

HKEX GUIDANCE LETTER HKEX-GL102-19 (April 2019) (updated in January 2022)

Subject	Guidance on accounting policies and stock-taking procedures performed by the reporting accountants
Listing Rules	Main Board Rules 4.03, 4.08(3), 4.11, and <u>4.12, 19.14, 19.25A, 19C.10D, 19C.23 and 19.39</u> GEM Rules 7.02, 7.08(3), 7.12, <u>7.14, 7.13 and 7.16, 24.18A</u>
Related Publications	Joint policy statement regarding the listing of overseas companies published by the Exchange and the SFC in September 2013 (updated in April 2018) (“JPS”)<u>Guidance Letter 111-22</u>
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Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department Division on a confidential basis for an interpretation of the Listing Rules, or this letter.*

1. Purpose

1.1 This letter provides guidance on the Exchange’s approach with respect to (i) change of accounting standard/ policy; (ii) adoption of accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12); and (iii) stock-taking procedures performed by the reporting accountants.

2. Guidance

2.1 The information disclosed in the listing document of a new applicant must enable investors to easily understand its business, financial position, management and prospects, etc.. Accordingly, irrespective of how certain matters/ transactions are accounted for, the Exchange encourages new applicants to disclose information in listing documents beyond those required under the applicable accounting standards to the extent necessary to fulfil the above purpose.

Change of accounting standard/ policy

2.2 If a material change in accounting standard/ policy is expected, new applicants should disclose in the listing document sufficient and meaningful information on the effect of the adoption of such change to enable investors to assess its financial results. Such information should not be a restatement of financial statement information in a narrative form or a tabulation of financial data without analysis, and should include the following, where applicable:

- (i) in the “Summary”, “Risk Factors” and “Financial Information” sections of the listing document, any announced/ possible amendments to the accounting standard¹/ policy and the expected effective date; underlying reasons for the change in the applicant’s accounting policy; and qualitative and quantitative assessment on the potential impact of the changes; and
- (ii) in the management discussion and analysis section and/ or notes to the financial information in the applicant’s annual or interim report after listing, an analysis of the relevant financial results at a level of details similar to what would be presented in the listing document.

Adoption of accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12)

2.3 ~~New applicants that are applying for a secondary listing on the Main Board or seeking dual primary listing on GEM and NYSE or NASDAQ are allowed to use US GAAP. New applicants incorporated in acceptable overseas jurisdictions are allowed to adopt other accounting standards as set out in paragraph 64 of the JPS(Deleted in January 2022).~~

2.4 ~~Other n~~New applicants that propose to adopt accounting standards other than those as set out in Main Board Rule 4.11 (GEM Rule 7.12)² (“**R4.11 Accounting Standards**”) would need to apply for a waiver from the Exchange, which is only granted in exceptional circumstances and on a company-specific basis. For details, please refer to the section headed “F. Financial Reporting Standards and Accounting Standards” in Guidance Letter 111-22. The Exchange will impose, at a minimum, the following conditions for such waiver:

- (i) the applicant’s accountants’ reports and annual/ interim/ quarterly reports (where applicable) after listing must include a reconciliation statement showing setting out the financial effect of the use of different accounting standards any material difference between those financial statements and financial statements prepared using Hong Kong Financial Reporting Standards or International Financial Reporting Standards — (“Reconciliation Statement”). The Reconciliation Statement which should be reviewed by the reporting accountants or auditors. Where a Reconciliation Statement is included as a note to the “audited”³ accountants’ reports or “audited” or “reviewed”⁴ financial statements, the reporting accountants and auditors are not required to provide a separate opinion on the Reconciliation Statement. Where the relevant financial statements (e.g.

¹ New applicants should refer to paragraphs 30 and 31 of International Accounting Standards 8/ Hong Kong Accounting Standards 8 which relates to new and revised standard that has been issued but is not yet effective.

² Note 2.1 to paragraph 2 of Appendix 16 to the Main Board Rules (GEM Rule 18.04) in respect of financial statements after listing.

³ In respect of accountants’ reports, “audited” in this context refers to the work done by the reporting accountants in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 200 “Accountants’ Reports on Historical Financial Information in Investment Circulars”

⁴ In respect of financial statements, “reviewed” in this context refers to a review by auditors in accordance with International Standard on Review Engagements 2410 or Hong Kong Standard on Review Engagements 2410.

~~interim/ quarterly financial statements)⁵ are not audited or reviewed by auditors, the Reconciliation Statement required to be included as a note to such statements should be reviewed by auditors in accordance with a standard comparable to International Standard on Assurance Engagements 3000 or Hong Kong Standard on Assurance Engagements 3000 audited (for accountants' report and annual reports) or reviewed (at least equivalent to International Standard on Assurance Engagements 3000 or Hong Kong Standard on Assurance Engagements 3000) (for interim/ quarterly reports); and~~

- (ii) the new applicant ~~(other than issuers incorporated in a member state of the European Union which have adopted EU-IFRS)~~ must revert to R4.11 Accounting Standards if ~~it de-lists from the jurisdiction of that alternative standard and must do so for any annual and interim financial statements that fall due under the Listing Rules, and are published, after the first anniversary of the date of its de-listing⁶ there is a change in the circumstances under which the waiver was granted (e.g. where a Main Board applicant adopted US GAAP at the time of listing because it was dual listed in Hong Kong and U.S. but was subsequently delisted from the US stock exchange).~~

(Updated in January 2022)

- 2.5 In all cases where a new applicant's ~~accounting accountants'~~ reports are drawn up in conformity with accounting standards other than the R4.11 Accounting Standards, the new applicant should disclose in the listing document, where applicable, (i) a description of the material differences between the accounting standard adopted and the R4.11 Accounting Standards; and (ii) a Reconciliation Statement⁷.

2.5A Secondary listed issuers that are listed in the US and new secondary listing applications from US-listed applicants should refer to Guidance Letter 111-22 for the transitional arrangements on the use of US GAAP for secondary listing. (Updated in January 2022)

- 2.6 In case of a spin-off, if the new applicant's parent is a listed issuer on the Exchange and the new applicant adopts different accounting standards (e.g. US GAAP and IFRS) from its parent, the parent should include a Reconciliation Statement in its circular, if any, in connection with the spin-off proposal.

Stocktaking procedures performed by the Reporting Accountants

- 2.7 The Exchange expects the reporting accountants appointed for the purpose under Main Board Rule 4.03 (GEM Rule 7.02) to conduct significant and substantive work in the preparation of the accountants' report for the purpose of listing. This work would

⁵ ~~The requirement to prepare a Reconciliation Statement for quarterly financial statements is only applicable to GEM issuers. For the avoidance of doubt, a secondary listed issuer listed in the US is not required to prepare a Reconciliation Statement in respect of its US GAAP quarterly financial statements which are published pursuant to overseas rules and regulations.~~

⁶ ~~Primary Listing: note 4 to Main Board Rule 19.14 and note 4 to GEM Rule 7.14 (accountants' reports) and note 4 to Main Board Rule 19.25A and note 4 to GEM Rule 24.18A (annual/ interim/ quarterly financial statements). Secondary Listing: note 4 to Main Board Rules 19C.10D (accountants' reports) and note 4 to Main Board Rule 19C.23 (annual/ interim financial statements).~~

⁷ ~~Main Board Rule 4.12 (GEM Rule 7.16).~~

necessarily entail the reporting accountants gathering sufficient and appropriate evidence to support their opinion through a variety of procedures including inspection, observation and direct confirmation.

- 2.8 If the reporting accountants were appointed during or after the trading record period, they are not able to perform physical count of inventory to ascertain the inventory balances at particular dates prior to their engagement. In those circumstances, it is acceptable for the reporting accountants to adopt roll-back procedures to ascertain inventory balances for the periods prior to their engagement. The directors of the new applicant and the sponsors must be satisfied that it is justifiable for the reporting accountants to adopt the alternative auditing procedures.
- 2.9 The Exchange usually does not find it compelling for the reporting accountants to adopt roll-forward procedures to ascertain the inventory level as at the end of the stub period/ financial year after they were appointed, as it is within the reporting accountants' control to attend/ schedule stocktakes. Even if, for whatever reason, a stocktake could not be arranged on those dates, the reporting accountants should (i) attend one additional stocktake after the end of the relevant period; (ii) perform roll-back procedures to ascertain the inventory balance as at the end of the relevant period; and (iii) compare the stocktake records as at end of the relevant period to the roll-back analysis.
