



A Snapshot of a snapshot - Summary of the recent HKEx "A Snapshot of INEDs' Roles and Responsibilities"

Independent non-executive directors ("INEDs") are essential to the success of corporate governance. They have the same duties of skills, care and diligence as other directors. An issuer must appoint INEDs representing at least one-third of the Board. Due to their independence and professional expertise, INEDs are expected to serve on board committees, including the audit, remuneration, nomination and other governance committees.

Even though they are not involved in the day to day management of the Company, INEDs should contribute to the development of the Company's strategy and policies through independent, constructive and informed comments.

HKEx has published "A Snapshot of INEDs' Roles and Responsibilities" (the "**Snapshot**") in November 2023. Being non-executive directors, INEDs may hide behind the executive directors and let the executive directors direct them what to do and as such, fail to fulfil their supervisory roles and responsibilities. The Snapshot is to ensure that INEDs will act proactively, ask questions and request information, exercise independent judgement and take a leading role in internal control, risk management and legal compliance. In short, INEDs should devote sufficient time and attention to their jobs, attending regular meetings, following up on red flags, keeping record and not relying wholly on the executive directors or even experts (especially when there is clearly a red flag).

The Snapshot is to bullet-point the duties and obligations of INEDs in the following areas:

- Actions to take when one becomes a new INED
- Role in the review and approval of business decisions and transactions
- Questions to ask when a transaction or a new business is being proposed and approved
- INEDs' role in internal controls
- INEDs' role in financial reporting
- INEDs' role in incident management

The Snapshot also gives case studies on the followings:

Case Study 1 - Financial reporting issue

Situation

- Late in publishing financial results for FY1 and FY2 and start to prepare for FY3.
- Auditors discovered significant Company's cash transferred to ED A and CFO (the "**transfers**"), and an interest free and repayment on demand loan been given to ED A's wife (the "**loans**"), both without the board's approval.

Proper INED's action

- Find out the reasons for late financial results for FY1 and FY2; look into the Company's internal control for financial reporting and remedy any deficiencies.
- (Audit Committee) meet the auditors as soon as possible after the financial year to discuss the scope and nature of the audit and reporting obligations before the audit starts.
- Set up a timetable and liaise with the auditors regularly, monitor the progress with the auditors and discuss with the auditors and the management of the Company.



- Convene a meeting to: i) ascertain the Listing Rule and legal implications of the transfers and loans e.g. whether to consult professional advisers or make any announcement; ii) arrange investigations of the transfers and loans to ascertain the reasons for the transfers and loans; iii) arrange review of the Company's internal control to understand how the transfers and loans can happen without the board's approval and not being detected until the audit; iv) take steps to recover the transfers and loans e.g. bringing legal action, suspending ED A and CFO or reporting the matter to the police; v) ensure the internal control reviewer's recommendations on the Company's internal controls are implemented properly and in a timely manner.

Case Study 2 – keeping apprised of affairs of the Company/Group

Situation

- Non-executive directors and INED do not receive monthly management account. They only receive information from the Company when they are asked to attend Board meetings for reviewing and approving transactions and/or financial results.

Proper INED's action

- Be proactive and ask for monthly updates from the Company, review them carefully and raise any appropriate questions.
- If an INED does not receive any monthly updates from the company secretary, requests them from the Board Chairman and executive directors in writing so there is a written record of the request; raises the matter to be discussed at the coming Board meeting.

Case Study 3 – Suspicious movement of funds and red flags

Situation

- Monthly management accounts for July 2022 showed circular payments involving receipt of a significant sum from one of the controlling shareholder companies on 30 June 2022, and the return of the same amount to the same controlling shareholder company on 1 July 2022 – either side of the Company's end of year financial reporting period. In addition, the management accounts show that the amount of receivables as at the end of July are significantly higher than as at end of June 2022.

Proper INED's action

- Do not rely on the executive director and the CFO; review the accounts in detail to see if there are any issues which need to be raised for discussion re circular payment.
- Ask for more information from the executive directors, including the purpose and/or nature of the payments and receivables.
- Any Listing Rule implication? Procure compliance; if in doubt, procure to seek professional advice; arrange the Company to report the advice to INEDs and steps taken to procure legal compliance.

Case Study 4 - prior undisclosed transactions mentioned in financial and annual reports

Situation

- The draft annual report of the Company for the financial year revealed a number of disposals of the Company's subsidiaries at nil or minimal consideration during the year.



Proper INED's action

If INED cannot attend the meeting:

- Review the draft report in details.
- Circulate comments before the board meeting.
- Ask for more information regarding the disposals – including the reasons for and commercial rationale of the disposals; why we were not previously told about them; whether there are any Listing Rule implications and, if so, steps must be taken to comply with the Rules as soon as possible.
- Ask why the Company's internal controls have not been able to identify and detect any failings; and what the steps taken to improve the internal controls are so that such failings do not happen again.
- Follow up by reading the draft and the final version of the minutes of the meeting.

If INED can attend the meeting, raise the above questions in the meeting and discuss them with the Board.

Case Study 5 - red flags in acquisition of new businesses

Situation

- The Company intends to acquire a target company ("**Target**") which is engaged in the manufacture and sales of Product A (totally unrelated to the Company's line of business) in Country Y.
- The government of Country Y has granted a licence to the Target to manufacture and sell Product A for five years.
- The Target has no track record and has not commenced business.
- None of the Company's directors have experience in the Product A business, which is new to the Company, or the laws and regulations of Country Y.
- The proposed consideration for the acquisition is 75% of the Company's market capitalisation.
- The valuation of the Target is based on, amongst others, a number of assumptions.
- The sole director and shareholder of the Target ("**Mr X**") will provide a profit guarantee to the Company which is twice the amount of the difference in the profit amount per year.
- The Company has engaged a number of professional advisers to advise on the proposed acquisition, e.g. a valuer, an accountant, a financial adviser (but does not advise on the merits of the acquisition), and lawyers.
- All the documents and information in respect of the Target and its business are provided by the vendor.

Proper INED's action

- Need to carry out appropriate due diligence, and make due enquiries, on the Target and relevant parties to the transaction.
- Need to take steps to verify the documents and the accuracy / reasonableness of the information provided by the vendor, and raise questions.
- Need to critically assess the valuation, including the reasonableness of the assumptions adopted. In addition, we should consider seeking professional advice to advise on the merits of the proposed acquisition and any legal implications (e.g. extension of the licence and other licensing requirements).
- Should critically assess the proposed business plan of the Target and the benefits of the acquisition.
- Must consider the reasonableness and adequacy of all the terms of the proposed acquisition, including the financial capability of Mr X to fulfil his obligation under the profit guarantee.



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- The Listing Rule implications?
- Now that the acquisition is approved, need to set up a reporting mechanism to ensure that the business and operations of the Target are reported to us on a regular basis; review the internal controls to ensure that they take into account the new business.

By setting out the dos and don't in each situation, HKEx expects the INEDs to take a proactive approach, constantly asking questions and requesting information and can exercise independent judgement in all the above cases.

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