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-----Original Message-----
From: David M Webb [n]
Sent: Monday, November 05, 2007 3:33 PM

Subject: Opinion poll on financial reporting

Dear Members of the Listing Committee,

This submission is as editor of *Webb-site.com*.

I attach the results of an opinion poll of our readers which ran from 24-Sep-07 until noon today, to coincide with the closing date for your consultation on financial reporting. Any person was entitled to vote, but only 1 vote per e-mail address was allowed, authenticated with a 4-digit PIN number which is sent to that e-mail address. We do not collect demographic information on our readers. Readers can opt in or out of the mailing list at any time.

I also attach our article which forms part of this submission.

The results of the poll should be self explanatory and compelling, but I will narrate them anyway. At least 477 persons responded (that being the greatest number of responses to a single question in the poll).

53% say the deadline for annual reports should be 60 days while 94% support reducing it to 90 days. 91% agree that quarterly reports should be mandatory, and 89% agree that the three quarters should follow the same format. 86% agreed that the very condensed format you proposed is unacceptable and that the unaudited quarterly format should instead follow the annual format with the exclusions proposed in our article. 90% agreed that the new requirements should apply to all companies at the same time, and 89% agreed that all requirements should take effect for financial periods (quarterly, interim and and annual) ending on or after 30-Jun-08 (i.e. the date of introduction should not depend on the issuer's financial year-end).

On the issue of communications, 80% agreed that quarterly reports do not need to be printed and mailed, and can just be filed electronically, while 94% agreed with a proposal you did not make, namely that you should allow hard-copy shareholder mailing lists to move to an opt-in basis rather than the current opt-out basis (see article for details of this proposal).

Regards

David M. Webb
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Poll results: Financial Reporting

Current time:	15:03:49 5-Nov-2007
Closing time:	12:00:00 5-Nov-2007
Time remaining:	**Poll closed**

Introduction

Please read our article on the Stock Exchange's financial reporting proposals, and then answer the following questions in our poll. If you have any additional views, then please make a direct submission to pfr@hkex.com.hk.

Questions

1. What should the deadline be for annual audited financial statements?

Answer	Responses	Share
60 days / 2 months	251	52.8%
90 days / 3 months	195	41.1%
4 months (current deadline)	29	6.1%
Total	475	100.0%

2. Do you agree that quarterly reports should be mandatory?

Answer	Responses	Share
Yes	432	90.6%
No	45	9.4%
Total	477	100.0%

3. Do you agree that 1st and 3rd quarter reports, if introduced, should have the same format as interim (2nd quarter) reports?

Answer	Responses	Share
Yes	412	89.4%
No	49	10.6%
Total	461	100.0%

4. Do you agree that the very condensed financial statements proposed by SEHK are unacceptable, and that the 3 quarterly financial statements should follow the annual format with exclusions as proposed in our article?

Answer	Responses	Share
Yes	388	86.4%
No	61	13.6%
Total	449	100.0%

5. Do you agree that all companies should comply with the new requirements at the same time?

Answer	Responses	Share
Yes	417	90.1%

No	46	9.9%
Total	463	100.0%

6. Do you agree that all requirements should take effect for periods ending on or after 30th June 2008?

Answer	Responses	Share
Yes	402	88.5%
No	52	11.5%
Total	454	100.0%

7. Do you agree that quarterly reports should just be filed electronically, not printed and mailed too?

Answer	Responses	Share
Yes	370	79.9%
No	93	20.1%
Total	463	100.0%

8. Do you agree that hard-copy mailing lists should move to an opt-in basis as proposed in our article?

Answer	Responses	Share
Yes	438	94.4%
No	26	5.6%
Total	464	100.0%

We need your help! After trying once in 1998 and again in 2002, Hong Kong is again proposing faster financial reporting and mandatory quarterly reporting, to catch up with the rest of Asia, including mainland China, where quarterly reports have been mandatory since the start of 2003. With your support, we hope to overcome vested interests this time. Please take our opinion poll!

Faster and Quarterly Financial Reporting

24th September 2007

Please take our Financial Reporting Poll

In a consultation paper published on 31-Aug-07, the Stock Exchange of Hong Kong Ltd (the **Exchange**)[1] has proposed the introduction of mandatory quarterly reporting for companies listed on its main board. This reporting frequency would bring the main board into line with the Exchange's Growth Enterprises Market (**GEM**), which has required quarterly reporting since it was launched in 1999, and with the rest of Asia, where HK is now the last significant market not to require it. Mainland China's CSRC has required quarterly reporting by all listed companies since the first quarter of 2003.

Long-time readers will recall that mandatory quarterly reporting was last proposed by the Exchange in its Jan-02 consultation, which included other proposals on corporate governance. Several of these proposals, including quarterly reporting, were abandoned a year later under pressure from vested interests. The Exchange justified its back-pedalling with a distorted analysis of responses, in which it counted 337 responses submitted by the public through a submission form on *Webb-site-com* as a single response, while counting responses from listed issuers and their advisers separately, and concluded that a 60% majority were opposed to quarterly reporting. If the public's responses had been counted, then overall, 82% of responses supported mandatory quarterly reporting, and 81% supported a 45-day deadline.

Key factors

The factors in relation to information disclosure in general are quite simple and relate to frequency, detail, speed, value and cost.

- **Value**: information is the basis of all rational decisions, including investment decisions. Less information increases uncertainty and risk, and investors accordingly discount the price they are willing to pay for shares. That increases the cost of capital for issuers, and makes them less competitive.
- **Speed**: Information decays over time. Faster disclosure increases information value. The older the information is, the less relevant and reliable it is in an investment evaluation. Insiders usually have fresher information than outsiders. Any company that can't produce monthly management accounts for insiders shouldn't, in our view, be listed.
- **Frequency**: The more frequent the disclosure is, the lower the average age of the information over any period of time, and the less variation in that age. More frequent disclosure reduces the gap, or "information asymmetry", and reduces the risk of loss through insider dealing. See the chart later in this article.
- **Detail**: The more detail in financial disclosures, the greater their value, but with diminishing returns the deeper you go. New information (assuming it is truthful) never has negative value (except in the world of quantum mechanics). Otherwise, by reading it, a completely ignorant person could come to know less than nothing. At worst, it has vanishingly small value . For example, the number of paperclips on a CEO's desk might tell you whether he is a tidy person, which is of little value unless you happen to know whether companies with tidy CEOs outperform on average.
- **Cost**: The cost of gathering and publishing information is always greater than zero, but improvements in technology (such as accounting software and electronic resource planning) and publication (electronic disclosure) reduce this. If the cost of publishing information is greater than its value, then shareholders are worse off financially. That's why companies don't publish financial statements every day (although a retail CEO might well get daily sales figures).

Current situation

For companies that report on or close to the current deadlines of 3 months for interim results and 4 months for annual results, the average age of balance sheet information throughout the year is about 6.5 months, ranging from 3 months just after the interim results to 10 months just before the annual results. For example, if a company has a December year-end and reports on 30th April, then the last financial information you have before that is the condensed balance sheet in the interim report for the 6 months to June, 10 months earlier. Not only that, but the period you are looking at actually began 16 months ago, and so the average age of the income statement is 13 months old. When you get the full-year results on 30th April, you can work out the second half-year, and again, that began on 1st July, 10 months ago, and its mid-point was 7 months ago. Throughout the year then, the average age of income statement data is 9.5 months.

As a result, investors spend a large part of each year in the dark, and the lights are dim even when they come on. It's a crapshoot, so it is no wonder investors treat the market like a casino. They trade on rumour or, if they can get it, inside information (sometimes the same thing). That's one of the reasons why fund managers and investment bank analysts spend so much time on company visits and talking to management, rather than just analysing publicly available information. Faster and more frequent reporting would make the playing field more level, and the professionals would have to work harder at their own research.

The new proposals

The consultation paper now proposes two changes on frequency and speed, all of which were first proposed in a consultation paper in Dec-98 and again in Jan-02, but were not implemented on either occasion:

- To require interim results within 60 days (or 2 months) and annual results within 90 days (or 3 months). This will reduce the average balance-sheet age from 6.5 months to 5.5 months, and the average income statement age from 9.5 months to 8.5 months.
- To require mandatory quarterly reporting within 45 days (1st and 3rd quarters). Together with the first proposal, this will cut the average balance sheet age to 3.5 months, and the average income statement age (based on the mid-point of the latest reported quarter) will be cut to 5 months.

We support the general direction of these proposals, but they don't go far enough. They are deficient in the following respects:

1. Even more condensed

The Exchange proposes to *"keep the content of the quarterly reports to a minimum"* (para 62). They make it sound like a vaccination - "don't worry, this won't hurt much".

The half-year financial statements have always been "condensed" - the income statement, balance sheet and cashflow statement show fewer lines and less information than the annual statements. In particular, we find the interim cashflow statement of many companies is often so condensed as to be meaningless. Now, the Exchange is proposing that the quarterly statements should be *even more* condensed than the interims. Pages 22-24 of the paper show what they have in mind - they should call it "very condensed". For example, there would be a single total for "current assets", without the normal breakdown between cash, receivables, inventory and investments, and a single total for current liabilities, without the detail of accounts payable, bank loans, and so on. It would be impossible to work out many of the most basic ratios of financial analysis, such as net debt, the quick ratio, debtor days and so forth. It's about as dense as a black hole, from which no information escapes.

All that this achieves is to hide details which the company must already have in order to produce the totals in the first place. You can't reach a sum without the parts. So it doesn't save them any material work. This is not a time-saving proposal, but a secrecy proposal.

In our view, the quarterly financial statements should be at the same standard of detail as the interim statements. In other words, there should be 3 quarterly statements in the same format. We also believe that the level of detail should be almost the same as for annual financial statements, except for the following:

- No requirement to audit the 3 quarterly statements. Either the audit committee or the auditor should review them, in line with the current requirement for interim results.
- No requirement to revalue property assets, goodwill or other intangibles (such as licences, trademarks or copyrights) each quarter, so long as the directors are of the view that there has been no material change in valuations. Since these valuations are subjective anyway, they can judge whether to update the valuations.
- No requirement for a breakdown of directors' and senior management's remuneration in the 3 quarterly results

- No requirement for lists of all the subsidiaries and associates - just a list of additions and removals for the quarter
- No requirement for list of investment properties - just a list of additions and removals for the quarter

The Exchange also proposes not to require a list of shareholdings of directors and substantial shareholdings or share buybacks in quarterly reports, as are currently found in interims. We find that information valuable, as it is a snapshot tabulation which is far more readable than the mish-mash of individual disclosures, using obscure codes, that can be found on the HKEx search page. It should be included in quarterly reports, as it is on the GEM.

To be clear, when we talk about the "same format" for financial statements, we are not suggesting that the other parts of an annual report, outside of the financial statements, need to appear quarterly. That would be overkill, as little of this (such as biographies and corporate governance) changes from quarter to quarter. All that is needed are the financial statements and a management discussion and analysis, including comments on current trading and prospects.

2. Timing

We see no reason for allowing 60 days (that is, an extra 15 days) for the 2nd quarterly results. It takes no more time to consolidate your accounts for the second quarter than it does for the first or third quarters. **So we propose that all three quarters should be produced within 45 days of the quarter end. That is the same as the GEM since its launch in 1999.**

3. Means of publication

Hard copy documents consume enormous amounts of paper as well as energy in printing them, transporting them and mailing them. They clog mail-boxes and landfills. They also increase the cost of being listed in Hong Kong. It is time for the Exchange to take the next step in the publication methods for financial reports and shareholder circulars. For several years, the Listing Rules have contained a process by which companies can invite registered shareholders to opt out of receiving hard copies, and instead receive e-mail notification or simply rely on a web site. However, many companies have not taken advantage of this, because those that do have found a very low response rate to the mail-in form, and there is an administration cost attached to the opt-out process. In short, it is probably cheaper to print and mail to everyone than to run an opt-out process.

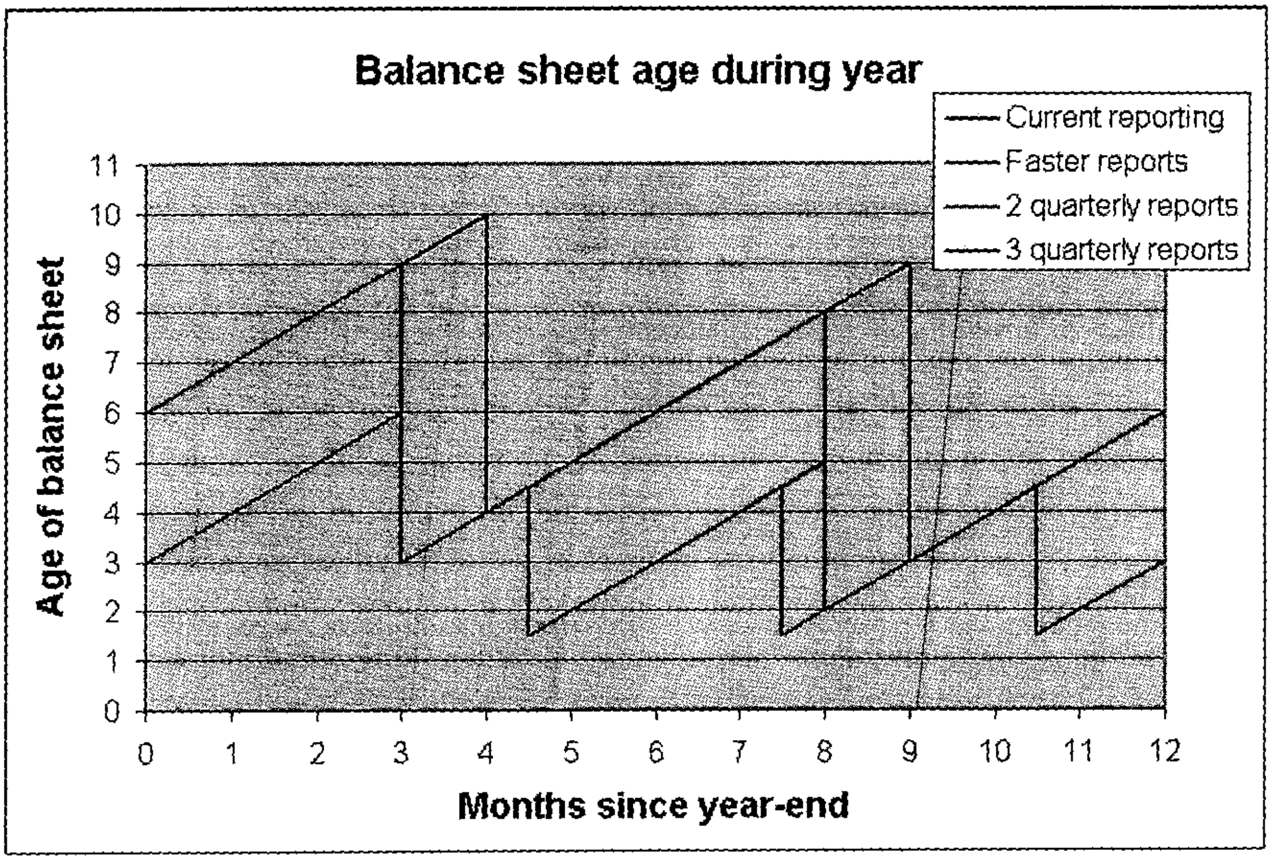
The Exchange should now move from an opt-out process to an opt-in process, whereby companies can write to shareholders once and say "until we hear from you, we will assume that you do not require hard copies". A shareholder could still opt-in to receive hard copies at any time. In doing this, we must be careful not to further disenfranchise investors from voting, so unless a shareholder has provided an e-mail address, they should still be sent hard copies of proxy forms whenever a shareholder meeting is called, together with a note which offers a printed circular and tells them where they can download it instead, and how to opt for e-mail notification in future.

The Exchange proposes that there should be no requirement for printed quarterly reports. We agree, but we think this should include the 2nd quarter, to be consistent with our proposal that all three quarterly reports should have the same format and content.

Comparison

Below is a chart which shows the staleness of the balance sheet data for a company which discloses on the deadlines. We show the current reporting (black line), the faster interim and annual reports the Exchange proposes, the Exchange's additional proposals for two quarterly reports (blue line) and our proposal for three quarterly reports (red line). As you can see, simply accelerating interim and annual reports by a month doesn't do much - you still find yourself eating stale bread most of the year. Quarterly reporting is the key to getting fresh bread.

The red line produces 3 equal cycles where the balance sheet ranges from 1.5 to 4.5 months old with an average of 3 months, followed by a longer wait for the year-end results, while the balance sheet age climbs to 6 months in the last 6-week period. That last part can't be resolved unless we introduce a 4th quarter unaudited result, ahead of the annual audited results. Singapore is one place which does this, requiring unaudited annual results within 45 days, but allowing 3 months for annual reports with audit.



No more delays

The Exchange notes that the large-caps of Hong Kong (which it defines as over HK$10bn (US$1.28bn) at 31-Dec-06) already report faster on average than the small-caps, for both interim and final results. It then makes an illogical leap by saying that companies below this size *"will require additional time to prepare for the new deadline."* And further suggests that small caps need more time than large caps to prepare for quarterly reporting.

There is no evidence to support this. GEM companies, most of which are small, have all been reporting three quarters (including interims) within 45 days and annually within 90 days since 1999. If they can do it with their limited resources, and usually with operations in the mainland, then so can main-board small-caps. In reality, there are other reasons for slow reporting by companies:

- The Listing Rules allow insiders to keep dealing until 1 month before the results come out. By delaying the results, they have more time for insider dealing, including share trading and option grants. Of course, if a regulator can prove that insider dealers knew that the results would surprise the market (negatively or positively), then it can still take action, but the burden of proof is much higher than for the 1-month closed period. We've been making this point for years and the Exchange has yet to close the loophole. Dealing should be prohibited from the period end until the results are announced.
- Competitive secrecy - they don't want competing businesses to see their results any sooner than they see their competitors' results.
- General disregard for minority shareholder interests - most of these companies have a controlling shareholder, so there is no risk of a hostile bid, and if they are not in capital-raising mode, then they see no reason to do more than the minimum required by Listing Rules. They may even be happy to see their share price discounted, so that the controller can increase its shareholding over time or privatise the company.

There is a precedent for the introduction of faster reporting in HK, and it didn't take long. On 16-May-00, the Exchange announced that annual reports would be required within 4 months of the year end, versus 5 months previously, and that (shock, horror) interim reports would have to include balance sheets and cashflow statements. The rules took effect for all companies, large and small, for periods ending on or after 1-Jul-00. In practice, that meant that companies with Dec-00 year-ends had to get their next annual report out by 30-Apr-01. **They all had less than 8 months to prepare.** Compliance was high, and the companies which put their results out at the last moment were the same ones as before - they had just brought it forward by a month when required to.

Not only does the Exchange propose discriminating between large and smaller companies, but it also proposes, in effect, to discriminate based on their year-ends, by introducing the faster interim reporting requirements for Jun-08 (Jun-10 for smaller companies) faster annual reports for Dec-08 (Dec-10 for smaller companies), and quarterly reports for Sep-08 (Sep-10 for smaller companies). That means that if you have a June year-end, then you won't have to produce your first "faster" report until the interim period for Dec-08 (Dec-10 for smaller companies).

In our view, the rule changes should take effect for all companies at the same time, regardless of their financial year-end. That is, the rules should take effect for quarterly, interim (2nd quarter) and annual reports for all periods ending on or after 30-Jun-08. Even then, this will all be taking effect almost 10 years after it was first proposed.

We need your support

Despite being the last man standing in Asia, getting quarterly reporting won't be an easy win. Already there are rumblings from the Chambers of Vested Interests that quarterly reporting is more information than investors can handle. They say that the additional information will increase uncertainty and hence volatility. In their quantum minds, information really does have negative value. We'd all speculate less if we didn't have so much information. Indeed, it follows from this twisted logic that if we had no information, or perhaps 5-yearly reporting rather than quarterly reporting, then nobody would speculate at all. They also suggest that management will behave in a short-term fashion if they have to report more often. That's hardly likely to be the case when the management is, or is appointed by, the controlling shareholder - they will continue to seek long-term value, at least for themselves, if not for everyone else. Perhaps what they are really afraid of is that the share price might better reflect the actual state of affairs if people had better information, and that would make it harder for insiders to exploit mis-pricing.

Accountants, of course, are unlikely to be jumping for joy either at the idea of having to work harder during the peak seasons for results. Senior partners must be agonising over the thought of their profit margins being hit with a higher headcount. But the Government should be happy that it creates more jobs in the profession.

The last time we asked you to send submissions through our site, 5 years ago, the submissions weren't counted. So we don't propose to do that again, although you can make a full submission if you want. Instead, we will use our opinion polling system, and present the result of that poll to the Exchange. Hopefully, through sheer weight of numbers, they will not ignore public opinion this time. So please, support our poll.

Please take our Financial Reporting Poll

Notes:

1. The Exchange is a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Ltd (**HKEx**, 0388). As an elected independent non-executive director of HKEx, your editor David Webb has no role in listing matters, which are handled by the Exchange and its Listing Committee of outside members.