



**The Stock Exchange of Hong Kong Limited**  
(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

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22 March 2013

To: Main Board Listed Issuers (Attn: Authorised Representatives)  
GEM Listed Issuers (Attn: Authorised Representatives)  
Market practitioners

Dear Sirs

**Guidance on issuers' Rule compliance based on the Exchange's review of disclosure in issuers' annual reports**

We have published today our first report on the findings and recommendations from a review of issuers' annual reports.

Our review focused on issuers' Rule compliance and their disclosure of material events and developments. Areas covered in the review include:

- Impairment of intangible assets arising from material acquisitions
- Results of performance guarantees on acquisitions
- Connected transactions
- Significant changes to financial position
- Newly listed issuers
- Periodic disclosure of mining or petroleum assets under Main Board Chapter 18 / GEM Chapter 18A
- Disclosure by investment companies listed under Main Board Chapter 21

The report is available on the HKEx website at <http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/rdiar-2012.pdf>.

We set out below areas where disclosure by issuers can be improved. You may refer to the report for further details of the guidance.

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### ***Impairment of intangible assets arising from material acquisitions***

Issuers should disclose details of material impairments to intangible assets made in the reporting period, including the basis of the impairment and a meaningful explanation of the events and circumstances that led to the recognition of impairment losses. Where valuations were performed to support the value of intangible assets, the issuers should disclose relevant information about the valuation in the “management discussion and analysis” section of the annual report. These may include the value of the inputs (e.g. projected cash flow, discount rate and growth rate) used in the valuation together with the basis and assumptions, the valuation methodology, and an explanation for any subsequent material changes in the value of inputs and assumptions or changes in the valuation methodology from those previously adopted.

### ***Results of performance guarantees on acquisitions***

From time to time issuers making acquisitions would require the vendor to guarantee the performance of the acquired business. In some acquisitions, performance guarantees are part of the terms of the acquisition agreement which support the basis of the consideration.

Where the guarantee is provided by a connected person, MB Rule 14A.57 / GEM Rule 20.57 requires an issuer to publish an announcement if the financial performance of the acquired business is less than the amount guaranteed. Such disclosures include the shortfall and the adjustment of the consideration, and whether the connected persons have fulfilled their obligations.

Where the guarantee is provided by an independent party, the Rules do not provide for specific disclosure requirements. Nevertheless, we consider that issuers should inform their shareholders about material developments and the outcome of performance guarantees. This is because if the terms of an acquisition agreement include guaranteed performance or the consideration is negotiated by reference to the future performance of the acquired business, they form part of the basis upon which shareholders evaluated, and if required, approved the acquisition.

When the issuer negotiates the acquisition, there should be clarity of the terms of the performance guarantee and the method to determine the compensation in the event the guarantee is not met. The issuer’s investment circular should clearly disclose the performance guarantee.

As a matter of accountability and transparency, the issuer should make clear disclosure about the performance of the acquired business, whether the performance guarantee was met, and whether and how the guarantor fulfilled its obligations under the terms of the agreement where the performance guarantee was not met.

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Where the guaranteed performance is not met, we also remind the directors of their obligations under MB Rule 3.08 / GEM Rule 5.01 to act for proper purpose and in the interest of the company as a whole, when they enforce the agreement to seek compensation.

Further, in circumstances where issuers re-negotiate the terms of the guarantee, they should disclose the revised terms by way of announcements.

### ***Connected transactions***

We remind issuers to disclose in the annual reports:

- (i) whether or not their related party transactions were connected transactions under the Rules and whether they have complied with the specific rule requirements for such connected transactions (see Paragraph 8(3) of Appendix 16 of the MB Rules / GEM Rule 18.09(3)); and
- (ii) for continuing connected transactions, the results of the annual reviews by the independent directors and auditors (see MB Rules 14A.37 and 14A.38 / GEM Rules 20.37 and 20.38).

### ***Significant changes to financial position***

Issuers with significant changes to their businesses and financial performances during the financial year should ensure the “management discussion and analysis” section adequately explains changes to the major items in the financial statements. Areas of note include:

- Trade receivables - Issuers should provide analysis and explanations about the fluctuations in trade receivables, subsequent settlement of the trade receivables after the year end date, and the actions taken by the issuers to follow up with the customers with long outstanding receivables.
- Effective tax rates and tax balances – Issuers should provide meaningful analysis on changes in tax rates and significant fluctuations in tax balances, including the reasons for the abnormal effective tax rates, the range of tax rates applicable to the major operating subsidiaries, and any tax benefits enjoyed by them.

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- Key performance indicators (**KPI**) - Some issuers employ specific KPIs to measure their performance and publish this information on their websites or in some cases in their annual reports. These KPIs provide a consistent benchmark for comparison of companies in the same industry. We encourage issuers disclosing information about the KPIs to also include this information in the “management discussion and analysis” section of their annual reports. The disclosure may include the definition and calculation of the KPIs, and the reasons for any significant changes in the KPIs.

### *Disclosure by issuers under Main Board Chapter 18 / GEM Chapter 18A*

Issuers engaged in exploration, development and mining production activities are required by the Rules to provide updates in their annual reports. We noted that some issuers that complied with the specific disclosure requirements under the Rules provided minimum disclosures which lack details. We have issued a guidance letter (HKEx GL47-13  
<http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/gl47-13.pdf>) in January 2013 setting out the recommended disclosure for their annual reports.

### *Disclosure by investment companies listed under Main Board Chapter 21*

The Rules set out specific disclosure requirements about issuers’ investments, including a breakdown of the investment portfolio and their performances. Issuers should comply with the Rule disclosure requirements in order to present shareholders with meaningful information about their investment portfolios.

If you have any questions on the above, please contact our case officers.

Yours faithfully  
For and on behalf of  
The Stock Exchange of Hong Kong Limited

*[Signed]*

David Graham  
Chief Regulatory Officer and Head of Listing