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THE HONG KONG SOCIETY OF FINANCIAL ANALYSTS

05 November 2007

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

Via fax to: 2524-0149

Re: *Consultation Paper on Periodic Financial Reporting*

Dear Sirs:

CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre")[1] and the Hong Kong Society of Financial Analysts (the "HKSFA") are pleased to comment on *Chapter 3: Introduction of Mandatory Quarterly Reporting for Main Board Issuers* of the *Consultation Paper on Periodic Financial Reporting* (the "Consultation") of the Stock Exchange of Hong Kong Limited (the "Exchange"). CFA Institute Centre represents the views of investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, the education and licensing requirements for investment professionals, and the efficiency and integrity of global financial markets. The HKSFA represents nearly 5,100 investment professionals in Hong Kong and mainland China, and is a member society of CFA Institute.

General Comments

Members of CFA Institute have long advocated the use of quarterly reporting throughout the world. Among the positions taken with regard to this issue and noted in a 1993 CFA Institute report, *Financial Reporting in the 1990s and Beyond*[2], was that quarterly "interim reporting satisfies optimally the trade-off between the maximum length of time an analyst should have to wait to receive a report on an enterprise's economic status, and the minimum period of time for which meaningful financial measures can be made."[3] The report also noted that quarterly reporting reduces the opportunities for insiders to trade on privileged information.

[1] The CFA Institute Centre for Financial Market Integrity is a part of CFA Institute. With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong, and New York, CFA Institute is a global, non-profit professional association of more than 94,500 financial analysts, portfolio managers, and other investment professionals in 136 countries and territories, of which nearly 79,400 are holders of the Chartered Financial Analyst® (CFA®) designation. CFA Institute membership also includes 135 Member Societies and Chapters in 56 countries and territories.

[2] The report was published by the Association for Investment Management and Research which changed its name in 2004 to CFA Institute.

[3] *Financial Reporting in the 1990s and Beyond*, 1993, Association for Investment Management and Research, p. 50.

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Those views have not changed. In 2006, CFA Institute adopted a similar position when advocating on behalf of its Singaporean members about the need for a quarterly reporting requirement in Singapore.

Indeed, CFA Institute members in Asia overwhelmingly support quarterly reporting. In our Asia-Pacific Corporate and Financial Disclosure survey conducted in November 2004, 82% of members said that dissemination of comprehensive quarterly reports was a global best practice that companies in the region should emulate. Just 10% said they were indifferent and 8% disagreed. Support among Hong Kong members of CFA Institute was strong as well, with 78% saying it was a global best practice to emulate, versus 13% without a view and 9% against it. A total of 683 members responded to this survey, 27% of whom follow the Hong Kong market.

CFA Institute Centre and HKSFA commend the Exchange for its thorough research in the preparation of the Consultation, and agree with every item tabled in Questions 1 through 8. As such, in the pages that follow, CFA Institute Centre and HKSFA will respond to the specific questions starting from Question 9. In every case, the response reflects the support among CFA Institute and HKSFA members for requiring companies to provide comprehensive quarterly financial reports to shareholders and investors.

Question 9: Do you agree that mandatory quarterly reporting should be introduced for Main Board issuers? Please state reasons for your views.

CFA Institute Centre and HKSFA strongly support mandatory quarterly reporting for a number of reasons.

First, timely information is needed by shareholders and investors to make informed decisions about their investment options. The quality of investment decisions can be no better than the quality of financial reporting, and a major factor in the quality of this information is its timeliness. If investors were not updated about the performance and financial condition of the company at least every three months, they would have to guess about it until new information was provided. The consequence of less-frequent reporting would be increased volatility of share prices, particularly prior to and immediately following the release of annual or semi-annual financial reports.

Second, while the required release of such financial information every three months will not eliminate the incentive for earnings manipulation or the incidence of fraud, it does require those who would manipulate earnings to report more frequently. By doing so, quarterly reporting gives investors more opportunities to uncover any attempts to manipulate the financial reports. It also reduces the time in which insiders can consider how to manipulate what they report, thereby making the manipulation process more difficult and, therefore, more prone to errors and discovery.

Third, quarterly reporting reduces the likelihood that insiders will have time to take advantage of privileged information at the expense of external investors and shareholders.

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Delaying the release of financial information by an additional three months would give insiders a greater opportunity to recognize developing trends in performance, the knowledge of which they or related parties could use to trade ahead of the rest of the market.

Fourth, reporting on financial performance and condition every three months does not encourage management to misreport earnings. Such misreporting of financial results is a function of poor ethics on the part of reporting parties, and is not a result of the behavior of users of that information.

Fifth, increased transparency resulting from quarterly reporting enhances shareholder interest in the shares of these companies, increasing daily share turnover, reducing pricing spreads, and lowering capital costs for companies. Studies of pricing changes resulting from changes in transparency requirements of companies in the United States and Europe with publicly listed shares have shown that increased pricing multiples typically develop as a consequence of increased reporting requirements, and vice versa.[4]

Sixth, it is shareholders' funds that managers of companies are using to prepare this information. If shareholders wish to have the information, they will not penalize management for providing it, so long as it is done efficiently and does not reveal problems with the internal controls used to create those reports. Besides, if all companies in the market are required to provide the same kind of information with the same frequency, none will be disadvantaged for doing so.

Neither CFA Institute Centre nor HKSFA subscribes to the suggestion that quarterly reporting creates greater volatility in share prices. On the contrary, information is the lifeblood of financial markets. Without it, investors would be forced to make decisions in a vacuum, one that often is filled by rumor, innuendo, or falsehoods about corporate performance. The result of information embargos, therefore, is reduced knowledge among investors, leading to reduced trading activity and wider spreads.

CFA Institute Centre and HKSFA also reject the suggestion used by some in other markets that continuous disclosure requirements will achieve the same objectives. Proponents of that view argue that regular and frequent updates of relevant corporate events and transactions will provide sufficient information for investors to determine ongoing performance and

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[4] Two studies are particularly helpful in this regard. The first, "The Economic Consequences of Increased Disclosure," by Christian Leuz and Robert E. Verrecchia (*Journal of Accounting Research*, vol. 38, Supplement (2000): 91-124), shows that German companies that committed to the higher transparency levels of an international reporting regime experienced significant reductions in bid-ask spreads and increases in daily turnover. A summary can be found at http://www.cfapubs.org/doi/abs/10.2469/dig.v32.n1.1001. The second study, "Economic Consequences of SEC Disclosure Regulation," (The Wharton Financial Institutions Center Working Paper Series, February 2003, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=307821), by Brian J. Bushee and Christian Leuz, showed that regulatory changes requiring small firms trading on the OTC Bulletin Board to comply with stricter U.S. Securities and Exchange Commission reporting requirements experienced higher costs that were offset by positive stock returns and permanent increases in market liquidity.
Another article on the subject appeared in the 30 March 2005 edition of the *Wall Street Journal* and was written by Rory Knight, chairman of the management consultancy Oxford Metrica and former dean of Templeton College, University of Oxford. Mr. Knight noted that European companies that established an American Depository Receipts program, thereby subjecting themselves to increased SEC reporting requirements, including quarterly reporting, saw increases in value of between 8% and 10%, while delisting from those requirements destroyed value by up to 40%. (This article is available for a $2.95 fee at http://online.wsj.com/PA2VJBNA4R/article/SB111213449520692373-search.html?)

conditions without having to consolidate that information into recognizable financial statements every three months.

We reject this view because such a regime gives company management significant latitude to determine what transactions or events are sufficiently material to warrant disclosure. Indeed, revenues from *individual* sales of products and services and related expenses typically are not considered material enough to warrant a press release to the market. Without mandating quarterly reporting, therefore, the normal course of business will never warrant reporting, forcing investors to guess about how the company is performing for three extra months.

Consequently, the solution to ensuring that financial markets and their participants receive timely, complete, accurate and relevant financial and performance information is to require companies to provide such information every three months.

As this list suggests, there are many advantages to mandating quarterly reporting by public listed companies.

***Question 10:* Do you agree that Main Board issuers should publish their quarterly reports within 45 days after the period end? If you believe that a reporting deadline for quarterly reporting other than 45 days is more appropriate, please state your preference. Please also state reasons for your views.**

CFA Institute Centre and HKSFA view that 45 days is an acceptable reporting deadline after period-end for companies to publish their quarterly reports, and strongly encourage the market to strive for a shorter reporting period in the future. Shorter reporting times make information more useful because it is more relevant to current operations. Likewise, any further delay in the dissemination of relevant information increases the opportunities for insiders to use their knowledge to trade ahead of the rest of the market. This possible outcome is not optimal for investors, financial markets in general, or even the issuing companies. Given the state of financial reporting and accounting technology available to listed companies today, the delay in disseminating this information should be minimal.

***Question 11:* Do you agree that quarterly reports of Main Board issuers should include as a minimum all the information set out in Table 8? Please state your reasons for your views. Please also comment, together with reasons, on those items which you believe may be considered to be added to Table 8.**

CFA Institute Centre and HKSFA agree that the information set out in Table 8 should be included in the minimum amount of information that companies should present in their quarterly reports.

We believe in principle, however, that quarterly reports should not be simplified to the extent that only the information in Table 8 is presented. Companies should endeavor to provide more information, as any effort to reduce the quantity and quality of financial information that is available will limit the ability by investors to analyze the financial statements.

The information contained in Section A of Table 8 does not provide sufficient information for an investor to analyze the financial health of the company. For example, an investor would like to know the breakdown of current assets into inventories, receivables, cash and other components to compare with previous periods, and also to calculate relevant financial ratios. The information gap between Table 8 and the annual financial statements are too wide. CFA Institute Centre and HKSFA believe that the best way to make quarterly reports more meaningful to users would be to require companies to provide, in unaudited form, the financial statements in the same format as in annual financial statements with detailed components. Notes to financial statements should be provided where relevant to enable investors, and this might be covered under sections B, C and D of Table 8.

Under current regulations, interim reports must be reviewed by an independent auditor, in accordance with 'Statement of Auditing Standards 700 – Engagements to Review Interim Financial Reports', and the interim report must therefore be accompanied by an 'Independent Auditor's Review Report'. As best practice, quarterly reports should also undergo the same independent review. However, for practical considerations – keeping in mind the cost and time such a review demands from companies – we agree with the Exchange's proposal that the quarterly report be reviewed by the Audit Committee.

Question 12: Do you agree that a condensed consolidated income statement in a quarterly report should contain the following information, together with prior year comparatives? Please state reasons for your views

a. Current quarter results

b. Cumulative year-to-date results

As stated above, CFA Institute Centre and HKFSA believe that comprehensive – rather than condensed – results should be presented to enable investors to gain a fuller understanding of the issuer's latest financial status. In this case, a comprehensive reporting of current-quarter and cumulative year-to-date results, together with prior year comparisons, is necessary.

Question 13: Do you believe that the following information, together with prior-year comparatives, should also be provided in the condensed consolidated income statement in the quarterly report for a third quarter? Please state reasons for your views.

a. The first quarter results

b. Immediately preceding quarter results

No. CFA Institute Centre and HKFSA believe that first quarter and immediately preceding quarter results are no longer necessary in a third-quarter report – as long as the report provides current-period and cumulative year-to-date results with their prior-year comparables. Adding such information would only make preparation of the report more costly and complicated. Should investors wish to know results from prior quarters, they will be able to do so by referring to prior statements.

Question 14: Do you agree that printing and mailing of hard copies of quarterly reports to all shareholders and holders of the company's other securities should not be required but listed issuers should be required to publish their quarterly reports on the HKEx website and the listed issuer's own website? Please state reasons for your views.

Yes. CFA Institute Centre and HKSFA believe that electronic delivery of financial information through the HKEx and the listed issuer's own website is not only cost-effective and environment-friendly, but also the most efficient way of disseminating information fairly to all shareholders. However, the Exchange should require listed companies to give their shareholders the option of choosing electronic or hard-copy delivery to ensure that those who do not have Internet access receive relevant financial information in a timely manner.

Question 15: Do you agree that the new quarterly reporting requirements should be introduced in phases with:

a. "large companies" being required to comply with the new Rules first; and

b. other companies allowed a transitional period of two years to meet the new deadlines?

Please state reasons for your views.

Question 16: Do you agree that the commencement dates for the new quarterly reporting requirements for Main Board issuers should be:

a. "large companies" – three months quarterly accounting periods ending on or after 30 September 2008; and

b. other companies – three months quarterly accounting periods ending on or after 30 September 2010.

Please state reasons for your views. Please also comment, including reasons, if you have other suggested commencement dates.

Yes. While CFA Institute Centre and HKSFA believe that implementation of the quarterly reporting requirement for Main Board companies should be universal, we believe that phased implementation as proposed in the Consultation is acceptable, for practical considerations.

CFA Institute Centre for Financial Market Integrity and the Hong Kong Society of Financial Analysts appreciate the opportunity to comment on the Exchange's consultation paper, *Consultation Paper on Periodic Financial Reporting*. If you have questions or seek amplification of our views, please feel free to contact Lee Kha Loon, CFA, by telephone at

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or by email at , or Karl Lung, CFA, at or .

Sincerely,

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