THE CODE ON CORPORATE GOVERNANCE PRACTICES AND THE CORPORATE GOVERNANCE REPORT

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THE CODE ON CORPORATE GOVERNANCE PRACTICES

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The Code on Corporate Governance Practices (the "Code")

- Main Board Appendix 14: GEM Appendix 15;

  Replaces the Main Board Code of Best Practice and GEM Rules 5.35 to 5.45;

- Effective January 1 2005 (except Code provision C2 on internal controls – effective July 1 2005);

- Same for Main Board and GEM except that quarterly reporting is a Recommended Best Practice under the Main Board Code but mandatory under GEM Listing Rules;

- Origin – UK Combined Code;

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

The Code contains 2 tiers of recommended board practices:

1st tier - "Code provisions"

- expected standards of board practices
- Compliance not mandatory
- "Comply or explain" approach adopted
- issuers must state whether they have complied with, and give "considered reasons" for any deviation from, the Code provisions in their preliminary half-year and annual results announcements; half-year and summary half-year reports; and in the Corporate Governance Report included in their annual and summary annual reports;
- Main Board Rule 3.25 and Appendix 16, paragraphs 34, 44 – 46 and 50;
- GEM Rules 5.34, 18.44, 18.50, 18.55, 18.78 and 18.81;

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

2nd tier - comprises **recommended best practices** that issuers are encouraged to adopt. Issuers are encouraged (but not required) to state whether they have complied with, and give considered reasons for deviations from, the recommended best practices in their half-year and annual reports (and summary half-year and annual reports).

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Disclosure of Deviations from Code provisions

Half-year and Summary Half-year Reports

Issuers must either:

- give considered reasons for each deviation; or
- refer to the immediately preceding annual report and give details of changes and considered reasons for deviations not reported in that report;
- half-year report cannot contain cross-reference only without any discussion;
- Main Board Appendix 16 paragraph 44(1);
- GEM Rules 5.34(2) and (3)(b) and 18.55(4)

The Code on Corporate Governance Practices (the "Code") (Cont'd)

Disclosure of Deviations from Code provisions (cont'd)

Preliminary Results Announcements

Preliminary Half-year Results Announcements

- Issuers may refer to the Corporate Governance Report in the immediately preceding annual report and summarise changes since that report;
- Main Board Appendix 16, paragraph 46(4);
- GEM Rule 18.78(4);

Preliminary Annual Results Announcements

- Issuers may refer to the immediately preceding half-year report or to the Corporate Governance Report in the immediately preceding annual report and summarise changes since that report;
- Main Board Appendix 16, paragraph 45(5);
- GEM Rule 18.50(6);

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Option to Adopt Own Code

Issuers can adopt own code on corporate governance practices *on such terms as they consider appropriate.* But must still disclose deviations from the Exchange's Code provisions.

The Code on Corporate Governance Practices (the “Code”) (Cont’d)

Code covers 5 principal areas:

- Directors
- Remuneration of Directors and Senior Management
- Accountability and Audit
- Delegation by the Board
- Communication with Shareholders

Each section sets out:

- General principles
- Code provisions
- Recommended best practices

The Code on Corporate Governance Practices (the "Code") (Cont'd)

Directors

Code provisions include

- Regular board meetings – minimum of 4 a year
- 14 days' notice of regular meetings
- Independent professional advice available to directors
- Matters involving conflict of interest to be considered by board meeting – not by circulation
- Different persons to be Chairman and CEO
- NEDs to be appointed for specified terms

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Directors

Code provisions (Cont'd)

- All directors subject to retirement by rotation every 3 years
- Directors to receive formal training on appointment and continuing professional development to ensure understanding of the business and legal and listing rule requirements
- Directors must comply with required standard for dealings by directors in securities of their listed issuers (ie. the Model Code in Appendix 10 of Main Board Rules and GEM Rules 5.48 – 5.67)
- Boards to establish equally exacting written guidelines for dealings by employees likely to possess unpublished price sensitive information
- Board papers to be sent out 3 days before meetings

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Directors

Recommended Best Practices include

- Issuers should provide insurance cover for legal actions against their directors
- INEDs should make up at least one third of the board
- Issuers should establish a nomination committee comprising a majority of INEDs
- Directors should periodically disclose other offices held and significant commitments to the issuer

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Remuneration of Directors and Senior Management

Code Provisions include

- Issuers should establish a remuneration committee comprising a majority of INEDs
- Authority and duties of remuneration committee to be set out in writing
- Terms of reference of remuneration committee to include:
  - recommending remuneration policy to the board
  - having delegated responsibility to set remuneration packages for directors and senior management
  - reviewing and approving performance based remuneration
  - approving compensation packages on termination
  - ensuring directors not involved in fixing own pay

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Remuneration of Directors and Senior Management

Recommended Best Practices include

- Executive directors' pay should be performance linked
- Senior management's remuneration should be disclosed on a named basis in annual reports and accounts
- If the board approves any remuneration or compensation arrangement previously not approved by the remuneration committee – the reasons for the board's approval must be disclosed in the next annual report

The Code on Corporate Governance Practices (the "Code") (Cont'd)

Accountability and Audit

Code provisions include

- *Financial Reporting*
  - Directors should acknowledge their responsibility for preparing the accounts in the Corporate Governance Report
  - Material uncertainties as to issuer's ability to continue as a going concern to be disclosed in the Corporate Governance Report
- *Internal Controls*
  - Directors should conduct an annual review of internal controls and report to shareholders that they have done so in the Corporate Governance Report
  - The review should cover financial controls, operational and compliance controls and risk management functions

The Code on Corporate Governance Practices (the "Code") (Cont'd)

Accountability and Audit

Code provisions (Cont'd)

- *Audit Committee*

  - Minutes to be kept
  - Former partner of the issuer's auditing firm prohibited from acting as a member of the issuer's audit committee for 1 year from the later of his ceasing to be a partner and ceasing to have any financial interest in the firm
  - Terms of reference to include:
    - recommendations to the board on the appointment, re-appointment and removal of the external auditor
    - monitoring external auditor's independence
    - monitoring integrity of issuer's financial statements
    - reviewing financial controls, internal control and risk management systems
    - discussing internal controls with management

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Accountability and Audit

Recommended Best Practices

- *Financial Reporting*
  - Quarterly reporting for Main Board issuers
  - Main Board issuers should announce the reason for ceasing to publish quarterly reports

- *Internal Controls*
  - The Corporate Governance Report should include a narrative statement as to how the issuer has complied with the Code provisions on internal control
  - Issuers without an internal audit function should review the need for one annually and disclose the outcome in their Corporate Governance Report

- *Audit Committee*
  - Terms of reference should cover arrangements for reporting and investigation of improprieties in financial reporting

The Code on Corporate Governance Practices (the "Code") (Cont'd)

Delegation by the Board

Code Provisions

- *Management functions*
  - When delegating to management, must give clear directions on when management must report back to the board
  - Issuers should formalize functions reserved to the board and functions delegated to management
- *Board Committees*
  - Board committees should be given clear terms of reference and required to report back to the board (in the absence of legal/regulatory restrictions)

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The Code on Corporate Governance Practices (the "Code") (Cont'd)

Communication with Shareholders

Code Provisions

- *Effective Communication*
  - Separate resolutions for each substantially separate issue at general meetings
  - AGMs to be attended by the chairman of the board and chairmen of the audit, remuneration and nomination committees
  - The chairman of the independent board committee should attend a general meeting approving a connected transaction or other transaction subject to independent shareholders' approval

- *Voting by Poll*
  - The right to demand a poll and the procedure for demanding it should be disclosed in circulars to shareholders and explained by the Chairman at the start of a meeting
  - The Chairman and/or directors holding proxies for > 5% of the total voting rights must demand a poll if vote on a show of hands goes against proxies' instruction

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THE CORPORATE GOVERNANCE REPORT

The Corporate Governance Report

- Appendix 23 Main Board Listing Rules
- Appendix 16 GEM Listing Rules

Listed issuers must include a separate Corporate Governance Report by their directors in their annual reports and summary annual reports (if any) for accounting periods commencing on or after January 1 2005. The disclosure requirements on internal controls took effect for accounting periods commencing on or after July 1 2005.

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The Corporate Governance Report (Cont'd)

Summary Annual Report – Corporate Governance Report

The Corporate Governance Report in a summary annual report may be a summary of the Corporate Governance Report in the annual report

Must contain, as a minimum:

- a narrative statement indicating overall compliance with the Code provisions
- highlighting any deviation from the Code provisions
- considered reasons for deviations from the Code

The Corporate Governance Report (Cont'd)

3 levels of disclosure requirements:

(i) 1st level - **mandatory disclosure** requirements. Failure to comply regarded as a breach of the Listing Rules;

(ii) 2nd level - summarises the **specified disclosures** which the Code provisions expect to be included in issuers' Corporate Governance Reports. Issuers must give considered reasons in the Corporate Governance Report for not including the Code's expected disclosures.

(iii) 3rd level - **recommended disclosures** that listed issuers are encouraged to include.

Corporate Governance Report must cover the period covered by the annual report and significant events for any subsequent period up to publication of the annual report.

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The Corporate Governance Report (Cont'd)

Mandatory Disclosures Include

(a) Corporate Governance Practices

- narrative statement of how the issuer has applied the Code's principles
- a statement as to whether the issuer meets the Code provisions (issuers can highlight that they have adopted a code which exceeds the Code provisions)
- details of and considered reasons for any deviation from the Code provisions

The Corporate Governance Report (Cont'd)

(b) Directors' Securities Transactions

- whether the issuer has adopted a code of conduct for directors' securities transactions meeting the required standard set out in the Model Code for Directors' Dealings (Appendix 10 Main Board Rules) and in GEM Rules 5.48 to 5.67

- having made enquiry of all directors, whether or not the required standard of the Listing Rules and their own code has been met

- details of any non-compliance and an explanation of remedial steps

The Code on Corporate Governance Practices (the "Code") (Cont'd)

(c) *Board of Directors*

- Composition of the board by category of directors
- Number of board meetings held during the year
- Individual attendance of directors at board meetings on named basis
- Statement of how the board operates including a statement of decisions reserved to the board and those delegated to management
- Details of non-compliance with the Rules' requirements for a minimum of 3 INEDs and one INED with financial or accounting expertise and remedial steps taken
- Relationships between board members and between the Chairman and CEO

The Code on Corporate Governance Practices (the "Code") (Cont'd)

(d) *Chairman and CEO*

- confirmation of segregation of the roles of the Chairman and CEO

Other Mandatory Disclosures cover:

- The term of appointment of NEDs
- Information relating to the Remuneration Committee
- Information relating to the Nomination Committee
- An analysis of the auditors' remuneration
- Information relating to the Audit Committee

The Corporate Governance Report (Cont'd)

Specified Disclosures

- Code provision C.1.2 – directors' acknowledgement of their responsibility for preparing the accounts and auditors' statement about their reporting responsibilities
- Code provision C.1.2 – a report on material uncertainties as to the issuer's ability to continue as a going concern
- Code provision C.2.1 - a statement that the board has reviewed the effectiveness of internal controls
- Code provision C.3.5 – a statement by the audit committee explaining its recommendation and the reason(s) for any different view taken by the board regarding the appointment or termination of the external auditors

The Corporate Governance Report (Cont'd)

Recommended Disclosures include

- Share interests of senior management
- Details of shareholders by type and aggregate shareholding
- Details relating to internal controls, including:
  - procedures and controls for handling price sensitive information
  - a statement whether the directors consider the internal control systems to be effective and adequate
  - details of any significant areas of concern for shareholders
  - the outcome of the annual review by an issuer without an internal audit function of the need for one

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The Corporate Governance Report (Cont'd)

Transitional Arrangements

1st Preliminary Annual and Half-year Results Announcements for A/C Periods commencing after January 1 2005

No need to disclose every deviation from the Code provisions. A summary of the major areas of deviation will be allowed. Considered reasons will not be required.

1st Half-Year Report after January 1 2005

Where no annual report complying with the new requirements has been issued, the 1st half-year report need not contain considered reasons for each deviation from the Code provisions.

Instead, the deviations must be disclosed and considered reasons for why the issuer does not propose to comply with the Code provision in the future or the steps it will take to comply in the future.

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