

Prada S.p.A and Coach Inc are world-known luxury handbags and accessories enterprises and both companies were incorporated in the countries where their management reside – Italy and USA respectively. Both were successfully listed in Hong Kong in 2011.

Dynam Japan Holding Co Ltd (“Dynam”) was incorporated in Japan with limited liability and is a pachinko hall operator in Japan with 45 years’ of experience in the pachinko industry. In August 2012, Dynam was the first Japanese company to be primarily listed in Hong Kong. It operated 355 pachinko halls as at the date of listing, and all were located in Japan. When Dynam was preparing for listing in 2011, HKEx has ruled Japan to be acceptable overseas jurisdiction based on Listing Decision LD110-1(2010).

When deciding the choice of jurisdiction for the listing vehicle, there are some factors to consider:

- Tax advantages offered by the jurisdiction;
- Any capital gains or other tax that may be incurred on a group restructuring;
- Different withholding tax rates for dividends paid in different jurisdictions;
- Familiarity with the legal and regulatory system;
- Plans for possible dual listings; and
- Whether the jurisdiction is already accepted by HKEx.

SPECIFIC IPO ISSUES

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CONTROL AND MANAGEMENT CONTINUITY

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¶4-000 Introduction

To qualify for a main board listing, one of the basic conditions to be met is the continuity of management and ownership in the track record period. According to Main Board Listing Rule 8.05, a listing applicant must satisfy one of the three tests, namely, the profit test, the market capitalisation/revenue/cash flow test or the market capitalisation/revenue test. Two common requirements of these three tests are:

- Management continuity for at least the three preceding financial years; and
- Ownership continuity and control for at least the most recent audited financial year.

The meaning of continuity is explained in para 3 of HKEx Practice Note 3 which states that the listing applicants have

normally been managed by substantially the same persons throughout the track record period up to the time of listing.

GEM Listing Rules 11.12A(2) and (3) require that the listing applicant must have:

- Continuity of ownership and control throughout the preceding full financial year; and
- Substantially the same management throughout the preceding two full financial years;

and both requirements must be met until the date of listing.

¶4-010 Meaning of management and management continuity

In para 31 of the Consultation Paper on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures¹ issued by HKEx in July 2002 (the "Consultation Paper"), HKEx stated that in order to meet the management continuity requirement, listing applicants are required to demonstrate that there has been no change in the majority of its board of directors and senior management of its principal operating entities during the track record period.

In para 12 of Listing Decision LD45-1(2005), HKEx stated that when assessing individual members of a management team, it follows the practice of ordinarily attributing proportionately greater responsibility to officers with more senior positions than those with more junior positions. This practice is intended to reflect the formal responsibilities of senior officers in their corporate roles.

¹ Consultation Paper on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures (July 2002).

A sound internal control system contains elements encompassing the policies, processes, tasks, behaviours and other aspects of a company, which, when taken together², would:

- Facilitate the company's effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks in relation to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use, loss or fraud, and ensures that liabilities are identified and managed;
- Help ensure the quality of internal and external reporting, which depends on the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation; and
- Help ensure compliance with applicable laws and regulations, and also internal policies with respect to the conduct of business.

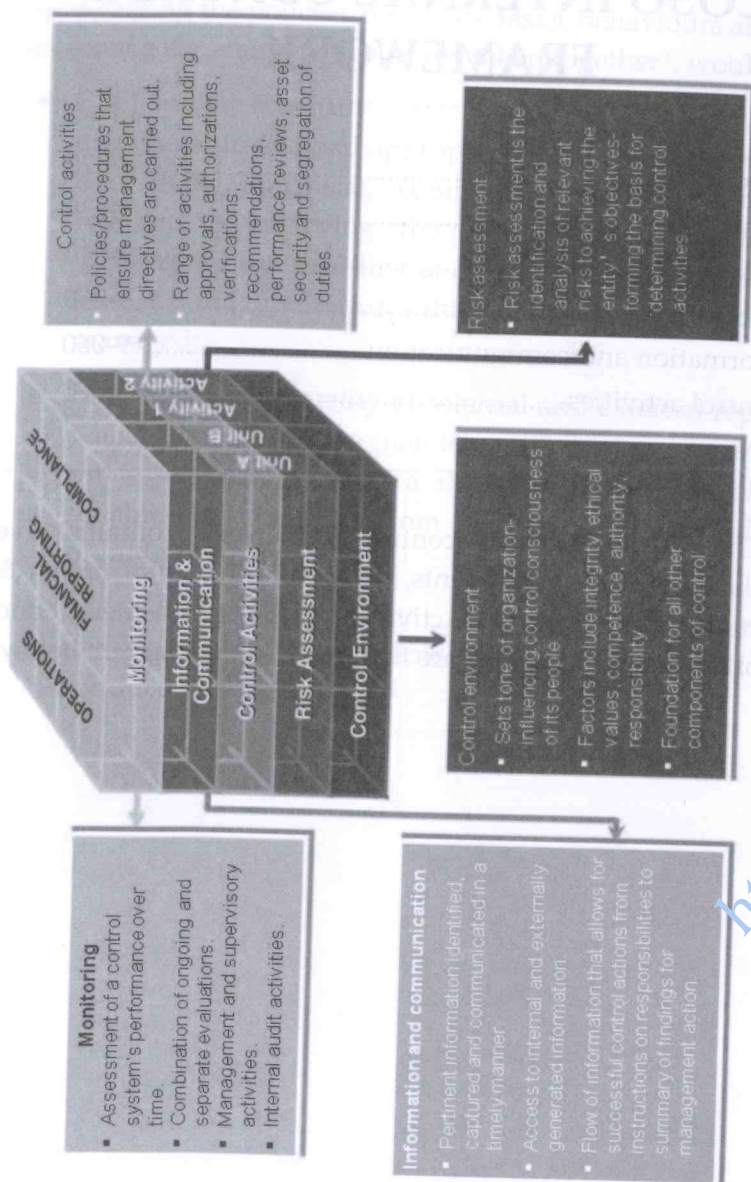
² Paragraph B.2.1 of HKICPA's Internal Control and Risk Management Guide.

COSO INTERNAL CONTROL FRAMEWORK

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¶9-020 Introduction

The COSO internal control framework contains five interrelated control components, ie, Monitoring, Information & Communication, Control Activities, Risk Assessment, and Control Environment, which are illustrated in the diagram below:



Under the COSO framework, internal control assessment is conducted at two levels:

- *Entity-level controls* – Activities generally operating at the corporate level, eg, corporate policies, activities of the board of directors, and period-ending financial close; and
- *Process-level controls* – Activities relating to individual business locations or business processes, eg, accounts payable, direct supervision of employees, and the hiring process for new employees.

Effective entity-level controls provide assurance that appropriate controls are operating throughout the company. For example, the corporate function may be responsible for issuing corporate accounting policies and procedures, but the individual locations or operations must also ensure that the policies are being appropriately applied. Examples of entity-level controls include:

- Control environment controls such as assignment of authority and responsibility, consistent policies and procedures, codes of conduct, etc;
- Management's risk assessment process;
- Centralised processing and controls (eg financial reporting);
- Establishment of communication channels and availability of information, eg management reports; and
- Monitoring controls such as internal audit functions and activities, audit committee, etc.

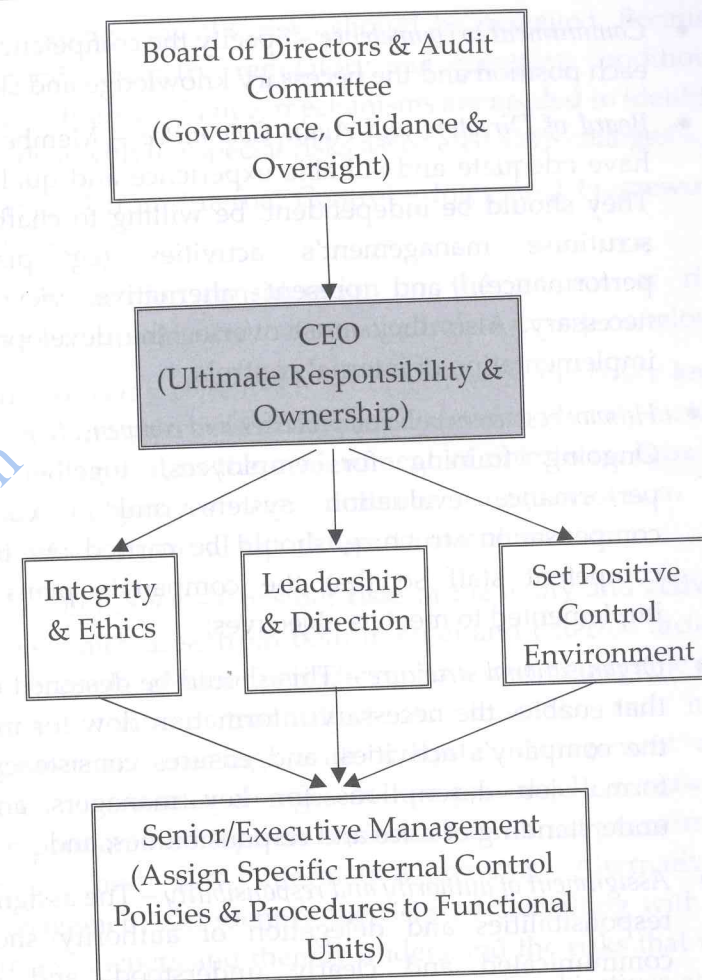
Below we further explain the features to consider in applying the COSO framework's five control components, and also illustrate in detail the factors or areas to be considered using the example of a listing applicant in the manufacturing industry.

¶9-030 Control environment

"The control environment sets the tone of an organisation, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organises and develops its people; and the attention and direction provided by the board of directors."

(Extracted from Internal Control – Integrated Framework by COSO)

The following diagram illustrates broadly the main roles of the parties involved in establishing the control environment:



Factors for consideration include:

- *Integrity and ethical values* – To ensure a strong commitment to a good control environment, management should communicate to the employee the values and behavioural standards expected;
- *Compliance* – Abide by the Listing Rules and relevant regulatory requirements, such as by disclosing of notifiable and connected transactions;