

ANALYSIS OF CORPORATE GOVERNANCE
PRACTICES DISCLOSURE IN
2007 ANNUAL REPORTS

February 2009



Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

EXECUTIVE SUMMARY

- The Listing Division of the Stock Exchange of Hong Kong Limited has completed its third annual review (the Third Review) of listed issuers' compliance with the Code on Corporate Governance Practices (the Code).
- The Third Review involved analysis of corporate governance practices disclosures made by 1213 listed issuers in their 2007 annual reports. In particular, we looked at whether these issuers said they had complied with the Code's code provisions and, if not, why not. We also asked these listed issuers whether or not they chose to comply in 2007 with the Code's recommended best practices. (Issuers are encouraged but not required to disclose whether they have complied with the Code's recommended best practices.) 584 issuers provided information regarding their compliance with the recommended best practices.
- The Third Review built on our second annual review (the Second Review), which was conducted in relation to corporate governance disclosures in the 2006 annual reports. The results of the Second Review were published in February 2008.
- In the Third Review, we found that all of the 1213 issuers met the "comply or explain" requirements in their 2007 annual reports in respect of all of the code provisions.
- As with the Second Review, large listed issuers complied with more code provisions than smaller listed issuers.
- 98 per cent of the 1213 issuers complied with 41 or more of the 45 code provisions, which is an improvement from the Second Review. (The Second Review found that 96 per cent of the 1114 issuers reviewed complied with 41 or more of the 44 code provisions with which compliance was analysed.)
- 17 of the 32 recommended best practices were fully complied with by more than 80 per cent (468 out of 584) of relevant issuers. In the Second Review 15 of the 32 recommended best practices were fully complied with by more than 80 per cent (446 out of 558) of relevant issuers.
- 25 of the 32 recommended best practices were fully complied with by 50 per cent of the relevant issuers. This is the same as in the Second Review when similarly around 50 per cent of relevant issuers complied with 25 of the 32 recommended best practices.
- As in the Second Report, the recommended best practices relating to quarterly reporting had the lowest compliance rates.

BACKGROUND

- The Code became effective in 2005. It is Appendix 14 to the Main Board Rules and Appendix 15 to the GEM Rules.
- The Code sets out the principles of good corporate governance, and two levels of recommendations: (a) code provisions; and (b) recommended best practices. Issuers are expected to comply with, but may choose to deviate from, the code provisions. The recommended best practices are for guidance only. The Code provides that issuers must state whether they have complied with the code provisions in their interim reports and annual reports. Issuers are required to explain any deviation.

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- In the Second Review, we analysed corporate governance disclosures made under the Code by 1114 issuers (that is, all listed issuers with a financial year ended 31 December which had published a 2006 annual report). Our findings were published in a report issued on 29 February 2008. That report is available at <http://www.hkexnews.hk/reports/corpgovpract/CG%20report.pdf>

SCOPE OF PROJECT

- In the Third Review, we reviewed the compliance of 1213 listed issuers, which is all issuers listed as at 31 December 2007 except those that were long suspended or delisted in 2007, and excluding one company. That company is Manulife Financial Corporation (00945), which is listed on Toronto Stock Exchange (TSX) with a secondary listing on the Exchange. Pursuant to Manulife's listing agreement, it is required to comply with the TSX corporate governance rules rather than those of the Exchange.
- In addition to having a slightly larger target population, the Third Review also built on the scope of the Second Review in the following ways:
 - Internal control - the Second review was restricted to asking how issuers complied with the code provisions. The Third Review asked issuers who was tasked with undertaking the review, what time resources were required to undertake it, and provided a list of commonly used approaches for respondents to choose from; and
 - With regard to recommended best practices the Second Review was restricted to asking if issuers complied or not with particular recommended best practices. In the Third Review, issuers were asked to select, for each recommended best practice, whether it is applicable, whether they have complied, and where they did not comply if they rectified or did not rectify the deviation.
- To facilitate its review, we asked issuers to answer a questionnaire regarding their compliance with the Code. Sections 1 and 2 of the questionnaire related to compliance with the code provisions and were mandatory. Section 3 of the questionnaire related to compliance with the recommended best practices and was voluntary. The questionnaire is available at <http://www.hkexnews.hk/reports/corpgovpract/survey.doc>
- There was a 100 per cent response rate to Sections 1 and 2 (that is, 1213 responses) and a 48 per cent response rate to Section 3 (that is, 584 responses).
- The findings set out in this report are based on the questionnaire responses. However, we tested a sample of the responses to Sections 1 and 2 to ensure they were sufficiently reliable.
- This year we also plan to review the Code to determine whether any changes should be made. This work will be informed, in part, by the results of the Second Review and the Third Review.

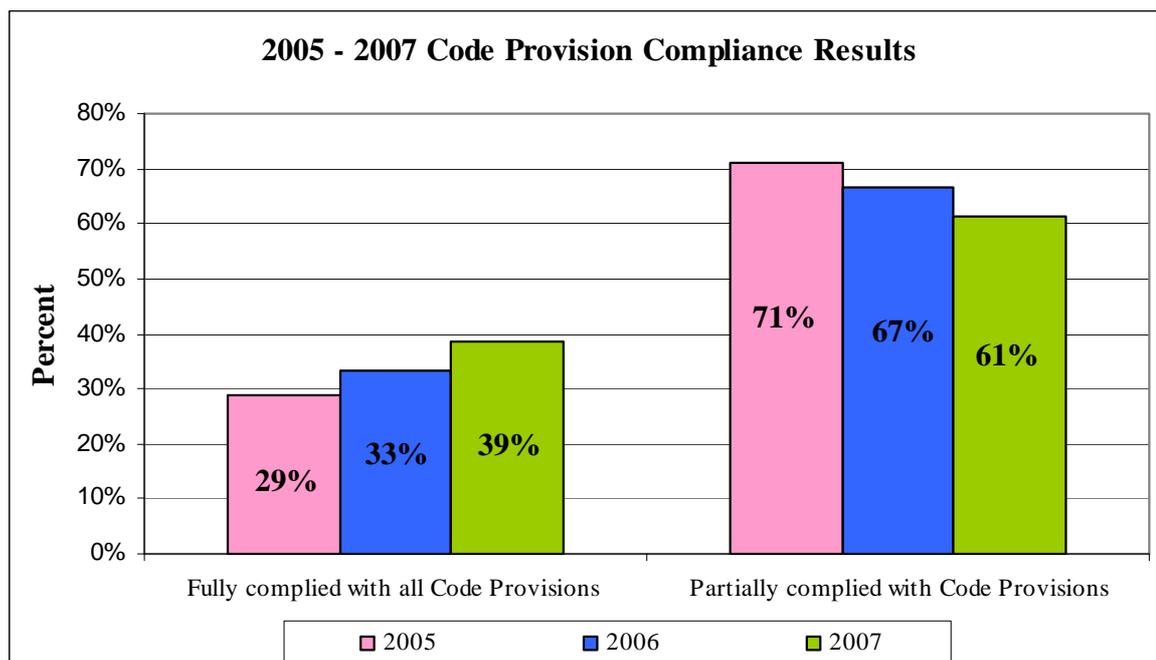
FINDINGS REGARDING CODE PROVISIONS

References to \$ are to Hong Kong dollars. Percentages are approximate; they are generally rounded to the nearest full percentage.

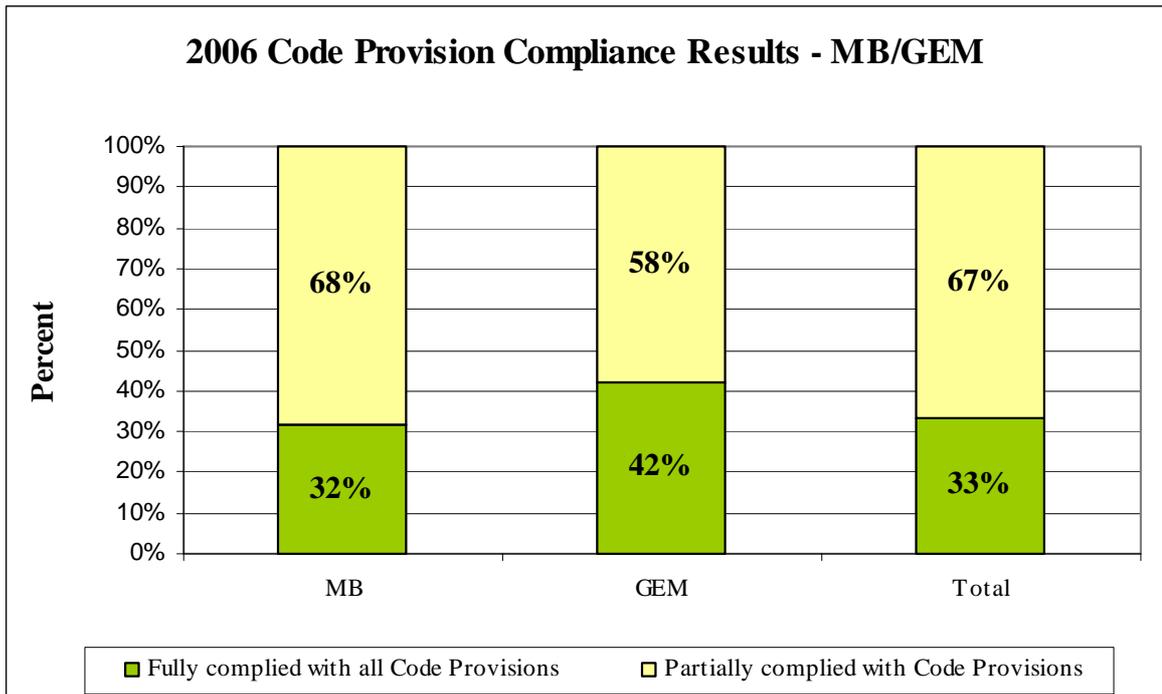
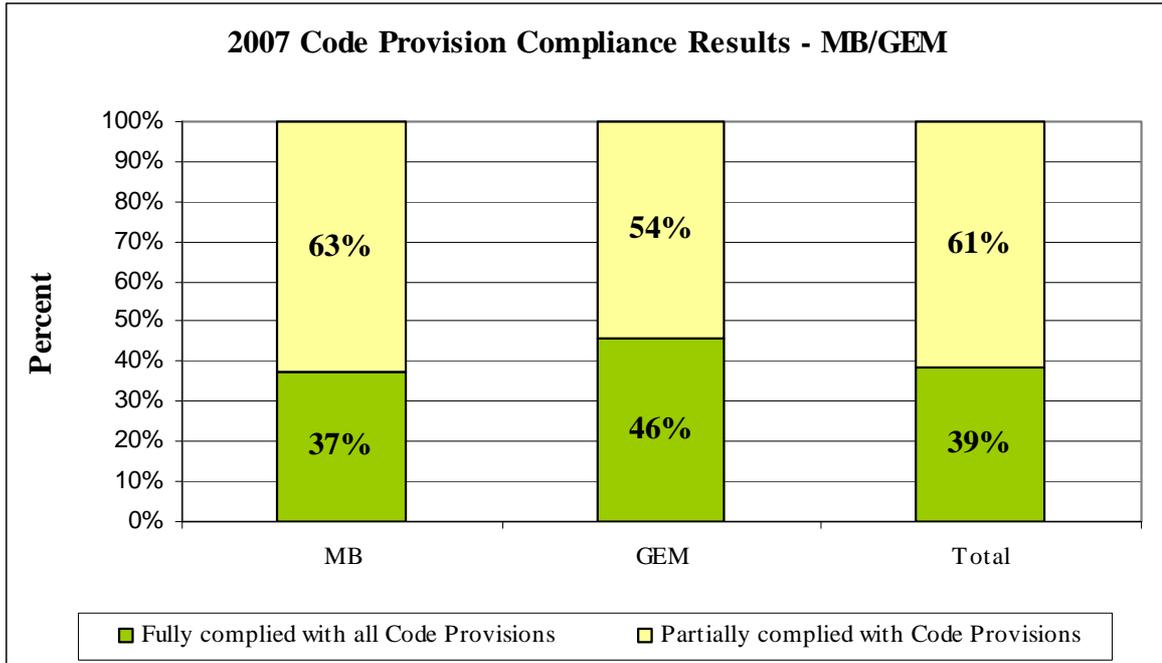
Overall Compliance

- Consistent with the Second Review, we found that ALL of the 1213 issuers either:
 - indicated in their annual reports that they had complied with the code provisions; or
 - explained their deviation from one or more code provisions.
- 39 per cent of issuers stated they had fully complied with all the code provisions for the whole accounting period. As illustrated by the graph below, that is an improvement of six per cent from the Second Review.

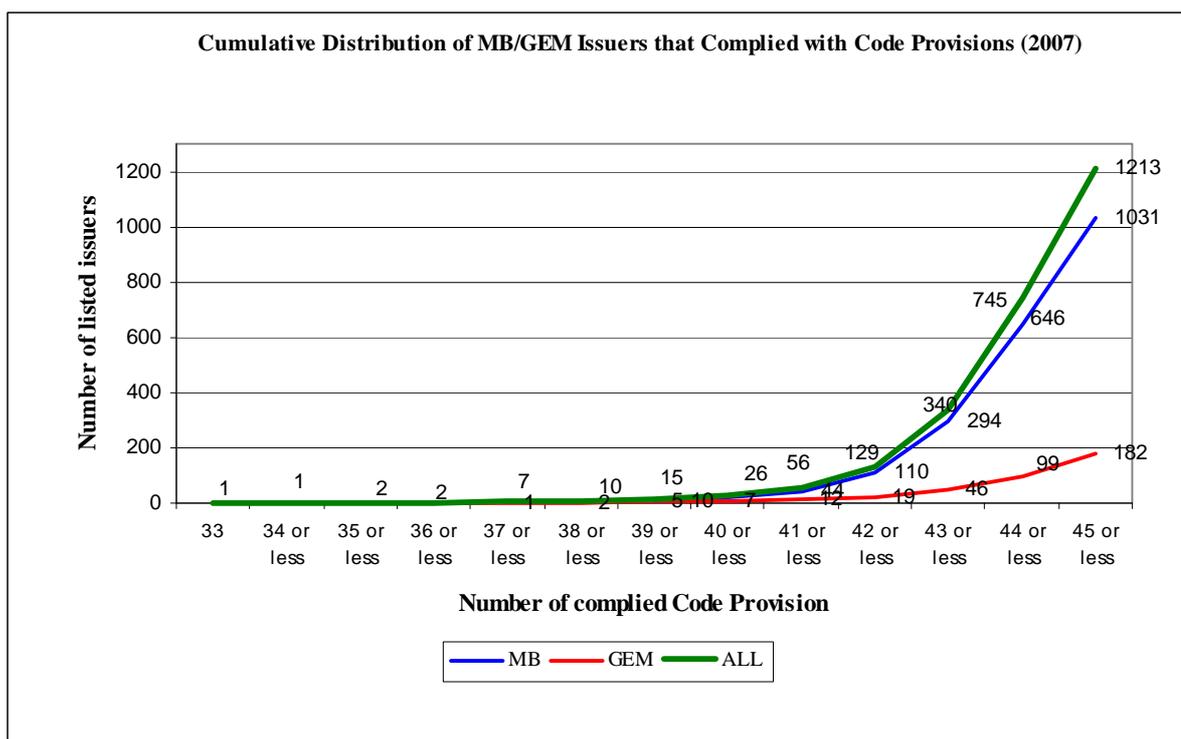
Remarks: Issuers having “partially complied with the code provisions” means that the issuer disclosed that they had complied with only some of the code provisions (whilst deviating from others) and/or they had complied with all of the code provisions but not for the whole year.



- Compliance of GEM issuers was higher than MB issuers (46 per cent for GEM vs 37 per cent for MB), which is generally consistent and further improvement from the Second Review findings (42 per cent for GEM vs 32 per cent for MB).



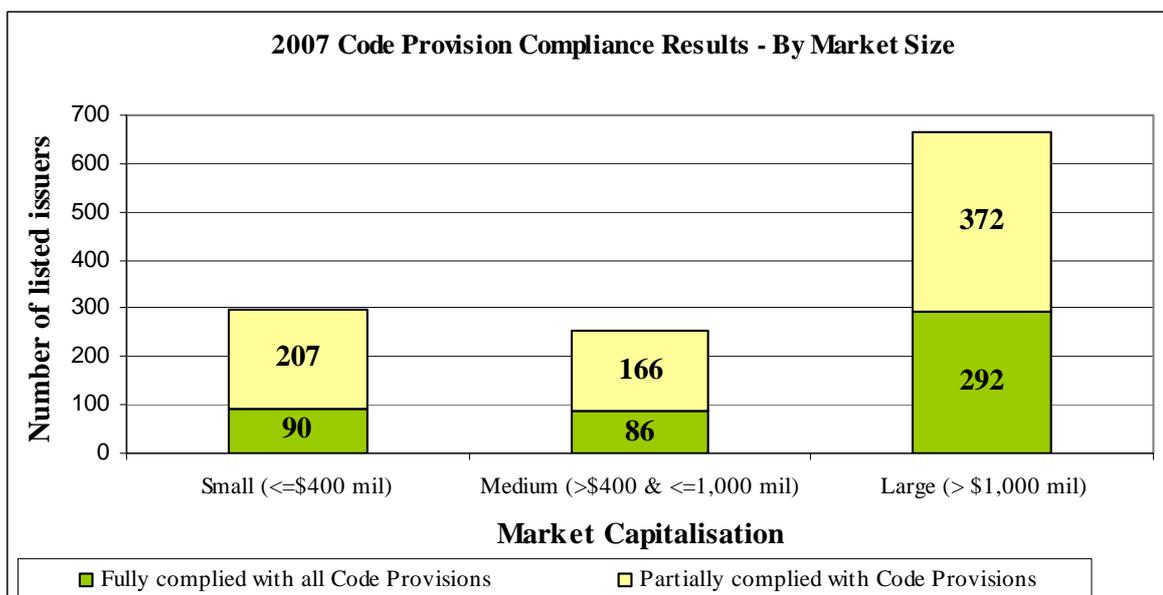
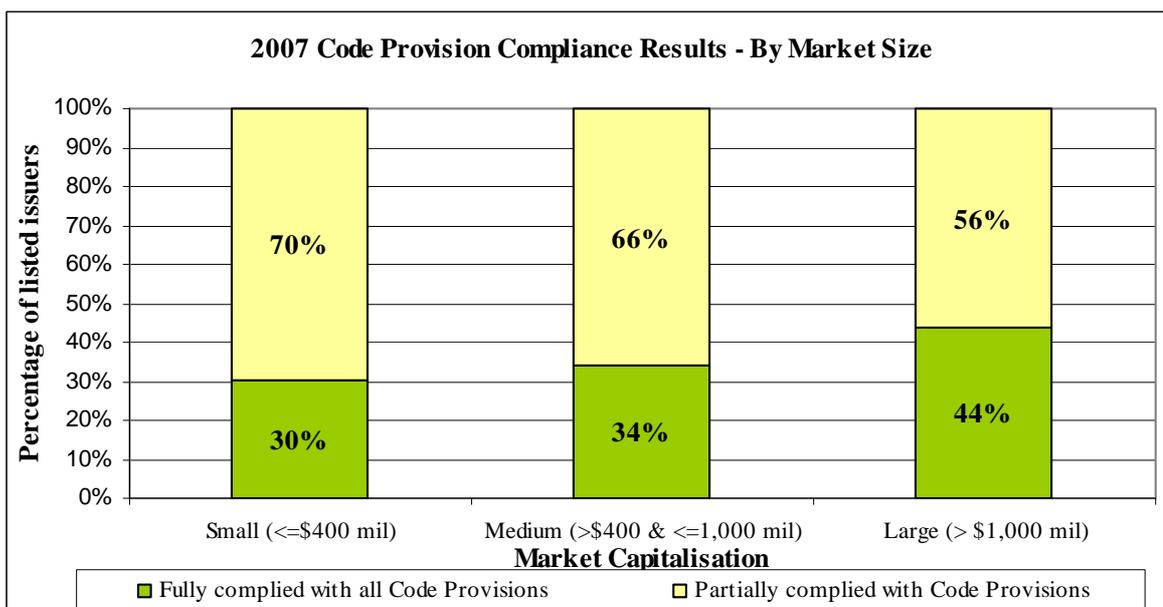
- About 98 per cent of listed issuers (1187 out of 1213) stated that they had fully complied with 41 or more of the 45 code provisions. In the Second Review, it was about 96 per cent of listed issuers (1066 out of 1114).
- The line graph below illustrates issuers' compliance levels in more detail. The same information, in addition to a more detailed comparison with the findings of the Second Review, is provided in the table below.



Number of code provisions complied with	2007			2006		
	MB	GEM	Total	MB	GEM	Total
33	1	0	1	0	0	0
34	0	0	0	2	0	2
35	1	0	1	4	0	4
36	0	0	0	3	0	3
37	4	1	5	5	0	5
38	2	1	3	3	2	5
39	2	3	5	8	2	10
40	9	2	11	14	5	19
41	25	5	30	37	6	43
42	66	7	73	99	9	108
43	184	27	211	207	23	230
44	352	53	405	262	56	318
45	385	83	468	293	74	367
Total	1031	182	1213	937	177	1114

Overview of Compliance by Market Size

- In the Third Review – consistent with the Second Review’s conclusions and the experience in other jurisdictions – we found that the size of listed issuers is a significant driver of corporate governance practice.
- As illustrated by the graphs below, similar to the Second Review, large listed issuers complied with more code provisions than small and medium-sized listed issuers.

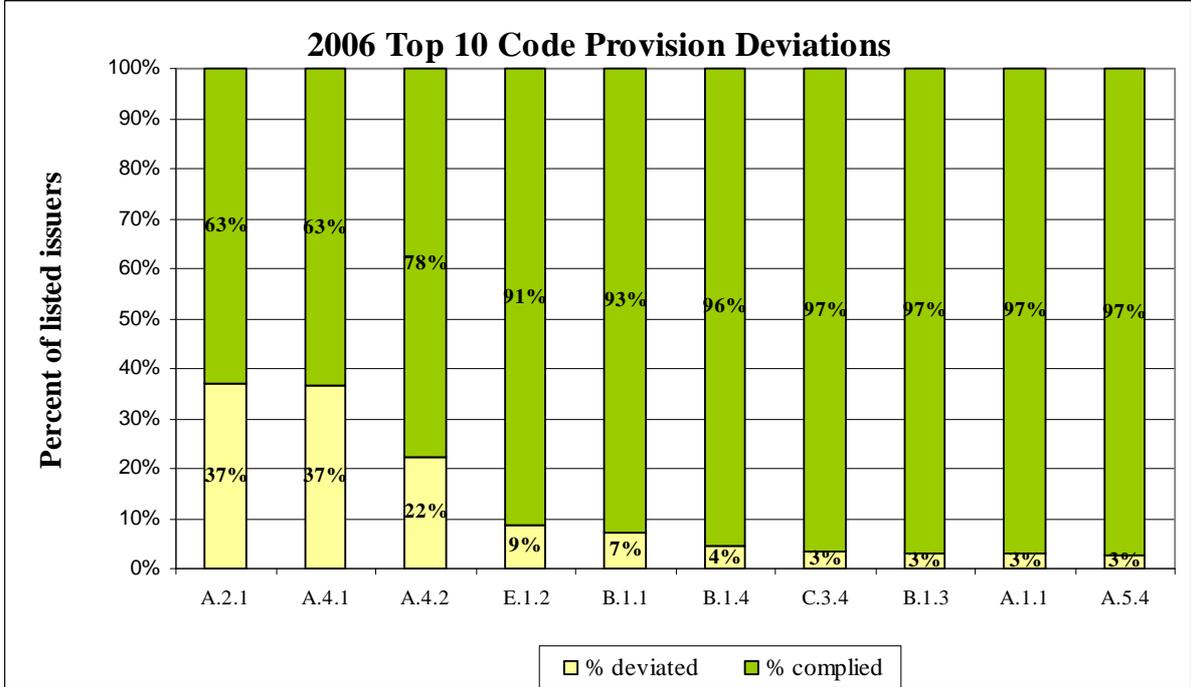
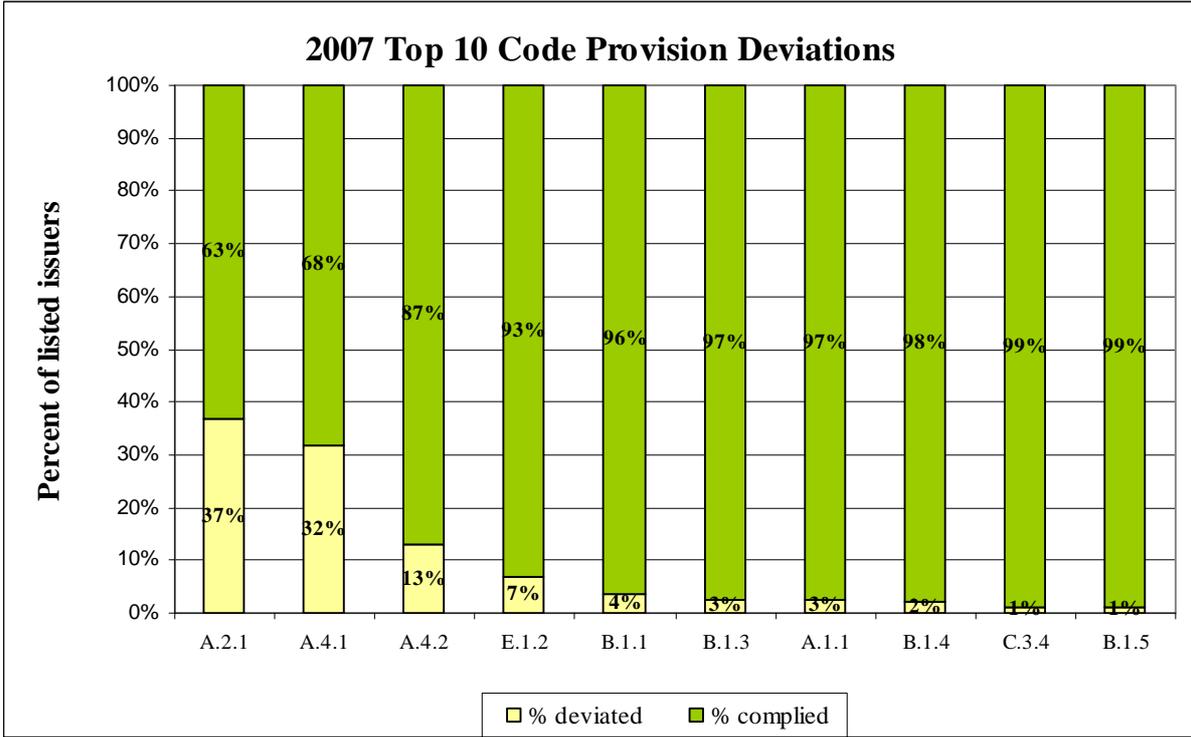


Overview of Compliance by Code Provision

- The following table illustrates that the code provisions most commonly deviated from have not changed significantly since 2006. (The top ten most common deviations are highlighted. There is only one difference between the findings of the Third Review and those of the Second Review. In 2007, code provision B.1.5, dealing with the providing sufficient resources to the remuneration committee, replaced code provision A.5.4, dealing with compliance with the Model Code, in the top ten most common deviations.)

	Code Provision	2007	2006
		% of compliance (by the 1,213 listed issuers)	% of compliance (by the 1,114 listed issuers)
1	A.1.2	100%	100%
2	A.1.5	100%	100%
3	A.6.2	100%	100%
4	A.6.3	100%	100%
5	C.1.1	100%	100%
6	C.1.2	100%	100%
7	C.1.3	100%	100%
8	E.2.2	100%	100%
9	E.2.3	100%	100%
10	A.5.3	100%	99.9%
11	E.2.1	100%	99.6%
12	A.1.4	99.9%	99.9%
13	A.1.6	99.9%	99.8%
14	A.5.1	99.9%	99.8%
15	A.5.2	99.8%	100%
16	C.3.2	99.8%	100%
17	C.3.5	99.8%	100%
18	C.3.6	99.8%	100%
19	A.2.2	99.8%	99.9%
20	A.2.3	99.8%	99.9%
21	A.6.1	99.8%	99.9%
22	E.1.1	99.8%	99.8%
23	D.2.2	99.8%	99.7%
24	D.2.1	99.8%	99.6%
25	A.1.8	99.8%	99.9%
26	C.3.1	99.8%	99.9%
27	D.1.1	99.8%	99.7%
28	A.1.7	99.7%	99.1%
29	A.3.1	99.6%	99.7%
30	D.1.2	99.4%	98.2%
31	A.1.3	99.3%	98.5%
32	C.2.1	99.3%	98.9%
33	A.5.4	99.2%	97.3%
34	C.3.3	99.1%	98.5%
35	B.1.2	98.8%	98.7%
36	B.1.5	98.8%	98.7%
37	C.3.4	98.8%	96.7%
38	B.1.4	97.9%	95.6%
39	A.1.1	97.4%	97.0%
40	B.1.3	97.4%	96.9%
41	B.1.1	96.5%	92.7%
42	E.1.2	93.0%	91.4%
43	A.4.2	87.1%	77.5%
44	A.4.1	68.1%	63.4%
45	A.2.1	63.2%	63.0%

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- Of the 45 code provisions, issuers in 2007 reported full (100 per cent) or near full compliance (that is, where the compliance is over 99%) in 34 code provisions. This is an improvement from 2006 where full or near full compliance arose in only 29 of the 45 code provisions.
 - The five code provisions most commonly deviated from were the same in 2007 and 2006. They were:
 - code provision A.2.1 (dealing with separation of the roles of chairman and chief executive officer, or CEO);
 - code provision A.4.1 (dealing with non-executive directors, or NEDs, being appointed for a specific term, subject to re-election);
 - code provision A.4.2 (dealing with directors appointed to fill a casual vacancy being subject to election by shareholders at the first general meeting after their appointment and every director being subject to retirement by rotation at least once every three years);
 - code provision E.1.2 (dealing with attendance and questioning of the chairman of the board and chairman of various committees at the annual general meeting, or AGM); and
 - code provision B.1.1 (dealing with establishing a remuneration committee with a majority of independent non-executive directors, or INEDs).
 - As illustrated by the bar chart below, the most common deviations were in respect of code provisions A.2.1 and A.4.1, followed by A.4.2. 37 per cent of listed issuers deviated from code provisions A.2.1, 32 per cent of listed issuers deviated from code provision A.4.1 and 13 per cent of listed issuers deviated from code provision A.4.2.
 - An important observation is for all of these top five deviations, there is some degree of compliance improvements from 2006, and the percentage value of compliance is higher in 2007 for each of them. These top five most common deviations are considered further below after the bar charts.



Detailed Analysis of Top Five Deviations

Code Provision A.2.1

- Code provision A.2.1 provides that “The roles of chairman and chief executive officer should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and chief executive officer should be clearly established and set out in writing”.

Status of compliance	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Decided not to follow the code provision	358	80%	324	78%
Rectified the deviation during the year	32	7%	28	7%
Proposed to rectify the deviation	56	13%	60	15%
Total	446	100%	412	100%

- In 2007, about the same percentage of issuers (approximately 37 per cent) did not follow this code provision when compared with 2006. 20 per cent of the listed issuers that disclosed they had deviated from code provision A.2.1 said that they had rectified, or proposed to rectify, the deviation during the year compared with 22 per cent in 2006.
- As shown by the table below, there were a number of reasons given for issuers’ decisions not to comply with code provision A.2.1 but the most common in both 2006 and 2007 was that the issuer considered that having the same person in the roles of chairman and CEO provided the issuer with strong and consistent leadership, allowing for more effective operation of the business.

Reasons given by listed issuers for their decision not to follow code provision A.2.1	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Same person provides the Group with strong and consistent leadership, and allows for more effective planning and implementation of long-term business strategies	118	33%	100	31%
All directors made a contribution, bringing different experience and expertise	88	24%	58	18%
The Board has confidence in the person who acts as CEO and chairman for reasons including that the person is knowledgeable, well known and/or has a good understanding of the operations of the issuer	49	14%	34	10%

It is necessary due to the size of the Group, the scope and/or nature of its business and/or a practical reasons relating to the corporate operating structure	44	12%	41	13%
The issuer considers that its arrangements are sufficiently consistent with the Code and the deviation has no materially adverse impact on its corporate governance structure	2	1%	7	2%
The responsibilities of the chairman and CEO are clear and distinct and therefore need not be set out in writing	3	1%	3	1%
Others	14	4%	3	1%
More than one of the above	40	11%	78	24%
Total	358	100%	324	100%

Code Provision A.4.1

- Code provision A.4.1 provides that “Non-executive directors should be appointed for a specific term, subject to re-election”.

Status of compliance	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Decided not to follow the code provision	326	84%	309	76%
Rectified the deviation during the year	26	7%	41	10%
Proposed to rectify the deviation	35	9%	57	14%
Total	387	100%	407	100%

- Like code provision A.2.1 and consistent with the finding in the Second Review, the majority of listed issuers that deviated from code provision A.4.1 disclosed they had decided not to follow this code provision.
- Most of the issuers (94 per cent or 305 out of 326) did so because, rather than appointing non-executive directors (or NEDs) for a specific term, the issuers’ NEDs are subject to retirement by rotation each annual general meeting – often pursuant to the companies’ by-laws or articles of association.

Code Provision A.4.2

- Code provision A.4.2 provides that “All directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years”.

Status of compliance	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Decided not to follow the code provision	114	73%	93	37%
Rectified the deviation during the year	31	20%	90	36%
Proposed to rectify the deviation	12	7%	62	25%
Proposed to rectify one limb but decide not to follow the others	0	0%	6	2%
Total	157	100%	251	100%

- Code provision A.4.2 has two limbs:
 - all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment (the First Limb); and
 - every director should be subject to retirement by rotation at least once every three years (the Second Limb).
- As was the case in the Second Review in 2006, it appears that some issuers deviated from only one limb whilst others deviated from both limbs. Specifically:
 - 8 per cent (9 out of 114) of relevant issuers disclosed that they had deviated from the First Limb;
 - 82 per cent (94 out of 114) of relevant issuers disclosed that they had deviated from the Second Limb; and
 - 10 per cent (11 out of 114) of relevant issuers disclosed that they had deviated from both the First Limb and the Second Limb.
- Most issuers stated that they made a positive decision not to follow this code provision and much fewer issuers than in 2006 that deviated from this code provision disclosed that they had or intended to rectify the deviation.
- As in the Second Review in 2006, the most common reason for deviation from the Second Limb was that the chairman and managing director are not subject to retirement by rotation (the First Reason). The other reason given was that, rather than requiring retirement by rotation at least once every three years, the issuers' constitutional documents provide for one-third of the directors – or if their number is not three or a multiple of three, then the number nearest to one-third – to retire from office each year (the Second Reason).

Code Provision E.1.2

- Code provision E.1.2 provides “The chairman of the board should attend the annual general meeting and arrange for the chairman of the audit, remuneration and nomination committees (as appropriate) or in the absence of the chairman of such committees, another member of the committee or failing this his duly appointed delegate, to be available to answer questions at the annual general meeting. The chairman of the independent board committee (if any) should also be available to answer questions at any general meeting to approve a connected transaction or any other transaction that is subject to independent shareholders’ approval”.

Status of compliance	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Decided not to follow the code provision	37	44%	39	41%
Rectified the deviation during the year	7	8%	8	8%
Proposed to rectify the deviation	41	48%	49	51%
Total	85	100%	96	100%

- Given the nature of code provision E.1.2, it is probably the case that issuers’ behaviour needs to be assessed year-to-year; it seems unlikely that issuers would have a positive policy in place that would contravene the code provision, for example, to provide that the chairman of the board need not attend the annual general meeting. For that reason there also seems little point in distinguishing between issuers that said they had decided not to follow the code provision and those that did not comply but proposed to rectify their deviation.
- In 2007, seven per cent (85 out of 1213) of issuers failed to comply with this code provision, which is a slight improvement from 2006 when almost nine per cent (96 out of 1114) failed to comply.
- Reasons given for deviation in 2007 included, most commonly, business engagement or other commitment. This was also the most common reason for deviation in 2006.

Code Provision B.1.1

- Code provision B.1.1 provides “Issuers should establish a remuneration committee with specific written terms of reference which deal clearly with its authority and duties. A majority of the members of the remuneration committee should be independent non-executive directors.”

Status of compliance	2007		2006	
	Number of listed issuers	Percentage	Number of listed issuers	Percentage
Decided not to follow the code provision	16	37%	16	20%
Rectified the deviation during the year	12	28%	44	54%
Proposed to rectify the deviation	15	35%	21	26%
Total	43	100%	81	100%

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- 2007 saw further improvement in compliance. In the Second Review for 2006, we found a compliance rate of 92.7 per cent. In the Third Review the compliance rate had improved further to 96.5 per cent.
 - The majority of issuers that did not comply with this code provision in the Third Review said that they had or planned to rectify their deviation.
 - The 16 issuers that decided not to follow code provision B.1.1 cited reasons including:
 - the small size of the issuer;
 - the board's preference to maintain responsibility for setting remuneration policies and packages; and
 - they had established a remuneration committee but it did not have an INED majority.

FINDINGS REGARDING CODE PROVISION C.2.1 – INTERNAL CONTROL

- Code provision C.2.1 provides that “the directors should at least annually conduct a review of the effectiveness of the system of internal control of the issuer and its subsidiaries and report to shareholders that they have done so in their Corporate Governance Report. The review should cover all material controls, including financial, operational and compliance controls and risk management functions”.
- This code provision became effective for accounting period commencing on or after 1 July 2005 and was first included in the Second Review. In 2006, particular attention was paid to the code provision because we are aware that some issuers have considered the implementation of code provision C.2.1 challenging. In the Second Review we asked issuers “How did you and your subsidiaries undertake the review”.
- The Third Review differs from the Second Review in that we further refined the above question, and instead of an open ended question, we gave issuers a list of seven options to choose from. We also asked issuers a new question number 2.5 “Again by contrast to your experience in previous years, what resources were required to undertake the review?”. The findings are discussed in more detail below.

Frequency of Review

- Code provision C.2.1 provides that an issuer's directors should conduct the internal control review at least annually.

Frequency for conducting internal control review		2007		2006	
		Number of listed issuers	Percentage	Number of listed issuers	Percentage
Annually		817	67.4%	746	68.6%
Half-yearly (or twice)		264	21.8%	219	20.1%
Quarterly		88	7.3%	83	7.6%
Other frequency	3 times	7	0.6%	6	0.6%
	4 times	3	0.2%	5	0.5%
	more than 4 times	4	0.3%	5	0.5%
	continuously	17	1.4%	10	0.9%
Not at all		9	0.7%	8	0.7%
Leave blank		4	0.3%	5	0.5%
Total		1,213	100%	1,087	100.0%

- Almost all issuers told us that they had done so in 2007 – only one per cent (13 out of 1213) of issuers disclosed that they had not conducted any review or left the section incomplete.¹ This is similar to 2006 when less than 1.2 per cent (13 out of 1087) of issuers disclosed that they had not conducted any review at all or did not complete the section.
- Approximately 67 per cent (817 out of 1213) conducted the review once in 2007. This is rather similar to 2006 when 69 per cent of issuers (746 out of 1087) conducted the review on an annual basis.
- Some issuers advised that they had conducted the required review more often than once during the year 2007:
 - 22 per cent (264 out of 1213) of issuers said they conducted the review half-yearly (or twice in 2007) compare with 20 per cent (219 out of 1087) in 2006; and
 - 10 per cent (119 out of 1213) of issuers said they conducted the review on a three or more times a year or on a continuous basis in 2007, which is same as the 10 per cent (109 out of 1087) noted in 2006.

Method of Review

- We asked issuers for information regarding how they undertook the reviews. A large number of respondents (43 per cent or 526 out of 1213) advised that the review was conducted by their internal audit function in 2007. This is an increase when compared with 2006 (more than 35 per cent or about 400 out of 1079) and indicates the expanding role of the internal audit function amongst issuers.

¹ Of the 13 issuers, 9 stated that they did not conduct a review at all, and four issuers did not complete this section.

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- A substantial number of respondents (24 per cent or 294 out of 1213) referred to an external auditor or consultant having been retained to conduct the review in 2007. This is a substantial increase from 2006 when only 11 per cent (122 out of 1079) retained outside professionals to conduct the review.
 - Due to the change of approach in the way the question was structured in the Third Review (using multiple choices with seven options for issuers to choose from) compared with the Second Review (open-end question) on how the issuers undertook the reviews, we have noted a marked difference in our findings between 2007 and 2006. Significant increases from 2006 were noted in 2007 possibly because guidance was made available and multiple options were allowed. Issuers told us the following in the Third Review:
 - 67 per cent (808 out of 1213) of issuers said that they had established written internal control policies and practices such as a checklist or guidance manual;
 - 58 per cent (705 out of 1213) of issuers said that the review was conducted using a risk-based approach;
 - 40 per cent (489 out of 1213) of issuers said the review was conducted using the guidance “Internal Control and Risk Management – A Basic Framework” prepared by the HKICPA²;
 - 19 per cent of issuers (227 out of 1213) said that their review was conducted with reference to the internal control framework enunciated by the Committee of Sponsoring Organisation of the Treadway Commission (COSO), which includes risk-based factors;
 - 4 per cent of issuers (50 out of 1213) also mentioned obtaining guidance from the Sarbanes-Oxley Act of 2002 and the Turnbull Guidance regarding compliance with the Combined Code’s principle C.2 on internal controls³; and
 - 28 per cent (342 out of 1213) of issuers said that they had either issued an internal control questionnaire or conducted interviews with relevant management and staff members to evaluate their internal control environment and risk.

N.B. - these percentages do not add up to 100 because issuers can choose more than one option.

Review Challenges

- We asked issuers what, if any, significant challenges they faced in complying with code provision C.2.1. Almost 44 per cent (530 out of 1213) of issuers either made no comment or said that they had encountered no significant challenges. This is a drop from 2006 when 52 per cent (559 out of 1079) said the same.

² “Internal Control and Risk Management – A Basic Framework”, published in June 2005

³ Financial Reporting Council’s “Internal Control: Guidance For Directors on the Combined Code” (also known as the Turnbull Guidance sets out guidance regarding compliance with code provision C.2.1 of the UK’s Combined Code, which is in very similar terms to code provision C.2.1 of the Code.

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- More specifically, issuers' responses on the more significant challenges included:
 - Almost 15 per cent (181 out of 1213) referred to the additional workload and compliance cost resulting from code provision C.2.1. This is similar to 2006 which also showed almost 15 per cent;
 - About seven per cent (89 out of 1213) said that it was difficult conducting the review effectively because of changes in the business environment such as internal reconstruction, changes in regulatory regime and/or business expansion. This compares with just four per cent (44 out of 1079) in 2006;
 - About four per cent (48 out of 1213) said that they had had difficulties determining or defining the scope and nature of the review that was required, or there was lack of formal guidance or procedures to follow. This is a drop from seven per cent (78 out of 1079) in 2006 and could partly be due to issuers gaining experience with conducting the exercise since the Second Review;
 - About four per cent (45 out of 1213) said they had difficulty in hiring and retaining qualified professionals. In 2006, less than three per cent of respondents said they had such difficulties;
 - About three per cent (37 out of 1213) said that it was difficult getting internal clients (that is, relevant members of their organisation) to co-operate so that the review could be undertaken effectively. 2006 also showed three per cent; and
 - Others mentioned challenges including: geographical, political, legal, regulatory and cultural differences between the local company and its overseas/PRC subsidiaries; difficulties in risk areas identification and risks management; difficulties in effective communication within the group; the cost of the exercise outweighing its benefits; and challenges in balancing the cost and the gain in efficiency.
 - In the Third Review, we also asked issuers what resources were required to undertake the internal control review. Most respondents (79 per cent) did not quantify the amount but 21 per cent (253 out of 1213) replied with quantifiable terms.
 - More specifically, the 253 issuers who responded with quantifiable terms stated the required amount of resources as follows:
 - 210 issuers reported time commitment of between 2 days to 9 months, with a mean of around 1.5 months;
 - 67 issuers reported the number of staff involved in the review as between 1 and 150, with a mean of 9 people; and
 - 7 issuers who hired external professionals to conduct the exercise incurred a cost of between HK\$20,000 and HK\$679,000, with a mean of around HK\$250,000.

FINDINGS REGARDING RECOMMENDED BEST PRACTICES

Overall Compliance

- Recommended best practices are for guidance only, that is, issuers are encouraged but not required to state whether or not they have complied with each recommended best practice. As it is not mandatory, few issuers make such disclosures.
- In the Third Review, we asked issuers about the extent to which they meet the recommended best practices. Issuers were not required to provide this information but we are grateful to the significant number of issuers that did respond. About 48 per cent (495 Main Board issuers and 89 GEM issuers out of a total of 1213) of issuers (the Relevant Respondents) responded to the section of the questionnaire relating to the recommended best practices.
- About four per cent of the Relevant Respondents (24 out of 584) said that in 2007 they complied with all 32 recommended best practices.
- None of the recommended best practices were fully complied with by all Relevant Issuers. However, 17 of the 32 recommended best practices were fully complied with by more than 80 per cent (468 out of 584) of the Relevant Issuers. This showed an improvement from the Second Review when just 15 of the 32 recommended best practices were fully complied with by about 80 per cent (446 out of 558) of relevant issuers.
- 25 of the 32 recommended best practices were fully complied with by 50 per cent of the relevant issuers. This is the same as in the Second Review when similarly around 50 per cent of relevant issuers complied with 25 of the 32 recommended best practices.
- The 17 recommended best practices where compliance is over 80 per cent were the following:
 - recommended best practice A.1.10 (which provides that board committees should adopt, so far as practicable, the principles, procedures and arrangements in code provisions A.1.1 to A.1.8 dealing with the role and procedures of the board);
 - recommended best practices A.2.4, A.2.5, A.2.6, A.2.8 and A.2.9 (which relate to the role and responsibilities of the chairman);
 - recommended best practice A.3.2 and A.3.3 (which provides that an issuer should appoint independent non-executive directors representing at least one-third of the board, and maintain on its website an updated list of its directors identifying their role and function and whether they are independent non-executive directors);
 - recommended best practices A.5.6, A.5.7 and A.5.8 (dealing with the responsibilities of directors including, for example, disclosure of directors' significant commitments, attendance at and participation in meetings of the board and its committees as well as general meetings, and making positive contributions to the development of issuers' strategies and policies through independent, constructive and informed comments);

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- recommended best practice B.1.6 (which provides that a significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance);
 - recommended best practices C.2.2 and C.2.4 (dealing with the board's annual review of the effectiveness of the system of internal controls of the issuer and its subsidiaries, and disclosure relating to that review);
 - recommended best practice C.3.7 (dealing with the terms of reference of the audit committee); and
 - recommended best practices D.1.3 and D.1.4 (dealing with disclosure of the division of responsibility between the board and management, and delegation arrangements for directors).
- Recommended best practices A.2.4, A.2.5, A.2.6, A.2.8, A.2.9 and A.5.8 were each complied with by 97 per cent or more (566 out of 584) of Relevant Issuers.
 - The following table sets out a more detailed overview of issuers' responses in relation to compliance with recommended best practices. The table illustrates that some of the recommended best practices were not applicable to a number of issuers. That is because some of the recommended best practices work together so that if one is deviated from, one or more others will not apply. For example, if an issuer does not adopt quarterly reporting in accordance with recommended best practice C.1.4, then recommended best practice C.1.5, which also relates to quarterly reporting, is inapplicable. Likewise, if an issuer does not establish a nomination committee in accordance with recommended best practice A.4.4, then recommended best practices A.4.5 to A.4.7 will not apply.

Recommended best practice	Topic of recommended best practice	Comply		Not comply but rectified		Not comply and not rectified		NA	
		Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers
A.1.9	Insurance cover for directors	413	70.7%	19	3.3%	150	25.7%	2	0.3%
A.1.10	Application of board principles, procedures and arrangements to board committees	538	92.1%	9	1.5%	37	6.3%	0	0.0%
A.2.4	Role of chairman	575	98.5%	0	0.0%	4	0.7%	5	0.9%
A.2.5	Chairman's responsibility for establishment of good corporate governance practices and procedures	574	98.3%	1	0.2%	4	0.7%	5	0.9%
A.2.6	Chairman's encouragement regarding directors' contribution to the board	578	99.0%	0	0.0%	1	0.2%	5	0.9%
A.2.7	Annual meetings between chairman and NEDs	380	65.1%	21	3.6%	166	28.4%	17	2.9%
A.2.8	Chairman's role in communication with shareholders	577	98.8%	1	0.2%	1	0.2%	5	0.9%
A.2.9	Chairman's role in relation to contribution of NEDs	576	98.6%	0	0.0%	1	0.2%	7	1.2%
A.3.2	Boards with at least one-third INEDs	488	83.6%	16	2.7%	80	13.7%	0	0.0%
A.3.3	Issuer website to include list of, and information about, directors	501	85.8%	14	2.4%	68	11.6%	1	0.2%
A.4.3	More than nine years' service affecting NED independence	339	58.0%	3	0.5%	56	9.6%	186	31.8%
A.4.4	Establishment and composition of a nomination committee	251	43.0%	20	3.4%	312	53.4%	1	0.2%
A.4.5	Terms of reference of the nomination committee	255	43.7%	10	1.7%	2	0.3%	317	54.3%
A.4.6	Availability of the terms of reference of the nomination committee	252	43.2%	11	1.9%	4	0.7%	317	54.3%
A.4.7	Resources for the nomination committee	258	44.2%	9	1.5%	0	0.0%	317	54.3%

Recommended best practice	Topic of recommended best practice	Comply		Not comply but rectified		Not comply and not rectified		NA	
		Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers
A.4.8	Information to be disclosed in respect of proposed resolution to elect an INED	409	70.0%	11	1.9%	74	12.7%	90	15.4%
A.5.5	Continuous professional development for directors	375	64.2%	24	4.1%	180	30.8%	5	0.9%
A.5.6	Directors' disclosure of their other commitments	550	94.2%	2	0.3%	28	4.8%	4	0.7%
A.5.7	NEDs' attendance and participation in the board and its committees as well as general meetings of the issuer	534	91.4%	6	1.0%	32	5.5%	12	2.1%
A.5.8	NEDs to contribute through independent, constructive and informed comments	566	96.9%	1	0.2%	5	0.9%	12	2.1%
B.1.6	Ensuring ED remuneration links reward and performance	540	92.5%	5	0.9%	37	6.3%	2	0.3%
B.1.7	Disclosure of senior management remuneration on an individual and named basis	284	48.6%	11	1.9%	281	48.1%	8	1.4%
B.1.8	Disclosure of reasons if the board approves remuneration or compensation arrangements previously refused by the remuneration committee	341	58.4%	0	0.0%	10	1.7%	233	39.9%
C.1.4 (MB only ⁴)	Content, publication and timeliness of quarterly financial results	63	10.8%	9	1.5%	423	72.4%	89	15.2%

⁴ Recommended best practice C.1.4 applies to Main Board issuers only; it does not apply to GEM issuers. Therefore the total pool of Relevant Issuers is reduced to 462 i.e. the number of Relevant Issuers that are Main Board-listed.

Recommended best practice	Topic of recommended best practice	Comply		Not comply but rectified		Not comply and not rectified		NA	
		Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers	Number of listed issuers	% of listed issuers
C.1.5 (MB only ⁵)	Giving reasons for ceasing to publish quarterly financial results once commenced	67	11.5%	3	0.5%	4	0.7%	510	87.3%
C.2.2	Scope of the board's annual review of the effectiveness of the system of internal controls of an issuer and its subsidiaries	537	92.0%	7	1.2%	37	6.3%	3	0.5%
C.2.3	Scope of issuers' disclosure in their Corporate Governance Report regarding the issuer's compliance with the code provisions on internal controls	432	74.0%	15	2.6%	129	22.1%	8	1.4%
C.2.4	Disclosures to provide meaningful information and not give a misleading impression	552	94.5%	2	0.3%	16	2.7%	14	2.4%
C.2.5	Annual review and disclosure of same regarding need for an internal audit function	329	56.3%	8	1.4%	77	13.2%	170	29.1%
C.3.7	Terms of reference of the audit committee	483	82.7%	7	1.2%	86	14.7%	8	1.4%
D.1.3	Disclosure of the division of responsibility between the board and management	503	86.1%	8	1.4%	66	11.3%	7	1.2%
D.1.4	Directors to understand delegation arrangements including by issuers having formal letters of appointment for directors	468	80.1%	11	1.9%	99	17.0%	6	1.0%

⁵ Recommended best practice C.1.5 applies to Main Board issuers only; it does not apply to GEM issuers. Therefore the total pool of Relevant Issuers is reduced to 462 i.e. the number of Relevant Issuers that are Main Board-listed.

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- The most common deviations are considered in more detail below.

Detailed Analysis of Top Three Most Common Deviations

- As in the Second Review, the recommended best practices that Relevant Issuers most often failed to fully comply in the Third Review were C.1.4, A.4.4 and B.1.7.

Recommended Best Practice C.1.4

- This provides that issuers should announce and publish quarterly results within 45 days after the end of the relevant quarter. It applies only to Main Board issuers.
- Recommended best practice C.1.4 had the lowest level of full compliance.
- Almost 13 per cent (63 out of 495) of Relevant Issuers listed on the Main Board advised that they complied with recommended best practice C.1.4. This is a small decline when compared with the Second Review in 2006 where almost 16 per cent of Relevant Issuers complied. The large majority indicated that they had decided not to follow this recommended best practice (including those that said it was not applicable).
- Where reasons for non-compliance were given, the most common was that quarterly reporting is too significant a burden and therefore not cost / time / resource effective. Other reasons included:
 - 22 issuers said that it would not be in shareholders' best interests because it would shift the issuer's focus to short-term financial performance;
 - 18 said that the existing disclosure regime including, for example, making ad hoc disclosures of price sensitive information and publishing operational data every month, is sufficient;
 - 12 said that quarterly financial reports do not reflect the actual performance of the company due to seasonality of business operation;
 - Nine said that they do not consider it necessary as their business is stable and there are no significant operational changes from quarter to quarter; and
 - Eight said that they would issue quarterly results but only after 45 days, thus technically not fulfilling the requirement.

Recommended Best Practice A.4.4

- This provides that issuers should establish a nomination committee with a majority of INEDs.
- Almost 54 per cent (312 out of 583) of Relevant Issuers said that they did not comply with recommended best practice A.4.4.

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- Of those that did not comply:
 - about eight per cent (25 out of 312) said that they intended to reconsider their position as soon as practicable; and
 - the balance 92 per cent (287 out of 312) said that they had made a positive decision not to adopt this recommended best practice.
 - Where issuers gave reasons, the reasons, included:
 - the most common reason was that the Board is responsible for the nomination process, which the issuer considers allows for more informed / balanced decisions as to nomination;
 - nomination duties are discharged by the executive committee, remuneration committee, human resources personnel or shareholders;
 - the issuer has a written nomination procedure or appointments are made pursuant to the company's constitutional documents; and
 - the issuer's size, structure or resources do not warrant or allow for a nomination committee with a majority of INEDs.

Recommended Best Practice B.1.7

- This provides that issuers should disclose details of any remuneration payable to members of senior management, on an individual and named basis, in their annual reports and accounts.
- 48 per cent (281 out of 584) of Relevant Issuers said that they did not comply with recommended best practice B.1.7.
- Of those that did not comply:
 - Seven per cent (19 out of 281) said that they intended to reconsider their position as soon as practicable;
 - Nine per cent (25 out of 281) said they have partially complied by either disclosing the top five highest paid individuals or disclosed remuneration on a total basis but not a named basis; and
 - 84 per cent (237 out of 281) said that they had made a positive decision not to adopt this recommended best practice.

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- Where issuers gave reasons, by far the most common reason was that the information is too sensitive to disclose publicly. Other reasons included:
 - the issuer's organisational structure / size of payroll is too small to warrant disclosure;
 - disclosure would facilitate staff being headhunted by other organisations;
 - disclosure would cause conflict amongst employees; and
 - there is no value to shareholders in this information being disclosed.