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# Hong Kong Stock Exchange's Code On Corporate Governance Practices And Corporate Governance Report Effective January 1, 2005

## Introduction

The amendments to the Listing Rules relating to the Code on Corporate Governance Practices (the **Code**) and the Corporate Governance Report to be included in listed companies' annual and summary annual reports have come into force for accounting periods commencing on or after January 1, 2005, subject to the transitional arrangements detailed below. The one exception is that Code provision C.2 on internal controls and the disclosure requirements of the Corporate Governance Report on internal controls will take effect for accounting periods commencing on or after July 1, 2005.

The Code and Corporate Governance Report are the same for Main Board and GEM issuers, except that while quarterly reporting will be a recommended best practice for Main Board issuers under the Code, it remains a mandatory obligation under the GEM Listing Rules.

The purpose of this note is to highlight the principal features of the new Code and Corporate Governance Report. Further information on the Code and Corporate Governance Report and the full text of both are included in our publication "A Guide for the Effective Board", a Hong Kong guide to corporate governance, which is published today. To view this publication in English, please [click here](/en/publications/CorporateGovernance/CorporateGovernanceEnglish.pdf). To view the publication in Chinese, please [click here](/en/publications/CorporateGovernance/CorporateGovernanceChinese.pdf).

## Amendments

The Code replaces the Code of Best Practice in Appendix 14 of the Main Board Rules. In the GEM Rules the Code is set out in a new Appendix 15 and replaces GEM Rules 5.35 to 5.45. The Listing Rules on the Corporate Governance Report are set out in a new Appendix 23 to the Main Board Rules and in a new Appendix 16 to the GEM Rules. Other consequential amendments have been made to the Listing Rules to facilitate the implementation of the Code and the Rules on the Corporate Governance Report.

## The Code On Corporate Governance Practices

The Code contains 2 levels of recommended board practices. The first level comprises the "Code provisions" which are the minimum standards of board practices with which listed companies are expected to comply. The second level consists of recommended best practices with which companies are encouraged to comply.

The Code covers 5 principal areas: Directors; Remuneration of Directors and Senior Management; Accountability and Audit; Delegation by the Board; and Communication with Shareholders. Each section contains a general principle, the Code provisions and recommended best practices.

### Code Provisions

Compliance with the Code provisions is not however mandatory and listed companies may choose to deviate from them. All listed companies must however state whether they have met the Code provisions and give considered reasons for any deviation from them in each of their preliminary half-year and annual results announcements, their half-year reports (and summary half-year reports, if any) and in the Corporate Governance Reports included in their annual reports (and summary annual reports, if any) (together **relevant financial reporting documents**).

#### Half-year reports

In the case of half-year and summary half-year reports, companies must either give considered reasons for each deviation from the Code provisions or may refer to the Corporate Governance Report in their immediately preceding annual report and include details of any changes and considered reasons for any deviation not reported in that report.

#### Preliminary results announcements

In the case of preliminary half-year and annual results announcements, companies may give the required information by reference to the Corporate Governance Report included in the immediately preceding annual report or, in the case of preliminary annual results announcements, by reference to the immediately preceding half-year report. In either case, a summary of any changes since the report referred to must be included.

#### Option to adopt own code

The final form of the Code allows listed companies to adopt their own codes on corporate governance practices on such terms as they consider appropriate (rather than on terms no less exacting than the Code provisions which was the original proposal). If they do so, companies will however still be required to disclose and give considered reasons for any deviation from the Code provisions as set out in the Listing Rules in their relevant financial reporting documents.

#### Changes made in the final Code

Other changes which were made in the final version of the Code are as follows:

1. *Eligibility of former partner of listed company's auditors to sit on audit committee*  
     
   An additional Code provision has been included (Code provision C.3.2) prohibiting a former partner of a listed company's existing auditing firm from acting as a member of the company's audit committee for a period of 1 year commencing on the date of his ceasing (a) to be a partner of the firm; or (b) to have any financial interest in the firm, whichever is the later.
2. *Elevation of recommended best practices to Code provisions*  
     
   The following recommended best practices in the draft Code appear as Code provisions in the final Code:
   1. the functions of non-executive directors to include scrutinising the listed company's performance (Code provision A.5.2(d));
   2. the terms of reference of the audit committee to include reviewing the external auditor's management letter and any material queries raised by the auditor to management (Code provision C.3.3.(k)); and
   3. the terms of reference of the audit committee to include ensuring that the board will provide a timely response to the issues raised in the external auditor's management letter (Code provision C.3.3(l)).

### Recommended Best Practices

Listed companies are encouraged, but are not required, to state whether they have complied with the recommended best practices and to give considered reasons for any deviation from them in their half-year and annual reports (and summary half-year and annual reports, if any).

## The Rules On The Corporate Governance Report

Listed companies must include a separate report by their board of directors on their corporate governance practices in their annual report and summary annual report (if any).

The Corporate Governance Report included in a summary annual report may be a summary of that contained in the annual report. It may also incorporate information by reference to the annual report, but must not include a cross-reference only without any discussion of the relevant matter. The summary must contain, as a minimum, a narrative statement indicating overall compliance with, and highlighting any deviation from, the Code provisions.

There are 2 levels of disclosure requirements: mandatory disclosures and recommended disclosures.

### Mandatory Disclosure Requirements

The Corporate Governance Report included in a listed company's annual and summary annual report must contain all the mandatory disclosures for the accounting period covered and any significant events relating to those disclosures for any subsequent period up to the date of publication of the annual report. The mandatory disclosures at paragraph 2 of the Corporate Governance Report include:

1. Corporate governance practices
   1. a narrative statement of how the listed company has applied the principles of the Code, providing explanation enabling its shareholders to evaluate how the principles have been applied;
   2. a statement as to whether the company meets the Code provisions. Companies can draw attention to the fact that they have adopted their own Code which exceeds the requirements of the Code provisions; and
   3. details of and considered reasons for any deviation from the Code provisions (as set out in the Listing Rules); and
2. Directors' securities transactions
   1. whether the company has adopted a code of conduct for securities transactions by directors meeting the required standard set out in the Model Code for Directors' Dealings (Appendix 10 of the Main Board Rules) and at GEM Rules 5.48 to 5.67;
   2. having made enquiries of all directors, whether or not the required standard has been met; and
   3. details of any non-compliance and an explanation of the remedial steps taken.

### Code Provisions' Expected Disclosures

Certain Code provisions of the Code on Corporate Governance Practices expect listed companies to include specified disclosures in their Corporate Governance Reports. The relevant Code provisions are C.1.2, C.2.1 and C.3.5. Where a listed company chooses not to make the expected disclosure, considered reasons for the deviation must be included in its Corporate Governance Report.

### Recommended Disclosures

Listed companies are encouraged to make the recommended disclosures set out at paragraph 3 of the Corporate Governance Report.

Rather than include lengthy and detailed information on the recommended disclosures in their Corporate Governance Reports, companies may include all or part of such information:

1. on their website if they highlight to investors where they can:
   1. access the soft copy of the information on their website by giving a hyperlink direct to the relevant webpage; and/or
   2. collect a hard copy of the information free of charge; or
2. if the information is publicly available, by stating where the information can be found. Any hyperlink should be direct to the relevant webpage.

## Transitional Arrangements

The following transitional arrangements will apply:

### First preliminary annual and half-year results announcements

Companies will not be required to disclose every deviation from the Code provisions in the first preliminary annual and half-year results announcements published for an accounting period commencing after January 1, 2005. Instead, they may give just a summary of the major areas of deviation. Considered reasons will not be required.

### Half-year reports

In the case of a half-year report for a period commencing on or after January 1, 2005 where the company has not yet published an annual report for a period commencing after that date, considered reasons for each deviation from the Code provision are not required. Instead, companies should disclose the deviations and, for each deviation, either give considered reasons as to why it does not propose to comply with the relevant Code provisions in the future or set out the steps it has taken or proposes to take in order to comply with those provisions in the future.

The Exchange's summary of the new disclosure requirements is set out at Annex A to this note.

# Annex A - Brief Summary of Disclosure Requirements

*(This table is for reference only and does not form part of the Listing Rules)*

**Financial Period**

**Reporting Document**

**Rule Reference**

**Minimum Disclosure Requirements**

1st quarter

Preliminary results announcement

No obligation to report on compliance with the Code

Financial report

No obligation to report on compliance with the Code

Interim/half-year

Preliminary results announcement

Transitional arrangement

First interim/half-year results announcement for the accounting period commencing on or after 1 January 2005:

* A summary of the major areas of deviation
* Need not give considered reasons

Main Board Appendix 16, Para. 46(4)

GEM Rule 18.78(4)

**Subsequent interim/half-year results announcements**:

* A statement as to whether the issuer meets the Code Provisions
* Disclose any deviations from the Code Provisions and give considered reasons for such deviations

(Issuer may refer to the Corporate Governance Report in the immediately preceding annual report, and summarising any changes since that annual report)

Financial report

Transitional arrangement

**First interim/half-year report for the accounting period commencing on or after 1 January 2005**:

* Disclose any deviations from the Code Provisions
* Need not give considered reasons for deviations
* In respect of each deviation, either:
  + give considered reasons as to why the issuer does not propose to comply with the relevant Code Provisions in the future; or
  + set out the steps the issuer has taken or proposes to take in order to be able to comply with the relevant Code Provisions in the future

Main Board Rules 3.25(2) & (3)(b)

Main Board Appendix 16, Para. 44(1)

GEM Rules 5.34(2) & (3)(b)

GEM Rule 18.55(4)

**Subsequent interim/half-year reports**:

* State whether the issuer has complied with the Code Provisions
* Either:
  + give considered reasons for each deviation; or
  + refer to the Corporate Governance Report in the immediately preceding annual report, and providing details of any changes together with considered reasons for any deviation not reported in that annual report

Summary interim/half-year report

Main Board Rules 3.25(2) & (3)(b)

GEM Rules 5.34(2) & (3)(b)

Same as interim/half-year financial results announcement

3rd quarter

Preliminary results announcement

No obligation to report on compliance with the Code

Financial report

No obligation to report on compliance with the Code

Annual

Preliminary results announcement

Transitional arrangement

**First annual results announcement for the accounting period commencing on or after 1 January 2005**:

* A summary of the major areas of deviation
* Need not give considered reasons for deviations

Main Board Appendix 16, Para. 45(5)

GEM Rule 18.50(6)

**Subsequent annual results announcements**:

* A statement as to whether the issuer meets the Code Provisions
* Disclose any deviations from the Code Provisions and give considered reasons for such deviations

(Issuer may refer to the immediately preceding interim/half-year report or to the Corporate Governance Report in the immediately preceding annual report, and summarising any changes since that report)

*This note is a summary only of the amendments to the Listing Rules relating to the Code on Corporate Governance Practices and the Corporate Governance Report. The full text of the amendments is available on the* [*Exchange's website*](http://www.hkex.com.hk/eng/newsconsul/mktconsul/documents/expocon.pdf)*.*

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