

Accounting Bulletin 3 (Revised) *Guidance on Disclosure of Directors' Remuneration*

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Background

Hong Kong Institute of Certified Public Accountants revised the Accounting Bulletin 3 Guidance on Disclosure of Directors' Remuneration. This Accounting Bulletin supersedes Accounting Bulletin 3 issued in January 2000 and has been developed in consultation with Companies Registry in so far as the provisions in the Hong Kong Companies Ordinance Cap. 622 ("CO") and the Companies (Disclosure of Information about Benefits of Directors) Regulation Cap. 622G (the "Regulation") are concerned. It provides general reference on certain requirements of the Hong Kong Companies Ordinance Cap. 622 and Cap. 622G with respect to the disclosure of directors' remuneration in notes to the financial statements.

Introduction

Section 383 of the CO requires that the financial statements of a company incorporated in Hong Kong must contain, in the notes to the financial statements, the information prescribed by the Regulation in relation to the following:

- (a) directors' emoluments;
- (b) directors' retirement benefits;
- (c) payments made or benefit provided in respect of the termination of the service of directors; and
- (d) consideration provided to or receivable by third parties for making available the services of a person as director.

All companies whose securities are listed on The Stock Exchange of Hong Kong Limited are also required by the Main Board Listing Rules and GEM Listing Rules to make disclosures required by section 383 of the CO and the Regulation, irrespective of whether or not they are incorporated in Hong Kong.

This Accounting Bulletin sets out the Financial Reporting Standards Committee's (the "Committee") understanding of the requirements in the above paragraph. This Accounting Bulletin also provides general reference on common practical issues encountered in preparing the required information. Here we draw your attention to certain required information which may be overlooked.

Practical Issues

A. *An employee acting as an alternate director*

“Alternate director” refers to an individual who attends meetings on behalf of a director on occasions when the director is unable to attend.

The Committee is of the view that remuneration of such a person would be included as directors’ remuneration only to the extent of any specific **incremental amount received or receivable** by the person in respect of acting as an alternate director, if any.

B. *Meaning of “subsidiary undertaking” is extended to non-controlled entities*

It is possible that the term “subsidiary undertaking” as used in the Regulation may include entities that would not fall within the definition of a controlled ‘subsidiary’ under HKFRS 10. For example, when a company owns more than 50% of the equity shares of another company but does not have control. In this case, the investee is a “subsidiary undertaking” within the meaning of Schedule 1 of the CO, even though for accounting purposes the investee is a joint venture or an associate, not a subsidiary.

According to sections 3(4) of the Regulation for this purpose, the term “subsidiary undertaking” also includes any other undertaking, not just a subsidiary undertaking of the company as defined in Schedule 1 of the CO, if the person is or was a director of the company and also a director of that undertaking **by virtue of the company’s nomination (whether direct or indirect)**.

This means that if a company has nominated one or more of its directors to sit on the boards of any of the company’s investees, whether they are subsidiaries, joint ventures, associates or other investments, then any remuneration paid to or receivable by that person or persons in respect of that **extra role** may need to be included in the directors’ remuneration disclosed by the investor company, unless the director occupies that position for reasons other than because of nomination rights held by the company. For example:

Company A has nominated one of its directors to the board of its associate, company B. Company B pays \$250,000 per year to the director in respect of his services to the company.

- As the director has been nominated by company A as a director of the associate, the associate is deemed to be a subsidiary undertaking (for the purposes of directors’ remuneration disclosure). The director is performing qualifying services for company A by being its representative on company B’s board. So, in this situation, company A **includes** the \$250,000 in its aggregate disclosure of emoluments paid to or receivable by the director.
- If the \$250,000 were paid directly to company A (that is, as a sum to be accounted for to the company) and not to the director personally, this amount would **NOT be included** as directors’ emoluments in company A’s financial statements. Company B should disclose the payment of \$250,000 in its own financial statements as a sum paid to a third party in respect of the director’s services.

In these circumstances, the Company is encouraged to explain in the financial statements the different meaning of “subsidiary undertaking”.

C. *Consideration provided to or receivable by third parties for making available the director's services*

Section 7 of the Regulation requires separate disclosure of the aggregate amount of the consideration provided to or receivable by any third party for making available qualifying services of a person who is a director of a company.

According to section 7(3), the reference to "third party" in this section is a reference to any person other than:

- (a) the director;
- (b) a connected entity of the director;
- (c) the company; or
- (d) a subsidiary undertaking of the company.

The disclosure requirement does not apply when the payment has been made to a connected entity of the director. For example:

- (a) a company with which the director is associated through an ownership interest of more than 30%; or
- (b) a partnership in which the director is a partner.

Any such amounts are deemed to be directors' emoluments, retirement benefits or payments for loss of office, depending on the circumstances in which the payment arose.

If a company makes a **payment to its holding company** in return for the holding company providing the services of one of the company's directors, **such payment also falls under section 7 of the Regulation as a "payment to third party"**.

D. *Types of services provided by a director*

The Regulation requires each type of directors' remuneration to be distinguished between:

- (a) remuneration in respect of services as director of the company or as a director of its subsidiary undertakings; and
- (b) remuneration for the management of the affairs of the company or its subsidiary undertakings.

Remuneration in respect of services **as a director** are normally those fees which are paid to directors in their capacity as such and not in any managerial or executive capacity. Typically these would be fees fixed either by the Articles of Association or by the company in general meeting.

The remainder of the remuneration of an executive director is generally assumed to be those sums which are paid to directors of the company in **connection with the management of the affairs** of the company or its subsidiary undertakings. This other remuneration normally includes salaries, bonuses and other benefits paid to executive directors, for instance, for acting as a managing director, or being responsible for a business segment.

All payments made to a director, except for **reimbursement of expenses**, would generally fall within one of these categories of directors' remuneration i.e. "as a director" or "in connection with the management of the affairs", unless it can clearly be demonstrated otherwise. When a director has specific technical skills, such as a professional valuer or legal adviser. In such cases, payments may also be made to the director in a **self-employed or an independent professional capacity** for the provision of technical services that are not connected with qualifying services as a director or otherwise in connection with managing the company or its subsidiary undertakings.

E. Apportioning payments between holding company and subsidiary undertakings

When a person is a director of more than one company within a group, it may be necessary to identify which amounts of the person's remuneration relate to which company. A common example of this is where an executive director of a holding company is also appointed as director of a number of that company's subsidiaries. In such cases, all of that individual's remuneration relating to the group will be discloseable in the holding company's financial statements. However, in each of the subsidiaries' financial statements, the amount to be disclosed should relate only to the qualifying services provided by that individual to that subsidiary.

In the case of **directors being paid solely by the holding company or by a service company in the larger group**, the following is typically disclosed by the company:

- (a) the fact that the directors of the company are also directors/employees of the holding company/fellow subsidiaries and are remunerated by the holding company/a fellow subsidiary in respect of their services to the group as a whole; and
- (b) an estimation of a reasonable amount of remuneration, for example based on an estimate of number of working hours spent on providing qualifying services to the company or its subsidiaries, if the director spends more than an insignificant amount of time on such activities and thus those services are more than just incidental.

Illustrative wording for disclosure:

When directors receive no remuneration

Directors' remuneration disclosed pursuant to section 383 of the Companies Ordinance (Cap. 622) and Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G) for the year is HK\$nil (201Y: HK\$nil).

When some directors are paid by another group company, and no apportionment is made

In addition to the directors' remuneration disclosed above, certain directors are not paid directly by the Company but receive remuneration from the Company's holding company, in respect of their services to the larger group which includes the Company and its subsidiaries. No apportionment has been made as the qualifying services provided by these directors to the Company and its subsidiaries are incidental to their responsibilities to the larger group.

F. *Guidance on valuing and disclosing benefits in kind*

If any emoluments, retirement benefits, payments for loss of office or consideration payable to third parties consist of a benefit otherwise than in cash, then the amounts disclosed for that category should include the estimated money value of that benefit.

Where the company has paid a third party to provide the benefit to the director (or the director's connected entity), then the estimated money value of that benefit is usually the cost incurred by the company.

In some cases, the money value may not be readily apparent from a transaction with third parties. In such cases, the directors should estimate the value from the perspective of the director as a market participant. This amount will not necessarily coincide with the cost borne by the company in providing such benefits, or the amount of expense recognised for financial reporting purposes in accordance with HKFRS.

Here are some examples of estimating money value of benefits in kind:

<i>Types of benefits in kind</i>	<i>Methods in estimating the money value</i>
Property owned by the company, used by the director	Market rental of the property as if it were let on arm's length terms plus any related charge borne by the company less any amount contributed by the director.
Company's product transferred to a director	Normal selling price of an equivalent product sold in an arm's length transaction.
Subsidised loans advanced to a director	Difference between the contractual interest payable by the director on the loan and the market interest otherwise payable by the director in obtaining the funding in the market.
Share options granted by the company to a director	<ul style="list-style-type: none">● An amount recognised as an expense in accordance with HKFRS 2; or● The amount of the gain if the options are exercised, or as if they were exercised, at the time of vesting, for those options which vested during the year.
An asset is provided to a director for a mixture of business and private use	An apportionment between business and private use would be required. The apportionment of the cost between business and private use should be on a reasonable and consistent basis.

The amount of non-cash benefits is not required to be disclosed separately from cash benefits. However, the nature of that benefit must be disclosed.

Illustrative wording for disclosure:

Other emoluments disclosed above include the estimated money value of accommodation provided by the company to the directors and their families. The money value of the accommodation is estimated to be the annual market rental of the accommodation less any amounts paid for by the directors personally and not reimbursed by the Company.

G. *Auditors' responsibilities under section 407(4) of the Companies Ordinance*

In addition to the general requirement to express an opinion under section 406(1)(a) of the CO on whether the financial statements have been properly prepared in compliance with the Companies Ordinance. In cases where a company has not complied with section 383(1) of the CO, the auditor would give a qualified opinion. The auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

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