FINANCIAL STATEMENTS REVIEW PROGRAMME
REPORT 2016
CONTENTS

EXECUTIVE SUMMARY 1

I. INTRODUCTION 3

II. FINDINGS REGARDING THE LISTING RULES 5

III. FINDINGS REGARDING ACCOUNTING STANDARDS 17

IV. FINDINGS REGARDING GENERAL ACCOUNTING REVIEW THEME
   – DISCLOSURE OF POSSIBLE IMPACT OF APPLYING A NEW OR AMENDED HKFRS IN ISSUE BUT NOT YET EFFECTIVE 26

V. FINDINGS REGARDING INDUSTRY REVIEW THEME
   – ACCOUNTING BY RETAIL AND CONSUMER GOODS COMPANIES 30

VI. FINDINGS REGARDING SPECIAL REVIEW THEME
   – NEW AUDITORS’ REPORTING 36

VII. CONCLUSION 40
EXECUTIVE SUMMARY

The Exchange has completed this year’s Financial Statements Review Programme (the “FSRP”) for compliance with the disclosure requirements of the Listing Rules, accounting standards and relevant disclosure requirements of the new Companies Ordinance (Cap. 622) (the “CO”). This is our eighth published report summarizing our key findings from the review of 100 reports comprising issuers’ annual, interim and quarterly reports released between February 2016 and April 2017.

Based on our review and issuers’ responses to our enquiries, except for three cases which were referred to the Financial Reporting Council (the “FRC”) for further enquiry and investigation of possible accounting and auditing irregularities, there were no significant breaches of the Listing Rules, accounting standards or relevant disclosures requirements of the CO that would render the financial statements misleading, require their restatement or warrant disciplinary action. Where disclosure was insufficient and not material to the financial statements as a whole, we obtained confirmations from issuers that the required information would be provided in future financial reports.

The review found several key areas in issuers’ financial disclosures and related matters where there is room for improvement and special focus is required, where appropriate:

- **Providing management commentary that is useful for investors** – Information in the Management Discussion and Analysis ("MD&A") and Business Review should be clear, understandable and entity-specific (see paragraphs 14 to 22). To achieve this objective, issuers should take note of the key areas below:

  - **Adequate explanation of performance**: Issuers should provide an adequate discussion of performance and properly identify reasons for fluctuation in profit or loss, such as elaborating on the underlying causes instead of only reciting the figures;

  - **Significant balances and transactions**: Issuers should assess materiality in the context of disclosure and provide commentary on items and transactions reported in the financial statements that are unusual or material because of their nature, size or incidence;

  - **Principal risks facing the businesses**: Issuers should discuss the operational and financial factors and risks in the environment which are specific to the reporting entity, such as risks of non-compliance with relevant laws and legislation, foreign exchange exposure, concentration of customers and cyber security, and explain how these principal risks are being managed and mitigated; and

  - **Using key performance indicators (“KPIs”)**: Issuers should follow good practices when presenting KPIs and non-Hong Kong Financial Reporting Standard financial measures and ensure that the information provided supplements Hong Kong Financial Reporting Standard (“HKFRS”) information rather than obscures it. Such non-HKFRS financial measures should be unbiased, presented with no greater prominence than HKFRS financial information, clearly defined, reconciled to the relevant amounts in the financial statements and presented consistently over time;
• **Rigorous assessment on impairment of assets** – Issuers are reminded that under Hong Kong Accounting Standard ("HKAS") 36 “Impairment of Assets”, one of the indications of impairment is when the carrying amount of the entity's net assets is more than its market capitalization. Under such circumstance, they should ascertain whether further impairment testing is considered necessary. In addition, it is the responsibility of directors and senior management to perform proper analysis and exercise judgement to assess the reasonableness of key assumptions applied in impairment testing, and they should not rely solely on professional valuers or other experts (see paragraphs 78 to 88);

• **Disclosure of judgements and assumptions in determining control or significant influence** – Issuers should clearly disclose significant judgements and assumptions they have made in determining whether they have control of or significant influence over another entity (see paragraphs 103 to 109);

• **Impact of applying key HKFRSs in issue but not yet effective** – Issuers should note that implementation of key HKFRSs (e.g. HKFRS 9 “Financial Instruments”, HKFRS 15 “Revenue from Contracts with Customers”, HKFRS 16 “Leases”) is not just an accounting exercise, but is expected to have a significant impact on some issuers, particularly on their information systems, internal controls and business contracting processes. They should early consult their professional advisers and perform a detailed review of these key HKFRSs as soon as practicable. They are also expected to progressively provide more entity-specific qualitative and quantitative information in their interim and annual financial statements about the application of these key HKFRSs (see paragraphs 113 to 126);

• **Segment reporting** – HKFRS 8 “Operating Segments” requires issuers to disclose segment information “through the eyes of management”. Issuers are expected to ensure that the elements presented in the segment information in the financial statements and those included in the MD&A are consistent in terms of segments presented and measures disclosed (see paragraphs 151 to 159); and

• **New auditors’ reporting** – Issuers are reminded that any key audit matters (“KAMs”) disclosures made by the auditors in the audit report should be normally on the basis that those matters are already disclosed by the issuers. Therefore, they should pay greater attention to the relevant disclosures in other sections of the annual reports to which reference is made in the audit report. In addition, issuers, in particular their audit committee, should have in-depth conversations with their auditors regarding KAMs, going concern issues and other significant events or transactions that occurred during the reporting period. They should also agree with the auditors on a timetable and ensure that the other information included in the issuer’s annual report is complete and provided to the auditors prior to the date of the audit report (see paragraphs 160 to 180).

For a financial report to be an effective communication tool, the overarching principle is that the “information provided should be relevant, material and entity-specific”; and issuers should consider removing irrelevant and immaterial disclosures.

We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report and stay alert to changes in the Listing Rules, accounting and auditing standards, and other relevant laws and regulations; and capitalize on opportunities to provide better disclosure. Directors should ensure that their finance department has the necessary resources and training to perform its role in financial reporting.
I. INTRODUCTION

1. As part of the Exchange’s regulatory function, the Listing Department operates a FSRP for compliance with the disclosure requirements of the Listing Rules, accounting standards† and relevant disclosure requirements of the CO.

2. We adopt a risk-based approach in selecting issuers for the FSRP. The selection criteria are set out in the table below:

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impact</td>
<td>Cases where an instance of major non-compliance by an issuer might adversely affect the reputation of the Hong Kong equity market as a whole.</td>
</tr>
</tbody>
</table>
| Probability    | Cases where there is a possible higher risk of misstatement or misapplication of accounting standards due to the existence of certain features, including where an issuer:  
  • experienced significant changes in its net assets;  
  • was newly listed;  
  • was the subject of complaints concerning compliance with the Listing Rules;  
  • issued financial statements with a qualified or modified audit report; and/or  
  • engaged a smaller accounting firm as its auditors. |
| Random         | Cases are selected at random so that any issuer may be selected for review. |

3. We reviewed 100 reports released by issuers between February 2016 and April 2017 and sent 83 letters (2015: 63) to issuers that contained more than 260 enquiries or observations (2015: 180). Of all the cases reviewed during the period, 99 cases were subsequently closed after considering the responses received to our letters. One case remains outstanding, as we are awaiting further clarification and information from the relevant issuer.

4. We publish a report of key findings and recommendations from the FSRP annually. The objective is to increase issuers’ awareness of the possible pitfalls in the preparation of periodic financial reports so that they may learn from the experience of others and improve the quality of their future reports.

5. This is our eighth published report. It highlights our key findings and recommendations relating to disclosures under the Listing Rules (Section II of this report) and accounting standards (Section III of this report), but does not include all the areas in which we raised comments or asked questions.

† Applicable accounting standards include:
  • HKFRSs issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”);
  • International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board (the “IASB”); and
  • China Accounting Standards for Business Enterprises (“CASBE”) issued by the Ministry of Finance of the People’s Republic of China, for those issuers incorporated in the Mainland (“PRC issuers”) that have elected to adopt it.
6. For each year’s review, we include specific accounting and industry themes (and, where appropriate, topical issues). For this year, we selected:

- as our accounting theme, “Disclosure of possible impact of applying a new or amended HKFRS in issue but not yet effective” (Section IV of this report);
- as our industry review theme, “Issuers whose major or principal activities include retail and consumer goods businesses” (Section V of this report); and
- as our special review theme, “New auditors’ reporting” (Section VI of this report).

7. The themes in our past reports are as follows:

<table>
<thead>
<tr>
<th>FSRP Year</th>
<th>Accounting Theme</th>
<th>Industry Review Theme</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>Accounting for consolidation, associates and joint arrangements, and disclosure of interests in other entities (HKFRSs 10, 11 and 12)</td>
<td>Hotels, gaming and leisure companies</td>
</tr>
<tr>
<td>2014</td>
<td>Fair value measurement (HKFRS 13)</td>
<td>Automotive companies</td>
</tr>
<tr>
<td>2013</td>
<td>Impairment of assets (HKAS 36)</td>
<td>Power and utilities companies</td>
</tr>
<tr>
<td>2012</td>
<td>Goodwill and intangible assets (HKAS 38)</td>
<td>Telecommunications and internet companies</td>
</tr>
<tr>
<td>2011</td>
<td>Segment reporting (HKFRS 8)</td>
<td>Property companies</td>
</tr>
<tr>
<td>2010</td>
<td>Financial instruments (HKAS 39 and HKFRS 7)</td>
<td>Mining activities</td>
</tr>
<tr>
<td>2009</td>
<td>Business combinations (HKFRS 3)</td>
<td>Toll road infrastructure facilities</td>
</tr>
</tbody>
</table>

8. Key findings and recommendations raised in our past reports may also be relevant and useful for reference. They can be accessed at: [http://www.hkex.com.hk/eng/rulesreg/listrules/guidref/finrept.htm](http://www.hkex.com.hk/eng/rulesreg/listrules/guidref/finrept.htm).


10. We take this opportunity to thank issuers for their cooperation and assistance in the review process.

11. Unless otherwise specified, the Rule references referred to in this report apply to both Main Board (“MB”) Rules and Growth Enterprise Market (“GEM”) Rules. While the discussion in this report will focus on the MB Rules, the discussion applies equally to the GEM Rules.
II. FINDINGS REGARDING THE LISTING RULES

12. Appendix 16 “Disclosure of Financial Information” to the MB Rules (“Appendix 16”) specifies a number of matters that issuers are required to disclose in their financial reports in addition to the disclosures required under accounting standards. Following the Revision of Appendix 16 in 2015, paragraph 28 of Appendix 16 has been revised to require an issuer (whether or not it is incorporated in Hong Kong) to provide certain disclosures under the CO. This principle maintains a level playing field for all issuers.

13. In this year’s review, from the samples selected, we noted that there was an increase in the number of omitted or incomplete disclosures required by Appendix 16. This section sets out below the most common omitted or incomplete disclosures which issuers should be alerted to:

- the management commentary;
- the company-level statement of financial position;
- auditors’ remuneration;
- directors’ permitted indemnity provisions;
- ageing analysis of accounts receivable and accounts payable;
- directors’ emoluments;
- financial statements with modified opinions issued by auditors; and
- financial reports using CASBE.

The management commentary

14. Paragraph 32 of Appendix 16 requires an issuer to include in its annual report a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position. The MD&A by an issuer should emphasize trends and identify significant events or transactions during the financial year under review. In addition, paragraph 32(1) to 32(12) of Appendix 16 sets out the minimum areas that should be covered in the MD&A.

Moreover, following the Revision of Appendix 16, paragraph 28(2)(d) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to include a Business Review in accordance with Schedule 5 of the CO (“Schedule 5”) in its directors’ report.

---

2 Issuers are reminded of the Rule amendments with reference to the new CO (“Revision of Appendix 16”). Those relating to the disclosure of financial information in Appendix 16 apply to accounting periods ended on or after 31 December 2015. The main changes include: (i) aligning the requirements for disclosure of financial information in Appendix 16 with reference to the disclosure provisions in the CO; and (ii) streamlining the disclosure requirements and removing duplications with HKFRS. For further details, see the consultation conclusions on “Review of Listing Rules on Disclosure of Financial Information with Reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments” published by the Exchange in February 2015, available at: http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201408cc.pdf.
Our findings

Minimum disclosure requirements under paragraph 32(1) to 32(12) of Appendix 16

16. During our review, we noted that some issuers overlooked the following minimum required disclosures:

- the group’s liquidity and financial resources;
- the currencies in which borrowings are made and in which cash and cash equivalents are held;
- significant investments held, their performance during the financial year and their future prospects;
- comments on segmental information, such as developments within the segment and changes in revenue and margins; and
- details of the number of employees and remuneration policies.

Business review under Schedule 5 of the CO

17. Based on our review, we noted that in a number of cases, there is room for improvement in this area. We observed that:

- the Business Review section was very general or brief, raising doubts as to whether the content requirements of Schedule 5 had been met;
- disclosures required under Schedule 5 appeared to be subsumed within the MD&A, but the directors’ report did not include a cross-reference to the MD&A;
- descriptions of principal risks and uncertainties facing the issuer tended to be generic rather than entity-specific; and
- non-HKFRS KPIs were sometimes used to discuss and analyze the performance, financial position and cash flows (e.g. “Earnings before interests, income tax, depreciation and amortization”, return on equity and free cash flow), but reconciliations between non-HKFRS KPIs and HKFRS financial information were not disclosed.

Significant balances and transactions

18. As with last year, we noted that there were insufficient disclosures in relation to the nature and impact of significant events or material balances and transactions. We have identified cases where issuers:

- did not provide additional analysis and explanation but merely repeated information available in the financial statements in narrative form; and
• did not adequately discuss key items in the statements of financial position. For example: (i) they failed to explain the reasons why deposits paid for the acquisition of major assets or businesses remained on the statements of financial position for over a year. In one case, an issuer merely stated that “it will continuously discuss the possibility to further proceed with the proposed investment”, without mentioning whether the deposit is recoverable in the event that there were further delays in the negotiation; and (ii) they failed to explain the reasons for the movements in allowance for doubtful debts and what actions have been taken to recover the debts.

Our recommendations

19. Issuers should ensure that the minimum disclosure requirements under paragraph 32(1) to 32(12) of Appendix 16 are included in their annual reports.

20. When preparing the Business Review, issuers should have particular regard to the following points:

• Cross-referencing – There are similarities between the required disclosures of the MD&A and the prescribed contents of a Business Review. Schedule 5 states that a directors’ report for the year must “contain” a Business Review. This requirement can be met by including a cross-reference in the directors’ report to the MD&A, provided that the cross-reference is clear and by stating that the cross-referenced part of the annual report “forms part of the directors’ report”. Issuers should take care to ensure that their disclosures in the MD&A are sufficient to meet the content requirements of Schedule 5.

• Principal risks and uncertainties – The risks and uncertainties facing issuers will vary according to the nature of the business. Schedule 5 uses the term “principal”, which means only the risks and uncertainties that issuers are genuinely concerned about should be included. The descriptions should be sufficiently specific that investors can understand why they are important to the issuer, such as risks of non-compliance with relevant laws and legislation, foreign exchange exposure, concentration of customers and cyber security. The Business Review should also explain how these principal risks are being managed and mitigated.

---


5 In section B of Appendix 1 to our guidance letter HKEX-GL86-16 (published in February 2016 and updated in May and September 2016) (the “Letter”), when preparing listing documents, we recommend that the “Risk Factors” section should include all the material risks associated with investing in an applicant and its securities, and explain why these risks are material from investors’ perspective. This guidance can also be applied to the Business Review in issuers’ annual reports. The Letter is available at: http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/g/l/gl8616.pdf.
Financial Statements Review Programme
Report 2016

• **KPIs** – When presenting KPIs and non-HKFRS financial measures, they should be useful to investors and presented in a transparent and unbiased way. Issuers are encouraged to read the IOSCO’s “Statement on Non-GAAP Financial Measures”\(^6\), which has identified the following elements as a frame of reference for the disclosure of non-GAAP financial measures. These elements, if present, would contribute to the reliability and comparability over time of non-GAAP financial measures and reduce the potential for misleading disclosures:

  - define the non-GAAP financial measures clearly and give meaningful labels;
  - use non-GAAP financial measures with an unbiased purpose, i.e. non-GAAP financial measures should not be used to avoid presenting adverse information to the market;
  - avoid displaying non-GAAP financial measures with more prominence than the GAAP measures;
  - reconcile the non-GAAP financial measures to the relevant comparable GAAP measures in the financial statements and ensure any adjustments are clearly explained; and
  - present comparatives, disclosing non-GAAP financial measures consistently over time.

21. The management commentary as a whole should provide the information necessary for investors to assess the issuer’s past performance, financial position and future prospects. When preparing the management commentary, issuers should:

  • provide an adequate explanation of performance or properly identifies components of growth or profit (e.g. elaborate on the underlying causes of the changes instead of only reciting the figures);
  • assess materiality in the context of disclosure and comment on items and transactions reported in the financial statements that are unusual or material because of their nature, size or incidence\(^7\) (e.g. discuss the actions that have been taken to recover the deposits when the potential investment was delayed or terminated); and
  • discuss not only the year’s performance but also their financial position and cash flows, in particular, where there is a mismatch between revenue and the underlying cash flows as a result of an accounting treatment (e.g. for those projects accounted for under Hong Kong (IFRIC) Interpretation 12 “Service Concession Arrangements”).

---


\(^7\) Issuers should take note that paragraph 112(c) of HKAS 1 (Revised) “Presentation of Financial Statements” further requires entities to provide information which is relevant to an understanding of the financial statements by way of inclusion of necessary additional notes to the financial statements.
22. Effective presentation of information\(^8\) is an essential element for producing a high quality management commentary. We recommend that issuers should challenge past practices of how key information is structured and conveyed. The management commentary should:

- be fair, balanced and understandable, such that both good and bad news are presented and reported clearly and evenly, without glossing over or omitting any material facts\(^9\);
- be focused and avoid obscuring material disclosures with unnecessary immaterial information\(^10\); and
- be consistent with information disclosed elsewhere in the reports, particularly the information in the financial statements.

**The company-level statement of financial position**

23. Paragraph 28(1)(b)(ii) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to comply with Schedule 4 Part 1(2) of the CO, which requires the holding company’s (a) statement of financial position; and (b) reserve movements, to be contained in the notes to the consolidated financial statements for the financial year when an issuer prepares annual consolidated financial statements.

**Our findings**

24. Our review indicates that issuers have generally complied with the CO requirements in paragraph 23 above. Most issuers put the company-level statement of financial position and reserve movements in a single note and placed it at the end of the note section.

25. We also observed that some issuers provided in the consolidated financial statements the accounting policies in respect of the methods used to account for the investments in subsidiaries, associates and joint ventures and how they are tested for impairment at the company-level statement.

---

\(^8\) The IASB’s “Disclosure Initiative” is a broad-based initiative exploring how to make disclosures more effective in financial statements and it forms a key part of the IASB’s work under the theme “Better Communication in Financial Reporting”. The current projects within the Disclosure Initiative include: (i) Principles of Disclosure; (ii) Materiality Practice Statement; (iii) Definition of Material; and (iv) Standards-level Review of Disclosures. In March 2017, the IASB published a discussion paper “Disclosure Initiative – Principles of Disclosure” seeking public feedback on disclosure issues (the IASB’s and HKICPA’s consultations are open for comments until 2 October 2017 and 4 August 2017 respectively). Further information relating to the IASB’s work on Better Communication in Financial Reporting is available on its website at: [http://www.ifrs.org/projects/better-communication/](http://www.ifrs.org/projects/better-communication/).

\(^9\) Issuers should take note of the requirement under MB Rule 2.13(2) such that any corporate communication (including financial reports) should be accurate, complete and not misleading.

\(^10\) In relation to financial statements, the IASB issued “Disclosure Initiative (Amendments to IAS 1)” in December 2014, which became effective for annual periods beginning on or after 1 January 2016. The amendments include clarifications of the materiality requirements in IAS/HKAS 1 (Revised) (new paragraph 30A and amended paragraph 31 of IAS/HKAS 1 (Revised)) to emphasize that entities should not aggregate or disaggregate information in a manner that obscures useful information.
Our recommendations

26. Paragraph 113 of HKAS 1 (Revised) states that notes should be presented in a systematic manner. The general principle is such that if a note is considered to be important, it should be disclosed more prominently. Issuers should take note that Schedule 4 of the CO is not explicit as to where in the notes the company-level statement of financial position should be placed. If the directors wish to draw attention to the company-level statement of financial position of the holding company and yet comply with a literal interpretation of Schedule 4 of the CO, they would be advised to include the statement as note 1 or otherwise in a prominent position in the notes to the consolidated financial statements.

27. In our view, the accounting policies for the investments in subsidiaries, associates and joint ventures assist investors in understanding how these investments are accounted for at the company-level statement. Issuers are recommended to disclose those policies to the extent that they are relevant to the company-level statement of financial position.

Auditors’ remuneration

28. Paragraph 28(1)(b)(iv) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to comply with Schedule 4 Part 2(1) of the CO, which requires disclosure of the amount of the remuneration of the auditors under a separate heading. As defined in the CO, “remuneration” includes any sum paid by the company in respect of the auditor’s expenses. This disclosure is required to be made in the financial statements.

29. Section M of Appendix 14 to the MB Rules requires an issuer to include an analysis of remuneration in respect of audit and non-audit services provided by the auditors to the issuer in its corporate governance report. The analysis must include, in respect of each significant non-audit service assignment, details of the nature of the services and the fees paid.

30. The purpose of these disclosures is to give some insight into the degree of independence of the auditors.

Our findings

31. We found a few cases where issuers incorporated outside Hong Kong did not disclose the auditors’ remuneration in their financial statements as required by Schedule 4 Part 2(1) of the CO.

32. Most issuers provided the analysis of audit and non-audit fees in the corporate governance reports. However, we identified some instances where the fees for non-audit services were relatively high compared to the audit fee but the nature of non-audit services was not disclosed in the corporate governance reports.

---

11 The “Disclosure Initiative (Amendments to IAS 1)” (see footnote 10 above) clarified that an entity should consider the understandability and comparability of its financial statements when deciding on note order (amended paragraphs 113 and 114 of IAS/HKAS 1 (Revised)).

33. We also observed that in some cases the amount of fees relating to audit services stated in corporate governance reports was not reconciled to the related amount disclosed in the financial statements.

**Our recommendations**

34. Issuers are reminded that the analysis as required by Section M of Appendix 14 to the MB Rules is different from the amount as required by the CO. Schedule 4 Part 2(1) of the CO requires the disclosure of the sum of audit fee and the related expenses associated with the audit of the financial statements but excluding amounts for non-audit services. Issuers should ensure that both are disclosed in their annual reports.

35. Issuers should also provide an explanation or reconciliation if the details of auditors’ remuneration in the corporate governance report are different from the information on audit fee disclosed in the financial statements.

36. Issuers should take note that in respect of each significant non-audit service, (for example, fee for preparing an accountants' report for an investment circular) details of the nature of the service and the fee paid should be disclosed separately in the corporate governance reports. For any amount paid/payable not recognized in profit or loss, a separate disclosure is expected.

37. The Code Provision C.3.3 of Appendix 14 to the MB Rules emphasizes the need for the audit committee to play a key role in overseeing the audit process and in ensuring that the independence of the auditors is maintained. We encourage issuers to enhance their disclosures in annual reports where the auditors are engaged for performing significant non-audit services. For example, when describing the work performed by the audit committee in discharging its responsibilities, issuers should include an explanation of what significant non-audit work was undertaken by the auditors and why such services provided would not impair the auditors’ independence. Moreover, issuers should have a policy in relation to non-audit services, and should disclose the policy in the corporate governance reports.

**Directors’ permitted indemnity provisions**

38. Paragraph 28(2)(b) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to comply with section 470 of the CO, which requires disclosure in the directors’ report if a permitted indemnity provision is, or was, in force.

**Our findings**

39. During our review, we found a few cases where issuers did not disclose their permitted indemnity provisions which were in force during the year. In responses to our enquiries, some of these issuers confirmed that they had put in place appropriate insurances cover in respect of their directors’ liabilities but overlooked the disclosure requirement under section 470 of the CO.

**Our recommendations**

40. Issuers should ensure that they comply with the requirement under section 470 of the CO to provide the necessary disclosure in the directors’ reports.
**Ageing analysis of accounts receivable and accounts payable**

41. Paragraph 4(2) of Appendix 16 requires an issuer to disclose in its financial statements the ageing analysis of accounts receivable and accounts payable. Note 4.2 to paragraph 4 of Appendix 16 (newly added in the Revision of Appendix 16) further requires disclosure of the basis on which the ageing analysis is presented and states that the ageing analysis should normally be presented on the basis of the date of the relevant invoice or demand note and categorized into time-bands based on analysis used by an issuer’s management to monitor the issuer’s financial position.

42. Certain disclosures as required by HKFRS 7 “Financial Instruments: Disclosures” are relevant to the evaluation of accounts receivables, including the policies for managing the credit risk (paragraph 33(b) of HKFRS 7) and analysis of trade debtors that was past due but not impaired (paragraph 37(a) of HKFRS 7).

**Our findings**

43. During our review, we noted that some issuers omitted to disclose the basis upon which the ageing analyses were presented (as required under Note 4.2 to paragraph 4 of Appendix 16).

44. We also noted other cases where an ageing analysis of trade debtors that were past due but not impaired (as required under paragraph 37(a) of HKFRS 7) was not provided in the financial statements.

45. We also identified a case where the issuer experienced substantial increase in the accounts receivable balance classified as outstanding for more than one year (about four times as compared with the previous year’s balance), and disclosed that balance was past due but not impaired. However, the issuer did not adequately explain the fluctuations and simply provided a generic description that “… based on past experience, management believes that no impairment allowance is necessary …” The generic description does not give meaningful information to investors. Upon our enquiry, the issuer explained that the long-outstanding debt was due from a specific customer and that balance had full insurance coverage.

**Our recommendations**

46. Issuers are reminded of the requirement of Note 4.2 to paragraph 4 of Appendix 16 to disclose in their financial statements the basis on which the ageing analysis is presented.

47. As in previous reports, issuers are reminded that the ageing analysis of accounts receivables as required by paragraph 4(2) of Appendix 16 and an analysis of the age of trade receivables that are past due but not impaired as required under paragraph 37(a) of HKFRS 7 are separate and distinct. Paragraph 37(a) of HKFRS 7 requires an analysis of the age of trade receivables that are past due but not impaired, which would not be based on the revenue recognition date but on the payment due date. Issuers should ensure that both disclosures are included in their financial statements.

---

13 The term “past due” is defined in Appendix A to HKFRS 7 as: “A financial asset is past due when a counterparty has failed to make a payment when contractually due.”
In order to communicate with investors on how management manages credit risk\(^{14}\), issuers should provide entity-specific information and avoid generic boilerplate disclosures. We also encourage issuers to provide additional information in the MD&A or in the note to financial statements that enable investors to understand significant fluctuations in trade receivables, e.g. if extended credit policy is given to specific customers and subsequent settlement of those trade receivables.

**Directors’ emoluments**

Paragraph 24 of Appendix 16 requires an issuer to disclose in its financial statements details of director’s and past director’s emoluments, by name as follows:

- directors’ fees for the financial year;
- directors’ basic salaries, housing allowances, other allowances and benefits in kind;
- contributions to pension schemes for directors or past directors for the financial year;
- discretionary bonuses paid or receivable by directors;
- the amounts paid during the financial year or receivable by directors as an inducement to join or upon joining the issuer; and
- contractual and other payments for the loss of office.

**Our findings**

As with last year, we noted that disclosures regarding directors’ emoluments in the financial statements were sometimes incomplete. For example, in some cases, issuers:

- incorrectly aggregated “discretionary” bonuses paid/receivable by directors with the basic salaries and other allowances and benefits in kind;
- omitted a disclosure of the contributions to pension schemes for directors or past directors for the financial year; and
- did not provide an analysis of the remuneration of supervisors (in the case of a PRC issuer) by name or a chief executive (who is not a director).

---

\(^{14}\) HKFRS 7 requires both qualitative and quantitative disclosures about exposure to credit risk (paragraphs 33 to 38 of HKFRS 7). HKFRS 7 also includes mandatory application guidance (paragraphs B6 to B10 of HKFRS 7) and is accompanied by non-mandatory implementation guidance (paragraphs IG15 to IG29 of HKFRS 7) to assist entities in applying and providing the disclosures required by HKFRS 7.
Financial Statements Review Programme
Report 2016

Our recommendations

51. Issuers should ensure that details of the components of directors’ emoluments are fully disclosed \(^{15}\), including the contributions to pension schemes. In relation to bonus payments, issuers should meet the requirements \(^{16}\) to:

- disclose under the category of “directors’ basic salaries” bonus payments to which the directors are contractually entitled and are fixed in amount; and
- disclose under the category of “bonuses paid or receivable by directors” bonus payments to which the directors are contractually entitled but are not fixed in amount, together with the basis upon which they are determined.

52. Moreover, issuers should provide an analysis of the remuneration of its chief executive if he/she is not a director \(^{17}\). In the case of a PRC issuer, “directors” and “past directors” include supervisors and past supervisors and the disclosures should include the remuneration of supervisors by name \(^{18}\).

Financial statements with modified opinions issued by auditors

53. Paragraph 2 of Appendix 16 requires that “Each set of financial statements presented in an annual report … 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 cashflows.”

54. Paragraph 3 of Appendix 16 further states that “If the financial statements do not give a true and fair view of the state of affairs of the listed issuer and of the results of its operations and its cashflows, more detailed and/or additional information must be provided.”

Our findings

55. In this year’s review, three sets of financial statements had audit reports with modified opinions \(^{19}\). The audit scope limitations were due to insufficient audit evidence in respect of the valuation of a business, adequacy of provisions and evaluation of the substance for certain sales transactions. Some of these matters indicated that there were deficiencies in their internal controls over financial reporting. We noted that the issuers generally did not provide additional information about the modifications or how they intended to address issues giving rise to the modifications.

\(^{15}\) Paragraph 28(1)(a) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to disclose directors’ remuneration in financial statements as required by section 383 of the CO. HKICPA is now revising the Accounting Bulletin 3 (“AB 3”) “Guidance on Disclosure of Directors’ Remuneration”, which will provide guidance in this area. The HKICPA’s current AB 3 issued in January 2000 is available at: [http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/circular/](http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/circular/).

\(^{16}\) Set out in notes 24.2 and 24.3 to paragraph 24 of Appendix 16.

\(^{17}\) Set out in note 24.5 to paragraph 24 of Appendix 16.

\(^{18}\) Set out in note 24.4 to paragraph 24 of Appendix 16.

\(^{19}\) The term “Modified opinion” is defined in paragraph 5(b) of Hong Kong Standard on Auditing (“HKSA”) 705 (Revised) “Modifications to the Opinion in the Independent Auditor’s Report” as “A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements.”
In one of these cases, the issuer delayed the publication of results announcement and annual report for the financial year over two months because additional time was required by the issuer to provide information for its auditors to complete the audit procedures.

In another case with a modified opinion, the issuer subsequently made announcements that it had issues of accounting irregularities in its previous years’ financial statements, it was unable to release its latest financial results and had other significant weaknesses in internal controls. This has resulted in the trading suspension of the issuer’s shares.

Our recommendations

Directors of issuers are primarily responsible for the preparation of financial statements that give a true and fair view and for establishing effective risk management and internal control systems so that the financial statements prepared are free from material misstatement, whether due to fraud or error. Issuers should note that the Code Provision C of Appendix 14 to the MB Rules on “Accountability and Audit” has been amended to, inter alia, emphasize that internal controls are an integral part of risk management and to enhance accountability of the board, board committees and management.

Issuers are reminded to enhance their disclosures in annual reports regarding auditors’ modified opinion. For example, in respect of scope limitation, issuers should disclose:

- reasons leading to the modified audit opinion;
- the relevant information or evidence requested by the auditors;
- reasons why the issuer cannot provide the requested information or evidence to the auditors;
- the audit committee’s view, including their review on major judgmental areas and any disagreement with management; and
- the actions that have been taken by the directors to address the modified opinion.

We strongly remind issuers whose financial statements have audit reports with modified opinions to take proactive steps to resolve the issues identified with their auditors as soon as practicable.

---

Moreover, for issuers that have entered into complex or material transactions during the year, they should have in-depth conversations with their auditors at an early stage and use their best endeavours to provide sufficient and relevant information to auditors. Doing so may help to minimize the risk of last minute surprises and avoid delays in releasing their annual results.  

**Financial reports using CASBE**

48 PRC issuers elected to prepare their financial statements for the year ended 31 December 2015 under CASBE (2014: 45). The Exchange, the FRC and the HKICPA have agreed to collaborate in reviewing the CASBE financial statements. Financial statements prepared under CASBE, like other published financial reports, are subject to selection and review under our FSRP.

**Our findings**

In this year's review, the Exchange selected 13 sets of financial reports using CASBE. Except for the one case mentioned in paragraph 57 above, for all the other cases reviewed, although some disclosures under the Listing Rules and/or CASBE were omitted, they were not material to the financial statements as a whole. The issuers confirmed that the required disclosures would be provided in their future annual reports.

**Our recommendations**

We would like to remind issuers using CASBE to ensure the disclosure requirements of both the Listing Rules and CASBE are met.

Pursuant to the Joint Declarations between the HKICPA, the China Accounting Standards Committee and the Chinese Auditing Standards Board on 6 December 2007, there is a mechanism to ensure effective ongoing convergence of the accounting and auditing standards between the Mainland and Hong Kong. We encourage PRC issuers that elect to adopt CASBE to stay alert of the progress on convergence and work closely with their auditors.

---

21 It is important to note that MB Rule 13.49 requires an issuer to publish its preliminary annual results announcement as soon as possible, which should be published not later than three months after the financial year end, and should have been agreed with the auditors before it is published. Furthermore, paragraph 45(7) of Appendix 16 requires an issuer to provide details of the modification in the results announcement and select the headline category “Qualified and/or Modified Audit Report” when its auditors issued the modified opinion. The FAQ No. 002-2017 provides further guidance which is available at: http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/f/a/FAQs_mb_appx24.pdf.

III. FINDINGS REGARDING ACCOUNTING STANDARDS

66. This section sets out the findings in relation to accounting standards arising from this year’s review. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section correspond to those in IFRSs.

HKAS 1 (Revised) “Presentation of Financial Statements”

Accounting policies, judgements and estimates

67. HKAS 1 (Revised) requires an entity to disclose significant accounting policies and measurement basis used (paragraph 117 of HKAS 1 (Revised)), judgements made in applying the accounting policies (paragraph 122 of HKAS 1 (Revised)) and key assumptions about the future and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year (paragraph 125 of HKAS 1 (Revised)).

Our findings

68. From this year’s review, we continued to note that in some issuers’ financial statements:

- accounting policies tended to be generic, with repetition of words and language extracted from accounting standards and illustrative financial statements; and

- critical accounting judgements were simply repeated or referred to the corresponding accounting policy without elaboration of the issuer’s specific facts and circumstances.

Our recommendations

69. Disclosure of accounting policies is important for investors to understand the recognition and measurement of the amounts presented in the financial statements. Therefore, issuers are reminded to include accounting policies for all material transactions conducted in both current and comparative reporting period. The accounting policies disclosed should be clear, understandable and sufficiently entity-specific, as well as comply with the relevant accounting standards, for example, whether the accounting policy is selected from alternatives allowed in HKFRSs. In addition, industry-specific accounting policies should be explained in plain language without the use of industry jargon.

70. Issuers should distinguish the disclosure of (i) judgements made in applying the accounting policies required by paragraph 122 of HKAS 1 (Revised); and (ii) assumptions and sources of estimation uncertainty required by paragraph 125 of HKAS 1 (Revised). Under (i) above, issuers should identify and disclose the most complex and subjective judgements that management has made in the process of applying the accounting policies and that have the most significant effect on the amounts recognized in the financial statements. This enables investors to understand the basis in applying accounting standards, where management has to exercise judgements in situations where a different judgement might lead to a materially different accounting treatment (for example, whether an acquisition is a business combination or an acquisition of assets). Under (ii) above, issuers should
identify and disclose the assumptions made about the future and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next year. With this approach, investors would be aware of where estimates have been made for which there is a significant potential for the actual outcome to be materially different from the estimate (for example, details of an impairment testing).

71. Judgements and estimates disclosed should be clear and entity-specific, and should reflect the facts so that investors are able to assess the quality of judgements made and the degree of estimation uncertainty around issuers’ financial position. Issuers should make sure that their disclosures are specific and do not simply repeat their accounting policies, or use extracts of the text from accounting standards or illustrative financial statements.

**HKAS 33 “Earnings per Share”**

72. HKAS 33 prescribes principles for the determination and presentation of earnings per share (“EPS”), so as to facilitate performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.

**Our findings**

73. We noted that nearly all issuers under review properly disclosed the basic and diluted EPS on the face of financial statements and their calculation. Through other related work at the Exchange, we noted that in one case, it appeared that the calculation of the weighted average number of ordinary shares outstanding was not correct as a result of a share consolidation and a rights issue completed during the reporting period. This case was referred to the FRC for consideration.

**Our recommendations**

74. The weighted average number of ordinary shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources. Examples include a capitalization or bonus issue, a bonus element in any other issue (such as an open offer to shareholders at a deep discount), a share split, consolidation of shares (paragraphs 26 and 27 of HKAS 33).

75. In a capitalization or bonus issue or a share split, ordinary shares are issued to existing shareholders for no additional consideration, which increases the number of ordinary shares outstanding without an increase in resources. As a result, number of ordinary shares outstanding before the event should be adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented (paragraph 28 of HKAS 33).

76. A share consolidation reduces the number of ordinary shares outstanding without a corresponding reduction in resources and thus the weighted average number of ordinary shares should be adjusted as if the share consolidation had taken place at the beginning of the earliest period for which EPS is presented. No such retrospective adjustment should be made when there is a share consolidation that
is combined with a special dividend if together they have the overall effect of being the same as a share repurchase at fair value (paragraph 29 of HKAS 33).

77. In a rights issue, shares are issued to existing shareholders for less than the fair value of the shares, which gives rise to a bonus element, and hence the weighted average number of ordinary shares outstanding during the period and for all periods presented should be adjusted (paragraph 27(b) of HKAS 33). Issuers are encouraged to read the application guidance set out in paragraph A2 of HKAS 33.

**HKAS 36 “Impairment of Assets”**

78. Non-financial assets are often significant assets of a company and impairment of non-financial assets remains an ongoing key area of focus for investors.

79. HKAS 36 sets out the requirements to account for asset impairment and extensive disclosures are required to be made in relation to impairment testing performed and impairment recognized or reversed during the reporting period. The impairment test involves comparing the carrying amount of an asset with its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use.

<table>
<thead>
<tr>
<th>Compare / Assess</th>
<th>Carrying value</th>
<th>and</th>
<th>Recoverable amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>equal to the higher of</td>
<td>Fair value less costs of disposal</td>
<td>and</td>
<td>Value in use</td>
</tr>
</tbody>
</table>

**Our findings**

80. We found in this year’s review that most issuers provided the disclosures required by HKAS 36. However, we also noted some omissions and deficiencies in issuers’ financial statements. For example:

- the explanations of the events and circumstances that led to the recognition and reversal of impairment losses tended to be short and generic (paragraph 130(a) of HKAS 36). A few issuers did not provide the required disclosures when an impairment was recognized or reversed;

- some issuers did not disclose whether the recoverable amount of the impaired asset was the fair value less costs of disposal or value in use (paragraph 130(e) of HKAS 36);

- key assumptions on which management based its cash flow projections for the period covered by the most recent budgets/forecasts were not clearly described and the description of management’s approach to determining the values assigned to each key assumption was brief or omitted (paragraphs 134(d)(i) and 134(d)(ii) of HKAS 36); and

- a few issuers omitted the disclosure of growth rate used to extrapolate cash flow projections beyond the period covered by the most recent
budgets/forecasts and the discount rate applied to cash flow projections (paragraphs 134(d)(iv) and 134(d)(v) of HKAS 36). One issuer did not disclose the growth rate and discount rate used to determine the recoverable amount of the cash-generating unit (in which goodwill was allocated) even though goodwill was identified as one of the KAMs by the auditors of that issuer.

81. We also raised enquiries with some issuers regarding the reasons that management considered no impairment was needed on their key assets and the growth rates, discount rates and other assumptions (such as profit margin) used in the calculation of recoverable amounts, were reasonable and supportable (paragraphs 33 to 38 of HKAS 36), particularly in cases where the issuers were loss making or suffered deterioration in revenue or net profits, or the fact that some of their mining or exploration licenses or permits would be expiring, etc. We identified possible non-compliance in one case and have referred it to the FRC for consideration. Except for this case, based on the responses to our enquiries, it did not appear that any of these issuers breached the accounting standards other than the fact that disclosures could be better enhanced.

Our recommendations

82. Issuers should ascertain the need and adequacy of asset impairment testing and ensure assets are carried at no more than their recoverable amount in accordance with the requirements in HKAS 36. Issuers are reminded of the following:

- for goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use, issuers should perform impairment testing on an annual basis irrespective of whether any indication of impairment exists (paragraph 10 of HKAS 36).

- for other non-financial assets within the scope of HKAS 36, issuers should assess at the end of each reporting period whether there is any indication that these assets may be impaired and, if so, estimate their recoverable amount (paragraph 9 of HKAS 36). For this purpose, issuers should consider, at a minimum, the non-exhaustive list of indications of impairment set out in paragraph 12 of HKAS 36.

83. Issuers should note that one of the indications of impairment is when the carrying amount of the reporting entity’s net assets is more than its market capitalization (paragraph 12(d) of HKAS 36). Issuers are reminded to compare their net assets with their market capitalization in order to ascertain whether further impairment testing is considered necessary.

84. When an impairment loss is recognized or reversed, issuers should provide the disclosures required by paragraph 130 of HKAS 36. In particular, issuers are reminded to explain the events and circumstances that led to the recognition or reversal of the impairment loss (paragraph 130(a) of HKAS 36). The narrative information should be case-specific and closely related to the issuer’s operations and activities. Issuers should also disclose the recoverable amount of the impaired asset or the cash-generating unit and whether the recoverable amount is its fair value less costs of disposal or value in use (paragraph 130(e) of HKAS 36), together with the corresponding information required (paragraphs 130(f) and 130(g) of HKAS 36).
85. Besides the disclosures required when an impairment loss is recognized or reversed (see paragraph 84 above), issuers are reminded to provide the information for each cash-generating unit for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that cash-generating unit is significant in comparison with the entity’s total carrying amount of goodwill or intangible assets with indefinite useful lives. Issuers should disclose whether the cash-generating unit’s recoverable amount is determined based on value in use or fair value less costs of disposal (paragraph 134(c) of HKAS 36), key assumptions made when estimating the recoverable amount (paragraphs 134(d)(i) and 134(e)(i) of HKAS 36), how key assumptions are determined, including whether they reflect past performance or, if appropriate, are consistent with external sources of information (paragraphs 134(d)(ii) and 134(e)(ii) of HKAS 36), growth rate used to extrapolate cash flow projections (paragraphs 134(d)(iv) and 134(e)(iv) of HKAS 36) and the discount rate applied to cash flow projections (paragraphs 134(d)(v) and 134(e)(v) of HKAS 36). In addition, where there is a change in the basis of calculation of the recoverable amount, issuers should disclose the details of the change together with the reasons for the change.

86. Issuers should assess the reasonableness of the assumptions used in performing impairment testing of an asset (paragraphs 33 to 38 of HKAS 36) and ensure that the assumptions used are reasonable and supportable, and represent their best estimate of the economic circumstances that will prevail over the remaining life of the asset or the cash-generating unit. Assumptions should not be overly optimistic with regard to historical cash flows and results, particularly where issuers are loss making or suffer deterioration in revenue and net profit. The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts should be a steady or declining rate and should not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified (paragraph 33(c) of HKAS 36).

87. Where impairment testing is performed with involvement of professional valuers, management should perform proper analysis and assess the reasonableness of key assumptions applied and should not leave the responsibility solely to professional valuers or other experts. It is unreasonable for management to rely on valuation reports without exercising any independent judgement in assessing the reasonableness of key assumptions used23.

88. In addition, if a reasonably possible change in a key assumption would cause the cash-generating unit’s carrying amount to exceed its recoverable amount, issuers should provide the information required by paragraph 134(f) of HKAS 36 so that investors can understand what the magnitude of change in values of key assumptions is used in impairment testing that would cause the carrying amount of the cash-generating unit to exceed the recoverable amount (i.e., how imminent is a possible impairment loss).

---

89. Intangible assets are non-monetary assets which are without physical substance and identifiable (either being separable or arising from contractual or other legal rights). HKAS 38 outlines the requirements to recognize and measure intangible assets.

Our findings

90. From this year’s review, we noted that some issuers omitted the disclosure of the amortization methods used and the useful lives for intangible assets with finite useful lives. Certain issuers disclosed the amount of amortization of intangible assets but did not disclose the line item of the statement of comprehensive income in which any amortization of intangible assets is included.

91. A few issuers which had intangible assets with indefinite useful lives did not explain the reasons in determining that the intangible assets had indefinite useful lives.

92. We also noted that a few issuers mentioned that they had research and development activities in the MD&A but did not disclose the amount of research and development expenditure recognized as an expense during the period.

Our recommendations

93. Issuers should disclose for each class of intangible assets whether their useful lives are finite or indefinite (paragraph 118(a) of HKAS 38).

94. For intangible assets with finite useful lives, issuers should disclose the useful lives used, amortization methods used and the line item of the statement of comprehensive income in which the amortization of intangible assets is included (paragraphs 118(a), 118(b) and 118(d) of HKAS 38). Issuers are also reminded to disclose a description, the carrying amount and remaining amortization period of any individual intangible asset that is material to their financial statements (paragraph 122(b) of HKAS 38).

95. The amortization method used should reflect the pattern in which the intangible asset’s future economic benefits are expected to be consumed by the issuers and the straight-line method should be used if that pattern cannot be determined reliably (paragraph 97 of HKAS 38). Issuers should note that the amendment to HKAS 38 “Clarification of Acceptable Methods of Depreciation and Amortisation” had been effective for annual periods beginning on or after 1 January 2016. The amendment established a rebuttable presumption that an amortization method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate (paragraph 98A of HKAS 38). The presumption can be rebutted only in the following limited circumstances:

- when the intangible asset is expressed as a measure of revenue; or
- when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.
96. For intangible assets with indefinite useful lives, issuers should review each period to determine whether events and circumstances continue to support an indefinite useful life assessment (paragraph 109 of HKAS 38) and should disclose the reasons supporting that those intangible assets have indefinite useful lives (paragraph 122(a) of HKAS 38).

97. Issuers that carry out research and development activities should disclose the amount of research and development expenditure recognized as an expense during the period (paragraph 126 of HKAS 38).

HKFRS 3 (Revised) “Business Combinations”

98. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. HKFRS 3 (Revised) sets out the principles on the recognition and measurement of acquired assets and liabilities, the determination of goodwill and the necessary disclosures.

Our findings

99. From this year’s review, some issuers had completed acquisitions of businesses. However, a few of them did not provide any disclosure in relation to their acquisitions in accordance with HKFRS 3 (Revised) while a few of them omitted certain information as required by HKFRS 3 (Revised), such as a qualitative description of the factors that make up the goodwill recognized or the reasons why the business combination results in a gain on bargain purchase, amounts of revenue and profit or loss of the acquiree since the acquisition and as if the acquisition date had been as of the beginning of the reporting period, etc.

Our recommendations

100. Issuers should disclose sufficient information to enable investors to evaluate the nature and financial effect of business combinations that occurred during the current reporting period or after the reporting date but before the financial statements are authorized for issue (paragraph 59 of HKFRS 3 (Revised)).

101. Issuers are reminded to disclose the factors that make up the goodwill recognized and explain the reasons why the business combination results in a gain on bargain purchase (paragraphs B64(e) and B64(n) of HKFRS 3 (Revised)). To measure goodwill or gain on bargain purchase correctly, issuers have to identify all assets acquired and liabilities assumed in a business combination as of the acquisition date (paragraphs 10 to 14 of HKFRS 3 (Revised)). The process may result in recognizing some assets and liabilities that the acquiree had not previously recognized. For example, issuers might identify and recognize certain acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship (paragraph 13 of HKFRS 3 (Revised)).

102. In addition, issuers are reminded of the requirement to disclose the amounts of revenue and profit or loss of the acquiree since the acquisition date and the revenue and profit or loss of the acquiree for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period (paragraph B64(q) of HKFRS 3 (Revised)).
HKFRS 12 “Disclosure of Interests in Other Entities”

103. HKFRS 12 aims to provide investors with sufficient disclosures to assess the nature of, and risks and financial effects associated with, an entity’s interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

Our findings

104. From this year’s review, we noted that a few issuers disclosed that they held less than 50% equity interests in subsidiaries or less than 20% equity interests in associates but did not explain the facts and circumstances or significant judgements and assumptions made in determining control or significant influence existed.

105. In some cases reviewed, issuers disclosed that they had some non-wholly owned subsidiaries, and it appeared that some of these subsidiaries had material non-controlling interests. However, there was no disclosure of the summarized financial information about those subsidiaries.

Our recommendations

106. Issuers are reminded to disclose significant judgements and assumptions they have made in determining that they have control of or significant influence over another entity (paragraphs 7 and 9 of HKFRS 12), in particular when:

- they do not control another entity even though they hold more than half of the voting rights of the other entity.
- they control another entity even though they hold less than half of the voting rights of the other entity.
- they do not have significant influence even though they hold 20 per cent or more of the voting rights of another entity.
- they have significant influence even though they hold less than 20 per cent of the voting rights of another entity.

107. For each subsidiary that has material non-controlling interests, issuers should disclose the summarized financial information about that subsidiary (paragraph 12(g) of HKFRS 12). The summarized financial information includes dividends paid to non-controlling interests and information about the assets, liabilities, profit or loss and cash flows of the subsidiary. It might also include, but is not limited to, current/non-current assets, current/non-current liabilities, revenue, profit or loss, and total comprehensive income (paragraph B10 of HKFRS 12).

108. Where the non-controlling interests are not material, we would recommend that issuers make a statement to disclose that fact, even though there is no specific requirement in this regard in HKFRS.
109. Issuers should note that “Annual Improvements to HKFRSs 2014-2016 Cycle” (published in March 2017) include amendments to HKFRS 12, which will be effective for annual periods beginning on or after 1 January 2017. It clarifies the scope of HKFRS 12 by specifying that the disclosure requirements in HKFRS 12, with some exceptions, apply to an entity’s interests listed in paragraph 5 of HKFRS 12 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with HKFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”.

Cooperation with other regulators

110. In addition to the Exchange, the FRC and the HKICPA also undertake a continuous review of issuers’ published financial statements. However, the focuses of the reviews are different. The Exchange’s FSRP focuses on compliance with the Listing Rules and accounting standards and our feedback is addressed to, and attempt to help, issuers. The FRC’s programme places greater emphasis on the detection of auditing irregularities, while the HKICPA’s professional standards monitoring (“PSM”) programme focuses on accounting standards and monitoring the quality of the work of listed companies’ auditors. Under our memorandums of understanding (“MOUs”) with the FRC and the HKICPA, respectively, the Exchange liaises, shares information and meets regularly with the two regulators to avoid duplication of work performed.

111. Pursuant to the MOUs, from this year’s review under our programme, we identified possible non-compliances with accounting and auditing standards in three cases (2015: one case) and had referred them to the FRC. Moreover, through other related work at the Exchange, we referred three cases to the FRC and one case to the HKICPA.

112. On 22 November 2016, we held a joint financial reporting forum together with the FRC and the HKICPA. The representatives of the three bodies shared common or significant observations identified from reviews of financial statements of listed companies. The financial reporting forum is held annually since 2011. A webcast of the event is available on the HKICPA’s website.

IV. FINDINGS REGARDING GENERAL ACCOUNTING REVIEW THEME – DISCLOSURE OF POSSIBLE IMPACT OF APPLYING A NEW OR AMENDED HKFRS IN ISSUE BUT NOT YET EFFECTIVE

113. The specific accounting standards theme chosen for this year’s FSRP was compliance with the disclosure requirements in relation to the possible impact of applying a new or amended HKFRS in issue but not yet effective under HKAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section correspond to those in IFRSs.

114. The three major new HKFRSs26 which have been issued by the HKICPA and will soon become effective are:

<table>
<thead>
<tr>
<th>HKFRS</th>
<th>Effective for annual periods beginning on or after</th>
</tr>
</thead>
<tbody>
<tr>
<td>HKFRS 9 “Financial Instruments”</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>(issued in September 2014)</td>
<td></td>
</tr>
<tr>
<td>HKFRS 15 “Revenue from Contracts with Customers”</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>(issued in July 2014)</td>
<td></td>
</tr>
<tr>
<td>HKFRS 16 “Leases”</td>
<td>1 January 2019</td>
</tr>
<tr>
<td>(issued in May 2016)</td>
<td></td>
</tr>
</tbody>
</table>

115. Paragraph 30 of HKAS 8 requires that when an entity has not applied a new or amended HKFRS in issue but is not yet effective, it should disclose this fact and “known or reasonably estimable information relevant to assessing the possible impact that application of the new HKFRS will have on the entity’s financial statements in the period of initial application.”

116. The HKICPA’s Alert Issue 2427 published in December 2016 states that the disclosure objective in paragraph 30 of HKAS 8 is to enable users of financial reports to gain an early understanding of the impacts that such new standards will have on the financial position and performance of the entity. Information about the estimated impact of new standards should become more accurate closer to the effective date.

117. Our review focused on the level of detail disclosed in issuers’ annual reports in accordance with requirements in paragraph 30 of HKAS 8, and whether the issuers had provided entity-specific information to investors.

Our findings

118. In relation to the disclosure pursuant to paragraph 30 of HKAS 8, we noted that most of the issuers under review disclosed a full list of HKFRSs that have been issued but are not yet effective and the fact that they had not yet applied those HKFRSs. Some issuers disclosed a list of selected HKFRSs issued but not yet effective that they considered relevant to them. Out of these issuers, only a few of them had stated that the impact of other HKFRSs not yet adopted was not expected to have material impact on their financial statements.

119. In relation to the possible impact of applying the new or amended HKFRSs, in particular for HKFRS 9, HKFRS 15 and HKFRS 16, we noted that many issuers under review disclosed that they were “assessing the impact of these new standards upon initial application but it was not practicable to provide a reasonable estimate of the effect”. We also found that a few issuers did not provide the disclosure required by paragraph 30 of HKAS 8 or a statement that the impact was not known or reasonably estimable. Through this review and our enquiries, the issuers confirmed that they will follow HKAS 8 disclosure requirements and progressively provide more specific disclosure about the potential impacts by implementation of the new standards as the effective dates become nearer.

120. We observed that some issuers stated that the application of the new or amended HKFRSs “may have a material impact”. Out of these issuers, a few of them provided entity-specific information arising from the initial application of these three major new standards. Below are some examples where issuers:

• disclosed that the new expected credit loss model under HKFRS 9 may result in early provision of credit loss in relation to the Group’s financial assets measured at amortized cost;

• described the impact of HKFRS 16 on the group’s financial position and provided a cross reference to the note to financial statements regarding the operating lease commitments which provided an insight of the possible quantitative impact of HKFRS 16; and

• commenced work on the designing and building of models, systems, processes and controls related to the implementation of the new standards.

Our recommendations

121. Same as last year’s report, we would like to reiterate that where issuers discuss the possible impact of a list of selected HKFRSs that are relevant to them, they should also include a statement that all other HKFRSs issued but not yet effective are not likely to have a significant impact on their financial statements. In particular, we recommend that issuers provide a complete list of HKFRSs issued but not yet effective and discuss their impact on the financial statements. This would be the most prudent approach to meet the requirement of paragraph 30 of HKAS 8 and to reduce the risk of overlooking any new HKFRSs.

122. Issuers should provide entity-specific information and avoid generic boilerplate disclosures. To meet the requirement of paragraph 30 of HKAS 8, issuers should consider the additional guidance set out in paragraph 31 of HKAS 8, including disclosure of a discussion of the impact that initial application of new or amended HKFRSs is expected to have on their financial statements.
123. At the issuers' next reporting season, issuers are expected to progressively provide more entity-specific qualitative and quantitative information about the application of the new standards in their interim and annual financial statements. Issuers are encouraged to consult their professional advisers and closely monitor developments in relation to the implementation of these standards.

124. Issuers are reminded that implementation of these three new standards is not just an accounting exercise, but is expected to have a significant impact on some issuers, particularly on their information systems, internal controls and business contracting processes. For example:

- **HKFRS 9** – amends classification and measurement of financial assets, introduces a new expected loss impairment model, reflects more closely risk management in hedge accounting and introduces a number of new disclosures. HKFRS 9 applies to all entities, in particular, financial institutions and entities with large portfolios of financial assets will be most affected.

- **HKFRS 15** – provides a five-step model to determine when to recognize revenue and at what amount: (i) identify the contract; (ii) identify performance obligations; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Issuers need to assess the extent of the impact, so that they can address the wider business implications, e.g. changes to the profile of margins on contracts.

- **HKFRS 16** – eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Issuers should consider whether the additional assets and liabilities recognized and the change in presentation may affect key performance ratios and debt covenants.

125. The recommendations discussed above may also be relevant in considering the implementation and disclosure of other new standards that are issued but not yet effective, such as IFRS 17 “Insurance Contracts”. Issuers are also encouraged to read the IOSCO’s “Statement on Implementation of New Accounting Standards” related to revenue, financial instruments, and leases, which highlights the importance of the implementation process by issuers and their audit committee.

---

28 IFRS 17 was issued by the IASB on 18 May 2017 (the HKICPA is expected to issue the corresponding HKFRS 17 soon) and will be effective for annual periods beginning on or after 1 January 2021. The IASB’s press release is available at: [http://www.ifrs.org/news-and-events/2017/05/iasb-finalises-fundamental-overhaul-of-insurance-accounting/](http://www.ifrs.org/news-and-events/2017/05/iasb-finalises-fundamental-overhaul-of-insurance-accounting/).

In addition, the amendments to IAS/HKAS 7 “Statement of Cash Flows”, as part of the IASB’s “Disclosure Initiative” project, are to be applied prospectively for annual periods beginning on or after 1 January 2017. Issuers shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The following changes in liabilities arising from financing activities are required to be disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. Below is a sample reconciliation table from the Investor Update Issue 12 published by the IASB in March 2017:

<table>
<thead>
<tr>
<th>Liabilities (column 1)</th>
<th>20X1</th>
<th>Cash flows (column 3)</th>
<th>Non-cash changes (column 4)</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Acquisition</td>
<td>Foreign exchange movement</td>
</tr>
<tr>
<td>Long-term borrowings</td>
<td>22,000</td>
<td>(1,000)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Short-term borrowings</td>
<td>10,000</td>
<td>(500)</td>
<td>-</td>
<td>200</td>
</tr>
<tr>
<td>Lease liabilities*</td>
<td>4,000</td>
<td>(800)</td>
<td>300</td>
<td>-</td>
</tr>
<tr>
<td>Assets held to hedge long-term borrowings</td>
<td>(675)</td>
<td>150</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total liabilities from financing activities</td>
<td>35,325</td>
<td>(2,150)</td>
<td>300</td>
<td>200</td>
</tr>
</tbody>
</table>

The above illustration shows that by applying the IAS/HKAS 7 amendment, opening and closing balances of liabilities (column 1) that arise from financing activities are reconciled by incorporating cash flow (column 3) and non-cash changes (column 4) over the reporting period.

* Note: IFRS/HKFRS 16 becomes effective for annual periods beginning on or after 1 January 2019, at which point operating lease liabilities will also appear in the information presented.

V. FINDINGS REGARDING INDUSTRY REVIEW THEME – ACCOUNTING BY RETAIL AND CONSUMER GOODS COMPANIES

127. For this year’s FSRP, we selected as the industry theme issuers whose major or principal activities include retail and consumer goods businesses. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section correspond to those in IFRSs.

128. The review focused on accounting and reporting issues of the industry including:

- revenue recognition;
- inventories;
- leases; and
- segment reporting.

129. We reviewed the annual reports of 19 issuers whose major or principal activities include retail and consumer goods businesses. Most of these issuers engaged in the production and selling of consumer goods and half engaged in the retail business.

130. Where potential non-compliance was noted, we raised enquiries with the issuers involved. In each case, the issuers confirmed that improvements would be made and the required disclosures would be provided in their future financial reports. We did not note any significant non-compliance amongst the issuers reviewed.

131. We noted certain areas of disclosure where there was room for improvement. Our key findings and recommendations are set out below.

Revenue recognition

132. The revenue from retail and consumer goods businesses are accounted for in accordance with HKAS 18 “Revenue”. Revenue is measured at the fair value of the consideration received or receivable for the sales of goods in the retail and consumer goods businesses. It is recognized on the transfer of risks and rewards of ownership, which generally coincides with the point of time when the customer has accepted the goods for retail businesses or the time when shipment is made for consumer goods businesses. Revenue is shown net of value-added tax, returns, rebates and discounts.

Our findings

133. We found that the retail and consumer goods issuers under review separately disclosed the revenue generated from their businesses and the accounting policy adopted for revenue recognition for different sales channels, for example, sale of merchandize in shops, through concessionaires or via e-commerce. Most of them disclosed that revenue from the sales of goods was usually recognized at the time when products were delivered to the customer, the customer has accepted the products, and there was no unfulfilled obligation that could affect the customer's acceptance of the products. They also disclosed that revenue was recognized net of sales return but only one of them further disclosed that sales returns were estimated and provided for at the time of sale based on past experience.
134. Offer of sales rebates and provision of warranties are common in retail and consumer goods sector. However, except for one of the 19 issuers under review, no disclosure of sales rebates and warranties and no separate accounting policy for sales rebates and warranties were provided in the financial statements.

135. Customer loyalty programme is popular in the retail and consumer goods sector. We observed that some issuers mentioned that they had run such a programme and stated that the fair value of the consideration received or receivable in respect of the initial sale was allocated between the award credits and the other components of the sale. The consideration allocated to the award credits was measured with reference to their fair values (i.e. the amount for which the award credits could be sold separately) and was recognized as revenue when award credits are redeemed and the company fulfilled its obligations to supply awards.

Our recommendations

136. For investors to better understand the financial statements, issuers should disclose more specific accounting policy on revenue recognition. It is expected that the transfer of significant risks and rewards of ownership of goods would be physical delivery of goods or transfer of legal title of goods to the customer. We encourage issuers to enhance disclosure of the timing of revenue recognition. Robust internal controls and processes should be in place to ensure revenue is properly recognized and in compliance with the relevant accounting standards.

137. Where retail and consumer goods issuers offer sales rebates, provide warranties or have a customer loyalty programme, they should consider the uniqueness and complexity of these components and provide separate disclosures and accounting policies.

138. In addition, as also explained in paragraph 124 above, HKFRS 15 is expected to have impacts on accounting processes, internal controls and business contracting processes. Issuers need to carefully evaluate all of their contracts and exercise more judgement than they do under HKAS 18. Issuers should read HKFRS 15 and make reference to the application guidance in Appendix B. For example:

- **Sales return** – HKFRS 15 requires the refund liability to be presented gross as a refund liability. An asset and corresponding adjustment to cost of sales are also recognized for the right to recover goods from customers on settling the refund liability, rather than the current presentation of allowances for returns on a net basis on the statement of financial position (paragraphs B20 to B27 of HKFRS 15);

- **Warranties** – Under HKFRS 15, warranties will be distinguished into service-type (warranty that provides a separate service) and assurance-type (warranty that provides assurance that the product will function as promised). Warranties that the customer has the option to purchase or those that provide the customer with a service such as specified tasks or longer than usual coverage periods are separate performance obligations when they are distinct from other promised goods and services. Revenue is allocated to the service-type warranty on a relative stand-alone selling price basis, which may differ from the contract price of the warranty. Assurance-type warranties continue to be accounted for as a cost accrual in accordance with HKAS 37 “Provisions, Contingent Liabilities and Contingent Assets” (paragraphs B28 to B33 of HKFRS 15); and
Consideration payable to a customer such as discounts, coupons, vouchers and free products or services – Cash amounts that an entity pays or expects to pay to a customer and credits, vouchers or coupons that can be applied against amounts owed by the customer are regarded as consideration payable to a customer. If a payment to a customer represents a payment for a distinct good or service, it is recognized as an expense or asset. That amount is limited to the fair value of the good or service and any excess is recognized as a reduction of revenue. When the payment to a customer is not made for a distinct good or service, it should be accounted for as a reduction in the transaction price (paragraphs 70 to 72 of HKFRS 15).

Inventories

Retail and consumer goods issuers normally have significant balance of inventories and measurement of inventories would have material impact on the financial statements.

Our findings

All the retail and consumer goods issuers under review disclosed the accounting policy for inventories. We noted that most of the retail and consumer goods issuers adopted the weighted average cost formula to account for inventories and the rest of them adopted the first-in, first-out formula.

We found that the majority of the retail and consumer goods issuers under review did not have significant write-down of inventories, except for one issuer which recognized significant write-down of inventories due to obsolescence. In addition, two-third of the retail and consumer goods issuers under review disclosed how they assessed the net realizable values of inventories at the financial year end.

Our recommendations

Issuers are reminded to disclose the accounting policies adopted in measuring inventories, including the cost formula used (paragraph 36(a) of HKAS 2 “Inventories”), and the amount of any write-down of inventories recognized as an expense in the year (paragraph 36(e) of HKAS 2).

Issuers are reminded to perform regular reviews of the carrying amounts of inventories with reference to aged inventories analyses, projections of expected future saleability of goods and, management experience and judgement. Issuers are reminded that the cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased (paragraph 28 of HKAS 2).

Issuers should carefully reassess the net realizable values of inventories at each financial year end. The underlying estimates of assessment on net realizable values of inventories may change significantly as a result of changes in customer preference and competitor actions in response to industry cycles.
Leases

145. The retail and consumer goods issuers are generally prolific lessees as they usually enter into operating leases to rent shops and stores.

Our findings

146. All of the retail and consumer goods issuers under review have disclosed the accounting policy on leases and provided the disclosure required by HKAS 17 “Leases”. Those issuers had their lease expenses recognized on a straight-line basis over the lease term under operating leases.

147. We also observed that nearly half of these issuers disclosed that the lease incentives were recognized as a reduction of rental expense on a straight-line basis over the lease terms. However, no further information, such as types and terms of lease incentives, was provided.

Our recommendations

148. Issuers should appropriately account for leases in accordance with HKAS 17. In addition, issuers are reminded that lease incentives should be recognized in accordance with Hong Kong (SIC) Interpretation (“HK(SIC)-Int”) 15 “Operating Leases - Incentives”. HK(SIC)-Int 15 paragraph 3 requires that “All incentives for the agreement of a new or renewed operating lease shall be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive’s nature or form or the timing of payments” and paragraph 5 requires that “The lessee shall recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee’s benefit from the use of the leased asset.”

149. The retail and consumer goods industry is likely to be significantly affected by the new HKFRS 16, given the extensive use of rented premises for their stores. As discussed in paragraph 124 above, the new lease accounting standard will fundamentally change the accounting for lease transactions and is likely to have significant business implications. Under HKFRS 16, a lease will be initially recognized by lessees as a lease liability at the present value of future lease payments and a right-of-use asset to an equal amount plus initial direct costs and restoration costs. A lessee will recognize interest on the lease liability and depreciation of the right-of-use asset. Regarding lease incentives, HKFRS 16 defines “lease incentives” as “Payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee” (Appendix A of HKFRS 16). Such payments will be offset against lease payments made by the lessee to the lessor (paragraphs 24 and 27 of HKFRS 16).

150. For retail and consumer goods issuers with a significant portfolio of leases, they are reminded to gather the required information on their existing leases and capture data on new leases at the outset for an orderly and smooth transition to HKFRS 16. This may result in the need for new systems, controls and processes, which will take time to identify, design, implement, and test. Issuers should also consider whether the additional assets and liabilities recognized and the change in presentation may affect key performance ratios and debt covenants.
**Segment reporting**

151. HKFRS 8 “Operating Segments” sets out the disclosure requirements for information about a company’s operating segments, products and services, as well as about the geographical areas in which it operates and its major customers. HKFRS 8 requires an entity to adopt the management approach to provide segment disclosures, which are based on the information about the components of the entity that management uses to make decisions about operating matters.

152. The minimum disclosure requirements under paragraph 32 of Appendix 16 include comments on segmental information. This may cover changes in the industry segment, developments within the segment and their effect on the results of that segment. It may also include changes in the market conditions, new products and services introduced or announced and their impact on the group’s performance and changes in revenue and margins.

153. These disclosures provide investors with insights into how the issuers’ businesses are viewed by their management and provide a better linkage between the financial statements and the information reported in the MD&A.

**Our findings**

154. Most of the retail and consumer goods issuers under review have diverse operations and operate in various geographical locations. Some issuers have several different types of operations, e.g. property development and securities investment, in addition to the retail operation. We found that most issuers had more than one reportable segment. They identified their segments based on their business activities, products and services, and geographical areas. Some issuers reported that their operations constituted one single reportable segment.

155. These issuers also provided the entity-wide disclosures such as information about their geographical areas and major customers (paragraphs 33 and 34 of HKFRS 8). However, only a few of them provided further analysis of revenue for their products and services (paragraph 32 of HKFRS 8).

156. In addition, we noted that in most of the cases the segments discussed in the MD&A as required by paragraph 32(6) of Appendix 16 were in line with the segment information in financial statements concerning HKFRS 8. There were a few cases where a single segment was reported under HKFRS 8 but the MD&A included the breakdown of revenue contributed by different sale channels including sales made through their self-operated shops, sales to third-party retailers and sales from e-commerce business.

**Our recommendations**

157. Although we did not identify any major issues from the cases reviewed, we would like to remind all issuers that HKFRS 8 requires operating segment information to be reported on the same basis as the information used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. Issuers are also encouraged to provide clear explanations in support of any decision to aggregate segments.
158. Issuers are also reminded that the entity-wide disclosures required by paragraphs 31 to 34 of HKFRS 8 apply to all entities including those entities that have a single reportable segment. These disclosures include:

- **Products and services** – Revenues from external customers for each product and service (or each group of similar products and services), e.g. by different sale channels (through self-operated shops, distributors, franchisees and e-commerce) and by brands (licensed and self-owned brands);

- **Geographical areas** – Information including revenue from external customers and non-current assets, which should be analyzed between an issuer’s country of domicile and foreign countries; and

- **Major customers** – Information about the extent of an issuer’s reliance on its major customers.

159. HKFRS 8 requires issuers to disclose segment information “through the eyes of management”. Issuers are expected to ensure that the elements presented in the segment information in the financial statements and those included in the MD&A are consistent in terms of segments presented and measures disclosed. In March 2017, the IASB published an exposure draft “Improvements to IFRS 8 Operating Segments”\(^\text{31}\). The proposed improvements in the exposure draft include amendment to require companies to provide information in the notes to the financial statements if segments in the financial statements differ from segments reported elsewhere in the annual report and in accompanying materials. The IASB believes that this will reinforce the management approach used in IFRS 8 and encourage consistent identification of segments between the financial statements, the MD&A and other reported information. Issuers should closely monitor the developments on the proposed improvements to IFRS/HKFRS 8.

---

VI. FINDINGS REGARDING SPECIAL REVIEW THEME – NEW AUDITORS’ REPORTING

160. A number of new and revised HKSAs issued by the HKICPA in August 2015 (the “Auditor Reporting Standards”) became effective for audits of financial statements for periods ended on or after 15 December 2016. Unless otherwise specified, HKSAs and their paragraph numbers referred to in this section correspond to those in International Standards on Auditing issued by the International Auditing and Assurance Standards Board.

161. Under the new and revised Auditor Reporting Standards, the form and content of the audit report for issuers have been substantially extended. The key enhancements to the new audit reports include requirements to:

<table>
<thead>
<tr>
<th>Key enhancements</th>
<th>HKSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present the audit opinion section first, followed by the basis for opinion section</td>
<td>HKSA 700 (Revised) “Forming an Opinion and Reporting on Financial Statements”</td>
</tr>
<tr>
<td>Include a new section to communicate KAMs</td>
<td>HKSA 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”</td>
</tr>
<tr>
<td>Include enhanced auditor reporting on going concern</td>
<td>HKSA 570 (Revised) “Going Concern”</td>
</tr>
<tr>
<td>Report on the auditors’ work related to other information (other than financial statements and the audit report thereon) included in an issuer’s annual report</td>
<td>HKSA 720 (Revised) “The Auditor’s Responsibilities Relating to Other Information”</td>
</tr>
</tbody>
</table>

162. The review focused on the key enhancements to new audit reports and consistency of disclosures between audit reports and financial statements and other parts of annual reports. Out of the cases reviewed in this year, 19 issuers’ auditors issued the audit reports using the new and revised Auditor Reporting Standards.

KAMs

163. Paragraph 8 of HKSA 701 defines KAMs as “Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.”

164. It is important to note that the purpose of reporting KAMs is to provide greater transparency about the audit that was performed. KAMs do not affect the audit opinion and only provides additional information about the audit.

---

Our findings

165. All the 19 issuers’ auditors reported KAMs in their audit reports. We noted that the five most common KAM topics reported by the auditors include:

- impairment of assets, including goodwill, intangible assets, property, plant and equipment;
- revenue recognition including the timing of recognition and allocation of fair value among each separable component;
- properties valuation including fair values of investment properties and net realizable values of properties under development and properties held for sale;
- trade receivables including valuation and recoverability; and
- business combination including identification and valuation of intangible assets and the allocation of purchase price to the assets and liabilities acquired.

166. We noted that KAMs provided additional information and were often related to the critical areas of accounting judgements and estimates. In addition, for those 19 cases, information disclosed in KAM section in audit reports was consistent with information provided in the financial statements.

Our recommendations

167. Although we did not identify any major issues from the 19 cases reviewed, we would like to remind all issuers that, in view of new KAM requirements, they should pay greater attention to the relevant disclosures in other sections of the annual reports (e.g. financial statements and MD&A) to which reference is made in the audit report. Any KAM disclosures made by the auditors in the audit report should be normally on the basis that those matters are already disclosed by the issuer. HKSA 701 points out that it is inappropriate for the auditors to be the provider of “original information”33 about the entity and such information is the responsibility of the entity’s management and those charged with governance34.

---

33 Original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g., has not been included in the financial statements or other information available at the date of the audit report, or addressed in other oral or written communications by management or those charged with governance, such as a preliminary announcement of financial information or investor briefings) (paragraph A35 of HKSA 701).

34 See paragraphs A34 to A39 of HKSA 701.
168. For example, KAMs reported in the audit report will include the most significant accounting judgements and estimates. Issuers should ensure that the relevant information is disclosed in the financial statements in accordance with HKAS 1 (Revised). The corporate governance report should also describe how the audit committee has met its responsibilities in its review of the significant financial reporting judgmental areas (Code Provision C.3.3(d) and paragraph L(d)(iv) of Appendix 14 to the MB Rules). Issuers are encouraged to link these disclosures by cross-referencing to minimize the extent to which information is repeated, but also ensure that the corporate governance report and audit report are more focused on the responsibilities and work done by the audit committee and auditors, respectively.

169. Moreover, all issuers, in particular their audit committee, are reminded that they should have more in-depth conversations with their auditors. Having discussions with their auditors at an early stage about the KAMs may help to minimize the risk of last minute surprises.

**Going concern**

170. HKSA 570 (Revised) enhances the reporting on going concern and requires specific descriptions of the responsibilities of management and the auditor for going concern. When a material uncertainty exists and is adequately disclosed in the financial statements (paragraphs 25 and 26 of HKAS 1 (Revised)), a separate section is included in the audit report with an unmodified opinion, which was previously included as an emphasis of matter paragraph.

171. In addition, Note 2 to Section M of Appendix 14 to the MB Rules also requires an issuer to include a “report on material uncertainties, if any, relating to events or conditions that may cast significant doubt upon the issuer’s ability to continue as a going concern (C.1.3 of the Code)” in the corporate governance report.

**Our findings**

172. We observed that two of the issuers under review had the “material uncertainty related to going concern” section in their audit reports regarding events or conditions identified that might cast doubt on the issuers’ ability to continue as a going concern.

173. We noted that these issuers included a discussion in the notes to the financial statements on the issue of going concern as required by paragraphs 25 and 26 of HKAS 1 (Revised). However, they omitted to include the discussion in their corporate governance reports of the existence of material uncertainties that may cast significant doubt upon their ability to continue as a going concern as required under Note 2 to Section M of Appendix 14 to the MB Rules.

**Our recommendations**

174. Issuers are reminded to include relevant discussion in their corporate governance reports as Appendix 14 to the MB Rules (Code Provision C.1.3 and Note 2 to Section M) requires an issuer to include a report on material uncertainties, if any, relating to events or conditions that may cast significant doubt upon the issuer’s ability to continue as a going concern.
175. Issuers are also reminded that the disclosure of material uncertainties related to events or conditions that may cast significant doubt upon the ability to continue as a going concern (as required by paragraphs 25 and 26 of HKAS 1 (Revised)) is important as it alerts investors about those uncertainties and management’s reaction and plans. When disclosing the material uncertainties, issuers should:

- provide a description of those uncertainties that is clear and case-specific;
- discuss management’s plans and actions taken or to be taken in order to alleviate those uncertainties; and
- explain in sufficient detail the basis for management’s conclusion to prepare the financial statements on a going concern basis.

176. Issuers are encouraged to discuss early with their auditors about going concern issues. It is also likely to be helpful if a draft of the relevant disclosures about going concern and liquidity risk is prepared and discussed with the auditors well before the end of the reporting period.

**Other Information**

177. HKSA 720 (Revised) introduces a new other information section in an audit report to explain responsibilities of management and auditor, and whether an auditor has any findings on material misstatements of the Other Information. Paragraph 12(c) of HKSA 720 (Revised) defines “Other Information” as “Financial or non-financial information (other than financial statements and the auditor’s report thereon) included in an entity’s annual report.”

**Our findings**

178. We observed that all of the 19 issuers under review provided the Other Information to their auditors in a timely manner prior to the dates of the audit reports. Except for one case which the auditors issued a modified report, the auditors of the remaining issuers concluded that there was no material misstatement of the Other Information and included a statement in their audit reports that they “have nothing to report” in this area.

**Our recommendations**

179. Although we did not identify any major issues from the 19 cases reviewed, we would like to remind all issuers that it is important that they should agree with their auditors on the timetable of when the Other Information will be available to the auditors to meet the reporting requirement of HKSA 720 (Revised). Issuers should discuss with their auditors which documents comprise the annual report and will be within the scope of Other Information as defined by HKSA 720 (Revised), and therefore within the scope of the auditors’ responsibilities. All of the Other Information should be complete and provided to the auditors prior to the date of the audit report.

180. Issuers should also bear in mind the requirement under MB Rule 2.13(2) that in any corporate communication “the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive ….” Information provided in other parts of annual reports should be consistent with the information included in the financial statements.
VII. CONCLUSION

181. For financial reports to be an effective communication tool, the overarching principle is that the “information provided should be relevant, material and entity-specific”; and issuers should consider removing irrelevant and immaterial disclosures.

182. We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report and stay alert to changes in the Listing Rules, accounting and auditing standards, and other relevant laws and regulations; and capitalize on opportunities to provide better disclosure. Directors should ensure that their finance department has the necessary resources and training to perform its role in financial reporting.

- End -