

January 2022 Legal and Regulatory Update

Top stories

HKEX review: annual reports disclosure

HKEX published a **report** on its review of issuers' **annual reports for 2020 year-end**.
([Announcement](#); [full report](#))

Scope: (i) **thematic review of selected areas/ disclosure**, (ii) thematic review of **selected issuers** (*this issue: newly-listed; biotech companies*); (iii) **financial statements review**; (iv) **rule compliance**.

A high level of compliance was noted. HKEX is also **generally satisfied with disclosure on impact related to covid 19**, in the business review section of MD+A (P.12). (*HKEX guidance on covid disclosure in last year's report; summary: [our Jan 2021 update](#)*)

HKEX's announcement highlighted its recommendations regarding (i) auditors' modified opinions, (ii) material lending transactions, and (iii) material intangible assets reported in financial statements.

We summarised below, HKEX recommendations in areas which might affect more issuers generally. Firstly, "**material intangible assets**"; secondly, **disclosure on share schemes**.

Other accounting-related themes (P.19) include revenue (*HKFRS 15*), leases (*HKFRS 16*) etc.

In addition, there is a summary of HKEX recommendations made in previous reports.
(*Appendix I, P. 38*)

What you should know:

"Material intangible assets" reported in financial statements (P.20)

- Issuers should ensure **financial forecasts** and **key assumptions** used in **impairment tests** are **reasonable** and **not overly optimistic**
 - having regard to historical cash flows, available market information and future prospects
- Would be helpful if **disclosure** on judgment/estimate could be **more entity-specific** (*instead of repeating the accounting policy*)
 - e.g. disclosing assumptions that requires its most difficult, subjective, or complex judgment, which depends on its specific circumstances
- Strongly reminds issuers of **substantial uncertainty** as **covid 19 continues to evolve**

- Issuers should **continuously review** the clarity and transparency of their disclosure of impairment tests

Disclosure on share schemes (P.32)

- HKEX reminds issuers of its recommendations in last year's report
- Grant of **share options to non-employee grantees**: disclose identities of grantees, terms of the options and rationale for the grants
 - provide **accountability to shareholders** on the alignment of the grants with objectives of the schemes
- **Other share award schemes (other than share options)**
 - make disclosure consistent with share option schemes requirements (*Chapter 17, Listing Rules*)

What you should do:

- Your forthcoming **annual reports/financial statement disclosure** — consider HKEX recommendations
- Disclosure on impact of **covid volatility** — note **key areas of disclosure** as reviewed by HKEX

Also in this issue

Regulators

3 notable HKEX cases on directors' duties

The cases reflect directors' duties in different context: **loans/advances** might take various forms, **repeated breaches of Listing Rules**. There are useful lessons on **internal controls** and **"culture"**, key concepts under **HKEX's enforcement priorities**. (See [our July 2021 update](#))

(A) (Loans/advances) HKEX censures Enviro Energy Holdings Limited and named executive directors, also directs the directors to attend training on Listing Rules compliance.

([Announcement](#); [Statement of Disciplinary Action](#))

Between June 2017 - Mar 2018, the company made four **prepayments** totalling over RMB 388m to purchase building materials for purported refurbishment projects. The sums were subsequently refunded to the company. It was found that there was **no apparent commercial substance or business rationale** for the prepayments. E.g. no payment date or delivery date was specified in some cases.

Each prepayment **exceeded 8 per cent of assets ratio** of the company, hence constituting an **“advance to an entity”** under the Listing Rules. The company failed to comply with the timely announcement requirements.

It was also found that the **directors**, whether or not they were directly involved in the decision to enter into the agreements relating to such prepayments, had failed to properly consider and take steps to **ensure that the board was aware** of and had considered the **potential Listing Rule implications**.

What you should know/do:

- This case illustrates how **“advances”** may take various **“forms”**

HKEX’s announcement specifically states that

- Transactions which involve **substantial prepayments** should be **subject to scrutiny**
- “Advances to an entity” Rules **not contingent** on company’s **expectation** that the **monies will be repaid**

(B) (Repeated breaches, subsidiary) HKEX criticises China Properties Investment Holdings Limited and named directors (executive, independent), and directs the company to conduct an internal control review and the above directors to undergo training. ([Announcement; Statement of Disciplinary Action](#))

In Jan and June 2019, the company’s wholly-owned subsidiary (*acted as its internal fund manager*) made two **disposals of listed shares** on its behalf. Each disposal constituted a **“discloseable transaction”**, but the company failed to make timely announcements under the Listing Rules.

This was a **repeated breach**. In 2018, the company had been **warned by HKEX** after a similar incident.

What you should know:

Internal controls deficiencies + failure in directors’ duties include

- “Fund manager” subsidiary **authorised to make disposals** for the company; but NOT required to **inform** it of **potential notifiable transactions** before any disposal
- **Delegation?**
 - **NOT absolve** directors from their **duty to supervise** discharge of delegated functions
 - Directors **collectively** and **individually** retain ultimate **responsibility**

- No effective system for directors to **monitor the subsidiary’s activities** to ensure Rule compliance
- **Insufficient training** to **directors, staff,** and the **subsidiary**

What you should do/watch out for:

- Must ensure that **subsidiaries comply with Listing Rules**

HKEX’s announcement specifically states that

- **Directors** must **respond appropriately** and **promptly** when breaches or deficiencies have been discovered
- Failure will constitute a breach of **directors’ duties**; “can call into question” the **issuer’s culture** and **attitude** towards **Listing Rule compliance**
- **Repeated breach** after HKEX warning/guidance is “**far more likely**” to result in **disciplinary action** and a **public sanction**

(C) (Repeated breaches) Listing Committee criticises Samson Holdings Ltd. and named executive director (deputy chairman), and directs the company to conduct an **internal control review**. ([Announcement](#); [Statement of Disciplinary Action](#))

In July 2018, the company entered into an **investment (US\$150m)**, which constituted a “**major transaction**” (a type of “*notifiable transactions*” under Listing Rules). It **failed** to comply with the announcement/shareholders’ approval requirements. Subsequently, it received a **guidance letter from HKEX** emphasising the importance of Rule compliance.

It made a partial **disposal** of the investment in Dec 2019 (*also a “major transaction”*), but **again failed** to comply with the **same Rule** requirements.

The named executive director was responsible for both the investment and the disposal.

What you should know:

Internal controls deficiencies + failure in directors’ duties include

- The term “*notifiable transactions*” (*Listing Rules*) not defined in the **internal control policy**
- No procedures requiring **correspondence from HKEX on material matters be reported to the board**
- No control mechanisms on the **powers** of the chairman and the deputy chairman to enter into transactions

What you should do/watch out for:

HKEX's announcement specifically states that

- **Repeated breaches** of the Listing Rules are “a hallmark of a **poor compliance environment**”
- Brings an “**increased likelihood**” of **disciplinary action** and **public sanction**
- Receipt of a **HKEX regulatory letter** should result in a “**proactive and meaningful response**” **by the board**, including any necessary **remedial action**

Legislation

The Competition Commission commenced proceedings in the Competition Tribunal against 4 undertakings and 2 individuals for “price fixing” in travel services. ([Press release](#))

In May 2016 - May 2017, 2 competing travel services providers agreed to fix the prices at which tourist attractions and transportation tickets were sold at hotels belonging to **9 hotel groups** in Hong Kong. The hotel groups and a **tour counter operator** in one of the hotels acted as **facilitators**, by passing on pricing information between the competitors hence actively contributed to the implementation of the **price-fixing agreement** (“*First Conduct Rule*” of the *Competition Ordinance*).

The Commission took **different actions against the parties**, reflecting their degree of **co-operation**.

Firstly, instead of bringing proceedings in the Tribunal, it issued to some hotel operators and the tour counter operator (*and all of them accepting*) “**Infringement Notices**” for acting as facilitators. These parties had **cooperated from an early stage of the investigation** and **made commitments to comply** with the requirements of the notices.

During the **investigation onward**, additional parties agreed to **cooperate** with the Commission under its “Cooperation and Settlement Policy for Undertakings Engaged in Cartel Conduct” (“**Cooperation Policy**”). The Commission agreed to enter into **cooperation agreements** with them. These will result in the parties jointly seeking orders in the Tribunal to allow the proceedings to be disposed of by way of consent.

What you should watch out for/do:

- “**First Conduct Rule**” means — parties acting together with an **agreement**, and/or engaged in a **concerted practice**, whose **object or effect** is “to prevent, restrict or distort” competition in HK

- Not only cartelists, but **third parties** who **facilitate anti-competitive conduct** between competing businesses are liable
- This case illustrates the significance of co-operation. The Commission urges parties already engaged in cartel conduct to seize opportunities to cooperate so as to secure lenient treatment

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