

Reminders on Financial Reporting Rules

With the reporting season approaching, HKEx is publishing this article to remind listed issuers, their directors and senior management responsible for financial reporting and auditors of listed issuers of the importance of certain financial reporting-related Listing Rules and their respective roles in ensuring compliance.

Preliminary Announcements

Preliminary announcements play a key part in the annual financial reporting cycle, being the first public release by listed issuers of information concerning their full year's results. Preliminary announcements are relied on to provide timely, sufficient and accurate information and ensure an orderly and efficient market. They are focal points for investors as they confirm or update market expectations. As a result, listed issuers and their auditors have vital roles to play in the processes leading up to the release of the announcements.

The rules on preliminary announcements of annual results are set out in Main Board Listing Rule 13.49 and Growth Enterprise Market (GEM) Listing Rule 18.49. The rules require that listed issuers publish their preliminary announcements but only after the financial information has been reviewed and "agreed" by their auditors.

In December 2005, in consultation with The Stock Exchange of Hong Kong Limited (the Exchange) and the Securities and Futures Commission, the Hong Kong Institute of Certified Public Accountants (HKICPA) issued Practice Note 730 "Guidance for Auditors Regarding Preliminary Announcements of Annual Results" to provide guidance to issuers and their auditors as to their responsibilities with regard to preliminary announcements. Both listed issuers and their auditors should familiarise themselves with the Practice Note which is available on the HKICPA website at: <http://www.hkicpa.org.hk/ebook/main.php>.

Some key points which listed issuers and their auditors should bear in mind are:

- The review of a preliminary announcement is a separate engagement from the audit engagement and a separate engagement letter is necessary. A specimen engagement letter is provided in the Practice Note.
- Preliminary announcements can be based on either audited financial statements or draft financial statements.
 - If a preliminary announcement is based on draft financial statements, which will normally be the case, both the listed issuer and its auditors will need to be satisfied that any outstanding audit issues will not result in changes to the figures in the financial statements in the annual report sent to shareholders.
 - Listed issuers should not state that information in a preliminary announcement has been "audited" unless the audit report on the financial statements, upon which the announcement is based, has been signed by the auditors.

- Auditors should provide evidence of their agreement to the financial information content of a preliminary announcement by sending a written report to the directors. An example of such a report is provided in the Practice Note.
- Listed issuers should not release a preliminary announcement until they have obtained their auditors' written report.
- Listed issuers should encourage their auditors to attend the directors' meeting at which the draft consolidated financial statements and the preliminary announcement are approved by the directors.
- If an auditor is aware of the fact that an issuer has released its preliminary announcement without his agreement, the matter should be reported promptly to the Exchange's Listing Division. The Practice Note sets out the steps auditors should take in the event that they become aware that the listed issuer has released a preliminary announcement with which they disagree.
- The Exchange will normally require a suspension of trading in a listed issuer's securities if a listed issuer fails to publish periodic financial information in accordance with the Listing Rules. The suspension will normally remain in force until the listed issuer publishes the requisite financial information.



Business Commentaries in Preliminary Announcements and in Quarterly, Interim and Annual Reports

With the exception of quarterly results announcements of GEM companies, listed issuers are required under the Listing Rules to present in their preliminary announcements and in their quarterly, interim and annual reports a narrative business commentary. In preparing these commentaries, listed issuers should aim to present a balanced and objective analysis. The commentaries should be clear and concise, and they should provide an unbiased analysis of the performance and financial position of the company including brief details of material

factors which have influenced the issuer's results. Commentaries should not be overly brief as extreme brevity may make the analysis appear biased or misleading.

Paragraphs 69 and 70 of Statement of Auditing Standards No.700 "Engagements to Review Interim Financial Statements" require auditors to ensure that the business commentary presented in an interim announcement is not materially inconsistent with the financial information reviewed by them. Similar obligations are included in paragraphs 24 to 27 of Practice Note 730 in respect of reviews by auditors of preliminary announcements.

Compliance with Accounting Standards

The Listing Rules are clear as to which accounting standards are acceptable to the Exchange and require that the annual financial statements of a listed issuer must conform to either Hong Kong Financial Reporting Standards (HKFRSs) or International Financial Reporting Standards (IFRSs). Paragraph 2 of Appendix 16 of the Listing Rules specifies that the annual financial statements shall provide a true and fair view of the state of affairs of the listed issuer and of the results of its operations and its cash flows. Paragraph 15 of Hong Kong Accounting Standards 1 “Presentation of Financial Statements” states, amongst other things, that in virtually all circumstances a true and fair view is achieved by compliance with applicable HKFRSs.

In the event that a listed issuer intends to deviate from HKFRSs/IFRSs either in respect of its interim or annual financial statements the Exchange will expect the issuer to explain its stance and the views of its auditors prior to the publication and/or announcement of the issuer’s interim/annual results.

The Exchange places considerable weight on the views of the listed issuer’s independent auditors in the application of accounting standards. An unmodified or unqualified opinion from its auditors would provide support for an issuer regarding its deviation from an applicable accounting standard, and it is unlikely that the Listing Division would make further substantive enquiries nor take any further action. However, a proposed or actual modified or qualified opinion of the auditors on an accounting issue would lead the Exchange to be concerned and it would seek further information and submissions before determining the appropriate course of regulatory action.

In summary, non-compliance with accounting standards may constitute a breach of the Listing Rules and the Exchange may institute disciplinary proceedings. Sanctions that may be imposed under the Listing Rules include a public sanction or the imposition of other regulatory actions on the company, its directors and officers, including a requirement to restate the issuer’s financial statements in compliance with the Listing Rules.

HKEx encourages all persons involved in or responsible for preparing financial information for listed issuers and their auditors to take note of the matters discussed in this article. Extra care and attention at the planning stage and other stages of the process leading to publication of financial information will ensure a proper outcome and will avoid possible subsequent embarrassment or regulatory action.