

FINANCIAL STATEMENTS REVIEW PROGRAMME
REPORT 2012

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Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

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Report 2012**

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EXECUTIVE SUMMARY

The Listing Division has completed its review of issuers' published financial reports for compliance with the disclosure requirements of the Listing Rules and accounting standards. This is our fourth published report summarising our key observations and findings.

We reviewed 120 reports of issuers covering the annual, interim and quarterly reports released between May 2011 and September 2012. During the review process, we issued 87 letters to issuers that contained more than 250 enquiries and observations. Our enquiries requested explanations and information about the accounting treatment adopted or clarifications on possible non-compliance or omitted disclosures.

Where the omitted disclosures were regarded as less significant or material, we requested issuers to confirm in writing that the required disclosures will be rectified in future financial reports.

Based on the responses to the 250 enquiries made during our review, there were no significant breaches of the Listing Rules or accounting standards that would render the financial statements misleading, would require their restatement or, warrant disciplinary action.

From other related work at the Exchange, during the year, we referred four cases to the Financial Reporting Council and three cases to the Hong Kong Institute of Certified Public Accountants for consideration of further enquiry and investigation into possible accounting and auditing irregularities.

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

The major findings and recommendations from our review are:-

- Issuers are still omitting certain disclosures required by Appendix 16 to the Main Board Rules (and equivalent GEM Rules). We remind issuers that in addition to the disclosure requirements in accounting standards, the Listing Rules also have disclosure requirements relating to financial information. These are primarily set out in Appendix 16 to the Main Board Rules (see paragraphs 15 to 17);
- Issuers are generally still not forthcoming in their explanation of significant events and transactions in their annual and interim reports. We remind issuers that for interim reports, IAS/HKAS 34 "*Interim Financial Reporting*" requires explanation of events and transactions that are significant (see paragraphs 34 to 37);
- Issuers should familiarise themselves with IFRS 3/HKFRS 3 (Revised) "*Business Combinations*" when carrying out acquisitions of businesses or assets, as inappropriate application of accounting standard IFRS 3/HKFRS 3 (Revised) could have major subsequent consequences for the issuers' financial statements, such as misstating the balances regarding goodwill and deferred tax and their effects on the profit and loss account (see paragraphs 38 to 43);

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- Issuers should improve and further enhance their disclosures relating to goodwill and intangible assets and management should ensure that the assumptions for growth rates applied in their discounted cash flows are achievable over the period under consideration (see paragraphs 50 to 68); and
- Issuers should follow good practices when providing non-IFRS/HKFRS financial information (see paragraphs 86 to 97) to ensure that such information is clearly distinguished from the financial information prepared in accordance with accounting standards.

We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report, in particular the requirements of the Listing Rules, accounting standards and other regulatory disclosure requirements. It is important that issuers should consult early with their auditors and other external professional advisers to provide them with insights into any changes to the above requirements and their implications on their periodic financial reports. They should also continuously improve their systems and checklists to ensure that all the required disclosures are made and that the information provided are entity specific, relevant, consistent and coherent such that the information will be useful to users in making economic decisions.

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BACKGROUND

1. As part of the Exchange's regulatory function, the Listing Division operates a Financial Statements Review Programme (the "FSRP") which reviews, on a sample basis, issuers' published periodic financial reports. The FSRP covers issuers' quarterly, interim and annual reports.
2. The objective of the FSRP is to monitor compliance with the requirements of the Main Board Rules and GEM Rules and, in parallel, to monitor compliance with the relevant disclosure requirements of the Companies Ordinance, and the applicable accounting standards, including Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board (the "IASB"). The review also covers samples to check compliance by issuers incorporated in the Mainland that have elected to adopt China Accounting Standards for Business Enterprises ("CASBE") issued by the Ministry of Finance of the People's Republic of China.
3. In order to enhance transparency and improve the quality of financial disclosures in periodic financial reports, we regularly publish our report of key observations and findings from our review programme. The purpose of the report 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 to improve the quality of their future reports.

Scope of financial statements review programme

4. A risk-based approach is adopted in selecting issuers for the FSRP. The selection criteria include:-
 - (a) Impact - issuers where an instance of major non-compliance might adversely affect the reputation of the Hong Kong equity market as a whole.
 - (b) Probability - issuers where there is a possible higher risk of misstatement or misapplication of accounting standards due to the existence of features that may indicate higher risk including where an issuer has any of the following characteristics:-
 - experienced significant changes in its net assets
 - newly listed
 - subject to complaints concerning compliance with the Listing Rules
 - issued with a qualified or modified auditors' report
 - subject to a frequent change of auditors or engaged a small accounting firm as its auditors
 - (c) Random - a number of cases are selected at random so that any issuer may be selected for review.

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5. As in previous years, we included an industry theme and for this review period, the theme was companies whose major or principal businesses are involved in telecommunications and internet services.
6. As in previous years, we also included a general accounting theme and for this review period, the general accounting theme is accounting for goodwill and intangible assets.
7. In this year's review, we further included a review of disclosure of non-IFRS/HKFRS financial information in financial reports.
8. We reviewed 120 reports released by issuers between May 2011 and September 2012 and issued 87 letters to issuers that contained more than 250 enquiries or observations.
9. All the cases reviewed during the period were subsequently closed after considering the responses received to our letters.
10. This is our fourth published report which summarises our key observations and findings. It is important to note that the findings do not include all areas in which we raised comments or asked questions.
11. Key observations and findings raised in our past reports may also be relevant and are useful references and they can be accessed at:-
<http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/guidance5.htm>
12. It is the primary responsibility of the directors of issuers to prepare financial reports. In this regard, directors and others responsible for the financial reporting function need to stay alert to changes to the Listing Rules, accounting standards and other regulatory requirements. They should also constantly review their financial reporting systems and procedures to ensure all revised financial disclosures are made in compliance with the new requirements.

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FINDINGS REGARDING THE LISTING RULES

13. Table 1 below highlights the key areas where issuers need to pay particular attention:-

Table 1: Findings relating to Listing Rules disclosures

Area	MB Rules	GEM Rules
Additional information in annual reports required by the Listing Rules	Appendix 16	Chapter 18
Corporate Governance Reports	Appendix 14	Appendix 15
Disclosures relating to annual review of continuing connected transactions	Chapter 14A	Chapter 20
Continuing Disclosure Requirements under the Listing Rules	Chapter 13	Chapter 17
Financial reports using CASBE	Chapter 19A	Chapter 25

14. Unless otherwise specified, the Rule references referred to in this section apply to both Main Board Rules and GEM Rules. While the discussion in this section will focus on Main Board Rules, the discussion applies equally to GEM Rules.

Additional information in annual reports required by the Listing Rules

15. Appendix 16 to the Main Board Rules specifies a number of matters that issuers are required to disclose in their annual reports in addition to those required by accounting standards. For certain of these disclosures, the Listing Rules specify that they should be included in the financial statements. Otherwise, the disclosures may be presented outside the financial statements, such as in the Management Discussion & Analysis (“MD&A”) or directors’ report.
16. Issuers should ensure that all the information included in periodic financial reports is accurate and complete in all material respects and should identify and remove any inconsistencies. Auditors also have a responsibility under Hong Kong Standard on Auditing 720 (Clarified) “*The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*” which requires that the auditors review information accompanying the audited financial statements to identify material inconsistency, if any.

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17. During our review we noted the following common omitted or incomplete disclosures which require attention and improvement:-

- (a) Credit policy and ageing analysis of accounts receivable (paragraph 4(2)(b)(ii) of Appendix 16 to the Main Board Rules)

During our review we noted that some issuers did not provide details of the policy regarding credit terms granted to trade customers and ageing analysis presented on the revenue recognition date, which is usually the invoice date.

We also noted that there were other cases where an ageing analysis of trade debtors that were past due but not impaired as required under paragraph 37(a) of IFRS/HKFRS 7 “*Financial Instruments: Disclosures*” was not provided in financial statements.

Although the Listing Rules do not specify the basis of the ageing analysis, the analysis should normally be presented on the basis of the revenue recognition date, which is usually the invoice date, and categorised into time-bands that are appropriate for the business (e.g. where the credit period is 30 days from the revenue recognition date, the ageing analysis could be categorised into 30 days, 60 days, 90 days, 120 days, etc.). This analysis would be different from the requirement under accounting standards (e.g. paragraph 37 of IFRS/HKFRS 7) where an analysis is required for those due but not impaired. For the latter, the analysis would be based not on the revenue recognition date but on the payment due date. Accordingly, two ageing analyses are expected to be disclosed.

- (b) Related party disclosures (paragraph 8(3) of Appendix 16 to the Main Board Rules)

Issuers sometimes omitted to state whether a related party transaction also constituted a connected transaction as defined under the Listing Rules. Issuers should pay particular attention to the disclosure requirements under paragraph 8(3) of Appendix 16 to the Main Board Rules which require companies to:-

- state whether or not the related party transactions disclosed in their annual financial statements in accordance with IAS 24/HKAS 24 (Revised) “*Related Party Disclosures*” fall under the definition of connected transactions or continuing connected transactions in Chapter 14A of the Main Board Rules; and
- confirm whether or not they have complied with the disclosure requirements in accordance with Chapter 14A of the Main Board Rules.

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(c) Directors' emoluments (paragraph 24 of Appendix 16 to the Main Board Rules)

A few issuers inadvertently overlooked the disclosure requirements under Notes 24.4 and 24.5 to paragraph 24 of Appendix 16 to the Main Board Rules which states that *"In the case of a PRC issuer, references to directors or past directors shall also mean and include supervisors and past supervisors (as appropriate)"* and *"References to "director" in paragraph 24 include a chief executive who is not a director"* respectively. In these cases, no separate analysis of remuneration by name of supervisors or a chief executive (who is not a director) was provided in the financial statements.

(d) Group's emolument policy and number of employees (paragraphs 24B and 32(7) of Appendix 16 to the Main Board Rules)

Some issuers provided the basis of determining the emolument payables to their directors but omitted disclosure of the group's emolument policy and number of employees.

Paragraphs 24B and 32(7) of Appendix 16 to the Main Board Rules require to disclose *"a general description of the emolument policy and any long-term incentive schemes of the group ..."* and *"details of the number and remuneration of employees, remuneration policies, bonus and share option schemes and training schemes"* respectively.

(e) Pension schemes (paragraph 26 of Appendix 16 to the Main Board Rules)

We observed that there was incomplete disclosure regarding pension schemes whether they are defined benefit plans or defined contribution plans. Some of the following disclosures were in certain cases omitted:-

- a brief outline of how contributions are calculated or benefits funded in relation to the group's pension scheme;
- the employer's pension cost charged to the income statement for the financial year; and
- details of the valuation of defined benefit plans, including a brief description of the main actuarial assumptions adopted by the independent actuary.

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(f) Disclosures required under the Hong Kong Companies Ordinance (paragraph 28 of Appendix 16 to the Main Board Rules)

Paragraph 28 of Appendix 16 to the Main Board Rules requires an issuer (whether or not it is incorporated in Hong Kong) to include in its annual report disclosures required under certain provisions of the Companies Ordinance, including information required under the Tenth Schedule.

As with last year, we continued to note instances where issuers incorporated outside Hong Kong did not provide the following disclosures required under the Tenth Schedule of the Hong Kong Companies Ordinance as referred to in the Listing Rules:-

- the balance sheet of the issuer itself;
- investments in subsidiaries;
- amounts due from subsidiaries;
- movements in the company's reserves;
- lease terms of land situated in Hong Kong and outside Hong Kong;
- whether investments were listed or unlisted, if listed, further disclosure as to whether they were listed in or outside Hong Kong; and
- auditors' remuneration, including expenses.

The financial statements of the issuer itself as a separate legal entity are different from the group or consolidated financial statements of the listed group. Main Board Rule 13.46(2) makes this distinction and states that "*In the case of an overseas issuer or a PRC issuer ... Such issuer shall send to ... every member of the issuer ... a copy of ... its annual report including its annual accounts and, where the issuer prepares group accounts, its group accounts, together with a copy of the auditors' report thereon ..., not less than 21 days before the date of the issuer's annual general meeting and in any event not more than four months after the end of the financial year to which they relate*".

Issuers that are not incorporated in Hong Kong should ensure they prepare financial statements that comply with the requirements of both the Listing Rules and the relevant sections of the Companies Ordinance.

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(g) Distributable reserves (paragraph 29 of Appendix 16 to the Main Board Rules)

We noted a few cases where the issuers did not provide a statement of the reserves available for distribution to shareholders as at the balance sheet date in their annual reports.

Paragraph 29 of Appendix 16 to the Main Board Rules states that:-

“A listed issuer shall include a statement of the reserves available for distribution to shareholders by the listed issuer as at the balance sheet date:-

- (1) in the case of a Hong Kong issuer, as calculated under the provisions of section 79B of the Companies Ordinance; and*
- (2) in other cases, as calculated in accordance with any statutory provisions applicable in the listed issuer’s place of incorporation or, in the absence of such provisions, with generally accepted accounting principles.”*

Hong Kong incorporated issuers should read Accounting Bulletin 4 “*Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance*” (“AB 4”) issued by the HKICPA which provides guidance on the determination of distributable profits under the Hong Kong Companies Ordinance. Overseas incorporated issuers are also encouraged to read AB 4 for reference where issuers taking into account advice from their legal counsel believe that AB 4 is relevant in determining the distributable profits. AB 4 is available on the HKICPA’s website at:-

http://app1.hkicpa.org.hk/hksaebk/HKSA_Members_Handbook_Master/volumeII/ab4.pdf

(h) Change of auditors (paragraph 30 of Appendix 16 to the Main Board Rules)

A few issuers did not include details of the change of auditors in any of preceding three years in their annual reports.

Section 441 “*Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong*” of the “*Code of Ethics for Professional Accountants*”, which was issued by the HKICPA in consultation with the Exchange and the Securities and Futures Commission (“SFC”), establishes a framework to enhance communication by auditors with an issuer where there is a change of auditors. Issuers and their auditors should take note of the above when making an announcement on the change of auditors as required by Main Board Rule 13.51(4) and make the necessary disclosure in the subsequent annual reports.

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(i) Management Discussion & Analysis (paragraph 32 of Appendix 16 to the Main Board Rules)

(i) Minimum disclosure requirements

Issuers sometimes overlooked some of the minimum disclosure requirements under paragraphs 32(1) to 32(12) of Appendix 16 to the Main Board Rules. These include:-

- the group's liquidity and financial resources;
- the capital structure of the group in terms of maturity profile of debt and obligation, type of capital instruments used, currency and interest rate structure (for example, disclosure of the foreign currencies in which borrowings were made and the currencies in which cash and cash equivalents were held);
- explanation or commentary regarding the material fluctuation of segment results;
- details of the number and remuneration of employees as mentioned in point (d) above; and
- gearing ratio and the basis on which the gearing ratio is computed.

(ii) Significant balances and transactions

Although we highlighted the issue in our past reports, we continued to identify instances where issuers experienced substantial fluctuations in turnover, operating results and net asset values during the period reported on but little explanation or discussion was provided regarding the reasons for the fluctuations. A common finding was that significant amounts were simply described as "other receivables/payables" without further details. Some issuers tended to repeat information available in the financial statements in narrative form without additional analysis and explanations.

Paragraph 32 of Appendix 16 to the Main Board Rules requires annual reports to include a separate statement "*containing a discussion and analysis of the group's performance during the financial year and the material factors underlying its results and financial position. It should emphasize trends and identify significant events or transactions during the financial year under review*". Moreover, IAS 1/HKAS 1 (Revised) "*Presentation of Financial Statements*" requires companies to provide information which is relevant to an understanding of the financial statements by way of additional notes to the financial statements. The absence of information on significant events leading to material balances and transactions in periodic financial reports may be viewed as non-compliance with the relevant Listing Rules or accounting standards.

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The MD&A should be balanced (including coverage of good as well as bad news), clear and concise; and consistent with information disclosed elsewhere in the reports, particularly the information in the financial statements, and not misleading.

Similar provisions (with less details) are required for interim reports as set out in paragraph 40(2) of Appendix 16 to the Main Board Rules. Disclosures in interim reports may focus on significant changes in the group's performance since the most recent published annual report. Where the current information in relation to the matters set out in paragraph 32 of Appendix 16 to Main Board Rules has not changed materially from the information disclosed in the most recent published annual report, a statement to this effect may be made and no additional disclosure is required.

Corporate Governance Reports

18. The majority of the reports reviewed complied with most of the mandatory disclosure requirements under Appendix 14 to the Main Board Rules (equivalent to previous Appendix 23 which was merged with Appendix 14 on 1 April 2012). However, some findings included:-
- limited descriptions of the role and functions of the board committees (remuneration committee/ nomination committee/ audit committee);
 - no disclosure of the number of meetings and the individual attendance record of directors at meetings of the board committees;
 - no summary of the work performed by the board committees, for example, the nomination procedures and the process and criteria adopted by the nomination committee or the board of directors (if there is no nomination committee) to select and recommend candidates for directorship during the year;
 - no analysis of remuneration in respect of audit and non-audit services provided by the auditors, in particular, the details of nature of significant non-audit service assignments; and
 - omission of the acknowledgement from the directors of their responsibility for preparing the financial statements.

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19. We also noted that a few issuers included an emphasis of matter or a disclaimer of opinion or a discussion in the note to the financial statements on the issue of going concern. However, they omitted to include disclosure 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 paragraph C.1.3 (equivalent to previous C.1.2 of Appendix 14 which was amended on 1 April 2012) and Note 2 to Section M of Appendix 14 to the Main Board Rules (equivalent to previous Note 2 to paragraph 2 of Appendix 23 that was merged with Appendix 14 on 1 April 2012). We recommend that in providing going concern disclosures in corporate governance reports, issuers should provide a balanced and clear disclosure by including a brief analysis and explanation together with making a cross-reference to the notes to the financial statements.
20. Issuers should also pay attention to the requirement under paragraph 34 of Appendix 16 to the Main Board Rules whereby to the extent that it is reasonable and appropriate, the issuer may incorporate by reference information in its annual report into the corporate governance report. Any such references must be clear and unambiguous and the corporate governance report must not contain only a cross-reference without any discussion of the matter.
21. Furthermore, if the amount of auditors' remuneration relating to audit services stated in corporate governance reports is different from information on audit fees disclosed in the financial statements, disclosure of an explanation or reconciliation is encouraged. Issuers are also reminded that in respect of each significant non-audit service (for example, fees for preparing an accountants' report for an initial public offering document), details of the nature of the service and the fees paid should be disclosed separately in the corporate governance report. If any amount paid/payable was not recognised in the income statement but charged directly to reserves, separate disclosure is expected.

Disclosures relating to annual review of continuing connected transactions

22. Issuers conducting continuing connected transactions should disclose the results of the annual reviews by their independent non-executive directors and the auditors in the annual reports as required under Main Board Rules 14A.37 to 14A.39.
23. In this year's review, we have seen an improvement in this area. There were a small number of non-compliance cases involving individual issuers. They agreed to take appropriate corrective actions to prevent their re-occurrence in future annual reports. We will continue to monitor this area in our programme.

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24. We also observed that some issuers included a clear statement on the work performed by the auditors in accordance with the illustrative example provided in paragraph 102 of the HKICPA Practice Note 740 “*Auditor’s Letter on Continuing Connected Transactions under the Hong Kong Listing Rules*” (“Practice Note 740”) which was developed in consultation with the Exchange and staff at the SFC. Practice Note 740 can be accessed at:-
http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeIII/pn740.pdf
25. The purpose of Practice Note 740 is to provide guidance to auditors and issuers on their respective responsibilities and to promote consistency in annual reporting. Issuers should ensure that the annual review of continuing connected transactions complies with Hong Kong Standard on Assurance Engagements 3000 “*Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*” and follows the guidance in Practice Note 740. Moreover, the work is an assurance engagement rather than an agreed-upon procedures engagement. Issuers are also encouraged to provide more information in their annual reports to ensure that readers understand the nature of the engagement and the work performed by their auditors.
26. To assist issuers to understand and comply with the Connected Transaction Rules, in April 2012, the Exchange published the “*Guide on Connected Transaction Rules*” in plain language. It covers the Rule requirements on connected transactions and the related interpretations published in listing decisions and frequently asked questions. It can be accessed at:-
http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/ctguide_e.pdf

Continuing Disclosure Requirements under the Listing Rules

27. Main Board Rules 13.20 to 13.22 require that if the following specific circumstances continue to exist as at the issuer’s interim period end or annual financial year end, specific disclosures should be included in the interim and annual reports:-
- Advance to an entity (Main Board Rules 13.13 to 13.15A);
 - Financial assistance and guarantees to affiliated companies of an issuer (Main Board Rule 13.16);
 - Pledging of shares by the controlling shareholder (Main Board Rule 13.17);
 - Loan agreements with covenants relating to specific performance of the controlling shareholder (Main Board Rule 13.18); and
 - Breach of loan agreement by an issuer (Main Board Rule 13.19).

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28. A few issuers inadvertently overlooked the disclosure requirement in the interim and annual reports in relation to the above matters. In response to our enquiries, these issuers acknowledged the omission and agreed to fully comply with the disclosure requirement and provide the relevant details, where applicable, in their subsequent financial reports.

Financial reports using CASBE

29. 28 Mainland incorporated issuers elected to prepare their financial statements for the year ended 31 December 2011 under CASBE. Financial statements prepared under CASBE, like other published financial reports, are subject to selection and review under our FSRP. The Exchange, the Financial Reporting Council (the “FRC”) and the HKICPA have together agreed to allocate the review of these CASBE financial reports among the three parties. As with last year, we were pleased to note that for the cases we reviewed in this year, although some disclosures were omitted, they were not material to the financial statements as a whole and the issuers confirmed that the required disclosures will be provided in their future annual reports.
30. Pursuant to the Joint Declarations between the HKICPA and 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 Mainland and Hong Kong. We encourage Mainland incorporated issuers that elect to adopt CASBE to stay alert to the progress on convergence. Useful information is available on the HKICPA’s website at:-
<http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/mainland-standards-convergence/>

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FINDINGS REGARDING ACCOUNTING STANDARDS

31. Table 2 below summarises the key findings and observations relating to accounting standards. Upon receipt and consideration of the responses from the issuers, there were no significant breaches of accounting standards noted that would render the financial statements misleading or warrant investigation or enforcement action. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

Table 2: Findings relating to Accounting Standards

Area	Accounting Standards
Consolidated and separate financial statements	HKAS 27 (Revised)
Investments in associates and interests in joint ventures	HKAS 28 HKAS 31
Interim financial reporting	HKAS 34
Business combinations	HKFRS 3 (Revised)
Financial instruments: Disclosures	HKFRS 7
Operating segments	HKFRS 8

HKAS 27 (Revised) “Consolidated and Separate Financial Statements”

32. We noted that some issuers did not clearly demonstrate how they had “control” over an investee when they did not hold more than 50% equity interest in an investee (paragraph 41(a) of HKAS 27 (Revised)). These issuers only provided a generic description of subsidiaries in their accounting policies, for example, “*Subsidiaries are entities controlled by the group. Control exists when the group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account*”. However, in these cases no additional information relating to the nature of the relationship between the parent and the subsidiaries concerned was provided with regard to how “de facto control” was established.

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HKAS 28 “Investments in Associates” and HKAS 31 “Interests in Joint Ventures”

33. Paragraph 26 of HKAS 28 requires that *“The investor’s financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances”*. A similar requirement for joint ventures is set out in paragraph 28 of HKAS 31. We recommend that information on whether the financial statements of associates and jointly ventures are prepared using uniform accounting policies should be disclosed in financial statements. This assists readers in understanding how associates and joint ventures are reflected in the issuers’ financial statements. We have seen some issuers disclosing this information in their financial statements.

HKAS 34 “Interim Financial Reporting”

34. Paragraph 15 of HKAS 34 requires an *“explanation of events and transactions that are significant”* to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions should update the relevant information presented in the most recent annual financial report. Paragraph 15B of HKAS 34 provides a non-exhaustive list of significant events and transactions. Paragraph 16A further provides a list of other items that should be included in the notes to the interim financial statements if they are not disclosed in other sections of the interim report.
35. We however noted that less than adequate disclosures were made in the notes to interim reports on the following areas:-
- explanation of circumstances or events that led to the significant write-down of inventories to net realisable value or recognition of material impairment loss on trade receivables (paragraphs 15B(a) and (b) of HKAS 34);
 - acquisitions and disposals of items of property, plant and equipment (paragraph 15B(d) of HKAS 34);
 - changes in capital commitments for significant construction projects or purchase of property, plant and equipment reported in prior year (paragraph 15B(e) of HKAS 34);
 - changes in the business or economic circumstances that led to the significant change in the fair value of financial instruments (paragraph 15B(h) of HKAS 34);
 - related party transactions (paragraph 15B(j) of HKAS 34);

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- statement that the same accounting policies and methods of computation were followed in the condensed interim financial statements as compared with the most recent annual financial statements (paragraph 16A(a) of HKAS 34);
 - nature and amount of unusual items because of their nature, size, or incidence (paragraph 16A(c) of HKAS 34); and
 - effect of changes in group structure (paragraph 16A(i) of HKAS 34).
36. Paragraph 15C of HKAS 34 states that *“Individual HKFRSs provide guidance regarding disclosure requirements for many of the items listed in paragraph 15B [of HKAS 34]. When an event or transaction is significant to an understanding of the changes in an entity’s financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period”*.
37. Although it is not an explicit requirement under the current HKAS 34 to disclose that the interim financial statements are prepared on a going concern basis, going concern is one of the underlying assumptions of financial reporting and is also applicable to interim reporting. If there is a going concern issue, merely disclosing a statement in the interim report that the same accounting policies and presentation as adopted in the most recent annual financial statements is not adequate. The interim report should disclose the material uncertainties and an explanation on why the directors believe preparing the interim report on a going concern basis is appropriate.

HKFRS 3 (Revised) “Business combinations”

38. Paragraphs B64 to B66 of Appendix B to HKFRS 3 (Revised) set out the disclosure requirements for business combinations that occur either during the current reporting period or after the end of the reporting period but before the financial statements are authorised for issue.
39. During our review, we noted a few cases where the issuers did not disclose the method in determining the fair value of equity and financial instruments, for example, non-redeemable convertible preference shares and promissory notes, which form part of the consideration (paragraph B64(f) of Appendix B to HKFRS 3 (Revised)).

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40. We also requested an issuer to provide information and explanations on the recognition and subsequent accounting treatment for contingent consideration linked to the future performance indicators of a subsidiary. Based on the responses to our enquiries, there was no apparent breach of the accounting standards, but the case indicated that the issuer should have disclosed additional information relating to the contingent consideration, including whether the future performance indicators had been met subsequently and whether it was classified as an equity or a financial instrument at the acquisition date. In this regard, issuers should pay particular attention to the disclosure requirements on initial recognition and subsequent measurement of a contingent consideration under paragraphs B64(g) and B67(b) of Appendix B to HKFRS 3 (Revised) respectively.
41. Furthermore, we continued to note that there appear to be inappropriate application of HKFRS 3 (Revised) concerning when there is an acquisition of a “business” and when there is an acquisition of an “asset”. It is important to understand at the outset and differentiate between the two as the accounting treatments for acquisition of a business or an asset are very different. The key differences in accounting requirements to note are as follows:-

	Acquisition of a business/Business combination	Acquisition of an asset
Applicable HKFRS	HKFRS 3 (Revised)	HKAS 16 ¹ , 38 ² , 40 ³ etc.
Initial measurement of assets acquired	At fair value	At cost
Goodwill/Gain on a bargain purchase	Yes	No
Deferred tax	Required	Not permitted
Acquisition related costs	Expensed	Can be capitalised

¹ HKAS 16 “*Property, Plant and Equipment*”

² HKAS 38 “*Intangible Assets*”

³ HKAS 40 “*Investment Property*”

42. Paragraph 122 of HKAS 1 (Revised) requires issuers to disclose significant judgements involved in preparing their financial statements. Therefore, we recommend that issuers should disclose the basis as to how they reach the conclusion on the accounting treatment adopted.

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43. Issuers are also reminded to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with HKAS 12 *“Income Taxes”* (paragraph 24 of HKFRS 3 (Revised)). In particular, paragraph 18(a) of HKAS 12 states that temporary differences arise when *“the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with HKFRS 3 Business Combinations, but no equivalent adjustment is made for tax purposes”* and paragraph 19 further states that *“Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66 [of HKAS 12])”*.

HKFRS 7 “Financial Instruments: Disclosures”

44. As also highlighted in our past reports, it was not always clear what method and assumptions were applied by management in determining the fair value of their unlisted investments, which were normally categorised under available-for-sale financial assets.
45. Information on methods and assumptions used in valuations which is required under paragraphs 25 to 30 of HKFRS 7, together with comparative information, is relevant to provide readers with a better understanding of the reasons for year-to-year changes in values.

HKFRS 8 “Operating Segments”

46. There were some minor omissions in disclosures. We noted that the basis of accounting for transactions between reportable segments (paragraph 27(a) of HKFRS 8) was not disclosed. Moreover, some issuers did not provide the information about the extent of their reliance on the major customer when the revenue from transactions with a single external customer amounted to 10% or more of the entity’s total revenue (paragraph 34 of HKFRS 8).
47. The entity-wide information required by paragraphs 31 to 34 of HKFRS 8 applies to all entities including those entities that have a single reportable segment.

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Observations from other related work

48. Earnings per share (“EPS”) is an important measure when performing financial statements analyses between entities. In recent years, there were a few non-compliance cases with the requirements of HKAS 33 “*Earnings per Share*” in relation to the calculation of EPS. Issuers and auditors should take note of this area, in particular, the requirements of paragraph 64 of HKAS 33:-

“If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the reporting period but before the financial statements are authorised for issue, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares. The fact that per share calculations reflect such changes in the number of shares shall be disclosed ...”

49. Issuers should comply fully with HKAS 33 (including application guidance). Further guidance and observations from other regulators in this area are available at:-

- Pages 37 to 39 of the HKICPA’s “*Quality Assurance Annual Report 2011*”:- http://www.hkicpa.org.hk/file/media/section6_standards/quality_assurance/practice-review/qa-annual-report-2011.pdf
- FRC’s press release issued on 13 December 2011:- http://www.frc.org.hk/en/content07_01_26.html

**FINDINGS REGARDING GENERAL ACCOUNTING REVIEW
THEME – GOODWILL AND INTANGIBLE ASSETS**

50. The specific accounting standards theme chosen for this year’s programme was compliance with the accounting standard dealing with goodwill under HKFRS 3 (Revised) and intangible assets under HKAS 38. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.
51. We did not note any significant non-compliance for issuers reviewed regarding goodwill and intangible assets. The key findings and observations together with our recommendations are set out below.

Our observations

52. We observed that from our review 66 issuers had goodwill and 91 issuers had intangible assets as at reporting period ends.

Factors giving rise to goodwill

53. We noted that 22 issuers recognised goodwill from business combinations during the period under review. However, factors that contributed to a cost that resulted in the recognition of goodwill on acquisitions were not clearly provided (paragraph B64(e) of HKFRS 3 (Revised)). Half of those issuers disclosed the factors giving rise to goodwill in their financial statements. Paragraph B64(e) of HKFRS 3 (Revised) requires preparers to disclose and provide “*a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors*” (e.g. the acquired workforce).

Allocating goodwill to cash-generating unit

54. Some issuers omitted disclosure regarding the carrying amount of goodwill attributable to each cash-generating unit.
55. Paragraph 76(a) of HKAS 36 “*Impairment of Assets*” requires that the carrying amount of a cash-generating unit “*includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit’s value in use*”. Paragraph 134(a) of HKAS 36 requires disclosures of the carrying amount of goodwill allocated to each cash-generating unit.

Amortisation of intangible assets

56. 87 issuers had intangible assets with finite useful lives and 17 issuers had intangible assets with indefinite useful lives. HKAS 38 allows an issuer to use either time-based or usage-based approaches for amortisation of intangible assets with finite useful lives. Paragraph 97 of HKAS 38 requires that “... *The amortisation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used...*”. We noted that issuers had disclosed the amortisation methods used for intangible assets with finite useful lives.

Impairment of goodwill and intangible assets

57. We observed that eight issuers had made impairments of goodwill and 11 issuers had made impairments of intangible assets during the periods reviewed. However, only a few issuers disclosed the events and circumstances that led to recognition of impairment losses on goodwill and intangible assets and such disclosures were generally short and generic.
58. With reference to paragraph 130(a) of HKAS 36, issuers should provide a description of the events and circumstances that led to the recognition of impairment of both goodwill and intangible assets to enhance users’ understanding.

Key assumptions applied in determining recoverable amounts

59. We noted that less than adequate disclosure of information on judgements made by management and key assumptions used in determining recoverable amounts of assets (paragraph 134(d) of HKAS 36) was provided in the financial statements.
60. In relation to goodwill, most of the issuers reviewed disclosed the key assumptions used in determining recoverable amounts of cash-generating units. Paragraph 134(d) of HKAS 36 requires that disclosures of key assumptions applied in the calculation of recoverable amounts to include the methodology, the length of the period covered by the financial budgets, the growth rate and the discount rate used. However, we noted omissions of disclosures of the following information:-
- the length of the period covered by the financial budgets;
 - the growth rate; and
 - the discount rate.
61. In relation to intangible assets with indefinite useful lives, only a few issuers disclosed the key assumptions applied in the calculation of recoverable amounts. We also noted omissions of disclosures of the length of period covered by the financial budgets, the growth rate and the discount rate used.

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Research and development expenditure

62. Paragraph 126 of HKAS 38 requires an entity to “disclose the aggregate amount of research and development expenditure recognised as an expense during the period”.
63. We noted that some issuers disclosed the accounting policy for research and development expenditure and mentioned the fluctuation of research and development expenditure in the MD&A. However, some issuers omitted disclosures of the aggregate amount of research and development expenditure recognised as an expense during the year in the financial statements.

Our recommendations

64. Issuers should disclose factors giving rise to goodwill on acquisitions (B64(e) of HKFRS 3 (Revised)).
65. Issuers should provide a description of the events and circumstances that led to recognition of impairment losses on goodwill and intangible assets (paragraph 130(a) of HKAS 36).
66. Issuers should disclose key assumptions applied in the calculation of recoverable amounts of goodwill and intangible assets including the methodology, the length of the period covered by the financial budgets, the growth rate and the discount rate used (paragraph 134(d) of HKAS 36).
67. Issuers should note that the amount of expected cash flow from cash-generating units applied in the calculation of recoverable amounts of goodwill should be reasonable and in line with disclosures shown in the business review and segment information.
68. If goodwill and intangible assets comprise a material part of assets of issuers, issuers should continuously review their systems and controls to ensure that goodwill and intangible assets are fairly stated. Management should ensure that the assumptions for growth rates applied in their discounted future cash flows are achievable over the period under consideration.

**FINDINGS REGARDING SPECIAL REVIEW THEME –
ACCOUNTING BY TELECOMMUNICATIONS COMPANIES AND
INTERNET COMPANIES**

69. In this year's review, we chose as the industry theme issuers whose major or principal activities included telecommunications or internet related business. The review focused particularly on the revenue recognition policy adopted and the extent of disclosure for users of financial statements to understand how these companies recognise the revenue from telecommunications business or internet related business. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

Our observations

70. In total, annual or interim reports of 19 issuers whose major or principal activities included telecommunications or internet related business were reviewed.

Telecommunications business

71. Most telecommunication companies offer handsets to customers for free or at a heavily discounted price upon entering into a telecommunication contract for a specific period of time.
72. From the review of financial reports of issuers whose principal activities included telecommunications business, we noted that most issuers included separate accounting policies for provision of telecommunications services and sales of goods. It was noted that issuers only provided a brief and generic accounting policy on revenue from provision of mobile or fixed-line telecommunications services either based on usage of network or on a straight-line basis over the contracted period.
73. Only one issuer provided more details on how revenue was recognised from provision of services and sale of goods for bundled transactions under contracts which consisted of provision of mobile telecommunications services and sale of a handset device. Another issuer mentioned that it had bundled transactions but how revenue was recognised for this kind of transactions were not provided.
74. In addition, one issuer provided the accounting policy on how the tariff-free periods granted to subscribers are recognised.
75. A few issuers disclosed that they received up-front fees for installation or activation of services and provided brief accounting policies on how up-front fees were recognised.

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76. Around half of these issuers provided in their financial reports some operational statistics, which included numbers of subscribers for different kind of telecommunications network, types of telecommunications network, areas serviced by different kind of telecommunications network, network capacity or volume, etc.

Internet related business

77. Companies that principally engaged in internet related business normally have transactions with multiple elements which may include sales of goods, licensing, subscription fee, advertising and related auxiliary services. Some transactions may be one-off and some may be entered into for a period of time.
78. From the review of financial reports of issuers whose principal activities included internet-related business, we noted that most of the issuers provided accounting policies on recognition of revenue from provision of different types of services together with a separate accounting policy on recognition of revenue from sales of goods. Only one issuer disclosed that it had transactions with packaged services fees which comprised a number of elements but did not disclose how revenue was allocated to different elements.
79. One issuer disclosed that it had received up-front fee / subscription premium and how it was recognised as revenue.
80. A few issuers disclosed limited operational statistics which mainly included number of registered users or active users or subscribers, average daily user hours, etc.

Our recommendations

81. We recommend that for users to better understand the financial statements, issuers should disclose more specific accounting policy on revenue recognition for each kind of revenue which is significant to the issuer. Where a contract with multiple elements is entered, the basis on which the revenue is allocated to each element should be clearly disclosed.
82. A tariff-free period is often granted to customers upon subscribing telecommunication service and internet service. However, only one issuer provided brief disclosure on how the tariff-free period is accounted for in the financial statements. Issuers should disclose more details on tariff-free periods, for example, average tariff-free period in number of months granted to different kinds of customers, and provide the accounting policy on how revenue is allocated and recognised for the tariff-free period granted.

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83. Industry specific operational data are useful for users to understand the financial performance. We observed that a number of issuers provided some operational statistics which were simple and we recommend issuers to enhance the disclosure. Non-exhaustive examples include:-
- types of networks / services provided and its geographical information;
 - analysis of number of subscribers / users by different kind of network / services and by location;
 - call minutes / user hours by different types of network / services and by different types of subscribers / users; and
 - average revenue per subscriber / user by different types of network / services.
84. Operational data on quality of services are useful to users of financial statements to evaluate the performance and future outlook of issuers. Some examples include frequency of network failures reported, number of complaints received, number of calls received by customer service hotline, etc.
85. Finally, the IASB is considering changes to the accounting for “Revenue” which will have significant implications for companies that have revenue generating transactions with multiple elements. Under the proposals, separate performance obligations should be identified in the contract and the contract price be allocated to separate performance obligations. Revenue of each performance obligation is recognised when each performance obligation is satisfied as proposed. We encourage issuers to monitor the development of this accounting standard and to carefully plan and consider how their systems can be updated once the standard becomes effective.

FINDINGS REGARDING DISCLOSURE OF NON-IFRS/HKFRS FINANCIAL INFORMATION

86. During the year, we specifically designed a programme as part of the review on disclosure of non-IFRS/HKFRS financial information.

Our observations

87. We noted that out of the 120 cases, about one-third presented non-IFRS/HKFRS financial information in the MD&A and financial review/highlights in their annual or interim reports. We also noted that a few issuers presented the non-IFRS/HKFRS financial information in their audited financial statements.
88. The most commonly presented non-IFRS/HKFRS financial information included earnings before interest, taxes, depreciation and amortisation (“EBITDA”), EBITDA margin (being EBITDA divided by revenue/turnover), adjusted EBITDA, adjusted EBITDA margin, adjusted profit before tax and adjusted cash flows.
89. We noted that only a few issuers provided a brief explanation on the purpose or reason for disclosing the non-IFRS/HKFRS financial information or how the non-IFRS/HKFRS financial information provided additional information to users of the financial statements.
90. We observed that the disclosure of non-IFRS/HKFRS financial information was generally presented with no greater emphasis when compared to the financial information prepared in accordance with accounting standards. The non-IFRS/HKFRS financial information was clearly labeled and distinguished from the financial information prepared under accounting standards. Also, most of these issuers disclosed the calculation basis or formula on which the non-IFRS/HKFRS financial information was computed and the calculation basis or formula was consistent with that used in prior years.
91. However, we noted that even though these issuers named the non-IFRS/HKFRS financial information in the same terms, the calculation basis or formula for computing the non-IFRS/HKFRS financial information varied between issuers and this could result in users of financial statements encountering difficulties in making a comparison of the performance among issuers based on non-standardised formulas.
92. Some of these issuers disclosed that the non-IFRS/HKFRS financial information was derived from figures in the financial statements prepared in accordance with accounting standards after adjusting for some selected items (e.g. unrealised fair value gain/losses, share of profit or loss of associates and jointly controlled entities, gain/loss on disposal of property, plant and equipment). However, there was no explanation of the reason why the directors believe the “adjustments” should be made.

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93. Without adequate explanation of the definition of the non-IFRS/HKFRS financial information, how they are computed and what they are supposed to indicate, users of financial statements may be confused or even be misled by the non-IFRS/HKFRS financial information.

Our recommendations

94. Properly presented non-IFRS/HKFRS financial information can assist users of financial statements in evaluating the financial performance and financial position of the issuers. Issuers who choose to present non-IFRS/HKFRS financial information should ensure that the non-IFRS/HKFRS financial information reflects the critical components of the financial performance and are accurate. The non-IFRS/HKFRS financial information should neither obscure the financial results and financial position nor provide an incomplete description of the financial results based on accounting standards.
95. In addition, we encourage issuers to provide explanation on the reason why the non-IFRS/HKFRS financial information is presented and how this information is helpful and relevant for users of financial statements to better understand the critical components of financial performance and financial position.
96. We emphasise that the financial information prepared in accordance with accounting standards is the most important part of the financial reports and issuers should provide explanation of their financial performance and financial positions based mainly on the financial information prepared in accordance with accounting standards. The disclosure of non-IFRS/HKFRS financial information is to provide additional information to assist users of financial statements in evaluating the financial performance and financial position of the issuers. Issuers should bear in mind that non-IFRS/HKFRS financial information should not be presented with greater prominence or in a biased manner as compared to the financial information prepared in accordance with accounting standards.
97. When non-IFRS/HKFRS financial information is presented, recommended disclosures include:-
- name the non-IFRS/HKFRS financial information in a way that clearly distinguishes such information from the financial information prepared in accordance with accounting standards;
 - demonstrate the purpose and usefulness of the non-IFRS/HKFRS financial information and explain how such information provides additional information to users of the financial statements;
 - provide a definition and the calculation formula used;

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- provide a clear quantitative reconciliation from the non-IFRS/HKFRS financial information to the figures in the financial statements prepared in accordance with accounting standards and explain reasons for any adjustments made; the adjustments should not be described as “non-recurring” or “one-off” if such adjustments are likely to occur in near future financial statements or have occurred in financial statements for recent prior years;
- present the non-IFRS/HKFRS financial information consistently; or explain and justify with reasons any changes to the definition or the calculation formula compared to those disclosed in previous financial reports; and
- alert users of the financial statements explicitly to the fact that the non-IFRS/HKFRS financial information presented may not be comparable to similarly titled measures published by other issuers as standardised formulas have not been developed by the standard-setters.

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CONCLUSION

98. We encourage all persons involved in or responsible for preparing financial information for issuers and their auditors to take note of the matters discussed in this report. Directors and other persons responsible for financial reporting are reminded to stay alert to changes to the Listing Rules, accounting standards and other regulatory disclosure requirements. It is important that issuers should consult early with their auditors and other external professional advisers to provide them with insights into the changes and their implications on annual audits or reviews of financial statements. They should also review and continuously improve their systems and checklists to ensure that all the required disclosures are made and useful information is presented to readers of financial statements.

- End -

