

Nov/Dec 2024 Legal and Regulatory Update

Top stories

Year-end audit

(i) (Nov) HKEX published its latest [Listed Regulation and Enforcement Newsletter](#), as re-named after the merger of its Listed Issuer Regulation and Listing Enforcement departments (now as Listing Regulation and Enforcement department).

Its themes include **reminders on planning for upcoming audit**, convertible bond offerings with concurrent share buyback, the de-listing Rules 6 year on.

Our focus is on the **audit planning** theme.

Firstly, issuers are reminded on **evaluating audit quality**, including the **responsibility of the audit committees** for recommending to the board re: **auditor appointment, reappointment and removal**.

As further summarised below, audit committees are reminded to consider **regulatory sanctions on auditors** when **evaluating the auditors' audit quality in a due and timely fashion**.

Secondly, **issuers and their board of directors are also reminded that the ultimate responsibility for the integrity of accounts** rests on them. HKEX also made cross references to its previous newsletters on the subject, and AFRC publications.

What you should know/do:

Evaluating audit quality

- HKEX noted recent instances with **auditors sanctioned by regulatory authorities** for failing to comply with certain reporting obligations or to identify material misstatements in issuers' financial statements
- Issuers should consider the **material misstatements or irregularities identified** by the regulatory authorities and their **relevance to the issuers' circumstances**
- **Due and timely evaluation: late change in the auditors** might result in the issuers **missing the reporting deadline**

(ii) (Dec) AFRC published “**Inspection Insights – root cause analysis and remediation: a call to action for quality improvement**” ([Press release](#), [full report](#))

The report shares AFRC’s observations on how auditors subject to its 2023 inspections, had performed root cause analysis of the identified deficiencies and responded by designing and implementing remedial actions.

Some areas are of particular interest to audit committees:

What you should know/do

- **Key observations on areas requiring improvement** (P.5 of report)
- **Key messages to audit committees** (P.16)
 - **Must assess the auditor’s competencies, capabilities and commitment to audit quality** before making recommendations to the board on **appointment/reappointment/removal**
 - **Review and monitor the effectiveness of the audit process**
 - E.g. how auditors have addressed **AFRC’s inspection findings** if audits of their companies were previously inspected
 - Understand how **identified deficiencies** have affected **auditors’ nature/scope of work** for current year audits; whether the audits are subject to any additional quality review by the firm
 - Strengthen **oversight and communication** among the board of directors, audit committees, and auditors

Also in this issue

ESG: HK Sustainability reporting roadmap

(iii) (Dec) **Our Government launched its Roadmap on sustainability disclosure in HK.** ([Press release](#), [full document](#)). **For HKEX-listed issuers**, the key points are:

- **HKICPA** is developing the Hong Kong Standards on a full alignment basis with the ISSB standards (*IFRS S1 and S2*) [Note: [HKFRS S1](#) and [S2](#) were subsequently published.]
- In light of its new climate requirements (*effective Jan 2025*), **HKEX will consult the market in 2027** on mandating sustainability reporting against the Hong Kong Standards for listed issuers, with an expected effective date of 1 Jan 2028, under a proportionate approach

- **AFRC** will work with relevant financial regulators and stakeholders to drive the development of **HK's regulatory regime for sustainability assurance** and promote high-quality assurance by adopting international standards

(iv) (Nov) HKEX published its review of listed issuers' latest ESG reports to assess their compliance. A high level of compliance with current requirements was noted. ([Report](#))

(As from 1 Jan 2026) **LargeCap issuers** would need to comply with **mandatory new climate disclosures**. A key theme of the review is to **assess their readiness for the same**.

It was noted, for instance, that a majority of LargeCap issuers have referenced international TCFD recommendations (70%) or ISSB (34%) standards.

Some areas with relatively **“lower” compliance** are:

- **Scope 3:** around 50% of LargeCap reported on this
 - For those that disclosed, **ALL** provided a breakdown in **Scope 3 categories**
 - **“Downstream” activities** have much lower reporting rates
- **Environmental targets** (*current HKEX requirements: “comply or explain”*)
 - 68%: **quantitative emission targets**
 - 65% (*of disclosed quantitative emission targets*) are **long-term** (5-10 years or over 10 years)

What you should do:

- Note the findings, as you prepare for the new climate requirements

Regulators

(v) (Dec) HKEX published (A) a report on its review of issuers' annual reports for 2023 year-end, and (B) a consolidated guide for the preparation of annual reports (HKEX AR Guide). ([Press release](#))

(A) [HKEX review of issuers' annual reports](#)

Firstly, its focus is on **compliance** with Listing Rules disclosure requirements. A high level of compliance was generally noted. Some areas with lower compliance are summarised below.

Secondly, HKEX followed a “**thematic approach**”, selecting a number of specific areas for review. These include **financial statements with modified audit opinion, material lending transactions, Management's discussion and analysis (MD+A)**.

HKEX's recommendations on MD+A are noteworthy (P.5) , as summarised below.

Thirdly, it also assessed compliance with specific **accounting standards** in financial statements. No significant non-compliance was identified. However, there is room for improvement in the **qualitative disclosure**, e.g. material accounting information, key judgments and estimates should focus on how issuers have applied the accounting requirements according to their own facts and circumstances. **Boilerplate description** that solely duplicates/summarises accounting requirements is not enough.

What you should know:

AREAS WITH LOWER COMPLIANCE

- **E.g. share schemes**
 - Only disclosed shares issuable under options available for grant
 - Failed to include also shares issuable under options already granted but not yet exercised
- **E.g. Significant investment**
 - Failed to disclose investment in **funds and wealth management products**

THEMATIC REVIEW

HKEX recommendations

- **E.g. Money lending transactions**
 - (**Money lenders**) customer profile, concentration risks, major loan terms
 - (**Non-money lenders**) rationale for lending
- **E.g. MD+A: quality of disclosure**

- Particularly in discussion of year-on-year performance variances; significant events and risks, impacts and issuers' counter measure
- **Useful examples of shortcomings**
 - E.g. Failed to discuss specific underlying causes or business factors that drove the results; only boilerplate statements
 - E.g. highlighted **business plans** (*which would demand significant investment*) ; failed to discuss estimated **capital expenditure** and **how** it is intended to be met

ACCOUNTING ASPECTS

HKEX recommendations

- Cross reference to **HKEX AR Guide** (*Section 3*)

What you should do:

- Your **forthcoming annual reports/financial statement disclosure** — consider HKEX recommendations

(B) [HKEX AR Guide](#)

It is a **consolidated guide**, divided into 3 areas, summarising (1) mandatory disclosure requirements under Listing Rules, (2) **recommended disclosure** in specific areas from **previous thematic reviews**, (3) **guidance for financial disclosure** under prevailing requirements (*including specific accounting standards*).

(vi) (Nov) (Loans, high risks) HKEX criticises China Sunshine 100 Holdings Ltd, censures 2 executive directors and criticises named non-executive directors (including independent directors). ([Announcement](#); [Statement of Disciplinary Action](#))

It concerns a **series of loans** (*total: RMB 1.11 billion*) granted to borrowers who are themselves creditors of debts of other ultimate borrowers. These debts of ultimate borrowers were secured by a building in Beijing.

The company envisaged that any default would lead to a fire sale opportunity in which it could purchase the Beijing building at a substantial discount as a distressed asset in a judicial action.

Despite the **high risks** (*poor credit worthiness of the borrowers and ultimate borrowers*), the **relevant directors** did not :

- Procure **sufficient due diligence** prior to granting the loans

- Properly devise a **strategy** for the company **to recover the loans** if the fire sale opportunity failed

The company had internal controls deficiencies which contributed to its failure to : (1) publish timely annual/interim financial statements, (2) comply with Listing Rule notifiable transactions requirements.

The relevant directors and the company agreed to settle the action.

(vii) (Nov) (Conflicts of interest, despite no personal interest) HKEX criticises a named non-executive director (NED) of Tenfu (Cayman) Holdings Limited. ([Announcement](#); [Statement of Disciplinary Action](#))

In Dec 2023, the NED was authorised to purchase the company shares on its behalf pursuant to a share repurchase scheme. At the same time, he also agreed with 2 **substantial shareholders** that he would purchase shares on their behalf. A number of purchases were made on behalf of the company and the substantial shareholders respectively.

NED's **dual roles gave rise to a conflict of duty**. He did **not inform the company** that he was also acting on behalf of the substantial shareholders, and took no other steps to **manage the conflicts**.

These are **regardless of whether he received any benefits** from the substantial shareholders.

NED admitted the breach and agreed to accept the sanction.

What you should know:

HKEX's key messages

- **Proper handling of conflicts of interest and duty** is a fundamental element of good corporate governance
- A director must always **put the interest of the company first**, and manage potential conflict with **full transparency**
- This applies even if the director derives **no personal benefit from the conflicting roles**

(viii) (Dec) HKEX published some new/updated FAQs

- [FAQ 17.2](#) on ESG reporting ([version with changes marked](#))
- [FAQ 17.3](#) ([marked-up version](#))
- [FAQ 10](#) ([marked- up version](#))

Legislation

(ix) (Nov) [The Companies \(Amendment\) Bill 2024](#) was gazetted, to enable HK-incorporated companies listed on HKEX to take advantage of Listing Rule amendments regarding **(A) Treasury shares (B) implied consent mechanism** for disseminating paperless corporate communications.

(x)(Dec) [The Companies \(Amendment\) Bill No.2 2024](#) was gazetted, which aims to provide a **simple and accessible re-domiciliation mechanism**. It enables non-HK incorporated companies to re-domicile to HK while maintaining their legal entities as a body corporate **without** the need to go through **complicated and costly judicial procedures**.

Generally speaking, re-domiciled companies will have the same rights as locally incorporated companies, and will be required to comply with Companies Ordinance requirements.

(xi) (Dec) **The Competition Commission announced that Hong Kong Commercial Cleaning Services Limited (“HKC”) has admitted liability re: alleged cartel conduct in the supply of cleansing services to HK Housing Authority (“HA”).** ([Press release](#))

The Commission had commenced legal proceedings against HKC and Man Shun Hong Kong & Kln Cleaning Company Limited (“MS”) and their 3 directors, for allegations that **cleansing service contractors** including HKC and MS were **colluding** with each other when **bidding for Hong Kong Housing Authority cleansing service contracts**.

All respondents admitted liability.

HKC admitted its liability for a contravention of the **First Conduct Rule** of the Competition Ordinance, by exchanging commercially sensitive information, which constitutes **price fixing**, when bidding for 17 HA contracts from at least May 2016 to Aug 2018. It agreed to pay a **penalty of HK\$10.96 m**.

What you should watch out for/do:

- **“First Conduct Rule”** means — parties acting together with an **agreement**, and/or engaging in a **concerted practice**, whose **object or effect** is **“to prevent, restrict or distort”** competition in HK
- Businesses should steer clear of anti-competitive practices, while **those already involved** should consider approaching the Commission for **leniency and co-operation**

Published by Practising Governance Limited, Feb 2025