

Jan 2017 Legal and Regulatory Update

Top stories

HKEX: what to note in preparing annual results announcement + report

(i) HKEX published a **report** on its review of issuers' **annual reports for year 2015**.

It gave **useful guidance on detailed disclosure expected** in various areas, including MD+A (e.g. more detailed disclosure on “**significant securities investments**”). As regards “annual review of **continuing connected transactions**” by independent directors, HKEX gave examples of internal controls procedures that should be in place, and reminded issuers that sufficient information be provided to independent directors for conducting the review. (Click here: [press release](#), [full report](#))

What you should know:

HKEX's specific recommendations include:

- **“Business review” in MD&A** (paragraphs 44-60):
 - (i) **“Principal risks and uncertainties”** (para 50-1): not only describe the major risk areas; but specifically how they would affect business operations, potential financial impact, and measures taken to manage the risks.
 - (ii) **“Environmental policies and compliance with relevant laws and regulations”** (para 52-3): not only confirming compliance; but explain the material impact of the relevant laws and regulations on business operations.
 - (iii) **“Key relationships with employees, customers and suppliers”** (para 54-5): not only “generic descriptions” (like “good and long term relationship”); but disclose the background of major customers and length of relationship, credit terms granted, subsequent settlement of trade receivables, risks associated with reliance on major customers, and measures to mitigate such risks.
 - (iv) **“Financial key performance indicators”** (para 56-7): explain the basis for selecting the indicators and how they are effective in measuring business performance.

- Better disclosure of **significant securities investments in MD&A** (para 58-60): noted that an increasing number of issuers have significant securities investment; and should provide sufficient information about investment portfolios and performance:
 - (i) A breakdown of major investments held
 - (ii) Fair value of each major investment at the financial year-end date, and its size compared to the issuer's total assets
 - (iii) Performance of each major investment during the year
 - (iv) Strategy for future investments and the prospects of these investments.

- **“Continuing connected transactions”** (para 28-37)
 - (i) Issuers should have in place **internal control procedures** to ensure that continuing connected transactions are conducted in compliance with the rules
 - (ii) **Internal audits** would review these transactions and internal control procedures, and provide the findings to independent directors
 - (iii) HKEX found that **some issuers only provided a “management’s confirmation”** on the fairness of the transactions, and **external auditor’s letter** to their independent directors. In addition, **these directors should have information about the work done by management to review the transactions and the internal control procedures**
 - (iv) (Para 34) **examples of work done by management** to monitor the effectiveness of internal controls procedures -- review of market intelligence concerning market prices and industry trends and /or compare pricing terms for transactions conducted with independent persons; to ensure the transactions are on “normal commercial terms”

- **Financial statements with auditors’ modified opinions** (para 61-9) – issuers should provide more detailed and additional information to enable shareholders to better understand the modifications, and their actual and potential impact on the financial position:
 - (i) **Audit committee** should critically review any major judgmental areas relating to such modified opinions (e.g. “going concern” assumptions), and ensure any disagreement with management is disclosed in the annual reports
 - (ii) Issuers and audit committees should engage in **early discussions with the auditors about the audit plans**, and how to address issues giving rise to previous year’s modifications in the current financial year.

- In the next HKEX annual review, it intends to cover most of the areas reviewed in the above report

What you should do:

- Reflects HKEX’s recurring theme of encouraging **better disclosure** in annual reports, going **beyond “generic descriptions”**. This report gives useful guidance on the type of detailed disclosure expected in various areas
- As regards independent directors’ annual review of “continuing connected transactions”, click [here](#) for our Jan 16 newsletter summarizing HKEX’s previous guidance letter (GL73-14)
- Should also note **new and more specific** Listing Rule **ESG** disclosure requirements (Appendix 27), effective for years commencing 1 Jan 2016 — e.g. the “Environmental Subject Area” has 3 specific “Aspects” (“emissions”, “use of resources”, “environment and natural resources”)

(ii) **HKEX updated the Frequently Asked Questions (“FAQ”)**, incorporating questions relating to the new **“extended auditor report”** requirements, “modified audit opinion”, and updated audit terminology. (Click here: [FAQ](#))

What you should know/do:

Particularly relevant for preparing your **annual results announcement/report**:

- **(FAQ 002-2017, P. 327)** need to disclose details of **“Key Audit Matters”** (in the new **“extended auditor report”**) in **annual results preliminary announcement**?
 - (i) No specific requirement to include such details in results announcement
 - (ii) More appropriate for such information to be read in conjunction with the full audit report and complete financial statements. Hence, the annual report should be published as soon as practicable after the results announcement

- **(FAQ 003-2017, P. 329)** where the auditors express an unmodified opinion, but include an **“Emphasis of Matter”** paragraph or in a separate section under the heading **“Material Uncertainty Related to Going Concern”**:
 - (i) Issuer should provide details in the results announcement
 - (ii) Select the headline category **“Qualified and/or Modified Audit Report”** for posting the announcement on HKEXnews website

- **(FAQ 004-2017, P.331) interim results** reviewed by auditors and where the **review report is modified**:
 - (i) Issuer should provide details of the modification in the results announcement, and select the headline category **“Qualified and/or Modified Audit Report”** for posting the announcement on HKEXnews website
 - (ii) Rationale — paragraph 46(5) of Appendix 16 requires an issuer to include any supplementary information which in the opinion of its directors is necessary for a reasonable appreciation of the results

Regulators

SFC commenced legal proceedings (under s.214, Securities and Futures Ordinance) in the Court of First Instance (click [here](#) for press release), to seek **disqualification orders** against the former chairman, and four current independent directors of Hanergy Thin Film Power Group (the “Company”).

In addition, SFC also seeks a **court order** requiring the former chairman to procure that the Company's parent and/or affiliates pay all outstanding receivables due to the Company, and for him to provide a guarantee.

These actions followed SFC's investigation into various very substantial connected transactions between the Company and its parent and/or affiliates. The Company relied on sales to these parties as a main source of revenue. In July 2015, SFC suspended the Company's share trading.

What you should know:

- Directors' failure:
 - (i) Did not question the viability of the Company's business model relying on sales to connected parties as main source of revenue; and failed to properly assess the financial positions of these connected parties and recoverability of receivables due.
 - (ii) Did not act in the Company's best interest, by failing to take proper steps to recover these receivables, and put the interests of the connected parties before that of the Company.
- As regards share trading resumption, SFC would require
 - (i) The directors not to contest the above legal proceedings
 - (ii) Publication of a disclosure document with detailed information to address SFC's concerns

What you should watch out for:

- SFC's active enforcement and use of various powers, as illustrated by various stages of this case — including the range of court remedies, and power for mandatory suspension of share trading

Legislation

Notice was gazetted to increase the Statutory Minimum Wage rate to HK\$34.50 per hour (current: HK\$32.50 per hour), effective on 1 May 2017.

What you should know/do:

- Payroll procedures — apart from costs implications, payroll procedures would need to be updated
- The current HK\$13,300 monthly cap (above which an employer is not required to keep a written record of the employee's hours worked) will be increased to HK\$14,100 per month