

AVISTA Insights

Summary of SFC and AFRC Joint Statement on Loans, Advances and Prepayments Arrangements

August 2023

Introduction

In July 2023, the Securities and Futures Commissions ("SFC") and the Accounting and Financial Reporting Council ("AFRC") issued a joint statement, saying that they will issue joint statements on common regulatory concerns to listed issuers. The first joint statement (hereunder referred as the "Statement"), this time, focuses on loans, advances and prepayments arrangements (hereunder referred as LAP arrangements).

This Statement recommends practices that listed issuers, their directors, audit committees, and auditors should adhere to in relation to LAP arrangements. This article aims to provide a summary of the Statement in respect of i) observed questionable practices; ii) role of directors; and iii) expectations on audit committee in relation to LAP arrangements.

<p>Observed Questionable Practices</p>	<p>1 Lack of Commercial Rationale</p> <ul style="list-style-type: none"> Offering loan interest rate substantially lower than cost of funds Granting loans without legitimate commercial justifications Arranging loans without contractual evidence 	<p>2 Insufficient Risk Assessments, Due Diligence and Documentation</p> <ul style="list-style-type: none"> Weak credit risk assessment procedures Lack of background checks on borrowers Lack of financial due diligence on borrowers and collateral Lack of assessment documentation 	<p>3 Inadequate Internal Controls</p> <ul style="list-style-type: none"> Without board-level approval Weak internal controls in monitoring loan repayment and recovery Extension of repayment period without justified commercial reasons Lack of approval documentation
<p>Role of Directors</p>	<p>1 Undergoing Fiduciary Duty - Duty of Care</p> <ul style="list-style-type: none"> Assessing the commercial rationale before approval Ensuring favorable borrowing terms Paying extra attention to loan i) in significant amount (both individually and in aggregate), ii) without security; and iii) falling outside the ordinary business scope 	<p>2 Ensuring Appropriate Internal Controls and Procedures</p> <ul style="list-style-type: none"> Formulating loan-related procedures from granting, repayment to disclosure Arranging credit assessments (such as background and financial checks) by competent personnel Maintaining proper documentation Establishing identification and board reporting mechanism for any loan-related issues Ensuring sufficient disclosure of related parties loans 	<p>3 Ensuring the Effectiveness of Risk Management and Internal Control Systems</p> <ul style="list-style-type: none"> Cannot solely rely on management's representations in the CG report Ensuring disclosure of all significant control deficiencies Engaging auditors to attend board meetings for loan-related issues
<p>Expectations on Audit Committee</p>	<p>Maintaining Good Corporate Governance Practices</p> <ul style="list-style-type: none"> Ensuring appropriate and effective internal controls Ensuring proper accounting and disclosure in the financial statements Establishing a monetary threshold for board-level approval Regularly reviewing the monetary threshold Maintaining robust communication with auditors during audit to promptly address identified significant matters 		

Conclusion

It is the first time that SFC and AFRC jointly publish a statement directly addressing to listed issuers' directors and audit committee on a highlighted topic (i.e., LAP arrangements). Listed issuers are recommended to consider the Statement as an official guideline. Additionally, they are encouraged to perform a gap analysis on the existing internal control systems on LAP arrangements and implement any necessary improvements accordingly.

Contact Us



Vincent Pang

CFA, FCPA, FCPA (Aust.), MRICS, RICS Registered Valuer
Managing Partner

vincent.pang@avaval.com
+852 3702 7338 / +852 9677 3357
+86 138 1023 8603



Derek Chim

CPA
**Principal, Risk Management
Advisory Services**

derek.chim@avaval.com
+852 3702 7312 / +852 6484 8205
+86 189 3866 2083

About AVISTA

AVISTA Group ("AVISTA") is a leading professional advisory firm. We are experienced in performing a full range of Valuation Advisory, Risk Management Advisory, ESG Advisory, Corporate Advisory, and Property Consultancy services for various purposes.

We have offices in Hong Kong, Shanghai, Beijing and Shenzhen.

The AVISTA professional team comprises more than 100 professional consultants, each with different areas of expertise and detailed familiarity of financial reporting standards and regulatory standards. Our team of experienced professionals come from globally-renowned valuation firms, consulting firms and international accounting firms with global qualifications such as CFA, CPA, CPV, FRM, MRICS and so on.

