transactions that would under the current rules be required to be announced and be the subject of a circular, and possibly shareholders' consent, no longer being subject to such disclosure and shareholders' consent requirements. If this is the case, the changes would not promote better corporate governance. We note that the Consultation Paper does not provide any analysis (based upon a representative cross-section of notifiable transactions over a certain historical period) to show whether the proposed changes would, had they been in force then, have resulted in some of those transactions ceasing to be notifiable (and hence not being disclosed) or ceasing to be subject to shareholders' consent.

An alternative approach might be to stipulate a threshold of minimum total assets or market capitalisation, such that where an issuer exceeded this it would be permitted to use total assets as the basis for computing the assets test.

Q48 **Disagree**. See reasons above for Q47. The proposed change may result in less transparency and disclosure by issuers engaging in transactions. The rationale behind the four tests is surely to provide an approximate comparison of the value of the issuer compared to the value of the assets being acquired or disposed of. Profits are surely a better typical approximation of value than revenue. If there are anomolies in applying the profits test to loss-making/minimal profit making companies, this could be dealt with by providing for certain relaxations of the profits test in the Listing Rules.

Q49 **Disagree**. See our reply to Q47 above.

New thresholds for notifiable transactions

Q50 **Disagree**. Based on the reasons set out in our comments on Q47 to Q49 above, we intend to retain the existing "assets test" and "profits test". As such, the threshold for the classification of a share transaction should be retained at 15%.

Q51 **Disagree**. The existing threshold should be retained based on the reasons set out in our replies to Q47 to Q49 above.

Q52 **Disagree**. The existing threshold should be retained based on the reasons set out in our replies to Q47 to Q49 above.

Q53 **Agree**.

Q54 **Disagree**. See our reply to Q40 above.

Valuation of properties

Q55 **Disagree**. Corporate governance is about transparency and fairness. The Listing Rules themselves should be transparent and the rules should be applied equally to all companies. The rules should specify more precisely the circumstances in which a valuation report is required. Giving the Listing Division

a discretion to require such reports when it considers there are "appropriate circumstances" would lead to uncertainty and may result in a perception that the rules are not being applied equally to all listed companies.

Under the current market conditions, valuations do not fluctuate in a short period of time. A 3-month-old valuation report would normally still be comparable to a current valuation and shareholders could challenge the transaction if there is no valuation report. In practice, the effect of the proposal might be to result in deals collapsing, given the time constraints that apply to many such transactions.

Q56 **Agree**.

Q57 **Disagree**. See our comments above on Q47.

Asset valuation

Q58 **Disagree**. Valuation of assets or businesses acquired by the issuers based on discounted cash flows or projections of profits, earnings or cash flow should not be regarded as a profit forecast in any event. If the Exchange is reluctant to accept such methods of valuation, then it should make this clear and indicate what it would regard as being more acceptable.

The fact that the assumptions of the valuations have not been reviewed by auditors should be disclosed. All the risk involved should also be disclosed. According to the HKSA Auditing Guideline 3.341 "Accountants' report on profit forecasts", under normal circumstances, auditors are not supposed to sign off profit forecasts which run over 1 year.

Options granted by issuers

Q59 **Agree**.

Q60 **Agree**.

Dilution of interest in subsidiaries resulting in deemed disposals

Q61 **Agree**.

CONNECTED TRANSACTIONS

Definition of "connected person"

Q62 **Agree**.

Q63 **Agree**.

Definition of "associate"

Q64 **Disagree**. The definition of "associate" should be extended to cover the following:

- in relation to any director, chief executive or substantial shareholder being an individual, settlors and beneficiaries of any trust of which such individual or any of his family interests is a beneficiary or a discretionary object, and any companies controlled by any such trust;

- in relation to a substantial shareholder being a company, the ultimate beneficial owners who control 30% or more of the voting power at general meetings or control the composition of a majority of the board of directors of such company;

- in relation to a substantial shareholder being a company, the ultimate beneficial owners who control 30% or more of the voting power at general meetings or control the composition of a majority of the board of directors of such company. Where the ultimate shareholders are corporates, this will also include the ultimate individual beneficial owners who control more than 50% of the voting power at general meetings or control the composition of a majority of the board of directors of such corporates; and

- persons with controlling interests in companies that are controlled by a director, chief executive or substantial shareholder and other companies controlled by these persons.

Transactions between connected persons and associated companies

Q65 **Agree**.

Transactions with non wholly owned subsidiaries

Q66 **Agree**.

De minimus thresholds for connected transactions

Q67 **Disagree**. See our comments on Q47 above.

Q68 **Disagree**. See our comments on Q47 above.

Continuing connected transactions

Q69 **Agree**.

Q70 **Disagree**. The percentage should be based upon net tangible assets rather than total assets.

Q71 **Disagree**. The percentage should be based upon net tangible assets rather than total assets.

Q72 **Agree**. We agree with the approval principle but subject to comments on assets tests. See our comments on Q47 above.

Q73 **Agree**. However, we have concerns about the suggestion that the level of the cap must be acceptable to the Exchange without any guidance being given as to how the acceptable level will be determined. This is important because the cap restricts the issuer's ability to do business and hence earn profits. All continuing

connected transactions should be on normal commercial terms and in the best interests of the issuer. The placing of a restriction on the issuer's ability to carry on business which is on normal commercial terms should be effected in a transparent manner with clear guidelines set out in the rules so that all issuers can operate on a level playing field.

Q74 **Agree**.

Q75 **Agree**.

Q76 **Disagree**. Although there should be a disclosure requirement, the original contract terms should stand; if not, there could be problems where, for example, shareholders do not agree to a pre-existing contract to which the company is bound.

MEANING OF "SUBSIDIARY"

Q77 **Agree**. We are in general agreement with the proposal. However, we consider the phrase "an entity which is accounted for in the audited consolidated accounts of an issuer as a subsidiary" should be changed to clearly refer to an entity which is consolidated in the audited consolidated accounts, for the avoidance of doubt. Otherwise, in the case of a Hong Kong incorporated company, there might be uncertainty as to whether the phrase would include a subsidiary that is excluded from consolidation due to the legal constraint explained in Statement of Standard Accounting Practice 32 (SSAP 32), but which is included in the separate note disclosure as required under SSAP 32.

DISPOSAL OF CONTROLLING SHAREHOLDERS' INTEREST

Commencement of lock-up period

Q78 **Agree**.

Agreement for disposal of shares

Q79 **Agree**.

Q80 **Agree**.

Deemed disposal of controlling shareholder's interests

Q81 **Agree**.

PART C DIRECTORS AND BOARD PRACTICES

INDEPENDENT NON-EXECUTIVE DIRECTORS

Further guidance regarding independence

Q82 **Disagree**. We believe that ideally independent non-executive directors (INEDs) should hold no shares, but in practice 1% should be the maximum that is allowed.

Q83 **Disagree**. We believe that ideally INEDs should receive no shares but in practice 1% should be the maximum that is allowed.

Q84 **Disagree.** The restriction period should be for 1 year only.

Q85 **Agree**, in principle but we would like to see a clearer indication of what constitutes an interest that is material. There is a difference, for example, between an ongoing business relationship and involvement in a single transaction.

Q86 **Agree**, in principle, but further clarification is required regarding the meaning of "allegiance".

Q87 **Agree**, in principle but we consider that this needs to be more clearly defined.

Q88 **Disagree.** The restriction period should be for 1 year only. It is not clear what "connected" means in this context. Clarification must be provided in the Rules, e.g. will the Exchange adopts the general definition of "connected person" as set out in Chapter 1 of the Main Board Rules or are there any other factors that the Exchange will take into account in deciding what constitutes a connection?

Q89 **Disagree.** The restriction period should be for 1 year only.

Q90 **Agree**. Consideration should be given to making some allowance for retired people who are INEDs.

Q91 **Agree**. It is advisable to require INEDs to sign an annual undertaking declaring their independence. The question of enforcement also needs to be considered.

Qualifications of INEDs

Q92 **Agree**.

Minimum number of INEDs

Q93 **Agree**.

Q94 **12 months.**

Q95 **Agree**.

Q96 **Agree**.

Independent board committees

Q97 **Agree**. We understand that the independent board committee referred to is intended to be an ad hoc committee rather than a standing committee. This should be made clear.

Q98 **Agree**. It would however be preferable to have at least three INEDs on the board so that if, for example, one INED is excluded from the independent board committee as a result of a conflict of interests, there will still be two INEDs in a position to consider the transaction.

Q99 **Agree**.

BOARD PRACTICES

Code of Best Practice

Q100 **Agree**.

Q101 **Agree**.

Report on corporate governance

Q102 **Agree**, but in addition the issuer's corporate governance policies and philosophy should be described. Separately, we would also propose a requirement for issuers to disclose in their annual reports, not only the number of meetings held and the attendance record of members in relation to the audit committee and remuneration committee (if any), as the Consultation Paper proposes, but in addition, the number of full board meetings held during the year and the attendance record of individual board members. The Society has previously made this recommendation in our publication, "Corporate Governance Disclosure in Annual Reports" (March 2001, paragraph 4.2)

Q103 **Agree**.

Audit committee

Q104 **Agree**.

Q105 **Agree**. This is in line with the recommendation in the Society's recent publication, "A Guide for Effective Audit Committees" (February 2002, paragraph 23). There should be further elaboration of the definition of "independence" in the Rules.

Q106 **Agree**.

Q107 **Agree**. The issue of possible sanctions also needs to be considered.

Q108 **Agree**, but the terms of reference should include reviewing the issuer's statement on internal controls, if any, to be included in the annual report. This follows the recommendation in our publication "A Guide for Effective Audit Committees" (February 2002, Appendix I, paragraph 9). See also our comments on Q122 below.

Q109 **Agree**.

Remuneration committee

Q110 **Agree.** We consider that detailed disclosure of individual directors' remuneration should be required to enhance transparency and accountability, especially if the requirement for a remuneration committee is not made mandatory.

Q111 **Agree**. We consider that executive director(s) should be invited to attend meetings of the remuneration committee to give views where necessary. However, as a general rule, no one should be involved in deciding his/her own remuneration package.

Q112 **Agree**.

Q113 **Agree**. The principle of linking pay to performance is something that should be considered seriously by remuneration committees.

Nomination committee

Q114 **Agree**.

Q115 **Agree**. We consider that the chief executive officer and other executive director(s) should be invited to attend meetings of the nomination committee to provide their input into the process where necessary.

Q116 **Agree**. The assessment of the independence of INEDs should inter alia be based on their undertakings (see our response to Q91 above). The evaluation of non-executive directors should be in relation to their re-appointment to the board.

Q117 **Agree**.

DIRECTORS' DUTIES AND RESPONSIBILITIES

Duties and responsibilities of non-executive directors

Q118 **Agree**.

Chairman and chief executive officer

Q119 **Agree**.

Q120 **Agree**.

Internal controls

Q121 **Agree.** We consider that more guidance should be given as to what "regularly" means. For large organisations even an annual review may be onerous.

Q122 **Disagree**. We believe that this proposal is too prescriptive and may penalise companies that are more diligent and do conduct a thorough review. We would suggest that companies be required to confirm whether or not a review has been conducted but it should be left to the directors to determine the details of the disclosure, as may be appropriate having regard to the nature of business.

However, the audit committee's terms of reference should include reviewing the issuer's statement on internal controls, if any, to be included in the annual report. This follows the recommendation our publication, "A Guide for Effective Audit Committees" (February 2002, Appendix I, paragraph 9).

Voting by interested directors

Q123 **Agree**. Disclosure should be made at the meeting and the board should decide if the interest is material.

SECURITIES TRANSACTIONS BY DIRECTORS

Disclosure of breaches

Q124 **Agree**.

Q125 **Agree**.

Definition of "dealing"

Q126 **Agree**, assuming that this does not apply to the exercise of an option upon expiry or termination of the option period, where the price was fixed at the time of the granting of the options.

Q127 **Agree**.

Dealings by directors in "exceptional circumstances"

Q128 **Agree**, but we would nevertheless like to seek further information about the rationale behind the proposal and, in particular, why acquisition is to be treated as different from selling.

Q129 **Agree**, subject to clarification of the role of the Exchange upon receiving such written notice.

Directors as trustees or beneficiaries

Q130 **Agree** in principle but the issue of whether the director has a real interest also needs to be considered. The dealings should be properly disclosed. We consider that the meaning of "influenced" should be clarified.

Securities transactions by "relevant employees"

Q131 **Agree**.

Q132 **Agree**. Persons connected to the relevant employee, e.g. spouse/close relations etc. should also considered. The Rules should focus on disclosure.

"Black out" period of directors' securities transactions

Q133 **Disagree**. "Black out" period should be 1 month, except for placing and subscribing back the same number of shares. The period should be the same as for half-year and annual results.

Q134 **Disagree.** We believe that a one-month period is adequate.

DIRECTORS' CONTRACTS, REMUNERATION AND APPOINTMENTS

Directors' service contracts

Q135 **Agree**.

Q136 **Agree**.

Q137 **Agree** with the principle but consider that this should be a role for the remuneration or nomination committee and only if there is none should it pass to an ad hoc independent board committee.

Disclosure of directors' remuneration

Q138 **Agree**. For our views on the details of disclosure recommendations, please referred to the Society's publications as follows: (a) Directors' Remuneration – Recommendations for Enhanced Transparency and Accountability (November 1999, paragraphs 15 – 18); and (b) Corporate Governance Disclosure in Annual Reports (March 2001, paragraph 4.4).

Appointment, reappointment and removal of directors

Q139 **Agree**.

Q140 **Disagree**.

PART D CORPORATE REPORTING AND DISCLOSURE OF INFORMATION

QUARTERLY REPORTING

Quarterly reports

Q141 **Agree**, but subject to our comments relating to the deadline for reporting, disclosure content and review of quarterly reports in Qs142, 144 and 147 below.

We support, in principle, the proposal to require Main Board issuers to publish their financial results on a quarterly basis. We believe that this should be a mandatory requirement rather than a voluntary measure in order to promote consistency of practice among listed companies, given that there would be little incentive for many Main Board listed companies to produce quarterly results on a voluntary basis. We believe that quarterly reports should be reviewed by the audit committee and it should be left to the audit committee to decide whether a review by the external auditors should also be conducted. However, we would suggest that the Exchange be empowered to require a quarterly report to be reviewed by external auditors in situations where there have been material breaches of the Listing Rules. We would also propose, for consistency, that both of these measures, i.e. a requirement for a review by the audit committee and a power to order a review by external auditors, should also be extended to half-year reports.

We note that there are arguments for and against the introduction of quarterly reporting among our members. Some have expressed concerns that it may put

greater pressure on companies to concentrate on short-term performance and, as a corollary, to seek ways to smooth out their results. In addition, there are concerns that without any requirement for the results to be reviewed by the auditors, the figures may be less reliable, depending on the competence of the preparers of quarterly reports and the members of the audit committees.

However, we believe that quarterly reporting encourages greater transparency and provides more timely financial information to shareholders and the market. In addition, we understand that the investing public is generally supportive of this initiative. The world's largest capital market and one of the main sources of investment into Hong Kong, namely the United States ("US"), has a well-established framework of quarterly reporting. Furthermore, as from the first quarter of 2002, Mainland listed companies are required to report their results on a quarterly basis. As Hong Kong is aiming to encourage more Mainland companies to use the Hong Kong market to raise capital, and as there are an increasing number of China-related companies listed in Hong Kong and the US, aligning the corporate reporting requirements with the US and China markets is a move in the right direction.

Q142 **Disagree**. The reporting deadline for quarterly reporting should be 2 months.

While we are in support of mandatory quarterly reporting, the practical issues and problems of implementation should not be underestimated. While some companies may already have the capacity to implement quarterly reporting, others will need some time to effect the required changes to their internal reporting processes and systems. In addition, one should also bear in mind the number of changes that may affect corporate reporting in Hong Kong, such as the introduction of summary financial reporting as well as the intention of the International Accounting Standards Board to issue a number of new and revised standards in the near future. These changes will put more pressure on many companies, including the preparers of financial statements and audit committees of listed issuers, as well as their external auditors, in the next 12 to 18 months.

Accordingly, we would propose that the deadline for issuing of quarterly reports should initially be two months from the quarter end, and not 45 days as proposed. While it is acknowledged that GEM companies are already required to report within 45 days of the quarter end, the practical problems for Main Board and GEM companies are not the same. Generally, GEM-listed companies tend to be smaller and less complex enterprises than many Main Board companies and they are obliged to gear themselves up for this reporting requirement from the time of their application for listing.

In view of the practical considerations referred to above, we would also propose that careful thought needs to be given as to the most appropriate timing to introduce a requirement for quarterly reports.

Q143 **Agree**. We agree with the Exchange's proposal that the financial reporting framework should comprise four reports annually, being quarterly reports for the first and third quarters of the financial year, a half-year report for the first half of the financial year and an annual report for the financial year end.

Q144 **Agree**. We agree that at this stage the disclosure in quarterly reports should not be as comprehensive as that required by Statement of Standard Accounting Practice

(SSAP) 25. Over time, given advancements in technology and the increasing effectiveness in listed issuers' financial reporting systems, the aim should be to streamline quarterly reporting by unifying the form and contents of the quarterly and half-yearly reports.

In relation to Item E of Appendix I, we have the following comments:

We would suggest that the term "audited" be expanded to "reviewed [by the external auditors]or audited". In addition, we should like to seek clarification as to what is expected to be disclosed under Items D and F of Appendix I, e.g. off balance sheet exposures or other matters.

We also consider that there should be a requirement to have quarterly reports signed by directors.

At present there is guidance in Appendix 16 of the Listing Rules as to what should be included in a "management discussion and analysis" in final and interim reports. Guidance should similarly be provided as to the content of the proposed "fair review of business developments" that is required to be included in quarterly reports.

In order to strengthen disclosure regarding the level of review undertaken, we would propose that a quarterly report should be required to state on it that is has been reviewed by the audit committee.

Q145 **Agree.**

Q146 **Agree.**

Q147 **Agree.** It should however be left to the audit committees to decide whether a review by the external auditors should be conducted. However, we would suggest that the Exchange be empowered to require a quarterly report to be reviewed by external auditors in situations where there have been material breaches of the Listing Rules. We would also propose, for consistency, that both of these measures, i.e. a requirement for a review by the audit committee and a power for the Exchange to order a review by external auditors, should also be extended to half-year reports.

Quarterly results announcements

Q148 **Disagree**. The reporting deadline should initially be set at 2 months instead of 45 days. See our response to Q142 above.

Q149 **Agree**, but see also our reply to Q144 above.

HALF-YEAR REPORTING

Half-year reports

We would propose that half-year reports should be required to be reviewed by the audit committee, but it should be left to the audit committee to recommend whether a review by the external auditors should also be conducted. However, we would also suggest that the Exchange be empowered to require a half-year report to be reviewed by external auditors in

situations where there have been material breaches of the Listing Rules. See also our reply to Q147 above.

In addition we consider that there should also be a requirement for a half-year report to state that it has been reviewed by the audit committee. We note that currently under the Listing Rules, a half-year report must already state whether or not it has been audited and, if it has been, a copy of the auditors' report must be reproduced with it.

Q150 **Agree**.

Q151 **Agree**, subject to our comments relating to disclosure content in Q152 below.

Q152 **Agree**.

We consider that half-year reports should be SSAP 25 compliant.

See our reply to Q144 above regarding the contents of the proposed fair review of business developments.

Q153 **Disagree**. The reporting deadline for half-year reporting should be 3 months.

In relation to half-year and annual reporting, we note that the Exchange is advocating reducing the deadline for reporting from three to two months and from four to three months, respectively for Main Board issuers. For the practical reasons outlined in Q142, we would again suggest that adequate lead time should be allowed for implementation of such changes and that the changes should be phased in after quarterly reporting has been adopted and is functioning properly, rather than having all these new requirements and reduced deadlines being imposed at the same time. In this respect it should be noted that the new regime will result in Hong Kong having one of the most extensive sets of reporting requirements of any major financial centre in the world.

We would also suggest that it is important for the Exchange to set out publicly and very clearly the implementation timetable for phasing in the new reporting arrangements so that issuers can make all the necessary preparations early and with certainty.

Half-year results announcements

Q154 **Agree**. See comments on Q152 above.

Q155 **Agree**. We agree provided that the reporting deadline is 3 months.

Q156 **Not applicable** (we agree with Q154 and Q155, subject to the qualifications expressed in the replies to those questions).

FULL-YEAR REPORTING

Annual reports

Q157 **Disagree**. The deadline for Main Board issuers should initially remain at 4 months. Please see our reply to Q153 above.

Q158 **Agree**.

Summary financial reports

Q159 **Agree**.

Annual results announcements

Q160 **Agree**. Guidance should be provided as to the content of the proposed "fair review of business developments". See also our reply to Q144 above.

Q161 **Agree**. Agree provided that the reporting deadline is 4 months. See our reply to Q153 above.

Q162 **Not applicable** (we agree with Q160 and Q161 subject to the qualifications expressed in the replies to those questions).

CONTENTS OF CIRCULARS AND ANNONCEMENTS RELATING TO NOTIFIABLE TRANSACTIONS

Very substantial acquisitions

Q163 **Agree**.

General information in all announcements and circulars of notifiable transactions

Q164 **Agree**.

Q165 **Agree**.

OTHERS

Changes in directorship

Q166 **Agree**.

Q167 **Agree**.

Despatch of notice of general meeting and circular

Q168 **Agree**.

Q169 **Disagree**. This could be too costly and all shareholders will in any case receive notice.