

# February 2022 Legal and Regulatory Update

## Top stories

### HKEX Enforcement Bulletin: internal controls guidance

HKEX published its latest [Enforcement Bulletin](#), with internal controls as its theme.

First of all, **the board is responsible for appropriate and effective internal controls**, with directors having **collective and individual responsibilities**. This is despite the fact that the **audit and risk committees** may have special roles under the Corporate Governance Code.

In **enforcement cases**, whilst part of **HKEX's focus** will be on whether **a breach** is involved, it will also investigate the issuer's **internal controls**, and the **steps** that the **individual directors** have taken to **discharge their responsibilities**.

It is noteworthy that if there has been **a failure in internal controls, disciplinary action** may follow on that alone, **even if no other breach** of Listing Rules are found.

The bulletin gives **useful guidance** on (i) what HKEX is looking for in investigations, (ii) dispelling some misconceptions, (iii) further guidance on effective internal controls. There are references to past enforcement cases. (*Read our previous legal updates*)

#### *What you should know:*

#### Useful HKEX Guidance

#### Investigations: what HKEX looks for (P.3)

- **Evidence of internal controls**
- **Steps taken by directors to review** (*at least annually*) and ensure **effective implementation and operation**
  - Expect **“audit trail”** (*detailed documentary evidence*)
- **Culture** re: internal controls and compliance
  - Beyond having policies/procedures in place
  - At all levels of organisation
  - E.g. whistle blowing mechanism (*and roles of audit committee*)

### Some misunderstandings dis-spelled (P.4)

- “**External auditors** will have checked internal controls”
  - While auditors may flag internal control concerns identified during audit work, it is **different from a dedicated and focused review**
- “We review internal controls annually, **but only check controls on a rotation**”
  - Under Corporate Governance Code, the board’s review has to **cover “all material controls”**
  - Might conduct “deeper dive” review of specific areas
- “Internal controls are **audit committee’s responsibilities**”
- “Internal controls **assumed sound if no red flags after last review**”
  - **Passive approach** is insufficient
  - Need to be considered on an **ongoing basis**
- “Disciplinary action inappropriate if **no loss suffered**/loss not attributable to internal controls”
  - **Internal controls deficiencies**, being a breach of duty, is **actionable in itself**
  - **Not contingent upon loss** being suffered

### Further guidance on “effective internal controls” (P.5)

- Reference materials cited
  - E.g. HKEX publications, HKICPA Guides (*its technical bulletin has an illustrative list of types of controls*)

### **What you should do:**

- **Update your board**, noting **HKEX’s expectations** of high standards
- Noteworthy that **internal controls deficiencies itself** may lead to **disciplinary action**
- Need to keep **documentary evidence**

## Also in this issue

### Regulators

(i) HKEX censures Beijing media Corporation Limited, imposes a “Prejudice to Investors’ Interests” statement (“PII statement”) on 4 named directors (executive/non-executive/independent), censures or criticises 19 named directors and supervisors (also directs such directors to attend training). ([Announcement](#); [Statement of Disciplinary Action](#))

Between Jan 2018- Mar 2019, the company through its subsidiaries provided loans of over RMB550 million to its controlling shareholder and associate.

Each loan exceeded 8 per cent of assets ratio of the company, hence constituting an “advance to an entity” under the Listing Rules (Chapter 13). All loans are “major transactions” (Chapter 14 Listing Rules), and some are “connected transactions” (Chapter 14A). The company failed to comply with HKEX requirements.

The above directors failed to ensure that the company maintained adequate and effective internal controls. PII Statements were imposed on 4 named directors who were found to have knowledge or involvement in some of the loans.

#### What you should know:

Internal controls deficiencies + failure in directors’ duties include

- Lack of written procedures for compliance with specified Listing Rules
- Staff at subsidiaries responsible for reporting transactions to the company are unfamiliar with relevant Listing Rules
- Directors and senior executives of subsidiaries not required to declare business relationships and potential conflicts to the company’s board

#### What you should do/watch out for:

- Must ensure that subsidiaries comply with Listing Rules
- Review relevant controls e.g. policies/procedures, reporting mechanism to listed holding company, training

(ii) HKEX issued an [updated FAQ \(last updated on 2 March\)](#), on the **2020 Joint Statement with SFC re results announcements** in light of covid travel restrictions.

(Q1) HKEX will continue to **adopt a similar approach per the Joint Statement** on a case-by-case basis, taking into account the prevailing circumstances. It invites issuers whose audits are affected by the recently announced pandemic-related measures to discuss their situation at the earliest instance.

As regards whether **AGMs can be held in a “virtual” mode**, there are no restrictions under Listing Rules, but issuers need to check their **articles of association** and **company law** of its place of incorporation. Where virtual meetings are held, the updated FAQ (Q11) reminds issuers to **use reasonable best efforts** to (a) ensure that shareholders attending remotely are **able to speak and vote** at the meetings; and (b) **explain how** they may do so.

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