

Summary of “Analysis of Corporate Governance Practice Disclosure in March year-end 2015 Annual Reports” (published by the Stock Exchange of Hong Kong Limited) May 2016

I. Background

This is a follow-up of a previous review of compliance of the Corporate Governance Code Provisions (“CPs”) by listed issuers with a December year-end (“Dec YE review”). Please refer to our summary contained in the [Nov 15 Legal update](#). As the findings are similar, we shall make appropriate cross references to our Nov legal update (“Nov 15 summary”) below.

It should also be noted that the March year-end companies are typically smaller in size, when compared with the Dec year – end companies.

II. Notable findings

The top 5 CPs that have the lowest compliance rates are as below. The first four are identical with the findings of the Dec YE review. The fifth item was also a weak area identified in the Dec YE review (ranked as the top 6 by a very narrow margin):

- (1) (A.2.1) Separation of the roles of the chairman and chief executive
- (2) (A.6.7) Non-executive directors’ regular attendance, active participation, and attendance at general meetings
- (3) (A.4.1) Non-executive directors being appointed for a specific term, subject to re-election
- (4) (E.1.2) Attendance of board chairman, chairmen of other committees at AGM
- (5) (A.4.2) Directors appointed to fill a casual vacancy being subject to election by shareholders at the first general meeting and every director being subject to retirement by rotation at least once every three years.

III. Points to note

- (1) HKEX’s comments on quality of disclosure

As with the findings of the Dec YE review, HKEX commented on room of improvement regarding the quality of explanation given for deviating from some CPs. The examples cited as “boilerplate” disclosure are similar to those in the Dec YE review. (Please refer our Nov 15 summary, some parts are extracted below):

- (E.1.2) Chairman’s attendance at AGM

The Exchange observed that an AGM is a major corporate event. Instead of merely stating that the absentee directors “had other commitments”, an issuer “should explain the efforts made and the specific reasons for the relevant directors’ non-attendance at the AGM”. (Paragraphs 63-67, P. 14 of the Dec YE review)

(extracted from our Nov 15 summary)

(2) HKEX commented that a certain degree of “boilerplate” style explanations which were “vague and had been repeated year after year” were noted. Some issuers do, however, gave “informative” reports (paragraph 51 on P.10):

- why they deviate from the CPs
- “what” they do to rectify the situation
- whether the deviation is temporary

(3) HKEX’s press release gave further guidance on its expectations:

- explanation of the deviation should be “informative and clear”
- explain the manner of deviations
- measures taken instead of compliance
- describe the decision process
- gave considered reasons

(4) Examples given for “better” disclosure:

(A.2.1) Separation of the roles of the chairman and chief executive

- follow-up actions or mitigating steps taken (e.g. resignation of chairman or chief executive for only part of the year; and subsequently recruited a replacement). (Paragraph 33, P. 8 of the report)

(5) Examples given for “better” disclosure:

(A.6.7) Non-executive directors’ regular attendance, active participation, and attendance at general meetings

- mitigation actions taken (e.g. those directors that failed to attend held follow-up meetings with the chairman of the board to express their opinions of concerns on the subject matters (Paragraph 40, P.9 of the report)

- action plan for achieving compliance (e.g. scheduling meetings earlier to avoid calendar clashes)

IV. **Other points to note:**

(1) (A.4.1) Non-executive directors being appointed for a specific term, subject to re-election

- As stated in the Dec YE review, HKEX takes the view that whilst re-election of directors by rotation is widely recognized as a good corporate governance practice, it is separate from the requirement in CP A.4.1. Issuers should specify the period of appointment of non-executive directors of no more than three years. (Paragraphs 59-62, P 13 of the Dec YE review)

(2) A smaller number of the March year-end companies have an internal audit function (21%), when compared with the Dec year-end companies (47%). This may be attributable to the relatively smaller size of the March year-end companies generally.

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