FINANCIAL STATEMENTS REVIEW PROGRAMME REPORT 2009

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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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EXECUTIVE SUMMARY

The Listing Division has completed its 2007/08 programme of review of listed issuers' published financial reports for compliance with the disclosure requirements of the Listing Rules and accounting standards. This report presents the major findings and observations arising from our review.

We reviewed 100 reports of listed issuers covering the annual, interim and quarterly reports released between July 2007 and September 2008. During the review process, we issued 96 letters to listed issuers that contained more than 500 enquiries and observations.

Our enquiries requested explanations and additional 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 listed issuers to confirm that the required disclosures will be rectified in their future financial reports.

Upon receipt and consideration of the responses from the issuers, we were pleased to note that except for two cases which were referred to the Financial Reporting Council (the "FRC"), there were no significant breaches of the Listing Rules or accounting standards that would render the financial statements false or misleading or warrant additional investigation or enforcement action.

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

The major findings and recommendations arising from the review are set out below:-

- Disclosures of material "other" account balances and income and expense items are too brief;
- Discussions in issuers' Management Discussion and Analysis should be more detailed;
- Disclosures made on the outcome of the auditors' work on continuing connected transactions should be improved;
- Clearer disclosure of adoption of uniform accounting policies in applying the equity method or proportionate consolidation in accounting for associates and joint ventures would assist readers in understanding how associates and joint ventures are reflected in issuers' financial statements;
- Disclosure of factors that contributed to a cost that resulted in the recognition of goodwill on acquisitions should be improved;
- Explanations on why no impairment provisions are made for significant assets where there are indications of possible impairment should be improved;

- Further disclosures concerning an assessment of fair value and risks associated with holdings in financial instruments and how they were managed would be helpful to readers to more fully understand the risks and exposure in these instruments; and

- Clearer descriptions of the usage-based approach adopted for amortising infrastructure assets should be provided by issuers whose major or principal activities include toll road investment, construction, operation and management.

The review findings and observations indicate that some disclosures could be improved and listed issuers should take the opportunity to reassess the adequacy and effectiveness of their existing financial reporting systems so as to enhance and improve the quality of disclosures in their future financial reports.

BACKGROUND

1. As part of the Exchange's regulatory role, the Listing Division operates a Financial Statements Review Programme (the "FSRP") which reviews, on a sample basis, the published periodic financial statements of listed issuers. The FSRP covers listed issuers' quarterly, interim and annual reports (the "Reports").

2. The main purpose of the FSRP is to monitor compliance with the requirements of the Main Board Rules and GEM Rules (together, the Listing Rules) and, in parallel, to monitor compliance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") or International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board (the "IASB"), and the relevant disclosure requirements of the Companies Ordinance. Through publicising the findings arising from the FSRP, we aim to encourage and promote higher standards of financial disclosures by listed issuers.

Scope of financial statements review programme

3. In selecting listed issuers for the FSRP, we adopted a "risk-based approach".

4. The companies selected included samples based on:-

   - Impact criteria

   Large listed issuers, where an instance of major non-compliance might adversely affect the reputation of the Hong Kong equity market as a whole.

   - Probability criteria

   Listed issuers, where there is a possible higher risk of misstatement or misapplication of financial reporting standards due to the existence of features that may be indicative of higher risk. Features include where a listed issuer has been:-

   - issued with a qualified or modified auditors' report
   - subject to complaints concerning compliance with the Listing Rules
   - subject to frequent changes of independent non-executive directors
   - subject to a frequent change of auditors

5. Included in the samples a number of cases were selected at random so that all listed issuers may be selected for review.

6. We included a general accounting theme on business combinations and investments in associates and joint ventures. We also included an industry theme and for this review period we chose companies involved in operating toll road infrastructure projects.

7. We reviewed 100 Reports released by listed issuers between July 2007 and September 2008 and issued 96 letters to the listed issuers for explanations or comments.

8. Of all the cases reviewed during the period, 99 were subsequently closed after considering the responses received to our letters and one case remains outstanding awaiting further clarifications and information from the issuer. The Division also referred two cases to the FRC for further enquiry or investigation and trading in the shares of these two companies remains suspended.

FINDINGS

9. This report summarises our key observations and findings noted during our review. It is important to note that the findings mentioned do not include all areas in which we raised comments or asked questions. The primary objective of this report is to increase listed issuer's awareness of the possible pitfalls in the preparation of Reports, so that listed issuers may learn from the experience of others and to improve the quality of their reports.

10. It is the primary responsibility of the directors of listed issuers to prepare financial reports. In this regard, directors and others responsible for the financial reporting function need to constantly stay alert to changes to the Listing Rules, accounting standards and other regulatory requirements.

FINDINGS REGARDING THE LISTING RULES

11. Table 1 below sets out key areas where issuers need to pay particular attention:-

Table 1: Findings relating to Listing Rules disclosures

Area	MB Rules	GEM Rules	No. of issuers
Disclosures relating to significant events, balances and transactions	Chapter 14 Chapter 14A Appendix 16	Chapter 19 Chapter 20 Chapter 18	34
Management discussion and analysis	Appendix 16	Chapter 18	37
Connected and related party disclosures	Chapter 14A Appendix 16	Chapter 20 Chapter 18	20
Corporate Governance Reports	Appendix 14 Appendix 23	Appendix 15 Appendix 16	16
Ageing analysis of receivables and payables	Appendix 16	Chapter 18	5
Continuing disclosure requirements relating to advances to entities	Chapter 13	Chapter 17	4

Disclosures relating to Significant Events, Balances and Transactions

Our observations

12. We noted that there is room for improvement and issuers are encouraged to provide more information in their reports to ensure that readers of financial statements understand the nature and impact of significant events or material balances and transactions. A common finding was that significant amounts were simply described as "other gains/expenses" or "other receivables/payables" without further details.

13. Main Board Rule 2.13(2) (and its GEM Rules equivalent) requires that *"the information contained in the documents must be accurate and complete in all material respects and not be misleading or deceptive"*. Moreover the *"Framework for the Preparation and Presentation of Financial Statements"* issued by the HKICPA states that the objective of financial statements is to provide financial information that is useful to users in making economic decisions and Hong Kong Accounting Standard ("HKAS") 1 *"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.

14. Accordingly, the absence of information on significant events or material balances and transactions in periodic financial reports may be viewed as non-compliance with the relevant Listing Rules or accounting standards.

15. During the course of our review, we requested listed issuers to provide information and explanations on the relevant significant balances or transactions identified to gain a better understanding of the nature of the items and to evaluate whether there was possible non-compliance with the Listing Rules or accounting standards. The listed issuers were also required to confirm in writing whether they had fully complied with the relevant provisions set out in Chapters 14 and 14A of the Main Board Rules (and their GEM Rules equivalent) and the relevant accounting standards, namely, HKAS 24 *"Related Party Disclosures"*.

16. Based on the responses to our enquiries, we were pleased to note that there was no apparent breach of the Listing Rules relating to notifiable, connected and related party disclosures. Nevertheless our observations indicated that brevity of disclosures in the Reports relating to significant events or material balances and transactions made the Reports less useful to shareholders and investors for making investment decisions. This is an area which requires attention and improvement.

Our recommendations

17. The assessment of what is material or significant is a matter of judgement. The directors of a listed issuer are in the best position to determine what is material and the extent of disclosures warranted. Materiality or significance of information will vary between listed issuers and considerations in assessing materiality should normally include the nature, size and frequency of incidence of the amounts involved with reference to the listed issuer's ordinary and principal activities, and its performance and financial position for the relevant period.

18. A useful guiding principle for determining materiality is whenever an omission of disclosure could cause information contained in the Reports to be false or misleading and thus wrongly influence the economic decisions of the users of the Reports.

19. Listed issuers should bear in mind that even if a significant transaction is not subject to the provisions under Chapters 14 and 14A of the Main Board Rules (and their GEM Rules equivalent), it may nevertheless be required to be disclosed under the listed issuer's general obligation to keep the market informed at all times of all price-sensitive information (see Main Board Rule 13.09 and its GEM Rules equivalent).

20. We would also emphasise that periodic reporting requirements and disclosure obligations under Main Board Rule 13.09(1) (and its GEM Rules equivalent) are not substitutes, but supplement each other. For example, if a prior year adjustment arising from a fundamental error is reflected in an annual report under relevant accounting standards, it would also likely represent price sensitive information that requires immediate disclosure at the time when the error was identified.

21. In view of recent economic developments, the Division issued a letter to all listed issuers on 31 October 2008 to refresh issuers' awareness of their continuous disclosure obligations. The letter, which can be accessed at (http://www.hkex.com.hk/listing/gemsharelistdoc/20081031.pdf), provides further guidance to issuers on the approach to meeting their disclosure obligations and the actions that can be taken, including a useful checklist of areas that should be considered.

Management Discussion and Analysis (MD&As)

Our observations

22. In the course of our review, we noted that 37 issuers could have provided more analytical and in-depth discussions in their MD&As. Some issuers tended to repeat information available in the financial statements in narrative form without additional analysis and explanations. Analyses of the historical data or highlights of significant events affecting the issuers' past and future operations were omitted or not clearly explained. Some issuers experienced substantial fluctuations in turnover, and/or operating profit/loss, and/or net asset values during the period reported on but little explanation of these changes were discussed.

23. Paragraph 32 of Appendix 16 of the Main Board Rules (and its GEM Rules equivalent) requires annual reports to include a separate statement containing a management discussion and analysis of the group's performance during the financial year and the material factors underlying its results and financial position. The MD&As should emphasise trends and identify significant events or transactions during the financial year under review. It further sets out the minimum requirements of the comments to be included in MD&As.

24. Similar provisions but less details are required for interim reports, preliminary and interim results announcements as set out in paragraphs 40(2), 45(3) and 46(3) of Appendix 16 to the Main Board Rules respectively (and their GEM Rules equivalent). For these, disclosures 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 (and its GEM Rules equivalent) 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.

Our recommendations

25. An MD&A is an important narrative which should provide an unbiased analysis of the information provided in the financial statements. It also discusses information provided outside the financial statements that assists and improves users' ability to make economic decisions.

26. Rather than merely replicating information disclosed in the notes to the financial statements the MD&As may make reference to the notes but should contain additional analysis and explanations, including:-

- narratives to provide an understanding of the facts and circumstances that resulted in the recognition of material, unusual and infrequent items reflected in the financial statements (for example, major acquisitions of assets or subsidiaries and significant exchange gains/losses or unrealised gains and losses from fair value changes); and
- an explanation of conditions and events that shaped the information contained in the financial statements, such as how the company was affected by a natural disaster (e.g. the Sichuan earthquake) or the impact of the volatility in commodity prices and exchange rates.

27. Further recommendations, in preparing MD&As to be included in annual reports, include:

- Discussion on all matters referred to in paragraphs 32(1) to 32(12) of Appendix 16 (and their GEM Rules equivalent) preferably should be included in a separate MD&A section of results announcements, interim and annual reports irrespective of whether information relating to these matters has been disclosed in the financial statements or in the notes to the financial statements as this will make the MD&A self-contained and easier to read and understand;
- The financial effect of each significant event which led to a significant fluctuation in results should be discussed;
- Issuers should refer to events which had a significant financial impact on the current reporting period notwithstanding the fact that these matters may have been previously published in prior announcements and circulars under the requirements of the Listing Rules, for example, the acquisition/realisation of material assets that contributed to a substantial amount of the results for the period reported on; and

- Comments should include the nature, size and abnormal frequency of the relevant transactions or balances.

28. The current global financial crisis and the changing expectations of financial markets increases the demand for more company-specific and industry-wide financial and non-financial information to facilitate an assessment of an issuer's performance and prospects. Recommended but non-mandatory disclosures set out in paragraph 52 of Appendix 16 to the Main Board Rules (and its GEM Rules equivalent) that may be considered by issuers include:-

- efficiency indicators;
- industry specific ratios;
- a discussion of the listed issuer's purpose, corporate strategy and principal drivers of performance;
- an overview of trends in the listed issuer's industry and business;
- a discussion on business risks, including known events, uncertainties and other factors which may substantially affect the issuers' future performance, and risks management policy;
- a discussion on the listed issuer's environmental policies and performance, including compliance with the relevant laws and regulations;
- a discussion on the listed issuer's policies and performance on community, social, ethical and reputational issues;
- an account of the listed issuer's key relationships with employees, customers, suppliers and others, on which its success depends; and
- receipts from, and returns to, shareholders.

29. Effective presentation of information is another essential element for high-quality MD&As. Listed issuers should challenge past practices of how key information is structured and conveyed. It is useful to mention here two general principles on presentation, namely, the MD&As should be:-

- balanced (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.

Connected and Related Party Disclosures

Our observations

30. There were 15 cases where listed issuers omitted to include a narrative statement in their annual reports (see Main Board Rule 14A.38 / GEM Rule 20.38) on whether their auditors had confirmed that continuing connected transactions:-

- had received the approval of the listed issuer's board of directors;
- were in accordance with the pricing policies of the listed issuer if the transactions involved provision of goods or services by the listed issuer;

- had been entered into in accordance with the relevant agreement governing the transactions; and
- had not exceeded the cap disclosed in previous announcement(s).

31. Although the current rule (see Main Board Rule 14A.39 / GEM Rule 20.39) does not require the statement to specifically mention the four bullet points, such disclosure is recommended as it makes the narrative statement more meaningful. A follow-up review of these 15 cases shows improvement in disclosures in subsequent financial reports. However, some issuers raised concerns that their auditors had difficulty in confirming certain matters required under Main Board Rule 14A.38 / GEM Rule 20.38. In this regard, a working group comprising representatives of the Exchange, the HKICPA and the SFC is studying the matter, and the HKICPA is expected to issue a practice note to provide guidance to auditors on performing procedures to satisfy the Listing Rules requirements on continuing connected transactions.

32. We noted that listed issuers sometimes omitted to state whether a related party transaction also constituted a connected transaction as defined under the Listing Rules. Listed issuers should pay particular attention to the disclosure requirements under paragraph 8(3) of Appendix 16 to the Main Board Rules (and its GEM Rules equivalent) which require companies to:-

    - state whether or not the related party transactions disclosed in their annual financial statements in accordance with HKAS 24 *"Related Party Disclosures"* (and its IFRS equivalent) fall under the definition of connected transactions or continuing connected transactions in Chapter 14A of the Main Board Rules (Chapter 20 of the GEM Rules); and
    - confirm whether or not they have complied with the disclosure requirements in accordance with Chapter 14A of the Main Board Rules (Chapter 20 of the GEM Rules).

Our recommendations

33. Listed issuers should have in place adequate procedures and effective internal control systems to ensure that connected and related parties are properly identified and that all transactions with these parties are captured separately. Control procedures should include establishing a list of connected persons and related parties of the Group and to review it periodically to ensure that the list is kept up-to-date.

34. Listed issuers should also regularly monitor transactions made and ensure that the caps have not been exceeded.

35. Each year listed issuers should remind their auditors of the need to provide their separate confirmation to the board of directors of the auditors' review of continuing connected transactions and the directors should ensure that confirmation has been received and this fact is disclosed in their annual reports in accordance with Main Board Rule 14A.39 (and its GEM Rules equivalent).

36. As a matter of good practice, related party transactions disclosed in the annual financial statements should be grouped into appropriate classes or groups to enable users to easily assess their relative importance and impact on the issuer's businesses.

Corporate Governance Reports

Our observations

37. We noted that the majority of Reports reviewed had complied with most of mandatory disclosure requirements under Appendix 23 to the Main Board Rules (Appendix 16 to the GEM Rules). However, some findings included:-

- omission of the acknowledgement from the directors of their responsibility for preparing the financial statements;
- no disclosure of the term of appointment of non-executive directors and information on the appointment and removal of directors;
- missing information on remuneration committees and limited descriptions of the emolument policy and long-term incentive schemes as well as the basis of determining the emoluments payable to directors;
- no detailed description of the work performed by the audit committee; and
- details of auditors' remuneration in Corporate Governance Reports were different from information on audit fees disclosed in the financial statements and no explanation or reconciliation was provided.

Our recommendations

38. Listed issuers should take care when preparing their annual Corporate Governance Reports. In complying with the Corporate Governance Code on the review of the effectiveness of internal controls, directors should refer to the guide *"Internal Control and Risk Management – A Basic Framework"* which was published by the HKICPA in June 2005 at the request of the Exchange. The guide not only helps listed issuers to understand and fulfill their obligations under the Corporate Governance Code, but also provides some useful recommendations on good corporate governance practices. The guide is available on the HKICPA's website at:- (http://www.hkicpa.org.hk/publications/corporategovernanceguides/Guide_Eng_August.pdf).

39. The disclosure requirements of auditors' remuneration in the Corporate Governance Report (see Main Board Rule A23.2(h) and its GEM Rules equivalent) call for an analysis of remuneration in respect of audit and non-audit services provided by the auditors of the listed issuer including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the audit firm nationally or internationally.

40. Therefore, in respect of each significant non-audit service assignment (e.g. fees for preparing an accountants' report for an initial public offering document), details of the nature of the services and the fees paid should be disclosed separately. If any amount paid/payable was not recognised in the income statement but charged directly to reserves this should be disclosed. For this purpose, any sums (including out-of-pocket expenses) paid/payable by the listed issuer should be regarded as "remuneration".

41. In addition to the above observations, the Division has reviewed the extent to which listed issuers comply with the Code in listed issuers' 2007 annual reports. Details of findings arising from this review are available at http://www.hkexnews.hk/reports/corpgovpract/CG_Practices_2009_E.pdf

Ageing Analysis of Receivables and Payables

Our observations

42. Some companies provided unclear descriptions of their accounts receivable and accounts payable. The disclosures required on the credit policy and ageing analysis of accounts receivable and the ageing analysis of accounts payable are set out under paragraphs 4(2)(b)(ii) and 4(2)(c)(ii) of Appendix 16 to the Listing Rules respectively (and their GEM Rules equivalent).

43. We noted that the disclosures varied considerably. Some of the financial statements included only a general credit policy statement stating that *"The Group maintains a defined credit policy for its customers"*, *"The credit terms are negotiated with and entered into on a customer by customer basis"*, or *"The Group applies credit policies appropriate to the particular business circumstances concerned"*. Some companies disclosed more, e.g. *"the Group allows an average credit period of 30 to 90 days to its trade debtors"* and others provided a table analysing the ageing of receivables as *"current"*, *"1 to 90 days overdue"*, *"more than 90 days overdue"*.

Our recommendations

44. In order to provide more useful information, we encourage issuers to develop clearly defined credit policies and to ensure that they are clearly disclosed in their annual reports. If different credit periods are granted to trade debtors for different business segments, separate credit policies for each segment should be developed and disclosed. In respect of ageing analyses, although the Listing Rules do not specify the basis of the ageing analysis, the analysis should normally be presented on the basis of the date of the relevant invoice and categorised into time-bands that are appropriate for the business (e.g. where the credit period is 30 days from the date of invoice, 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 HKFRS 7) where an analysis is required for those due but are not impaired. For the latter, the analysis would be based not on the invoice date but on the payment due date. Accordingly, two ageing analysis are expected to be disclosed.

<u>Continuing Disclosure Requirements relating to Advances to Entities</u>

Our observations

45. Four listed issuers inadvertently overlooked the disclosure requirement under Main Board Rule 13.20 (and its GEM Rules equivalent) which requires that where an issuer makes advances to an entity and the balance exceeds 8% of the assets ratio (as defined under Main Board Rule 14.07(1) and its GEM Rules equivalent) at the period/year end date, details of the relevant advances should be disclosed. We noted that the issuers agreed and provided the relevant details, where applicable, in their subsequent financial reports.

Our recommendations

46. Although details of making these advances are disclosed in announcements, advances that continue to exist are also required to be disclosed in subsequent interim, quarterly or annual reports in accordance with Main Board Rule 13.20 (and its GEM Rules equivalent).

47. As the requirements require the tracking of relevant advances, we strongly advise that listed issuers should have in place accounting systems and control procedures which provide the directors with assurance that the issuer is able to meet its disclosure obligations.

FINDINGS REGARDING ACCOUNTING STANDARDS

48. Table 2 below summarises key findings and observations noted relating to disclosure requirements under accounting standards. Upon receipt and consideration of the responses from the issuers, we were pleased to note that, except for two cases which were referred to the FRC, no significant breach of the accounting standards arose that would render the financial statements false or misleading that would require a restatement or reissue of the financial statements. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section also correspond with those in IFRSs.

Table 2: Findings relating to Accounting Standards

Area	Accounting Standards	No. of issuers
Presentation of financial statements - significant events, balances and transactions	Framework HKAS 1 HKAS 34	31
Investments in subsidiaries, associates and jointly controlled entities	HKAS 27 HKAS 28 HKAS 31	30
Impairment of assets, including goodwill	HKAS 36	26
Business combinations and intangible assets	HKFRS 3 HKAS 38	17

Area	Accounting Standards	No. of issuers
Financial instruments	HKAS 32 HKAS 39 HKFRS 7	12
Foreign exchange - functional currency	HKAS 21	5
Related party disclosures	HKAS 24	5

Our observations

49. During our review we noted the following:-

(a) Presentation of financial statements - significant events, balances and transactions

(i) No additional information is presented in the financial statements to provide a better understanding of the nature and impact of significant events or material balances and transactions (e.g. the issue of a new convertible bond, entering into derivative financial instruments, acquisition of a major asset or business) (paragraph 103(c) of HKAS 1 *"Presentation of Financial Statements"*); and

(ii) Less than expected disclosures in the notes to interim reports on the:-

- nature and amount of unusual items because of their nature, size, or incidence (paragraph 16(c) of HKAS 34 *"Interim Financial Reporting"*);
- nature and amount of changes in "key" amounts reported in prior year comparative interim reports (paragraph 16(d) of HKAS 34); and
- effect of changes in group structure (paragraph 16(i) of HKAS 34).

(b) Investments in subsidiaries, associates and jointly controlled entities

(i) Missing disclosure of reasons why an investor did not control an investee despite the fact that it holds more than 50% equity interest in an investee (paragraph 40(c) & (d) of HKAS 27 *"Consolidated and Separate Financial Statements"*);

(ii) Absence of the reasons why an investor has significant influence over an investee despite the fact that the investor holds less than 20% equity interest in the investee (paragraph 37(c) & (d) of HKAS 28 *"Investments in Associates"*); and

(iii) Less than expected disclosure about adoption of uniform accounting policies in applying the equity method or proportionate consolidation in accounting for associates and joint ventures that would assist readers in understanding how associates and joint ventures are reflected in the issuers' financial statements (paragraph 26 of HKAS 28 and paragraph 28 of HKAS 31 *"Interests in Joint Ventures"*).

(c) Impairment of assets, including goodwill

(i) No detailed explanations on why no impairment of a significant asset was made when there were indications of possible impairment (e.g. recurring operating losses of associates and subsidiaries which indicate possible impairment of goodwill) (paragraph 9 of HKAS 36 *"Impairment of Assets"*);

(ii) Less than expected disclosure of information on judgements made by management and key assumptions used in determining recoverable amounts of assets (paragraphs 10 and 90 of HKAS 36); and

(iii) Less than expected disclosures of the events and circumstances that led to the recognition or reversal of material impairment losses (paragraph 130(a) of HKAS 36).

(d) Business combinations and intangible assets

(i) Although disclosure of the date and shares exchanged were disclosed there was no disclosure of the fair value and the basis for determining the fair value of equity instruments issued as consideration for a business combination (paragraph 67(d) of HKFRS 3 *"Business Combinations"*); and

(ii) Factors that contributed to a cost that resulted in the recognition of goodwill on acquisitions were not clearly provided (paragraph 67(h) of HKFRS 3).

(e) Financial instruments

(i) Less than expected disclosures concerning assessment of fair value, including the assumptions and valuation techniques used (paragraphs 25 to 30 of HKFRS 7 *"Financial Instruments: Disclosures"*); and

(ii) Incomplete disclosures of risks associated with holdings in financial instruments and how directors managed exposures (paragraphs 31 to 42 of HKFRS 7). Some issuers only provided minimal or boilerplate disclosures to describe the nature and types of financial instruments held and their related risks.

(f) Foreign exchange – functional currency

(i) Possible use of incorrect functional currency (defined in paragraph 8 of HKAS 21 *"The Effects of Changes in Foreign Exchange Rates"*) which should be the currency of the primary economic environment in which the issuer operates (i.e. the one which the issuer normally generates and expends cash). Listed issuers should refer to paragraphs 9 to 14 of HKAS 21 for further guidance on determination of functional currency; and

(ii) No disclosure of the reason for using a presentation currency different from the functional currency (paragraph 53 of HKAS 21).

(g) Related party disclosures

(i) Incomplete disclosure of all information required on key management personnel compensation (paragraph 16 of HKAS 24 *"Related Party Disclosures"*).

Our recommendations

50. Directors and others responsible for the financial reporting function should take note of the examples of non full-compliance with accounting standards and take appropriate actions to improve their systems and checklists to ensure the quality of disclosures in future periodic financial reports.

51. Whenever an issuer considers the adoption of a new accounting policy or standard, it should plan the steps to be taken to ensure proper implementation. Where deemed necessary, it should seek external professional advice.

52. In addition, listed issuers should ensure staff involved in the accounting and financial reporting function attend update training courses so that they are aware of the impact of new developments on the issuer, and can prepare for the proper implementation of new accounting policies and standards. Preparers of financial statements may also consult their external auditors and make use of illustrative financial statements and disclosure checklists that are freely available from the websites of international accounting firms.

53. The Professional Standards Monitoring Committee of the HKICPA also undertakes a continuous review of published financial statements of listed companies and publishes its report of findings on the HKICPA website at http://www.hkicpa.org.hk/compliance/standards/rm_doc/2007_PSMC.pdf. Its findings may also be a useful reference to persons who are preparing financial statements for listed issuers.

FINDINGS REGARDING GENERAL ACCOUNTING REVIEW THEME – ACCOUNTING FOR BUSINESS COMBINATIONS AND INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

54. The accounting standards review theme chosen for this year's programme was compliance with the accounting standards dealing with business combinations and investments in associates and joint ventures. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section also correspond with those in IFRSs.

55. We were encouraged that the level of compliance for issuers reviewed was generally satisfactory. The key findings and observations were:-

- All selected issuers properly included all subsidiaries in the consolidated financial statements (paragraph 12 of HKAS 27 *"Consolidated and Separate Financial Statements"*);

- All issuers under review used the financial statements of the company and their subsidiaries as at the same reporting date (paragraph 26 of HKAS 27);

- All selected issuers that had non-wholly owned subsidiaries had properly complied with the presentation requirements for minority interests and showed the amounts within equity (paragraph 33 of HKAS 27);

- All issuers under review properly accounted for investments in associates using the equity method (paragraph 13 of HKAS 28 *"Investments in Associates"*);

- 48 issuers under review had jointly controlled entities. 9 issuers accounted for their investments using the proportionate consolidation method and the remaining issuers adopted the preferred alternative of using the equity method (paragraphs 30 and 38 of HKAS 31 *"Interests in Joint Ventures"*). Issuers should note that the IASB has decided to disallow in the future the use of the proportionate consolidation method and those adopting this method should monitor developments and plan for a required change in their accounting policies;

- Over 80% of issuers reviewed provided both the separate financial statements of the company and the consolidated financial statements of the group. Issuers are reminded that HKFRS 3 *"Business Combinations"* and HKAS 27 *"Consolidated and Separate Financial Statements"* have been revised substantially and the revised standards become effective for financial statements beginning on or after 1 July 2009. Appropriate steps should be taken to ensure proper implementation of the revised standards in future annual and interim financial statements; and

- A majority of issuers disclosed two or more reportable segments in their financial statements. Issuers should however note that HKAS 14 *"Segment Reporting"* will be replaced by HKFRS 8 *"Operating Segments"* which is effective for financial periods commencing on or after 1 January 2009. The requirements of HKFRS 8 require the disclosure of segmental information based on the "management perspective", that is, how management manages the company and makes decisions. Comparative information in the first year of application of HKFRS 8 is required and therefore comparatives will need to be restated. Listed issuers should therefore study and understand the new accounting standard and ensure proper implementation of the new accounting standard in their future annual and interim financial statements.

56. We would also take this opportunity to specifically remind listed issuers that are not incorporated in Hong Kong that when preparing their annual reports the Listing Rules require them to provide certain disclosures required under provisions of the Hong Kong Companies Ordinance, including the Tenth Schedule (paragraph 28 of Appendix 16 to the Main Board Rules and its GEM Rules equivalent). Moreover, Main Board Rule 13.46(2) (and its GEM Rules equivalent) 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."* There appear to be divergent practices in the interpretation of the rule in that some interpret the rule to only require the presentation of consolidated financial statements without the presentation of the financial statements of the issuer itself. The apparent reason for this interpretation is that under the current accounting standards the presentation of separate financial statements of the company is not normally required unless the company elects to present them or it is required by local regulations. Issuers should comply with the requirements under both the accounting standards and the Listing Rules.

FINDINGS REGARDING SPECIAL REVIEW THEME – ACCOUNTING FOR TOLL ROAD INFRASTRUCTURE FACILITIES

57. In this year's review, we chose an industry theme – the review of issuers whose major or principal activities included toll road investment, construction, operation and management. The review focused particularly on the accounting treatment adopted for transport infrastructure assets to determine whether there was compliance with the applicable accounting standards. Unless otherwise specified, HKFRSs and their paragraph numbers referred to in this section correspond with those in IFRSs.

Our observations

58. Under Hong Kong Interpretation 1 *"The Appropriate Accounting Policies for Infrastructure Facilities"* issued in 2004 (which was developed locally by the HKICPA with no corresponding IFRS), listed issuers are permitted to use either time-based approach (straight-line method) or traffic usage-based approach (units of production method) for amortisation of infrastructure facilities and the sinking fund method is not considered an appropriate method. We were pleased to note that none of the issuers reviewed adopted the sinking fund method.

59. In total, 13 toll road companies were selected for review and the accounting policies adopted are summarised below:-

- 5 issuers separated amounts attributable to toll road infrastructures from toll road operation rights and of these:-
  - 1 adopted the traffic usage-based method to amortise both toll road infrastructures and operation rights;
  - 1 adopted the time-based method to amortise both toll road infrastructures and operation rights; and
  - 3 adopted the traffic usage-based method to amortise toll road infrastructures and used the time-based method to amortise operation rights;
- 5 issuers only held toll road infrastructures and they all adopted the traffic usage-based method to amortise toll road infrastructures; and
- 3 issuers only held toll road operation rights and 2 adopted the traffic usage-based method and 1 used the time-based method.

60. We however noted that the issuers applied different formulae in calculating the amortisation/depreciation of infrastructure facilities under the usage-based approach.

Our comments and recommendations

61. Although a majority of listed issuers used the usage-based approach which is permitted, there appear to be different formulae applied in calculating amortisation/depreciation. No matter which formula is used, the amortisation/depreciation of assets with finite useful lives should be applied consistently and reviewed at least at each financial year end (see paragraph 104 of HKAS 38 *"Intangible Assets"* and paragraph 61 of HKAS 16 *"Property, Plant and Equipment"* respectively) and in particular projections of traffic volume.

62. Issuers should ensure that they have properly identified the relevant "asset" that is depreciated as the nature and classification of the asset may require a different accounting treatment, for example, the distinction between tangible infrastructures and operating rights.

63. We noted that very often incomplete information was disclosed on the amortisation/depreciation method adopted. Issuers sometimes stated the overall method used in the notes but omitted details on the practices in applying the method, in particular, the measurement basis and key assumptions used in the estimation of traffic volume. During our review, we requested the issuers to provide further explanations, including supporting documents, in order to obtain a clearer understanding of the method adopted.

64. Effective for annual accounting periods beginning on or after 1 January 2008, issuers are reminded to consider HK(IFRIC) Interpretation 12 *"Service Concession Arrangements"* which sets out general principles on recognising and measuring the obligations and related rights in service concession arrangements.

65. Specifically, paragraph 11 of HK(IFRIC) Interpretation 12 provides that the operator's rights over the infrastructure should not be recognised as property, plant and equipment of the operator when the contractual service arrangement does not convey the operator the right to control the use of the public service infrastructure.

66. Moreover, HKAS 38 *"Intangible Assets"* provides some additional guidance and requires that in determining whether an asset that incorporates both intangible and tangible elements, an issuer is required to use judgement to assess which element is more significant (see paragraph 4 of HKAS 38).

67. HKAS 38 allows an issuer to use either time-based or usage-based approaches for amortisation of intangible assets. Paragraph 98 of HKAS 38 requires that the method used should be based on the expected pattern of consumption of the expected future economic benefits embodied in the asset, however, what constitutes "expected pattern of consumption" is unclear and this may require a decision on whether the time-based approach or usage-based approach should be adopted.

68. The usage-based approach based on traffic volume will normally result in a lower initial amortisation in the earlier years of the asset's life than the time-based method. Paragraph 97 of HKAS 38 specifies that if the expected pattern of consumption cannot be determined reliably, the straight-line method should be adopted.

CONCLUSION

69. We plan to continue to undertake a financial statements review programme and communicate the results to listed issuers on a regular basis.

70. We encourage all persons involved in or responsible for preparing financial information for listed issuers and their auditors to take note of the matters discussed in this report. Extra care and attention at the planning stage and other stages of the process leading to publication of financial information will ensure a proper outcome and useful information being presented to readers of financial statements.

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