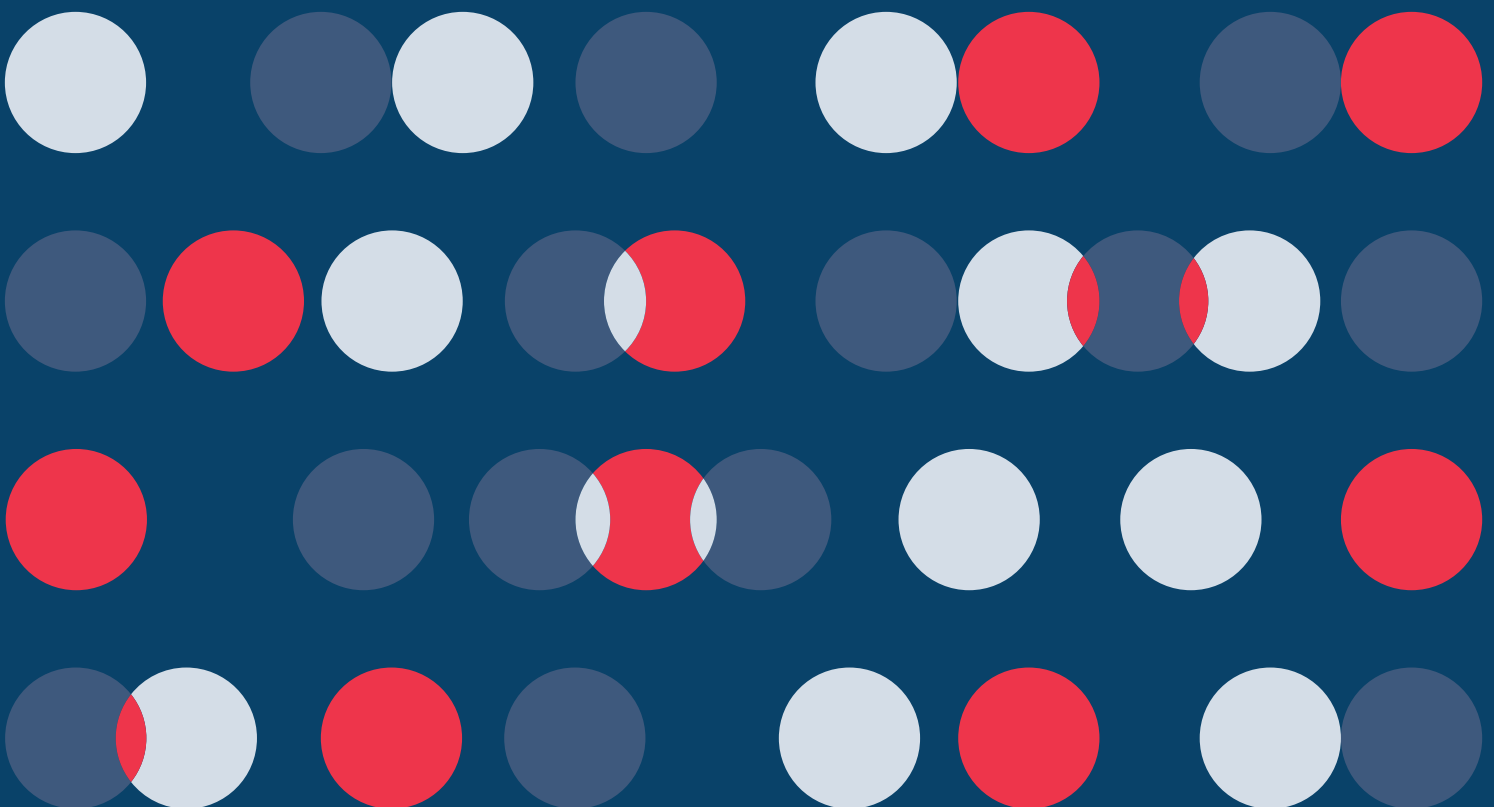


May 2016

ANALYSIS OF CORPORATE GOVERNANCE
PRACTICE DISCLOSURE IN MARCH YEAR-END
2015 ANNUAL REPORTS



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EXECUTIVE SUMMARY

1. In November 2015, the Stock Exchange of Hong Kong Limited (“**Exchange**”) published its review (“**December Review**”) of 1,237 issuers’¹ compliance with the Corporate Governance Code and Corporate Governance Report (“**Code**”)² in their 2014 annual reports. These issuers, selected on the basis that they had a financial year-end date of 31 December (“**December FYE issuers**”), represented approximately 70% of all issuers listed as at 31 December 2014.
2. For a more holistic view of issuers’ overall compliance with the Code, the Exchange recently conducted a review of the disclosures made by 318 issuers³ (“**March FYE issuers**”) with a financial year-end date of 31 March 2015 (“**March Review**”). These issuers represent approximately 18% of all issuers listed as at 31 March 2015. The March Review is based on the same set of review criteria and follows the same approach adopted in the December Review.
3. Large-cap, mid-cap and small-cap groups accounted for 12%, 42% and 46% respectively of the March FYE issuers, compared with 37%, 39% and 24% respectively of the December FYE issuers.⁴ Overall, the March FYE issuers’ compliance level with the Code is comparable to the December FYE issuers’, with certain exceptions set out in this paper.
4. Chapter 1 contains a summary of the results and findings of the March Review. Chapter 2 sets out a summary of the explanations given by issuers in respect of the five Code Provisions (“**CPs**”) with the lowest compliance rates.

Key Findings of the March Review compared with the December Review

	March Review	December Review
Compliance with all 75 CPs	25%	35%
Compliance with 70 or more CPs	99%	98%
Level of full compliance with reference to market capitalisation	Mid-cap > Large-cap > Small-cap	Large-cap > Small-cap > Mid-cap

¹ 1,117 Main Board issuers and 120 GEM issuers.

² Appendix 14 of Main Board Listing Rules and Appendix 15 of GEM Listing Rules.

³ 262 Main Board issuers and 56 GEM issuers.

⁴ “Large-cap” is defined in the March Review as issuers with a market capitalisation of greater than HK\$4.2 billion, “mid-cap” as issuers with a market capitalisation greater than HK\$0.7 billion and smaller than or equal to HK\$4.2 billion, and “small-cap” as issuers with a market capitalisation of smaller than or equal to HK\$0.7 billion. These definitions are the same with those in the December Review.

	March Review	December Review
Omitting disclosures of board diversity policies (under CP A.5.6) ⁵	28%	12%
Five CPs with the lowest compliance rates in ascending order	<ul style="list-style-type: none"> (i) A.2.1: separation of the roles of chairman and chief executive (ii) A.4.1: non-executive directors being appointed for a specific term, subject to re-election (iii) A.6.7: non-executive directors' attendance at general meetings (iv) E.1.2: chairman's attendance at annual general meeting (v) A.4.2: directors appointed to fill a casual vacancy being subject to election by shareholders at the first general meeting and every director being subject to retirement by rotation at least once every three years 	<ul style="list-style-type: none"> (i) A.2.1 (ii) A.6.7 (iii) A.4.1 (iv) E.1.2 (v) A.5.1: establishment of a nomination committee
Disclosed compliance rates of Recommended Best Practices ("RBPs")	10%	12%
Disclosed having an internal audit function	21%	47%

⁵ See paragraph 15.

CHAPTER 1: RESULTS AND FINDINGS

Scope of Review

5. We examined the annual reports of 318 issuers with a financial year-end date of 31 March 2015, which represents approximately 18% of all issuers listed as at 31 March 2015.
6. In line with the December Review, we analysed the statistics in the following areas:
 - (a) compliance rate of the CPs from the following perspectives⁶:
 - overall;
 - market capitalisation; and
 - board diversity;
 - (b) disclosed compliance rates of RBPs; and
 - (c) disclosed compliance rates in relation to internal control.

A. Compliance Rate of CPs

Overall

7. Fewer March FYE issuers (at 25%) reported full compliance with all CPs, as compared with the December FYE issuers (at 35%).
8. 99% of the March FYE issuers complied with 70 or more CPs, out of 75. This is slightly better than the findings of the December Review. See **Table A**.

Table A: Number of CPs disclosed by issuers as compliant

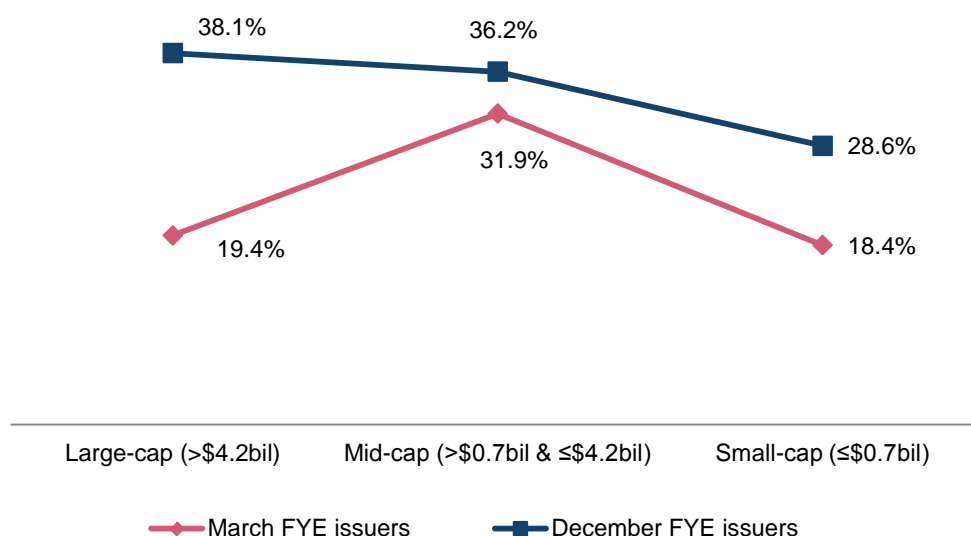
Number of CPs complied	March Review		December Review	
	Number of issuers	Percentage of issuers	Number of issuers	Percentage of issuers
75	77	25%	433	35%
74	118	37%	416	34%
73	70	22%	210	17%
72	26	8%	88	7%
71	20	6%	53	4%
70	3	1%	15	1%
<70	4	1%	22	2%
Total	318	100%	1,237	100%

⁶ The December Review contains analysis of the compliance rate from the perspective of Hang Seng Index (“HSI”) companies versus non-HSI companies. Since only one of the March FYE issuers is a HSI company, we have not included such a comparison.

Market Capitalisation

9. We examined the distribution of the March FYE issuers that achieved full compliance with all 75 CPs by reference to their market capitalisation. These issuers are divided into large-cap, mid-cap and small-cap groups.⁷
10. A larger portion of the mid-cap issuers achieved full compliance compared to the large-cap and small-cap issuers.
11. Fewer March FYE issuers across all three market capitalisation categories achieved full compliance, as compared with the December FYE issuers. It is worth noting that the large-cap March FYE issuers had a lower rate of full compliance than the small-cap December FYE issuers. See **Chart A**.

Chart A: Percentage of issuers with full compliance (by market capitalisation)



Board Diversity

12. Effective on 1 September 2013, the nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose the policy or a summary of the policy in the corporate governance report (CP A.5.6).
13. In mid-2014, we spot-checked the annual reports of issuers with 31 December 2013 year-ends, and noted that a number of issuers neither disclosed the policies (or a summary of the policies) nor gave considered reasons for non-disclosure. In view of this, we issued a letter to all issuers on 2 July 2014, urging them to take a closer look at their corporate governance reports and rectify any possible omissions in their next reports.

⁷ See paragraph 3.

14. In the December Review, we revisited this matter by selecting 10% of the December FYE issuers (that stated they complied with CP A.5.6) and examining their actual disclosures in the corporate governance reports. We noted omissions in 12% of the reports.
15. In the March Review, we found that all of the issuers reported that they had complied with this CP. As with the December Review, we randomly selected 10% of the issuers and noted omissions in 28% of the reports. The March Review revealed a higher level of omissions than the December Review.
16. We urge issuers to take a closer look at their corporate governance reports and rectify any possible omissions in their next report. Non-compliance with any part of the CPs without giving considered reasons amounts to a breach of the Listing Rules. We will continue to monitor issuers' compliance with this CP.

B. Disclosure and Compliance Rates of RBPs

17. As of 31 March 2015, the Code contained 11 RBPs. The RBPs are for guidance only. Issuers are encouraged, but not required, to disclose whether they have complied with the RBPs. 10% of the March FYE issuers disclosed their compliance with the RBPs, including 1% that stated full compliance, and 9% that stated partial compliance.
18. The disclosure rate of the March FYE issuers is slightly lower than that of the December FYE issuers (at 12%).
19. These figures may be an underestimation of RBP compliance because, unlike CPs, disclosure of RBP compliance (or non-compliance) is not mandatory.

C. Internal Control

Internal Control Review

20. In the December Review, we analysed issuers' disclosures from a number of perspectives regarding internal control in their 2014 annual reports. These disclosures were based on the internal control section of the Code prior to the Code amendments that became effective on 1 January 2016. The March Review adopts the same approach.
21. The Code calls for directors to at least annually conduct a review of the issuer's internal control systems (CP C.2.1). As with the December FYE issuers, all March FYE issuers stated that they complied with this CP and had conducted at least one internal control review during their 2015 financial year.
22. **Table B** summarises the frequency of the issuers' internal control reviews. The frequency statistics are for general reference as, in our view, the substance and impact of the internal control review matters more than the frequency of the review.

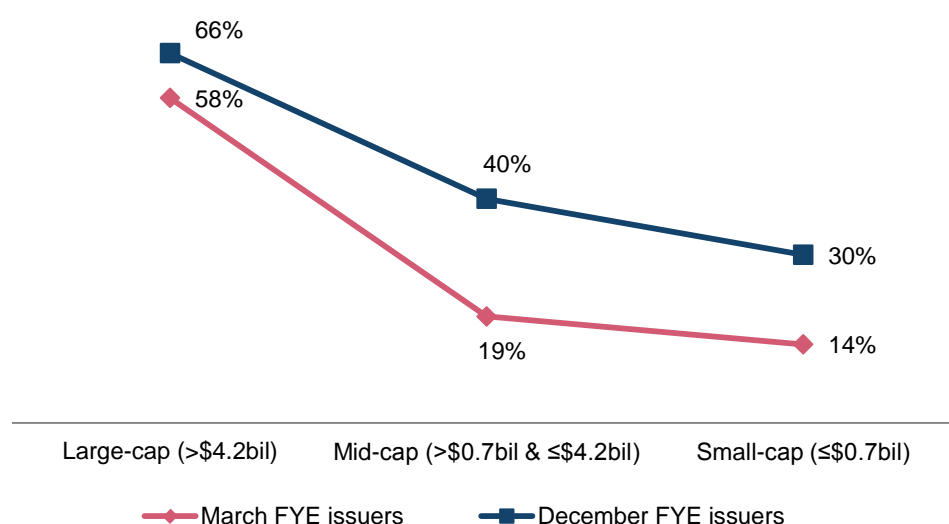
Table B: Frequency of Internal Control Review

Frequency	March Review		December Review	
	Number of issuers	Percentage of issuers	Number of issuers	Percentage of issuers
Annually	237	75%	736	60%
Half-yearly	4	1%	51	4%
Quarterly	0	0%	30	2%
Other frequency (e.g. 3 or 5 times)	3	1%	6	1%
Not specified ⁸	74	23%	414	33%
Total	318	100%	1,237	100%

Internal Audit Function

23. As of 31 March 2015, it was still an RBP that issuers without an internal audit function should review the need for one on an annual basis (RBP C.2.6). 21% of the March FYE issuers disclosed that they had an internal audit function. This is, however, significantly lower than the 47% of December FYE issuers that disclosed this information. Such disparity may be attributed to the fact that a majority of the March FYE issuers are small- and mid-caps⁹. Larger issuers are likely to have more resources than smaller issuers for establishing an internal audit function.
24. **Chart C** shows that it is more common for large-cap March FYE issuers than small- to mid-cap issuers to have an internal audit function. Overall, fewer March FYE issuers across all three market capitalisation categories disclosed they had an internal audit function, as compared with the December FYE issuers.

Chart C: Percentage of issuers with an internal audit function (by market capitalisation)



⁸ This means that the issuer did not specify the frequency of the review, but disclosed that a review had been carried out at least once during the financial year.

⁹ See paragraph 3.

CHAPTER 2: ANALYSIS OF DEVIATIONS

25. The compliance rates of all CPs are set out in **Table 1** of the **Appendix**. The ten CPs with the lowest compliance rates and the percentage of issuers that deviated from the CPs are set out in **Chart 1** of the **Appendix**.

A. The Five CPs with the Lowest Compliance Rates and Issuers' Reasons

26. The five CPs with the lowest compliance rates in the March Review were A.2.1, A.4.1, A.6.7, E.1.2 and A.4.2.

27. Four of the same CPs were found to have the lowest compliance rates in the December Review as well. The only exception is CP A.5.1, which was found to have the fifth lowest compliance rate in the December Review, whilst it is the sixth lowest in the March Review. See **Table C**.

Table C: CPs with the lowest compliance rates

CPs		Compliance rates	
		March FYE issuers (in ascending order)	December FYE issuers
A.2.1	Separation of the roles of chairman and chief executive	57%	64%
A.4.1	Non-executive directors being appointed for a specific term, subject to re-election	72%	86%
A.6.7	Non-executive directors' attendance at general meetings	77%	80%
E.1.2	Chairman's attendance at AGM	89%	87%
A.4.2	Directors appointed to fill a casual vacancy being subject to election by shareholders at the first general meeting and every director being subject to retirement by rotation at least once every three years	91%	95%
A.5.1	Establishment of a nomination committee which is chaired by the chairman of the board or an independent non-executive director	95%	95%

28. The five CPs with the lowest compliance rates in the March Review are examined further below. The reasons given by March FYE issuers for deviation are similar to those given by the December FYE issuers.

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

Summary of Explanations

29. Fewer March FYE issuers (at 57%) complied with this CP, as compared with the December FYE issuers (at 64%). Many of these issuers gave more than one reason explaining their deviations from the CP.
30. The most common reason given was that one person performing the roles of both chairman and chief executive can provide strong and consistent leadership, and can enable more effective planning and better execution of long-term strategies.
31. Another reason was that contributions are made by the board as a whole; all executive and non-executive directors bring diverse experience and expertise to the board. They have regular discussions in relation to the issuer's operations and are, in practice, collectively playing the roles of chairman and chief executive.
32. Other reasons given include: the board's confidence in the capability of the individual undertaking both roles, the size of the group, the scope and nature of the company's business, or a practical necessity arising from the corporate operating structure.
33. Amongst those that deviated from this CP, 29% took follow-up actions or explained the mitigation action they had taken. For example, a number of issuers were non-compliant with the CP for only part of the year due to the resignation of the chairman or chief executive. Some of them had subsequently complied during the year by recruiting a replacement. The figure is higher than that in the December Review (at 27%).
34. The statistics relating to the reasons given for the deviation from this CP are set out in **Table 2** of the **Appendix**.

A.4.1 - Non-executive directors should be appointed for a specific term, subject to re-election.

Summary of Explanations

35. Fewer March FYE issuers (at 72%) complied with this CP, as compared with the December FYE issuers (at 86%).
36. The most commonly cited reason was that non-executive directors are not appointed for a specific term but are subject to retirement by rotation¹⁰ at least once every three

¹⁰ Retirement by rotation generally refers to a process whereby at each AGM one-third of the directors must retire from their position and seek re-election as a director.

years at each AGM according to their articles of association, by-laws or equivalent constitutional documents.

A.6.7 - Independent non-executive directors and other non-executive directors, as equal board members, should give the board and any committees on which they serve the benefit of their skills, expertise and varied backgrounds and qualifications through regular attendance and active participation. They should also attend general meetings and develop a balanced understanding of the views of shareholders.

Summary of Explanations

37. This CP was upgraded from an RBP in April 2012.
38. Fewer March FYE issuers (at 77%) complied with this CP, as compared with the December FYE issuers (at 80%).
39. The most common reason given was that the issuers' non-executive directors failed to attend meetings due to other business engagements. Some issuers only briefly disclosed that their non-executive directors were not available or travelling overseas.
40. In the December Review, we found that 9% of the December FYE issuers that departed from this CP took mitigation actions (for example, those directors who failed to attend held follow-up meetings with the chairman of the board to express their opinions or concerns on the subject matters). However, the March Review did not find any references to mitigation actions in issuers' disclosures.
41. Amongst the March FYE issuers that deviated from this CP, 11% included an action plan for achieving compliance in the coming year, such as scheduling meetings earlier to avoid timetable clashes. The figure is higher than that in the December Review (at 9%).
42. The statistics relating to the reasons given for the deviation from this CP are set out in **Table 3** of the **Appendix**.

E.1.2 - The chairman of the board should attend the annual general meeting. He should also invite the chairmen of the audit, remuneration, nomination and any other committees (as appropriate) to attend. In their absence, he should invite another member of the committee or failing this his duly appointed delegate, to attend. These persons should 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 requires independent shareholders' approval. An issuer's management should ensure the external auditor attend the annual general meeting to answer questions about the conduct of the audit, the preparation and content of the auditors' report, the accounting policies and auditor independence.

Summary of Explanations

43. More March FYE issuers (at 89%) complied with this CP, as compared with the December FYE issuers (at 87%).

44. The most commonly stated reason was that the person(s) required by this CP to attend the AGM were unable to do so as they had other commitments (mainly business engagements).
45. The statistics relating to the reasons given for the deviation from this CP are set out in **Table 4** of the **Appendix**.
46. A breakdown of whether it was the chairman or the chairman of the committee(s) who failed to attend is set out in **Table 5** of the **Appendix**. In a vast majority of cases, it was the chairman of the board who failed to attend the AGM. We also note that these chairmen tend not to be those with a combined role of chairman and chief executive. This is similar to the findings of the December Review.

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

Summary of Explanations

47. Fewer March FYE issuers (at 91%) complied with this CP, as compared with the December FYE issuers (at 95%).
48. Among the March FYE issuers that did not comply with the first part of this CP, most explained that the time between filling a casual vacancy and the next AGM was too short to require a re-election. Some stated that directors appointed to fill a casual vacancy were not subject to re-election according to their articles of association, by-laws or equivalent constitutional documents.
49. A majority of the March FYE issuers departing from this CP only failed to comply with the second part of the CP. They gave either one or both of the following reasons: (a) the directors were not subject to retirement by rotation as the issuer considered that continuity was key to the successful implementation of long-term business plans; and/or (b) the issuer's constitutional documents provided for one-third of the directors to retire from office each year.
50. The statistics relating to the reasons given for the deviation from this CP are set out in **Table 6** of the **Appendix**.

B. Quality of Explanation

51. As with the findings of the December Review, the quality of explanations given for non-compliance by the March FYE issuers was varied. Some issuers gave informative reports that set out why they departed from a particular CP, what they would do to rectify the deviation, and whether the departure was temporary. In general, however, there is room for improvement. We observed a certain degree of "boilerplate" style explanations which were vague and had been repeated year after year.

APPENDIX: SUMMARY OF STATISTICS

Table 1: Compliance rate of each CP

CPs	Compliance rates	
	March FYE issuers	December FYE issuers
A.1.1	98%	98%
A.1.2	100%	100%
A.1.3	97%	99%
A.1.4	100%	100%
A.1.5	100%	100%
A.1.6	100%	100%
A.1.7	100%	100%
A.1.8	97%	98%
A.2.1	57%	64%
A.2.2	100%	100%
A.2.3	100%	100%
A.2.4	100%	100%
A.2.5	100%	100%
A.2.6	100%	100%
A.2.7	97%	96%
A.2.8	100%	100%
A.2.9	100%	100%
A.3.1	100%	100%
A.3.2	100%	100%
A.4.1	72%	86%
A.4.2	91%	95%
A.4.3	99%	100%
A.5.1	95%	95%
A.5.2	99%	97%
A.5.3	99%	97%
A.5.4	99%	97%
A.5.5	100%	100%
A.5.6	100%	99%
A.6.1	100%	100%
A.6.2	100%	100%
A.6.3	100%	100%
A.6.4	100%	100%
A.6.5	100%	100%
A.6.6	100%	100%
A.6.7	77%	80%
A.6.8	100%	100%
A.7.1	99%	100%
A.7.2	100%	100%
A.7.3	100%	100%
B.1.1	100%	100%
B.1.2	99%	99%
B.1.3	100%	100%
B.1.4	100%	100%
B.1.5	99%	100%

Compliance rates		
CPs	March FYE issuers	December FYE issuers
C.1.1	100%	100%
C.1.2	97%	99%
C.1.3	100%	100%
C.1.4	100%	100%
C.1.5	100%	100%
C.2.1	100%	100%
C.2.2	100%	100%
C.3.1	100%	100%
C.3.2	100%	100%
C.3.3	100%	99%
C.3.4	100%	100%
C.3.5	100%	100%
C.3.6	100%	100%
C.3.7	100%	100%
D.1.1	100%	100%
D.1.2	100%	100%
D.1.3	100%	100%
D.1.4	97%	98%
D.2.1	100%	100%
D.2.2	100%	100%
D.3.1	100%	100%
D.3.2	100%	100%
E.1.1	100%	100%
E.1.2	89%	87%
E.1.3	100%	100%
E.1.4	100%	100%
E.2.1	100%	100%
F.1.1	100%	99%
F.1.2	99%	100%
F.1.3	99%	99%
F.1.4	100%	100%

Chart 1: The ten CPs with the lowest compliance rates

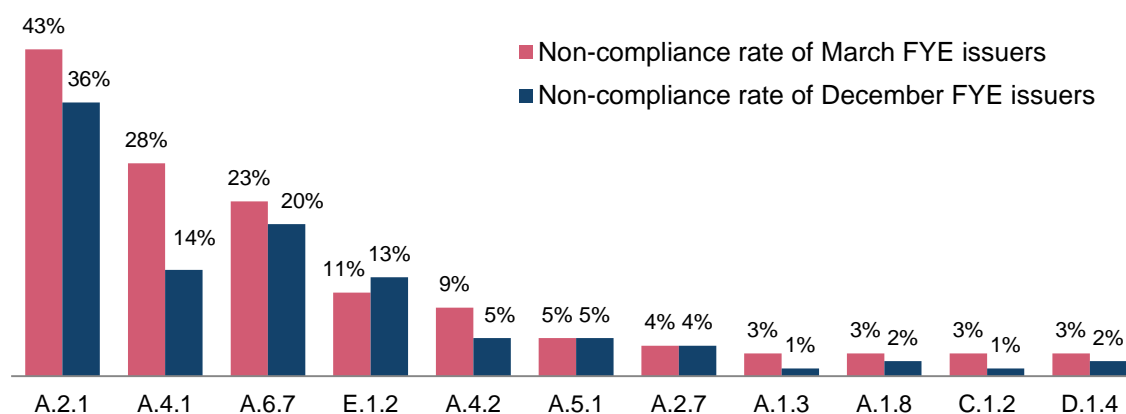


Table 2: Reasons disclosed for not separating the roles of Chairman and Chief Executive (CP A.2.1)

Reasons	Number (and %) of March FYE issuers deviated from CP A.2.1	Number (and %) of December FYE issuers deviated from CP A.2.1
The same person provides the Group with strong and consistent leadership, allows for more effective planning/formulation and execution/implementation of long-term business strategies.	32 (23%)	161 (36%)
The board has confidence in the person who acts as chief executive and chairman, e.g. because the person is knowledgeable, well-known and/or has a good understanding of the operations of the issuer.	5 (4%)	60 (13%)
Contributions are made by all executive directors/independent non-executive directors, who bring different experience and expertise and who meet regularly to discuss issues affecting the issuer's operations.	14 (10%)	51 (11%)
Due to the size of the Group, the scope and/or nature of its business and/or a practical necessity arising from the corporate operating structure.	5 (4%)	38 (9%)
The issuer considers its structure is sufficiently consistent with the Code and the deviation has no materially adverse impact on its corporate governance structure.	0 (0%)	8 (2%)
The responsibilities of the chairman and chief executive are clear and distinct and therefore need not be set out in writing.	0(0%)	3 (1%)
More than one of the above	59 (43%)	68 (15%)
Others	22 (16%)	57 (13%)
Total	137 (100%)	446 (100%)

Table 3: Reasons disclosed for non-executive directors' absence at the general meetings (CP A.6.7)

Reasons	Number (and %) of March FYE issuers deviated from CP A.6.7	Number (and %) of December FYE issuers deviated from CP A.6.7
Business engagement	48 (65%)	152 (61%)
Health / other personal reason	1 (1%)	18 (7%)
Others (including oversea engagement, resignation and retirement)	16 (22%)	74 (30%)
More than one of the above	9 (12%)	4 (2%)
Total	74 (100%)	248 (100%)

Table 4: Reasons disclosed for absence of chairman of the board/ board committees at AGM (CP E.1.2)

Reasons	Number (and %) of March FYE issuers deviated from CP E.1.2	Number (and %) of December FYE issuers deviated from CP E.1.2
Business engagement	24 (66%)	120 (71%)
Health / other personal reason	2 (6%)	8 (5%)
Others (including oversea engagement, resignation and retirement)	9 (25%)	38 (23%)
More than one of the above	1 (3%)	2 (1%)
Total	36 (100%)	168 (100%)

Table 5: Breakdown on parties unable to attend AGM (CP E.1.2)

Parties	Number (and %) of March FYE issuers deviated from CP E.1.2	Number (and %) of December FYE issuers deviated from CP E.1.2
Chairman of the board	27 (75%)	132 (78%)
Chairman of board committee(s)	2 (6%)	28 (17%)
Both of the above	7 (19%)	8 (5%)
Total	36 (100%)	168 (100%)

Table 6: Non-compliance relating to director's appointment (CP A.4.2)

Two Parts of CP A.4.2	Number of issuers	% of issuers deviated from CP A.4.2
First part: All directors filling a casual vacancy should be subject to election at first general meeting after appointment	3	10%
Second part: Every director should be subject to retirement by rotation at least once every three years	22	76%
Both parts	4	14%
Total	29	100%

