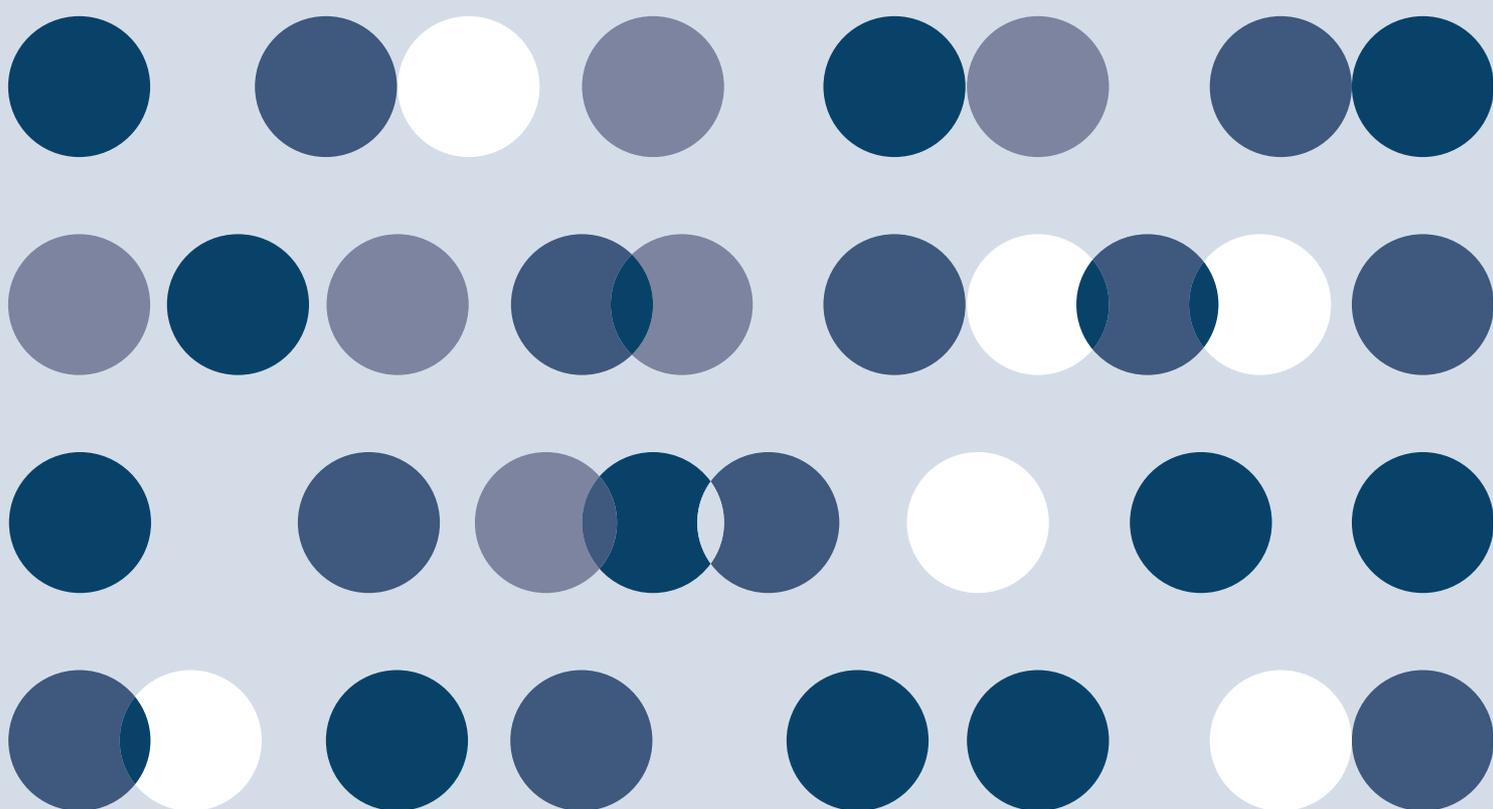


July 2016

FINANCIAL STATEMENTS REVIEW PROGRAMME
REPORT 2015



**Financial Statements Review Programme
Report 2015**

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EXECUTIVE SUMMARY

The Exchange has completed its review of issuers' published financial reports for compliance with the disclosure requirements of the Listing Rules and accounting standards. This is our seventh published report summarising our key findings from the review of 100 reports comprising issuers' annual, interim and quarterly reports released between March 2015 and April 2016.

During the review process, we sent 63 letters to issuers. The letters contained more than 180 enquiries and observations, including requests for explanations and information about the accounting treatment adopted or clarifications of possible non-compliance or omitted disclosures.

Based on the responses to our enquiries, except for one case which was referred to the Financial Reporting Council (the "FRC") for further enquiry and investigation of possible accounting and auditing irregularities, there were no significant breaches of the Listing Rules or accounting standards that would render the financial statements misleading, require their restatement or warrant disciplinary action. Where disclosure was insufficient and not material to the financial statements as a whole, we obtained confirmations from issuers that the required information would be provided in future financial reports.

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

The review found several key areas in issuers' financial disclosures and related matters where there is room for improvement and special focus is required, where appropriate:

- **Enhancements to Management Discussion and Analysis ("MD&A")** – MD&A should be balanced (with coverage of good news as well as bad news) and sufficiently tailored to the issuer's specific circumstances, including coverage of the nature and impact of significant events or material balances and transactions. Issuers should avoid boilerplate disclosure that obscures useful information (see paragraphs 14 to 22);
- **Disclosures under the Companies Ordinance – a level playing field for all issuers** – Issuers should pay attention to the recent Listing Rule amendments with reference to the new Companies Ordinance (Cap. 622) (the "New CO") whereby all issuers (whether or not they are incorporated in Hong Kong) should make relevant disclosures set out in paragraph 28 of Appendix 16 to the Main Board ("MB") Rules (and equivalent Growth Enterprise Market ("GEM") Rules) (see paragraphs 23 to 27);
- **Issues relating to modified auditors' reports should be addressed** – Issuers whose financial statements have auditors' reports with modified opinions should take proactive steps to resolve the issues identified with their auditors as soon as practicable (see paragraphs 46 to 49);
- **Extended auditor reporting** – Issuers, in particular their audit committee, should note that with effective for audits of financial statements for periods ending on or after 15 December 2016, they should have in-depth conversations with their auditors, either at an early stage or throughout the reporting period, regarding key audit matters, going concern issues and other significant events or transactions that occurred during the reporting period (see paragraphs 50 and 51);

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- **Key HKFRSs that will soon become effective** – Issuers should note that a number of key accounting standards have been issued and will soon become effective (e.g. Hong Kong Financial Reporting Standard (“HKFRS”) 9 “*Financial Instruments*”, HKFRS 15 “*Revenue from Contracts with Customers*”, HKFRS 16 “*Leases*”). These new standards are expected to have material impact on some issuers, particularly on their information systems, accounting processes, internal controls and business contracting processes. Issuers should early consult their professional advisers and closely monitor the developments on the implementation and perform a detailed review of these standards as soon as practicable (see paragraphs 79 to 89);
- **Rigorous assessment on impairment of assets** – Issuers should aim to improve the quality of their disclosures in relation to impairment of assets, particularly where the recoverable amount was based on value in use, which required management’s estimation of cash flow projections, growth rates and appropriate discount rates (in accordance with Hong Kong Accounting Standard (“HKAS”) 36 “*Impairment of Assets*”). In addition, issuers should assess the reasonableness of key assumptions applied in impairment testing of both tangible and intangible assets (including goodwill) and make sure the assumptions applied are not overly optimistic, in particular, where issuers are loss making or there are other indications that an impairment loss may have occurred (see paragraphs 103 to 114);
- **Non-HKFRS financial information** – Issuers that choose to present non-HKFRS financial information to provide additional insight into their financial performance should ensure that they follow guidance from reputable sources on such disclosure. This is to ensure that the non-HKFRS financial information is not misleading, would not obscure their financial results and financial position, or provide an incomplete description of their financial results based on accounting standards (see paragraphs 115 to 119); and
- **Determination of control over investees** – Issuers should properly determine whether control over investees exists and consolidation of financial statements is required, and ensure that the relevant facts and circumstances are clearly disclosed so that investors and other users of financial statements understand why the issuer has control, in particular, with regard to cases where issuers only have de facto control over the investees (in accordance with HKFRS 10 “*Consolidated Financial Statements*”) (see paragraphs 126 to 135).

The overarching principle for high quality financial reporting is that the “information provided should be relevant, material and entity-specific”; and issuers should avoid making irrelevant and immaterial disclosures.

We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report. In today’s challenging global economic environment, issuers should stay alert to changes to the Listing Rules, accounting and auditing standards, and other relevant laws and regulations; and capitalise on opportunities to improve disclosure. Financial reporting is more than merely a compliance exercise. Clear and concise financial reporting is an effective communication tool through which issuers should provide investors with the information they need to make informed investment decisions.

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I. INTRODUCTION

1. As part of the Exchange's regulatory function, the Listing Department operates a Financial Statements Review Programme (the "FSRP") which reviews, on a risk-based basis, issuers' published periodic financial reports. The FSRP covers issuers' quarterly, interim and annual reports.
2. The objective of the FSRP is to monitor issuers' compliance with:
 - the requirements of the Listing Rules in relation to periodic financial reports;
 - the relevant disclosure requirements of the Companies Ordinance; and
 - the applicable accounting standards, including:
 - Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA");
 - International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board (the "IASB"); and
 - China Accounting Standards for Business Enterprises ("CASBE") issued by the Ministry of Finance of the People's Republic of China, for those issuers incorporated in the Mainland ("PRC issuers") that have elected to adopt it.
3. In order to enhance transparency and help issuers improve the quality of their financial disclosures, we regularly publish reports of our key findings and recommendations resulting from the FSRP. The purpose of these reports is to increase issuers' awareness of the possible pitfalls in the preparation of periodic financial reports so that they may learn from the experience of others and improve the quality of their future reports.

Scope of the FSRP

4. A risk-based approach is adopted in selecting issuers for the FSRP. The selection criteria include:
 - Impact – where an instance of major non-compliance by an issuer might adversely affect the reputation of the Hong Kong equity market as a whole.
 - Probability – where there is a possible higher risk of misstatement or misapplication of accounting standards due to the existence of certain features, including where an issuer:
 - experienced significant changes in its net assets;
 - was newly listed;
 - was the subject of complaints concerning compliance with the Listing Rules;
 - issued financial statements with a qualified or modified auditors' report; and/or
 - engaged a smaller accounting firm as its auditors.
 - Random – a number of cases are selected at random so that any issuer may be selected for review.

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5. We reviewed 100 reports released by issuers between March 2015 and April 2016 and sent 63 letters (2014: 61) to issuers that contained more than 180 enquiries or observations (2014: 210).
6. Of all the cases reviewed during the period, 98 were subsequently closed after considering the responses received to our letters. Two cases remain outstanding, as we are awaiting further clarification and information from the relevant issuers.
7. This is our seventh published report. It highlights our key findings and recommendations relating to disclosures under the Listing Rules (Section II of this report) and accounting standards (Section III of this report), but does not include all the areas in which we raised comments or asked questions.
8. For each year's review, in addition to monitoring compliance with the Listing Rules and accounting standards from a general perspective, we also do so through the lens of specific accounting and industry themes (and, where appropriate, topical issues). For this year, we selected:
 - as our accounting theme, "Accounting for consolidation, associates and joint arrangements, and disclosure of interests in other entities" (Section IV of this report); and
 - as our industry review theme, "Issuers whose major or principal activities included hotels, gaming and leisure related businesses" (Section V of this report).
9. Key findings and recommendations raised in our past reports may also be relevant and useful for reference. They can be accessed at:
<http://www.hkex.com.hk/eng/rulesreg/listrules/guidref/finrept.htm>.
10. This FSRP is separate from our Review of Disclosure in Issuers' Annual Reports to Monitor Rule Compliance (the "Compliance Review"). The Compliance Review focuses on issuers' compliance with the Listing Rules and their disclosure of material events and developments. The Compliance Review Report 2015 can be accessed at:
<http://www.hkex.com.hk/eng/rulesreg/listrules/guidref/issuergdo.htm>.
11. Unless otherwise specified, the Rule references referred to in this report apply to both MB Rules and GEM Rules. While the discussion in this report will focus on MB Rules, the discussion applies equally to GEM Rules.

II. FINDINGS REGARDING THE LISTING RULES

12. This section sets out below findings and recommendations in relation to disclosure requirements in Appendix 16 to the MB Rules (“Appendix 16”) for issuers to consider:
- the MD&A and Business Review;
 - other disclosures required under the Companies Ordinance;
 - ageing analysis of accounts receivable;
 - directors’ emoluments;
 - the five highest paid individuals and senior management remuneration by band;
 - distributable reserves;
 - financial statements with modified opinions issued by auditors; and
 - financial reports using CASBE.
13. Although the commonly omitted or incomplete disclosures identified in this year’s review were similar to those identified in previous years, there was a general improvement in this area as the number of omitted disclosures required by Appendix 16 decreased.

The MD&A and Business Review

MD&A

14. Paragraph 32 of Appendix 16 requires an issuer to include in its annual reports a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position; and should emphasise trends and identify significant events or transactions during the financial year under review. In addition, paragraph 32(1) to 32(12) of Appendix 16 sets out the minimum areas that should be covered in the MD&A.

Our findings

15. Although we have highlighted this issue in our past reports, there are still instances of insufficient disclosure in relation to the nature and impact of significant events or material balances and transactions. For example, we have identified cases where issuers:
- merely repeated information available in the financial statements in narrative form without additional analysis and explanation;
 - did not adequately discuss unusual items, e.g. they failed to explain the reasons for the movements in allowance for doubtful debts and what actions have been taken to recover the amounts written off; and

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- did not adequately discuss key balance sheet items, e.g. they failed to explain the reasons for making very significant prepayments to suppliers for raw materials, why the current portion of certain balances remained in the balance sheet for over a year, and whether such balances were part of the normal course of their businesses.
16. We also noted that the following minimum required disclosures were sometimes omitted from or incomplete in issuers' annual reports:
- the group's liquidity and financial resources;
 - the currencies in which borrowings are made and in which cash and cash equivalents are held;
 - the extent to which borrowings are at fixed interest rates;
 - comments on segmental information, such as developments within the segment and changes in revenue and margins; and
 - details of the number of employees and remuneration policies.
17. In addition, we would like to draw issuers' attention to certain presentation issues evident in some annual reports which indicated a lack of care in their preparation. For example, we noted that in some cases there were inconsistencies between matters reported in the MD&A and the financial statements.

Business Review

18. Following the Revision of Appendix 16¹, paragraph 28(2)(d) of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to include a Business Review in accordance with Schedule 5 of the New CO ("Schedule 5") in its directors' report. The following sets out the requirements of Schedule 5:
- a directors' report for a financial year must contain a Business Review that consists of:
 - a fair review of the company's business;
 - a description of the principal risks and uncertainties facing the company;
 - particulars of important events affecting the company that have occurred since the end of the financial year; and
 - an indication of likely future development in the company's business.

¹ Issuers are reminded of the Rule amendments with reference to the New CO ("Revision of Appendix 16"). Those relating to the disclosure of financial information in Appendix 16 apply to accounting periods ended on or after 31 December 2015. The main changes include: (i) aligning the requirements for disclosure of financial information in Appendix 16 with reference to the disclosure provisions in the New CO; and (ii) streamlining the disclosure requirements and removing duplications with HKFRS. For further details, see the consultation conclusions on "Review of Listing Rules on Disclosure of Financial Information with Reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments" published by the Exchange in February 2015, available at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201408cc.pdf>.

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- to the extent necessary for an understanding of the development, performance or position of the company's business, a Business Review must include:
 - an analysis using financial key performance indicators;
 - a discussion on: (i) the company's environmental policies and performance²; and (ii) the company's compliance with the relevant laws and regulations that have a significant impact on the company; and
 - an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company and on which the company's success depends.

Our findings

19. Except for 13 cases where the issuers were required to provide their first Business Review, the revised Rules were not yet effective for the remaining cases reviewed. In the course of our review, we identified a few general areas in which issuers' Business Reviews had room to improve. For example, we observed that:
- the disclosures required under Schedule 5 appeared to be subsumed within the MD&A, but the directors' report did not include a cross-reference to the MD&A;
 - the Business Review section was very general or brief, raising doubts as to whether the content requirements of Schedule 5 had been met; and
 - the descriptions of principal risks and uncertainties facing the issuer were noted to be generic rather than entity-specific.

Our recommendations

20. Issuers' financial reports should contain sufficient details for investors to make a reasonable and realistic assessment of their businesses. Bearing this in mind, issuers should ensure as far as possible that the MD&A:
- provides an adequate explanation of performance or properly identifies components of growth or profit (e.g. elaborate on the underlying causes of the changes instead of only reciting the figures);

² It should be noted that this requirement is separate and distinct from the information called for under the Environmental, Social and Governance Reporting Guide (MB Rules Appendix 27) (the "ESG Guide") (see the FAQ Series 18 FAQ No. 9)

Issuers are also reminded of the amendments to the ESG Guide and related Rules which are coming into effect in two phases: (i) for financial years beginning on or after 1 January 2016 (amended Rules, upgrade of the General Disclosures in the ESG Guide from recommended disclosures to "comply or explain" provisions, and revised recommended disclosures); and (ii) for financial years beginning on or after 1 January 2017 (upgrade of the key performance indicators in the "Environmental" Subject Area of the ESG Guide from recommended disclosures to "comply or explain" provisions). For further details, see the consultation conclusions on *"Review of the Environmental, Social and Governance Reporting Guide"* published by the Exchange in December 2015.

The above FAQ and consultation conclusions can be accessed at our designated ESG webpage, which sets out practical steps, tools and reporting guidance aimed at helping issuers to start ESG reporting under the revised ESG Guide, available at: <http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/esg/index.htm>.

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- comments on unusual items and material transactions reported in the financial statements³ (e.g. discuss the actions that have been taken to recover the debts that were significantly impaired);
 - covers not just the year's performance but also the position at the end of the year (e.g. disclosures should include discussions of significant balance sheet and cash flow amounts, not just items that impact the income statement); and
 - is consistent with other sections of the report (e.g. the segments discussed in the MD&A should be in line with the information in note to the financial statements concerning HKFRS 8 "*Operating Segments*").
21. With effect from December 2015 onwards, as required under paragraph 28(2)(d) of Appendix 16, issuers should include a Business Review in their directors' report in accordance with Schedule 5. We will continue to monitor this area in our coming review programme. When preparing a Business Review, issuers should have particular regard to the following points⁴:
- *Cross-referencing* – There are similarities between the required disclosures of MD&A and the prescribed contents of a Business Review. Schedule 5 states that a directors' report for the year must "contain" a Business Review. This requirement can be met by including a cross-reference in the directors' report to the MD&A, provided that the cross-reference is clear and states that the cross-referenced part of the annual report "forms part of the directors' report"⁵. Issuers should take care to ensure that their disclosures in the MD&A are sufficient to meet the content requirements of Schedule 5.
 - *Principal risks and uncertainties* – Reporting a long list of risks could make it difficult for investors to identify and understand which risks are the most significant for issuers' businesses. Schedule 5 uses the term "principal". This means only the risks and uncertainties that issuers are genuinely concerned about should be included⁶. For example, risks of cyber-attacks and data losses are of growing concern for businesses around the world and have received prominent media coverage in recent years; as such, investors would likely expect these risks to be reported more often as principal risks.

³ Issuers should take note that paragraph 112(c) of HKAS 1 (Revised) "*Presentation of Financial Statements*" further requires entities to provide information which is relevant to an understanding of the financial statements by way of inclusion of necessary additional notes to the financial statements. Our observations and further guidance are detailed in paragraphs 72 to 75 of Section III "*Findings regarding Accounting Standards*".

⁴ For further guidance on the preparation of a Business Review, issuers may refer to: (i) the HKICPA's Accounting Bulletin 5 "*Guidance for the Preparation and Presentation of a Business Review under the Hong Kong Companies Ordinance Cap. 622*", available at: <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/circular/>; and (ii) the Hong Kong Institute of Directors' "*Clear and Concise: A Director's Guide to Writing the Business Review of an Annual Report*", available at: <http://www.hkiod.com/clear-and-concise.html>.

⁵ See the Response to Question A8 relating to "Location of the business review" in the HKICPA's Q&A series on the New CO (in the sub-section "Part A – Directors' report" under the category "other than those relating to transition from the predecessor Ordinance (Cap. 32)"), available at: <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/new-co/ga-index/pa-director-report/>.

⁶ In section B of Appendix 1 to our guidance letter HKEX-GL86-16 (issued in February 2016 and updated in May 2016) (the "Letter"), when preparing listing documents, we recommend that the "Risk Factors" section should include all the material risks associated with investing in an applicant and its securities, and explain why these risks are material from investors' perspective. This guidance can also be applied to the Business Review in issuers' annual reports. The Letter is available at: http://en-rules.hkex.com.hk/net_file_store/new_rulebooks/gl8616.pdf.

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The Business Review should also explain how principal risks are being managed and mitigated.

22. The key objective of financial reporting is to achieve balance, such that both good and bad news are presented and reported clearly and evenly, without glossing over or omitting any material facts⁷.

Other disclosures required under the Companies Ordinance

23. Paragraph 28 of Appendix 16 requires an issuer (whether or not it is incorporated in Hong Kong) to include in its annual report disclosures required under certain provisions of the Companies Ordinance.

Our findings

24. Apart from the findings concerning the Business Review discussed above (see paragraph 19 above), we found a few cases where issuers did not disclose the auditors' remuneration (as required under Schedule 4 of the New CO, which was previously set out in the Tenth Schedule of the predecessor Companies Ordinance (Cap. 32) (the "Predecessor Ordinance")) in the financial statements.
25. On the other hand, we are pleased to note that in nearly all the cases reviewed, issuers provided the holding company's statement of financial position for the financial year and the movement in the holding company's reserves in the financial statements (as required under Schedule 4 of the New CO).

Our recommendations

26. Issuers should pay attention to the revised paragraph 28 of Appendix 16 with reference to the New CO⁸ and ensure that they prepare annual reports and financial statements which comply with the disclosure requirements of both the Listing Rules and the relevant sections of the New CO.
27. There are many resources available to issuers that can help them improve the quality of their financial reports (e.g. practical guides, illustrative financial statements and disclosure checklists available on the websites of accounting firms⁹), but it is important that staff involved in the financial reporting function understand the requirements underlying the resources so they can be tailored to address the issuers' specific circumstances.

Ageing analysis of accounts receivable

28. Paragraph 4(2)(a) of Appendix 16 requires an issuer to disclose in its financial statements the ageing analysis of accounts receivable. In addition, paragraphs 33(b) and 37(a) of HKFRS 7 "*Financial Instruments: Disclosures*" require an entity to disclose its policies for managing the credit risk and an ageing analysis of trade debtors that were past due but not impaired.

⁷ Issuers should take note of the requirement under MB Rule 2.13 for any corporate communication (including financial reports) to be accurate, complete and not misleading.

⁸ See footnote 1 above.

⁹ The HKICPA also provides some guidance materials on its designated webpage "New Companies Ordinance Resource Centre", available at:
<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/new-co/>.

Our findings

29. During our review, we noted that in some cases issuers did not provide the basis upon which the ageing analyses were presented. We also noted other cases where an ageing analysis of trade debtors that were past due but not impaired (as required under paragraph 37(a) of HKFRS 7) was not provided in the financial statements.
30. Disclosures also varied considerably. Some issuers included only a generic credit policy statement, for example: *“The credit terms of trade receivables are in accordance with specific payment schedules agreed with various customers”*. In one case, the carrying amount of trade receivables (net of allowance for doubtful debts) as at the year-end date was greater than the total revenue for the year; however, the issuer provided a table analysing the ageing of receivables based on the invoice date as *“0-30 days”, “31-60 days”, “61-90 days”* and *“over 90 days”*; and the longest time-band presented for the past due information was *“over 3 months”* only, which was unlikely to assist investors in understanding the credit policy and how the issuer managed its credit risk relating to the receivables.

Our recommendations

31. In order to communicate to investors how management manages credit risk¹⁰, issuers should provide entity-specific information and avoid generic boilerplate disclosures. Issuers are encouraged to develop clearly defined credit policies and disclose these in their annual reports; and if different credit periods are granted to trade debtors for different business segments, they should develop and disclose separate credit policies for each segment.
32. In previous reports, we have repeatedly emphasised that the analysis as required by paragraph 37(a) of HKFRS 7 is different from the analysis as required by paragraph 4(2)(a) of Appendix 16. Issuers are reminded that paragraph 37(a) of HKFRS 7 requires an analysis of the age of trade receivables that are past due¹¹ but not impaired, which would be based not on the revenue recognition date but on the payment due date. Accordingly, the two ageing analyses should both be provided in the financial statements.
33. Issuers are also reminded of the requirement of Note 4.2 to paragraph 4 of Appendix 16 (newly added in the Revision of Appendix 16) which states that *“The ageing analysis should normally be presented on the basis of the date of the relevant invoice or demand note and categorised into time-bands based on analysis used by an issuer’s management to monitor the issuer’s financial position. The basis on which the ageing analysis is presented should be disclosed.”* For example, where the credit period is 30 days from the invoice date, the ageing analysis could be categorised into 30 days, 60 days, 90 days, 120 days, etc.

¹⁰ It should be noted that HKFRS 7 requires both qualitative and quantitative disclosures about exposure to credit risk (paragraphs 33 to 38 of HKFRS 7). HKFRS 7 also includes mandatory application guidance (paragraphs B6 to B10 of HKFRS 7) and is accompanied by non-mandatory implementation guidance (paragraphs IG15 to IG29 of HKFRS 7) to assist entities in applying and providing the disclosures required by HKFRS 7.

¹¹ The term “past due” is defined in Appendix A to HKFRS 7 as: *“A financial asset is past due when a counterparty has failed to make a payment when contractually due.”*

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Directors' emoluments

34. Paragraph 24 of Appendix 16 requires an issuer to disclose in its financial statements details of director's and past director's emoluments, by name.

Our findings

35. As with last year, we noted that disclosures regarding directors' emoluments in the financial statements were sometimes incomplete. For examples, in some cases issuers:
- incorrectly aggregated "discretionary" bonuses paid/receivable by directors with the basic salaries and other allowances and benefits in kind;
 - omitted a disclosure of the contributions to pension schemes for directors or past directors for the financial year; and
 - did not provide an analysis of the remuneration of supervisors (in the case of a PRC issuer) by name or a chief executive (who is not a director).

Our recommendations

36. Issuers should ensure that details of the components of directors' emoluments are fully disclosed, including the contributions to pension schemes. In relation to bonus payments, issuers should meet the requirements¹² to:
- disclose under the category of "directors' basic salaries" bonus payments to which the directors are contractually entitled and are fixed in amount; and
 - disclose under the category of "bonuses paid or receivable by directors" bonus payments to which the directors are contractually entitled but are not fixed in amount, together with the basis upon which they are determined.
37. Moreover, issuers should provide an analysis of the remuneration of its chief executive if he/she is not a director¹³. In the case of a PRC issuer, "directors" and "past directors" include supervisors and past supervisors and the disclosures should include the remuneration of supervisors by name¹⁴.

The five highest paid individuals and senior management remuneration by band

38. Paragraph 25 of Appendix 16 requires that *"An issuer must disclose in its financial statements information in respect of the five highest paid individuals during the financial year ..."* In addition, Code Provision B.1.5 of Appendix 14 to the MB Rules requires (on a "comply or explain" basis) that *"Issuers should disclose details of any remuneration payable to members of senior management by band in their annual reports."*

¹² Set out in notes 24.2 and 24.3 to paragraph 24 of Appendix 16.

¹³ Set out in note 24.5 to paragraph 24 of Appendix 16.

¹⁴ Set out in note 24.4 to paragraph 24 of Appendix 16.

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Our findings

39. Issuers generally complied with the requirement to disclose the remuneration paid to the five highest paid individuals by band. Where all five of the highest paid individuals were directors, that fact was clearly stated in their financial statements.
40. However, as was the case last year, some issuers did not disclose in their annual reports details of the remuneration paid to members of senior management by band or explain their reasons for non-disclosure in their corporate governance reports.

Our recommendations

41. Issuers are reminded that the requirements to disclose the remuneration of the five highest paid individuals and details of the remuneration paid to members of senior management are separate and distinct. Issuers should ensure that both disclosures are included in their annual reports.

Distributable reserves

42. Paragraph 29 of Appendix 16 requires an issuer to provide a statement of the reserves available for distribution to shareholders as at the reporting date in its annual reports.

Our findings

43. Most issuers provided the statement of the reserves available for distribution to shareholders as at the reporting date. The specific amount of distributable reserves was disclosed either in their directors' reports or financial statements.
44. However, we found a few cases where issuers only mentioned the proposed final dividends and the remaining distributable reserves for the current year to be carried forward to the next year, instead of the amount of "accumulated" distributable reserves as at the end of the reporting period.

Our recommendations

45. Issuers should disclose the amount of their distributable reserves as at the reporting date. To enhance clarity, the information may be disclosed alongside the movement in their holding company's reserves, showing the distributable/non-distributable components. In calculating the amount available for distribution, issuers should take into account any restrictions in the issuers' articles and statutory provisions applicable in its place of incorporation¹⁵.

¹⁵ Hong Kong incorporated issuers should read the HKICPA's Accounting Bulletin 4 "Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance" ("AB 4") issued in May 2010 which provides guidance on the determination of distributable profits. The Companies Registry Briefing Notes mentioned that Part 6 of the New CO "Distribution of Profits and Assets" does not introduce fundamental changes to the distribution provisions in the Predecessor Ordinance. Issuers incorporated outside Hong Kong are also encouraged to read AB 4 for reference where issuers taking into account advice from their legal counsel believe that AB 4 is relevant in determining the distributable profits. The Companies Registry Briefing Notes and HKICPA AB 4 are available at: http://www.cr.gov.hk/en/companies_ordinance/docs/briefingnotes_part06-e.pdf and <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/circular/>.

Financial statements with modified opinions issued by auditors

46. Paragraph 2 of Appendix 16 requires that *“Each set of financial statements presented in an annual report ... shall provide a true and fair view of the state of affairs of the listed issuer and of the results of its operations and its cashflows.”*

Our findings

47. In this year’s review, five financial statements had auditors’ reports with modified opinions¹⁶. We noted that in one of these cases where the auditors issued a disclaimer of opinion on the issuer’s financial statements because of an audit scope limitation and non-availability of certain subsidiaries’ books and records. The matters giving rise to the disclaimer of opinion indicated a possible breakdown in the internal control systems of the issuer. To address the investors’ concern, the issuer disclosed in its corporate governance report that it had taken steps and made appropriate disclosure that *“In order to improve the internal control, the Company has engaged an external independent audit firm to perform a review of the procedures, systems and controls for the Group. Based on the opinion of the external independent audit firm, the Board considers that the Group has adequate internal control systems to comply with the Listing Rules and other relevant rules and regulations and there is no major internal control deficiency of the Group that has given rise to material changes to the Group’s operation after completion of the internal control review.”* We will follow up with this issuer in next year’s review to ascertain whether it has resolved the matters causing the disclaimer of opinion.

Our recommendations

48. Directors of issuers are primarily responsible for the preparation of financial statements that give a true and fair view and for establishing effective risk management and internal control systems such that the financial statements prepared are free from material misstatement, whether due to fraud or error. Issuers should note that the Code Provision C on “Accountability and Audit”¹⁷ has been amended to, inter alia, emphasise that internal controls are integral part of risk management and to enhance accountability of the board, board committees and management in relation to risk management and internal controls.
49. We strongly remind issuers whose financial statements have auditors’ reports with modified opinions to take proactive steps to resolve the issues identified with their auditors as soon as practicable.
50. Issuers should take note of the new and revised HKSA’s issued by the HKICPA in August 2015 (the “Auditor Reporting Standards”)¹⁸, which are effective for audits of

¹⁶ The term “Modified opinion” is defined in paragraph 5(b) of Hong Kong Standard on Auditing (“HKSA”) 705 (Revised) *“Modifications to the Opinion in the Independent Auditor’s Report”* as: *“A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements.”*

¹⁷ Issuers are reminded of the Rule amendments relating to the risk management and internal control section of the Corporate Governance Code and Corporate Governance Report became effective for accounting periods beginning on or after 1 January 2016. For further details, see the consultation conclusions on *“Risk Management and Internal Control: Review of the Corporate Governance Code and Corporate Governance Report”* published by the Exchange in December 2014, available at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201406cc.pdf>.

¹⁸ The new and revised HKSA’s are issued in response to the International Auditing and Assurance Board’s (the “IAASB”) project on auditor reporting to enhance auditor’s reports for investors and other users of financial statements. The HKSA’s conform with the IAASB’s new and revised auditor reporting standards.

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financial statements for periods ending on or after 15 December 2016. The current form and content of an auditors' report is generally short and standardised. Under the new and revised Auditor Reporting Standards, the form and content of the auditors' report will be substantially extended¹⁹.

51. In view of the new and revised Auditor Reporting Standards, issuers, in particular their audit committees, should have in-depth conversations with their auditors, either at an early stage or throughout the reporting period (e.g. about key audit matters, going concern issues and other significant events or transactions that occurred during the reporting period). Doing so may help to minimise the risk of last minute surprises and avoid delays in releasing their annual results.

Financial reports using CASBE

52. 45 PRC issuers elected to prepare their financial statements for the year ended 31 December 2014 under CASBE (2013: 40). The Exchange, the FRC and the HKICPA have agreed to collaborate in reviewing the CASBE financial statements. Financial statements prepared under CASBE, like other published financial reports, are subject to selection and review under our FSRP.

Our findings

53. In this year's review, the Exchange selected 11 sets of financial reports using CASBE. Although some disclosures under the Listing Rules and/or CASBE were omitted, they were not material to the financial statements as a whole and the issuers confirmed that the required disclosures would be provided in their future annual reports.

Our recommendations

54. Although there were no major issues identified from the reviews, we would like to remind issuers using CASBE to ensure the disclosure requirements of both the Listing Rules and CASBE are met.
55. Pursuant to the Joint Declarations between the HKICPA and the China Accounting Standards Committee and the Chinese Auditing Standards Board on 6 December 2007, there is a mechanism to ensure effective ongoing convergence of the accounting and auditing standards between Mainland China and Hong Kong²⁰. We encourage PRC issuers that elect to adopt CASBE to stay alert to the progress on convergence and work closely with their auditors.

For further details, see the IAASB's press release issued on 15 January 2015, available on the IAASB's website at:

<http://www.ifac.org/news-events/2015-01/iaasb-issues-final-standards-improve-auditors-report>.

¹⁹ The key changes to the auditors' report include requirements to: (a) present the opinion section first, followed by the basis for opinion section; (b) include enhanced auditor reporting on going concern, e.g. description of the respective responsibilities of management and the auditor for going concern; (c) include a new section to communicate key audit matters; and (d) report on the auditors' work relating to other information (other than financial statements and the auditors' report thereon) included in an entity's annual report.

²⁰ Additional information is available on the HKICPA's website at:
<http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/mainland-standards-convergence/>.

III. FINDINGS REGARDING ACCOUNTING STANDARDS

56. This section sets out our findings and recommendations in relation to accounting standards arising from this year's review. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

HKAS 1 (Revised) "Presentation of Financial Statements"

Going concern

57. Financial statements are generally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future (unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative to do so). When management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, these uncertainties should be disclosed (paragraph 25 of HKAS 1 (Revised))²¹.

Our findings

58. From this year's review, we observed that a few issuers generated losses or had net current liabilities/net liabilities for two consecutive years or more. This appeared to cast doubt on the issuers' ability to continue as a going concern, but the disclosure as required by paragraph 25 of HKAS 1 (Revised) was not provided.

Our recommendations

59. When preparing financial statements, issuers should make an assessment of their ability to continue as a going concern. Issuers are reminded that the assessment as to whether the going concern assumption is appropriate takes into account not only the events at the end of the reporting period but also the events after the end of the reporting period (see paragraph 14 of HKAS 10 "*Events after the Reporting Period*").
60. The disclosure of material uncertainties related to events or conditions that may cast significant doubt upon the ability to continue as a going concern is important as it alerts investors and other users of financial statements about those uncertainties and management's reaction and plans.
61. Such uncertainties are considered to be material if their disclosure could reasonably be expected to affect the economic decision of investors and other users of financial statements. In determining whether there are material uncertainties, issuers should consider the magnitude of the potential impacts of future events or changes in conditions and the likelihood of their occurrence. Issuers should also consider whether there is action that could be taken to avoid, or reduce the impact or likelihood of, their occurrence.

²¹ Issuers are also reminded of the requirement (subject to "comply or explain") in Appendix 14 to the MB Rules to disclose in the corporate governance report material uncertainties relating to events or conditions that may cast significant doubt on the issuer's ability to continue as a going concern (Code Provision C.1.3).

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62. Issuers should note that when they have a history of profitable operations and ready access to financial resources, they may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis (paragraph 26 of HKAS 1 (Revised)). Therefore, where an issuer generates losses or has net current liabilities/net liabilities, the issuer should carry out a detailed analysis and consider providing the disclosure required by paragraph 25 of HKAS 1 (Revised).
63. When disclosing the material uncertainties, issuers should:
- provide a description of those uncertainties that is clear and case-specific;
 - discuss management's plans and actions taken or to be taken in order to alleviate those uncertainties; and
 - explain in sufficient detail the basis for management's conclusion to prepare the financial statements on a going concern basis.

Accounting policies, judgements and estimates

64. HKAS 1 (Revised) requires an entity to disclose:
- in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements, and the other accounting policies used that are relevant to an understanding of the financial statements (paragraph 117 of HKAS 1 (Revised));
 - in the summary of significant accounting policies or other notes, the judgements that management has made in the process of applying their policies and that have the most significant effect on the amounts recognised in the financial statements (paragraph 122 of HKAS 1 (Revised)); and
 - the key assumptions that management has made about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year (paragraph 125 of HKAS 1 (Revised)).

Our findings

65. From this year's review, we noted that in some issuers' financial statements:
- accounting policies tended to be generic, with repetition of words and language in accounting standards and illustrative financial statements; and
 - critical accounting judgements were simply repeated or referred to the corresponding accounting policy without elaboration of the issuer's facts and circumstances.

Our recommendations

Disclosure of accounting policies

66. Issuers should bear in mind that investors and other users of financial statements rely on the disclosure of accounting policies to understand how the amounts presented in the financial statements are recognised and measured.
67. In deciding whether a particular accounting policy should be disclosed, issuers should consider the guidance in paragraphs 119 to 121 of HKAS 1 (Revised):
- whether disclosure would assist investors and other users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position;
 - whether the accounting policy is selected from alternatives allowed in HKFRSs;
 - the nature of their operations and the policies that investors and other users of financial statements would expect to be disclosed for that type of issuer;
 - whether the accounting policy is significant because of the nature of their operations, even if amounts for current and prior periods are not material; and
 - whether the accounting policy that is not specifically required by HKFRS but is selected and applied in accordance with HKAS 8 *“Accounting Policies, Changes in Accounting Estimates and Errors”*.
68. Issuers are reminded to include accounting policies for all material transactions and the accounting policies disclosed should be clear, understandable and entity-specific. The disclosure should enable investors and other users of financial statements to understand how the accounting policies are relevant and appropriate to an issuer and its business; and how the issuer applies the accounting policies. Issuers should avoid using boilerplate text such as extracts from accounting standards or illustrative financial statements. In addition, where issuers have industry-specific accounting policies, these policies should be disclosed clearly, in plain language and without the use of industry jargon.
69. Where there were unusual or non-recurring transactions carried out during the reporting period, issuers are reminded to include the accounting policies for these transactions. In addition, where transactions were carried out in the comparative reporting period (rather than the current one), issuers should not omit the accounting policies for these transactions if they are significant to the financial statements.

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Disclosure of judgements and estimates

70. Issuers should identify and disclose the judgements that management has made in the process of applying the accounting policies and that have the most significant effect on the amounts recognised in the financial statements. This enables investors and other users of financial statements to understand how accounting policies have been applied and to make comparisons between issuers regarding the basis upon which management makes these judgements. Issuers should read the examples provided in paragraphs 123 and 124 of HKAS 1 (Revised) and the requirements in paragraphs 126 to 132 of HKAS 1 (Revised) when disclosing the sources of estimation uncertainty.
71. Disclosure of judgements and estimates should be clear and entity-specific, and should reflect the facts so as to provide useful and meaningful information to investors and other users of financial statements so they are able to make informed decisions. Issuers should make sure that their disclosures are specific and do not simply repeat their accounting policies, or use extracts of the text from accounting standards or illustrative financial statements.

Significant events, balances and transactions

72. Paragraph 112(c) of HKAS 1 (Revised) requires an entity to provide information which is relevant to an understanding of the financial statements by way of additional notes to the financial statements.

Our findings

73. We observed that disclosure of the nature and impact of significant events or material balances and transactions was less than adequately explained. For example, some issuers had material “other receivables” or “other payables” but did not provide further analysis and explanation of the nature of these balances. In some cases, deposits paid for the acquisition of major assets or businesses remained on the statement of financial position for over a year, but the development and status of these acquisitions were not updated in the financial statements or elsewhere in the annual reports.

Our recommendations

74. Issuers should consider including an analysis and explanation of the nature and fluctuation of balances such as “other receivables” or “other payables”, deposits paid, capital commitments, etc., where they are of such significance that they would enhance investors’ and other users’ understanding of the financial statements.
75. Information disclosed in financial reports should be relevant and material. When considering whether a disclosure should be made, issuers should consider what value the disclosure would provide to investors and other users, and whether omission or misrepresentation would influence investors’ and other users’ decisions. Moreover, issuers should ensure the disclosures in financial reports are clear, easy to understand and entity-specific. All these together would make communications through financial reports more clear and concise.

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Forthcoming amendments to HKAS 1 (Revised)

76. Issuers should be aware that the IASB is progressing with its project on “Disclosure Initiatives”²² which aims at improving the quality of disclosures in the financial statements. Issuers are reminded to stay abreast of the developments of the project.
77. *“Disclosure Initiative (Amendments to HKAS 1)”* published in January 2015 by the HKICPA is effective for annual periods beginning on or after 1 January 2016. The narrow-scope amendments to HKAS 1 (Revised) are designed to further encourage entities to apply professional judgement in determining what information should be disclosed in their financial statements. The amendments include clarifications of the materiality requirements in HKAS 1 (Revised) (new paragraph 30A and revised paragraph 31 of HKAS 1 (Revised)) to emphasise that:
- entities should not aggregate or disaggregate information in a manner that obscures useful information;
 - the materiality requirements apply to the financial statements as a whole, including the primary statements and the notes;
 - materiality should be applied to specific disclosure requirements in individual standards; and
 - entities should consider whether information about matters addressed by an HKFRS needs to be presented or disclosed to meet the needs of investors and other users, even if that information is not included in the specific disclosure requirements of the HKFRS.
78. The amendments to HKAS 1 (Revised) also clarify that:
- line items of statement of financial position and statement of profit or loss and other comprehensive income listed in paragraphs 54 and 82 of HKAS 1 (Revised) respectively can be disaggregated and aggregated as relevant and includes additional guidance on presentation of subtotals²³;
 - share of other comprehensive income of associates and joint ventures accounted for using the equity method should be presented in aggregate as single line items based on whether or not it will subsequently be reclassified to profit or loss²⁴; and
 - entities have flexibility when designing the structure of the notes and include guidance on how to determine a systematic order of the notes²⁵.

²² Under “Disclosure Initiatives”, the IASB has completed and published two amendments, including *“Disclosure Initiative (Amendments to IAS 1)”* and *“Disclosure Initiative (Amendments to IAS 7 – 2016)”*, and is working on the amendments to IAS 8 *“Accounting Policies, Changes in Accounting Estimates and Errors”* and some other research projects.

²³ Paragraphs 55A, 85A and 85B of HKAS 1 (Revised).

²⁴ Paragraph 82A(b) of HKAS 1 (Revised).

²⁵ Paragraph 114 of HKAS 1 (Revised).

HKAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”

Disclosure in relation to new or amended HKFRS in issue but not yet effective

79. Paragraph 30 of HKAS 8 requires that when an entity has not applied a new or amended HKFRS in issue but not effective, it should disclose this fact and the known or reasonably estimable information relevant to assessing the possible impact that application of the new or amended HKFRS will have on the entity's financial statements in the period of initial application.
80. During this year's review, we continued to review issuers' disclosure pursuant to paragraph 30 of HKAS 8 and, in particular, the possible impact of applying HKFRS 15 “Revenue from Contracts with Customers”. HKFRS 15 will be effective for annual periods beginning on or after 1 January 2018 and would have significant impact on how issuers recognise revenue, which is a material line item in financial statements.

Our findings

81. In relation to the disclosure pursuant to paragraph 30 of HKAS 8, we noted that most issuers under review provided the disclosure. Most of them disclosed a full list of the HKFRSs that have been issued but are not yet effective and the fact that they had not yet applied those HKFRSs. These issuers also disclosed whether the application of HKFRSs issued but not yet effective would have material impact on their financial statements.
82. Some issuers disclosed a list of selected HKFRSs issued but not yet effective that they considered relevant to them. Out of these issuers, only a few of them had stated that the impact of other HKFRSs not yet adopted was not expected to have material impact on their financial statements. We also found that two issuers did not provide the disclosure required by paragraph 30 of HKAS 8. Upon enquiry, these issuers confirmed that they would include the required disclosure in future financial reports.
83. In relation to the possible impact of applying HKFRS 15, we noted that most of the issuers under review disclosed that they had assessed or were assessing the impact of HKFRS 15 upon initial application. Some issuers stated that the application of HKFRS 15 would not have a material impact on their financial statements; whilst other issuers stated that the application of HKFRS 15 may have a material impact but it was not practicable to provide a reasonable estimate of the effect. We also observed that a few issuers did not mention whether initial application of HKFRS 15 would have significant impact on the financial statements.

Our recommendations

84. Issuers are reminded that the disclosure required by paragraph 30 of HKAS 8 should be made in respect of all HKFRSs that have been issued but are not yet effective before the date of issue of their financial statements. To meet this requirement, issuers should consider the additional guidance set out in paragraph 31 of HKAS 8, including disclosure of a discussion of the impact that initial application of the HKFRS is expected to have on their financial statements. If the impact is not known or cannot be reasonably estimated, issuers should include a statement to that effect.

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85. In last year's report, we suggested that where issuers discuss the possible impact of a list of selected HKFRSs that are relevant to them, they should also include a statement that all other HKFRSs issued but not yet effective are not likely to have a significant impact on their financial statements. We would like to reiterate this point. However, we recommend that issuers provide a complete list of HKFRSs issued but not yet effective and discuss their impact on the financial statements. This would be the most prudent approach to meet the requirement of paragraph 30 of HKAS 8 and to reduce the risk of overlooking any new HKFRSs.
86. In June 2016, the HKICPA published an amendment to HKFRS 15 which added clarifications in identifying performance obligations; principal versus agent considerations; and determining whether the revenue from granting a licence should be recognised at a point of time or over time. We recommend that issuers give early consideration to HKFRS 15, as it will have a significant impact on how and when issuers recognise revenue.
87. In addition to HKFRS 15, issuers should also note two other key new standards, HKFRS 16 "*Leases*" and HKFRS 9 "*Financial Instruments*". In May 2016, the HKICPA published HKFRS 16, effective for annual periods beginning on or after 1 January 2019 with earlier application permitted for entities that have also adopted HKFRS 15. HKFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between finance leases ("on-balance sheet") and operating leases ("off-balance sheet"), and introduces a single on-balance sheet accounting model to all leases. Entities that lease major assets for use in their business will recognise more assets and liabilities on their statements of financial position. This will affect a wide variety of sectors.
88. In addition, HKFRS 9 (published in September 2014 by the HKICPA) amends classification and measurement of financial assets and introduces a new expected loss impairment model. The standard will be effective for annual periods beginning on or after 1 January 2018. HKFRS 9 applies to all entities, in particular, financial institutions and entities with large portfolios of financial assets will be most affected.
89. The above new standards are expected to have a significant impact on some issuers, particularly on their information systems, accounting processes, internal controls and business contracting processes. Issuers are encouraged to early consult their professional advisers and closely monitor developments in relation to the implementation of these standards, perform a detailed review as soon as practicable, identify areas that require attention and establish transition plans.

HKAS 32 "*Financial Instruments: Presentation*"

Classification of preference shares as liability or equity

90. Preference shares are often issued as a means of raising capital without diluting the voting power of the ordinary shareholders. To compensate for the loss of voting power, preference shares have preferred rights over the ordinary shares (for example, fixed dividends and redemption rights).

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91. Paragraph 15 of HKAS 32 requires that a financial instrument or its component parts should be classified upon initial recognition as a financial liability or an equity instrument according to the substance of the contractual arrangement, rather than its legal form. The classification as a financial liability, equity or a combination of both should be determined by an entity when the financial instrument is initially recognised and that classification is not generally changed subsequently unless the terms of the instrument change.

Our findings

92. We observed that a few of the issuers under review had issued preference shares. Based on the terms of the preference shares, some issuers classified them as financial liabilities and others as equity. Some issuers disclosed the accounting policy adopted for the preference shares and their major terms. We did not observe any misapplication. However, given that more issuers may consider issuing preference shares as a source of financing, we highlight some recommendations below.

Our recommendations

93. The terms of preference shares vary significantly. An entity may issue several series of preference shares with different features and priorities on dividends or assets in case of liquidation. Issuers should consider carefully the terms and features of the preference shares to classify them as (1) entirely equity, (2) entirely debt, or (3) a hybrid instrument with characteristics of both equity and debt.
94. Issuers should read the examples and guidance in HKAS 32. For example, if an entity issues a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, it is obvious that a contractual obligation to deliver cash or another financial asset exists for the issuer to repay the principal. Therefore, the preference share should be classified as a financial liability (paragraph 18(a) of HKAS 32).
95. Normally, if distributions to holders of the non-redeemable preference shares (whether cumulative or non-cumulative) are at the discretion of the issuer, the preference shares should be classified as an equity instrument (paragraph AG26 of HKAS 32). If distributions are non-discretionary, the preference share should be classified as a financial liability. However, consideration needs to be given to all the terms and features of a preference share, such as redemption features, dividend payment, call option and conversion option (amongst others), as these add complexity to the instrument and to its classification as a financial liability or an equity.
96. Therefore, in determining how a preference share should be classified, an issuer should assess its terms and features and work closely with its professional advisers.

HKAS 33 “Earnings per Share”

97. Earnings per share (“EPS”) is an important measure in the analysis of financial statements which enables investors and other users of financial statements to compare the performance of different entities. HKAS 33 prescribes the principles for the determination and presentation of EPS, so as to enable comparisons between different entities in the same reporting period and between different reporting periods for the same entity.

Our findings

98. We observed that nearly all issuers under review properly disclosed the basic and diluted EPS on the face of financial statements and their calculation. We noted that a few issuers retrospectively adjusted the EPS as a result of a capitalisation, share split or bonus issue. However, in one case, it appeared that the calculation of the weighted average number of ordinary shares outstanding was not adjusted to reflect a share consolidation after the reporting period but before the financial statements were authorised for issue. This case was referred to the FRC for consideration.

Our recommendations

99. When calculating EPS, issuers should note that:
- the number of ordinary shares should be the weighted average number of ordinary shares outstanding during the period, which is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor (paragraphs 19 and 20 of HKAS 33); and
 - the weighted average number of ordinary shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources, such as a capitalisation or bonus issue, a share split, etc. (paragraphs 26 and 27 of HKAS 33).
100. Issuers are also reminded to take into account changes after the reporting period. If any changes in the number of ordinary or potential ordinary shares resulting from a capitalisation or bonus issue, share split or reverse share split occurs after the reporting period but before the financial statements are authorised for issue, the EPS calculations for those and any prior period financial statements presented should be based on the new number of shares (paragraph 64 of HKAS 33).
101. However, other ordinary or potential ordinary share transactions that occur after the reporting period but before the financial statements are authorised for issue are not adjusted retrospectively because these transactions do not affect the amount of capital used to produce profit or loss for the period²⁶. Disclosure of such share transactions in financial statements is required (paragraph 70(d) of HKAS 33).

²⁶ Paragraph 71 of HKAS 33 provides examples of share transactions that are not adjusted retrospectively, such as an issue of shares for cash, the redemption of ordinary shares outstanding, an issue of options, warrants, or convertible instruments, etc.

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102. Calculating EPS is complex and issuers are reminded to ensure that they do so is in accordance with HKAS 33. In this regard, we recommend that issuers read the Illustrative Examples accompanying HKAS 33 in order to improve their understanding of the proper method for calculation.

HKAS 36 “Impairment of Assets”

103. Impairment of assets is a key area of focus of investors and other users of financial statements, particularly in view of recent economic volatility and uncertainty, which may lead to issuers revising their budgets and forecasts used in the calculation of recoverable amounts of non-financial assets.
104. HKAS 36 sets out the requirements to account for and report the impairment of most non-financial assets (including goodwill). A number of assets are excluded from its scope such as financial instruments and inventories (paragraph 2 of HKAS 36). HKAS 36 seeks to prescribe the procedures that an entity should apply to ensure that its assets are carried at no more than their recoverable amount and requires extensive disclosure in respect of the impairment testing performed and impairment recognised.

Our findings

105. We found in this year’s review that most issuers provided the disclosures required by HKAS 36. However, we also noted some omissions and deficiencies in issuers’ financial statements. For example:
- the explanations of the events and circumstances that led to the recognition of impairment losses tended to be short and generic (paragraph 130(a) of HKAS 36). A few issuers did not even disclose this information when an impairment was recognised;
 - a few issuers did not disclose whether the recoverable amount of the impaired asset was the fair value less costs of disposal or value in use (paragraph 130(e) of HKAS 36);
 - key assumptions on which management based its cash flow projections for the period covered by the most recent budgets/forecasts were not clearly described (paragraph 134(d)(i) of HKAS 36); and
 - the description of management’s approach to determining the values assigned to each key assumption was brief (paragraph 134(d)(ii) of HKAS 36).
106. In addition, we raised enquiries with a few issuers regarding the reasons that management considered the growth rates and discount rates used in the calculation of recoverable amounts to be reasonable and supportable (paragraphs 33 to 38 of HKAS 36), particularly in cases where the issuers were loss making or suffered deterioration in revenue or net profits. Based on the responses to our enquiries, it does not appear that any of these issuers breached the accounting standards.

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107. From this year's review, we noted that a few issuers voluntarily provided a negative statement indicating that reasonably possible change in key assumptions on which management had based its determination of a cash-generating unit's recoverable amount would not cause an impairment loss (which is not required by paragraph 134(f) of HKAS 36).

Our recommendations

108. Issuers are reminded that impairment testing is required to be performed on an annual basis irrespective of whether any indication of impairment exists for goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use (paragraph 10 of HKAS 36), and that the concept of materiality (paragraph 15 of HKAS 36) is not applicable to these assets. For other non-financial assets within the scope of HKAS 36, issuers have to assess at the end of each reporting period whether there is any indication that these assets may be impaired and, if so, estimate their recoverable amount (paragraph 9 of HKAS 36). For this purpose, we recommend that issuers consider, at a minimum, the non-exhaustive list of indications of impairment set out in paragraph 12 of HKAS 36.
109. Issuers should bear in mind that one indication of impairment is if the carrying amount of their net assets is more than their market capitalisation. Issuers are therefore reminded to compare their net assets with their market capitalisation in order to ascertain whether provisions for impairment on key assets are necessary.
110. When performing impairment testing of an asset, issuers should assess the reasonableness of the assumptions used (paragraphs 33 to 38 of HKAS 36). Assumptions should not be overly optimistic with regard to historical cash flows and results, particularly where issuers are loss making or suffer deterioration in revenue and net profit. The growth rate applied in impairment testing should not exceed the issuer's actual performance over recent years; or the long-term average growth rate for its products, industries or countries where it operates, or for the market in which the asset is used. Issuers should ensure that the assumptions used are reasonable and supportable, and represent their best estimate of the economic circumstances that will prevail over the remaining life of the asset or the cash-generating unit.
111. Issuers are reminded to provide the disclosures required by HKAS 36, in particular, to disclose the information required by paragraph 130 of HKAS 36 when an impairment loss for an individual asset or a cash-generating unit is recognised or reversed; and the information required by paragraph 134 of HKAS 36 for each cash-generating unit where the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives.
112. Issuers should aim to improve the quality of the narrative information they provide on the events and circumstances that lead to a recognition or reversal of impairment losses. In order to enable investors and other users of financial statements to understand the reason for the recognition or reversal of impairment losses, the narrative information should be case-specific and closely related to the issuer's operations and activities. In addition, separate narrative information should be provided for each significant impairment loss recognised or reversed.

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113. Moreover, for various cash-generating units of different risk profile, issuers should consider disclosing separately, for each cash-generating unit, the information required by HKAS 36, such as growth rates and discount rates. Issuers should bear in mind that disclosing either (i) a single average growth rate and discount rate; or (ii) a range of growth rates and discount rates may obscure information that may be relevant to investors and other users of financial statements.
114. Issuers are reminded to disclose the amount by which a cash-generating unit's recoverable amount exceeds its carry amount if a reasonably possible change of a key assumption on which management has based its determination of the cash-generating unit's recoverable amount would cause the carrying amount of the cash-generating unit to exceed its recoverable amount (paragraph 134(f) of HKAS 36). Issuers should make realistic estimates in determining possible changes in key assumptions that would cause a cash-generating unit's carrying amount to exceed its recoverable amount and disclose clear information when providing the required analysis. In making this disclosure, issuers should aim to provide investors and other users with information on what change in the values of key assumptions used in impairment testing would cause the carrying amount of the cash-generating unit to exceed the recoverable amount (i.e., how imminent is a possible impairment loss).

Non-HKFRS financial information

115. Non-HKFRS financial information is the financial information that is presented other than in accordance with the requirements set out in HKFRS. Properly presented non-HKFRS financial information can assist investors and other users of financial statements in evaluating the financial performance and financial position of issuers.

Our findings

116. In this year's review, we observed that some issuers used non-HKFRS financial information to discuss and analyse their performance. The most commonly used non-HKFRS financial information was earnings before interests, income tax, depreciation and amortisation ("EBITDA"), EBITDA margin, adjusted EBITDA and adjusted profits. Most of the issuers who disclosed non-HKFRS financial information provided a description of the information or reconciled the information with the figures in the financial statements prepared in accordance with HKFRS. However, none of these issuers explained their reasons for disclosing the non-HKFRS financial information.

Our recommendations

117. Issuers that choose to present this information should ensure that it is not misleading; and neither obscures their financial results and financial position, nor provides an incomplete description of their financial results based on accounting standards.

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118. When presenting non-HKFRS financial information, issuers should ensure their disclosures are transparent and their methods of calculation are consistent with those employed in prior periods. In this regard, we set out below some recommended disclosures and additional points to note:
- non-HKFRS financial information should not be presented with greater prominence or in a biased manner as compared to the financial information prepared in accordance with HKFRS;
 - issuers should explain: (i) why they present the non-HKFRS financial information; and (ii) how this information helps investors and other users of financial statements to better understand the issuers' financial performance and financial position;
 - issuers should explain how the non-HKFRS financial information is calculated;
 - issuers should reconcile the non-HKFRS financial information with the figures in the financial statements prepared in accordance with accounting standards and explain each significant adjustment;
 - items that have occurred in the past or are likely to occur in future should not be described as "one-off" or "non-recurring";
 - non-HKFRS financial information should be presented consistently from period to period; where there is a change, issuers should disclose the nature, reasons and financial impact of the change; and
 - issuers should consider including a statement to alert investors and other users of financial statements that the non-HKFRS financial information may not be comparable to similarly titled measures published by other issuers, as standard-setters have not developed standardised formulas.
119. Issuers are encouraged to read the "*Statement on Non-GAAP Financial Measures*" (the "Statement") which was issued by the International Organization of Securities Commissions (the "IOSCO") in June 2016²⁷. The Statement is intended to assist issuers in providing clear and useful disclosure for investors and other users of non-GAAP financial measures, and to help reduce the risk that such measures are presented in a way that could be misleading.

²⁷ The Statement issued by the IOSCO is available at:
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD532.pdf> .

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Cooperation with other regulators

120. In addition to the Exchange, the FRC and the HKICPA also undertake a continuous review of issuers' published financial statements. However, the focuses of the reviews are different. The Exchange's FSRP focuses on compliance with the Listing Rules and accounting standards and our feedback is addressed to, and attempt to help, issuers. The FRC's programme places greater emphasis on the detection of auditing irregularities²⁸, while the HKICPA's professional standards monitoring ("PSM") programme²⁹ focuses on accounting standards and monitoring the quality of listed companies' auditors' work. Under our memorandums of understanding ("MOUs") with the FRC and the HKICPA, respectively, the Exchange liaises, shares information and meets regularly with the two regulators to avoid duplication of work performed.
121. Pursuant to the MOUs, from this year's review under our programme, we referred one case to the FRC based on the responses from the issuer that indicated possible non-compliances with accounting and auditing standards. Moreover, through other related work at the Exchange, we referred four cases to the FRC and one case to the HKICPA.
122. We held a joint financial reporting forum with the FRC and HKICPA on 25 November 2015. The representatives of the three bodies shared common or significant observations identified from reviews of financial statements of listed companies. This is an annual event we have held since 2011. A webcast of the event is available on the HKICPA's website.

²⁸ Further information relating to the FRC's work is available on its website at:
<http://www.frc.org.hk/en/index.php>.

²⁹ Further information relating to the PSM programme is available on the HKICPA's website at:
<http://www.hkicpa.org.hk/en/standards-and-regulations/quality-assurance/professional-standards-monitoring/>.

IV. FINDINGS REGARDING GENERAL ACCOUNTING REVIEW THEME – ACCOUNTING FOR CONSOLIDATION, ASSOCIATES AND JOINT ARRANGEMENTS, AND DISCLOSURE OF INTERESTS IN OTHER ENTITIES

123. The specific accounting standards theme chosen for this year’s FSRP was compliance with the accounting standards dealing with consolidation, associates and joint arrangements, and disclosure of interests in other entities under HKFRS 10 “*Consolidated Financial Statements*”, HKFRS 11 “*Joint Arrangements*” and HKFRS 12 “*Disclosure of Interests in Other Entities*”. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.
124. The review focused on accounting and reporting issues including:
- determination of whether control exists (HKFRS 10);
 - classification of joint arrangements (HKFRS 11); and
 - extensive disclosure requirements for interests in other entities (HKFRS 12).
125. Where potential non-compliance was noted, we raised enquiries with the issuers involved. In each case, the issuers confirmed that they had properly accounted for subsidiaries, joint arrangements and associates in accordance with the accounting standards; except for one case where the auditor had already modified its opinion in relation to the misapplication of HKFRS 10. Where the required disclosures were omitted this year, issuers confirmed that they would be provided in their future financial reports. Based on the replies received, we did not note any other significant non-compliance. Through related work during the period, we referred a case to the FRC in relation to possible misapplication of HKFRS 10. Our key findings and recommendations are set out below.

Determination of whether control exists (HKFRS 10)

126. HKFRS 10 establishes a single control model that applies to all entities. Paragraph 7 of HKFRS 10 states that an investor controls an investee if and only if the investor has all of the following three elements:
- (a) power over the investee;
 - (b) exposure, or rights, to variable returns from its involvement with the investee; and
 - (c) the ability to use its power over the investee to affect the amount of the investor’s returns.

Our findings

127. In one case, an issuer lost control over certain subsidiaries as it could not direct the relevant activities of those subsidiaries. However, the issuer deconsolidated the subsidiaries earlier than the date it lost control, as it could not access the books and records of the subsidiaries. This resulted in the issuer’s auditor modifying its opinion on the financial statements.

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128. In another case, an issuer accounted for a 40% owned investee as a subsidiary in the current financial year but as an associate in the previous financial year. It was unclear what changes in facts and circumstances led the issuer to conclude it had control over the investee and thus consolidate it in the current financial year. Upon enquiry, the issuer explained that after reassessment of control over the investee during the current financial year, the issuer concluded that it had de facto control.
129. One case that arose through our related work in this area concerned the possible misapplication of HKFRS 10. It was unclear whether the issuer in this case had control over the subject subsidiary, which had been consolidated. There was doubt as to whether the issuer had power, such as substantive rights, over the relevant activities of the subsidiary. We therefore referred this case to the FRC for further investigation.

Our recommendations

130. When assessing whether control exists over an investee, an issuer should carefully assess whether it has power over the relevant activities of the investee, which includes the following aspects:
- *substantive rights* – only substantive rights held by the issuer and other parties are considered. For rights to be substantive, they need to be exercisable when decisions about the relevant activities are being made, and the issuer needs to have the practical ability to exercise them;
 - *voting rights* – an issuer can have power over an investee where the relevant activities are directed through voting rights, and the issuer holds the majority of the voting rights and these rights are substantive. Where an issuer holds less than half the voting rights, it can have power over an investee if it has an agreement with other vote holders, holds rights arising from other contractual arrangements, holds substantive potential voting rights, holds rights sufficient to unilaterally direct the relevant activities of the investee (de facto power) or holds a combination thereof; and
 - *rights other than voting rights* – when holders of voting rights as a group do not have the ability to significantly affect an investee's returns, an issuer considers the purpose and design of the investee as well as the factors including evidence of the issuer's practical ability to direct the relevant activities unilaterally, indications of the issuer's special relationship with the investee and whether the issuer has a large exposure to variability in returns.
131. When an issuer assesses whether it is exposed to variability in returns, it should be aware that returns are defined broadly and include distributions of economic benefits and changes in the value of the investment, as well as fees, remunerations, tax benefits, economies of scale, cost savings and other synergies.

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132. An issuer controls an investee if the issuer not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use the issuer's power to affect its returns from its involvement with the investee. Thus, when an issuer with decision-making rights assesses whether it controls an investee, it should determine whether it is a principal or an agent. If the issuer determines that it is an agent, it does not control an investee. To determine whether it is an agent, the issuer considers substantive removal and other rights held by a single or multiple parties; whether its remuneration is on arm's length terms; and the overall relationship between itself and other parties, through a series of factors³⁰.
133. We would remind issuers that they are required to conduct continuous assessments of their control over an investee. This continuous reassessment should consider both changes in an issuer's power over the investee and changes in the issuer's exposure or rights to variable returns. As required under paragraph B80 of HKFRS 10, this assessment must be made if facts and circumstances indicate there are changes to one or more of the three elements of control listed in paragraph 126 above. Accordingly, issuers should also assess on a continuous basis the manner in which decisions about the relevant activities are made.
134. In relation to de facto power, an issuer should make reference to specific guidance and examples (paragraphs B42 to B46 of HKFRS 10) on how to determine whether an issuer that does not hold a majority of voting rights has de facto power over an investee. In making this determination, an issuer considers all facts and circumstances, including:
- the size of an issuer's holding of voting rights relative to the size and dispersion of holding of the other parties;
 - potential voting rights held by an issuer and other parties;
 - rights arising from other contractual arrangements; and
 - any additional facts and circumstances that indicate an issuer has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.
135. Where an issuer holds less than a majority of voting rights, determining the date on which the issuer obtains de facto control over an investee may be a challenging issue. At the date that an issuer initially acquires less than a majority of voting rights, the issuer may assess that it does not have de facto control as it may not know how other shareholders are likely to behave. As time passes, the issuer may obtain more information about the other shareholders, gain experience from shareholders' meetings and ultimately assess that it does have de facto control. Issuers should note that determining the point at which this happens is likely to require significant judgement.

³⁰ Further guidance, see paragraphs B58 to B72 of HKFRS 10.

Classification of joint arrangements (HKFRS 11)

136. HKFRS 11 describes the accounting for a joint arrangement, which is defined as a contractual arrangement over which two or more parties have joint control. Joint control exists only when the unanimous consent of those parties sharing control is required to make decisions about the relevant activities that significantly affect the returns of the arrangement. Joint arrangements are classified as either joint operations (whereby the parties have rights to the assets and obligations for the liabilities relating to the arrangement) or joint ventures (whereby the parties with joint control have rights to the net assets of the arrangement).

Our findings

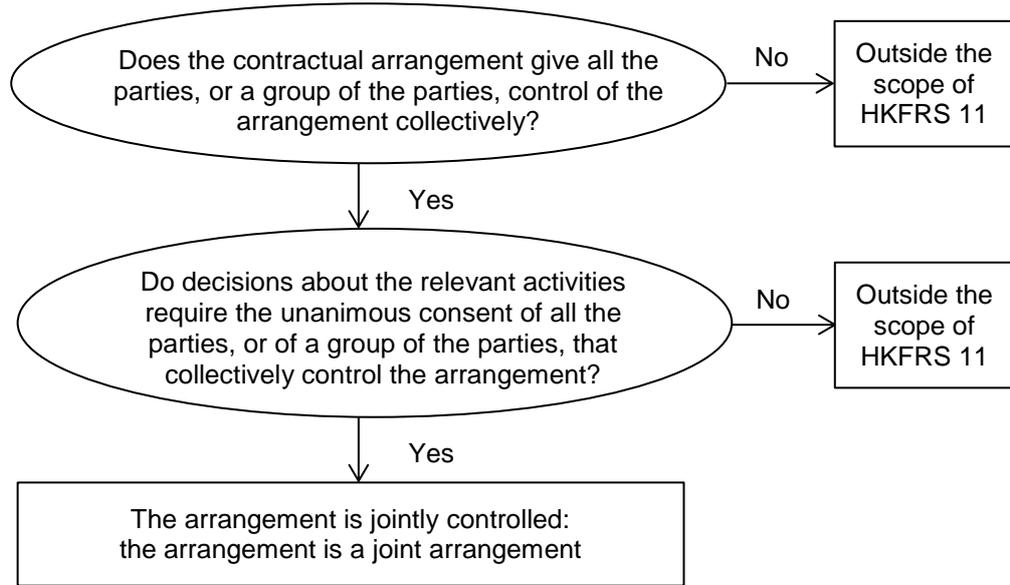
137. We observed that a few issuers under review had both joint operations and joint ventures, while some issuers had joint ventures only. Those issuers with both had separate accounting policies for their joint operations and joint ventures, respectively. They also properly disclosed in their accounting policies the judgements and estimates used to determine whether a joint arrangement was classified as a joint operation or a joint venture. We did not note any significant non-compliance regarding classification of joint arrangements. However, given the importance of this topic to all issuers, we highlight some recommendations below.

Our recommendations

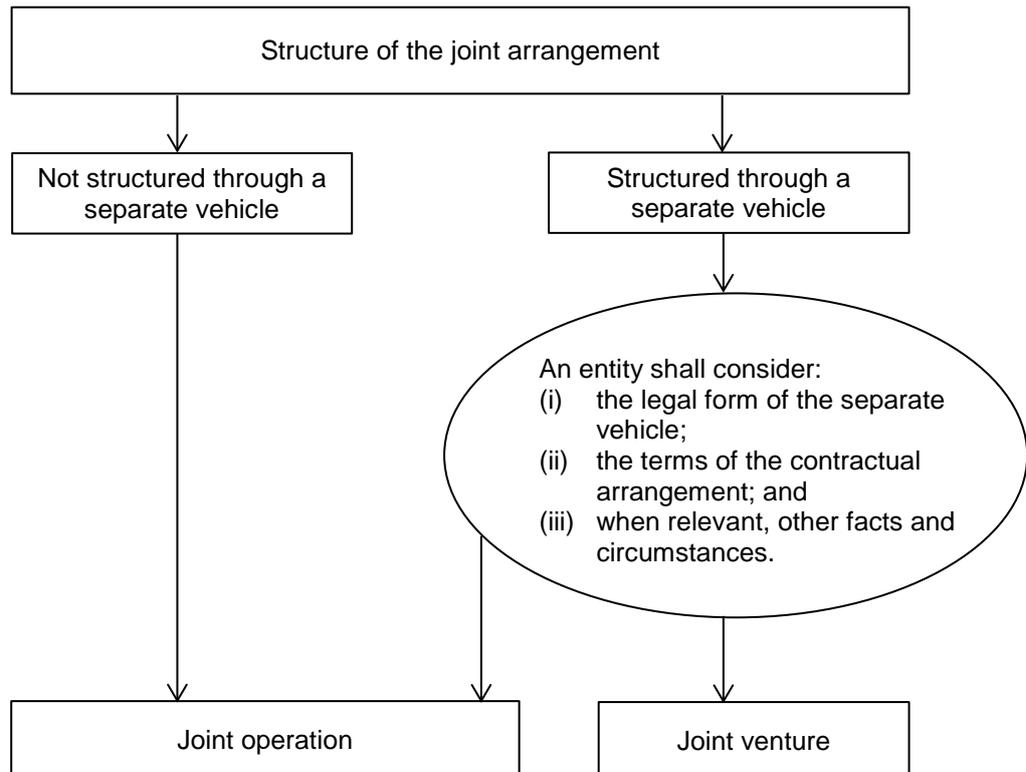
138. The key to determining the type of arrangement is the rights and obligations of the parties to the arrangement:
- a joint operation is one whereby the jointly controlling parties (the joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint operations are required to be accounted for with the assets, liabilities, revenues and expenses relating to the interests in joint operations in accordance with the applicable HKFRSs; and
 - a joint venture is one whereby the jointly controlling parties (the joint venturers) have rights to the net assets of the arrangement. Joint ventures are now required to be accounted for using the equity method.
139. The classification of joint arrangements may have significant implications for their subsequent accounting (see paragraph 138 above). In determining the type of joint arrangement, issuers are reminded to make reference to the Application Guidance in Appendix B to HKFRS 11 and in particular, the following flowcharts:

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• **Assessing joint control**



• **Classification of a joint arrangement: assessment of the parties' rights and obligations arising from the arrangement**



Extensive disclosure requirements for interests in other entities (HKFRS 12)

Disclosure of significant judgements and assumptions regarding the existence of control or significant influence

140. Issuers should disclose information about significant judgements and assumptions made in determining whether control of another entity, joint control of an arrangement, or significant influence over another entity exists (paragraph 7 of HKFRS 12).

Our findings

141. We observed that some issuers did not disclose the facts and circumstances or significant judgements and assumptions made in determining whether they controlled or had significant influence over another entity.
142. From our review, we observed that one issuer did not disclose the proportion of ownership interest it held. Another issuer had equity interest in an associate that had two types of shares. The issuer held 100% equity interest in one type of the associate's shares and zero equity interest in the other type. There was no information provided on the nature and respective voting rights of the two types of shares. The issuer's disclosure in relation to why the investee was treated as an associate was unclear.
143. In another case, the issuer had around 30% to 40% attributable equity interests in a number of subsidiaries. Upon enquiry, the issuer explained that these subsidiaries were all indirectly held by various non-wholly owned subsidiaries, each of which the issuer held indirectly more than 50% of the legal ownership or voting rights.

Our recommendations

144. Issuers are reminded that they should disclose the facts and circumstances or significant judgements and assumptions made in determining whether control or significant influence exists in the following scenarios (paragraph 9 of HKFRS 12):
- where the issuer does not control the other entity even though it holds more than half the voting rights of the other entity;
 - where the issuer controls the other entity even though it holds less than half the voting rights of the other entity;
 - where the issuer does not have significant influence even though it holds 20% or more of the voting rights of the other entity; and
 - where the issuer has significant influence even though it holds less than 20% of the voting rights of the other entity.

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145. Issuers should disclose information about facts and circumstances relating to the following matters, where appropriate:
- substantive potential voting rights;
 - rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
 - de facto control;
 - contractual arrangement with other voting right holders; and
 - participation in policy-making processes, including participation in decisions about dividends or other distributions, etc.

Interests in joint arrangements and associates

146. HKFRS 12 requires disclosure of the nature, extent and financial effects of an entity's interests in joint arrangements and associates. In particular, for each joint venture and associate that is material to the reporting entity, summarised financial information about the joint venture or associate should be disclosed. In case of joint ventures and associates that are not individually material, financial information in aggregate for all individually immaterial joint ventures and, separately, in aggregate for all individually immaterial associates should be disclosed.

Our findings

147. We observed that nearly half the issuers under review had interests in associates and over one-third had interests in joint arrangements.
148. However, some issuers appeared to have material associates or joint ventures but did not provide any disclosure of summarised financial information in relation to the associate or joint venture. They did not follow the requirements under paragraphs 21(b), B12 and B13 of HKFRS 12. Upon enquiry, these issuers confirmed that the summarised financial information would be provided in future financial statements.
149. In addition, a few issuers did not disclose the principal place of business (and country of incorporation, if applicable and different from the principal place of business) for each joint arrangement and associate.

Our recommendations

150. Issuers are reminded to disclose the information of each material joint arrangement and associate, including the principal place of business, and the summarised financial information about each material joint venture and associate (paragraphs 21(a) and (b), B12 and B13 of HKFRS 12). Further, if an issuer's investments in joint ventures and associates are not individually material, then the financial information in aggregate for: (i) all individually immaterial joint ventures; and (ii) all individually immaterial associates should be disclosed (paragraphs 21(c) and B16 of HKFRS 12).

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Material non-controlling interests

151. Issuers should disclose for each of their subsidiaries which have non-controlling interests that are material to them (paragraphs 12 and B10 of HKFRS 12).

Our findings

152. We observed that most of the issuers reviewed had subsidiaries with non-controlling interests. Most of these issuers properly disclosed:
- the name of the subsidiary;
 - the principal place of business of the subsidiary;
 - the proportion of ownership interests held by non-controlling interests;
 - the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period; and
 - accumulated non-controlling interests of the subsidiary at the end of the reporting period.
153. In some cases reviewed, issuers disclosed that they had some non-wholly owned subsidiaries, and it appeared that some of these subsidiaries had material non-controlling interests. However, there was no disclosure of the summarised financial information about each of the material subsidiaries. Upon enquiry, some issuers advised that the non-controlling interests were not material, while others stated they would provide this disclosure in future financial statements.

Our recommendations

154. Issuers are reminded to disclose the summarised financial information for each of the subsidiaries that have material non-controlling interests. This information may include, but is not limited to the relevant subsidiary's current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income.
155. Where an issuer discloses that it has principal subsidiaries that are non-wholly owned, this indicates that it has subsidiaries with non-controlling interests. Issuers are reminded to disclose the information described in paragraph 151 above if the non-controlling interests are material. Where the non-controlling interests are not material, we would recommend that issuers make a statement to disclose that fact, even though there is no specific requirement in this regard in HKFRS.

V. FINDINGS REGARDING INDUSTRY REVIEW THEME – ACCOUNTING BY HOTELS, GAMING AND LEISURE COMPANIES

156. For this year's FSRP, we selected as the industry theme issuers whose major or principal activities included hotels, gaming and leisure related businesses. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.
157. The review focused on accounting and reporting issues of the industry including:
- revenue recognition;
 - intangible assets;
 - impairment of non-financial assets;
 - acquisition of hotels, gaming and leisure businesses; and
 - operating statistics.
158. We reviewed the annual reports of 16 issuers whose major or principal activities included hotels, gaming and leisure related businesses. Most of these issuers engaged in the hotels business and catering business; half engaged in the casino or gaming business; and one engaged in the entertainment business. More than half also engaged in other businesses including property leasing, travel agency, retail goods, passenger transportation and logistics, shopping malls, and manufacturing and distribution of gaming chips and plaques, etc.
159. Where potential non-compliance was noted, we raised enquiries with the issuers involved. In each case, the issuers confirmed that improvements would be made and the required disclosures would be provided in their future financial reports. We did not note any significant non-compliance amongst the issuers reviewed.
160. We did note certain areas of disclosure where there was room for improvement. Our key findings and recommendations are set out below.

Revenue recognition

161. The revenue from hotels, gaming and leisure businesses are accounted for in accordance with HKAS 18 "*Revenue*". Revenue from the hotels business (including room rental, hotels management, food and beverage sales and related services) should be recognised when the services are rendered. Entertainment revenue derived from theatre shows, concerts and sporting events is recognised at the time of performance.
162. Casino revenue is measured by the aggregate net difference between gaming wins and losses, with liabilities recognised for funds deposited by customers before gaming play occurs and for chips in customers' possession. Certain arrangements, such as points earned in customer loyalty programmes, commissions rebated directly or indirectly through gaming promoters to customers, cash discounts and other cash incentives to customers related to gaming play, add complexity to the revenue recognition of gaming companies.

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Our findings

163. We found that, except for the observations noted below, the issuers reviewed separately disclosed the revenue generated from their different businesses and the accounting policy adopted for revenue recognition for each major type of revenue.
164. Offers of commission rebates, sales incentives and loyalty card programmes are common in the hotels, gaming and leisure sector. We observed that some issuers stated that revenue was recognised after commission rebates, sales incentives and loyalty card programmes were taken into account. However, one issuer did not disclose the accounting policy adopted for the loyalty card programme, as well as the related line items and amounts in the financial statements. Upon enquiry, this issuer explained that the expenses in relation to the loyalty card programme were not material and as such the issuer did not disclose the relevant accounting policy.
165. The hotels, gaming and leisure industry is increasingly relying on deal coupon companies to promote their products and services at reduced prices in order to attract more customers. There are various arrangements among hotels, gaming and leisure entities and the deal coupon companies. The accounting treatment for such transactions depends on the terms and conditions of the arrangement. None of the hotels, gaming and leisure issuers under review mentioned that they had deal coupon arrangements in place.

Our recommendations

166. For investors and other users to better understand the financial statements, accounting policies adopted for revenue recognition should be provided and should be specific to each type of revenue arising from the issuer's principal activities (e.g. hotels, gaming and leisure) separately.
167. Where issuers in this industry offer commission rebates, sales incentives and loyalty card programmes, they should consider the uniqueness and complexity of these arrangements in order to determine whether they should be accounted for separately, if they are material, or as a reduction to the revenues earned from hotels, gaming and leisure businesses.
168. Issuers should have regard to current HK(IFRIC) Interpretation 13 "*Customer Loyalty Programmes*" guidance on how to account for loyalty programmes, which provides that an entity should apply paragraph 13 of HKAS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted. Revenue is allocated between the initial service and the award credits, taking into consideration the fair value of the award credits to the customer. The fair value allocated to the award credits is deferred and recognised when the awards are redeemed or expire.

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169. Where hotels, gaming and leisure issuers have arrangements with deal coupon companies, they should consider whether they are acting as principals or agents (paragraph 21 of Illustrative Examples accompanying HKAS 18). Where an issuer is acting as a principal, it will have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Issuers should determine whether to report revenue on a gross basis (as a principal in the arrangement) or on a net basis (as an agent in the arrangement). We would also remind issuers to disclose the accounting policy adopted for any material deal coupon arrangements.
170. Issuers in this industry, in particular, should begin considering and planning for the initial adoption of HKFRS 15, as the standard may have an impact on the amounts reported and disclosures made in their financial statements.

Intangible assets

171. Intangible assets acquired are either stated at cost less accumulated amortisation (where the estimated useful life is finite) and impairment losses or are not amortised when their useful lives are assessed to be indefinite. Where the useful life of an intangible asset is indefinite, it should be reviewed annually to determine whether events and circumstances continue to support the indefinite useful life assessment for that asset.

Our findings

172. We observed that a few hotels, gaming and leisure issuers had significant intangible assets (such as casino operating concessions and licences of operation), and a few of them recognised goodwill (see paragraphs 183 and 184 below).
173. We found that these issuers stated their intangible assets at cost less subsequent accumulated amortisation and accumulated impairment losses, and adopted a straight-line method of amortisation over the useful lives of these intangible assets. However, some issuers did not disclose the useful lives (such as the duration of operation licences and trademarks) or the amortisation rates used for finite intangible assets.

Our recommendations

174. Issuers should provide the disclosures for intangible assets including whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used (paragraph 118 of HKAS 38 "*Intangible Assets*"). Hotels, gaming and leisure issuers are also reminded to disclose the duration of casino operating concessions, sub-concession agreements and operation licences, etc.
175. We would also remind issuers to disclose the reasons supporting the assessment of intangible assets with indefinite useful lives (paragraph 122 of HKAS 38). Further, for any individual intangible asset that is material to the financial statements, issuers should provide a description of the asset and the carrying amount.

Impairment of non-financial assets

176. Issuers should make use of internal and external sources of information and review them at the end of each reporting period to identify indications that the issuers' non-financial assets may be impaired. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised in profit or loss if the carrying amount of an asset exceeds its recoverable amount (paragraph 126 of HKAS 36).

Our findings

177. All 16 issuers under review disclosed an accounting policy for impairment of assets; and a few recognised impairment losses on property, plant and equipment or intangible assets.
178. We also observed that nearly half the issuers had a net asset value larger than their market capitalisation, without any impairment losses on their assets.

Our recommendations

179. Management agreements, franchise agreements, license agreements, customer lists, trademarks, and goodwill represent some of the assets with long or indefinite useful lives held by hotels, gaming and leisure issuers. HKFRS requires that goodwill and other intangibles with indefinite useful lives should be tested for impairment at least annually, or more frequently if an indicator is present (paragraph 12 of HKAS 36). Other assets with long useful lives are reviewed at the end of each reporting period for any indication of impairment, and tested for impairment if necessary.
180. Where significant impairment loss is recognised, issuers should disclose the events and circumstances that led to the loss. Issuers' disclosures in this regard should be case-specific and closely related to their operations and activities. In addition, issuers should disclose clearly how the recoverable amounts of the assets or cash-generating units are measured, together with the key assumptions and estimates applied in the measurement. Issuers should also consider whether the discount rates applied by management in measuring the amounts of value in use are reasonable and supportable (paragraph 38 of HKAS 36).
181. One indication of impairment is where an issuer's net asset value is larger than its market capitalisation. Issuers should bear this in mind and should carefully assess whether any impairment losses need to be provided on their assets. For details, please also see paragraphs 108 to 114 of Section III "*Findings regarding Accounting Standards*".

Acquisition of hotels, gaming and leisure businesses

182. Goodwill arising on a business combination is measured as the difference between the consideration transferred and the fair value of the identifiable assets and liabilities acquired (paragraph 32 of HKFRS 3 (Revised) “*Business Combinations*”).

Our findings

183. A few issuers acquired hotels, gaming and leisure businesses during the respective financial years under review. These issuers adopted the acquisition method to account for the transactions. Some of these issuers recognised goodwill arising from the acquisitions. However, the factors that made up the goodwill recognised were not disclosed.
184. One of these issuers did not disclose information on the reconciliation of the goodwill as of the date of acquisition.

Our recommendations

185. When issuers recognise goodwill, they are reminded to provide the information including a qualitative description of the factors that make up the goodwill recognised, in addition to the other information required (paragraphs B64 to B67 of HKFRS 3 (Revised)).
186. Issuers are also reminded to disclose information on the reconciliation of the goodwill as of the acquisition date. This is measured as the excess of the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the group’s previously held equity interest in the acquiree; over the net fair value of the acquiree’s identifiable assets and liabilities measured as at the acquisition date (paragraph 32 of HKFRS 3 (Revised)).

Operating statistics

187. Operating statistics are sometimes disclosed to provide operational and industry specific information for investors and other users of financial reports to have a better understanding of the performance of issuers.

Our findings

188. Most of the issuers presented industry specific operating statistics in their MD&A of performance or in their Business Review. We observed that issuers often presented the following industry specific operating statistics:

Hotels business

- occupancy rate;
- average room rate; and
- revenue per average room; and

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Gaming business

- rolling chip volume;
- rolling chip win rate;
- table games win (amount of wagers won net of wagers lost on gaming tables that is retained and recorded as casino revenue);
- gaming machine handle (total amount wagered in gaming machines); and
- gaming machine win rate.

Our recommendations

189. We emphasise that the MD&A and Business Review should guide investors and other users through the financial statements and provide an unbiased explanation of the performance, financial position and future prospects of issuers so that investors and other users can make informed decisions. Any operating statistics disclosed should contribute to this objective. Issuers may make reference to the guidance provided in paragraphs 117 to 119 of Section III *“Findings regarding Accounting Standards”*, where appropriate.
190. If operating statistics are presented in financial reports, they should be clearly described. We would recommend issuers to disclose:
- the title of the operating statistics;
 - the purpose of the operating statistics and their usefulness;
 - definitions and calculation formulas;
 - explanations and reasons for any changes to the definitions or calculation formulas compared to those disclosed in previous financial reports; and
 - a statement to alert investors and other users that the operating statistics presented may not be comparable to similarly titled measures published by other issuers.

VI. CONCLUSION

191. The overarching principle for high quality financial reporting is that the “information provided should be relevant, material and entity-specific”; and issuers should avoid making irrelevant and immaterial disclosures.
192. We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report. In today’s challenging global economic environment, issuers should stay alert to changes to the Listing Rules, accounting and auditing standards, and other relevant laws and regulations. These challenges and changes provide an opportunity for issuers to reassess their approach to financial reporting and to improve the quality of their disclosure. Financial reporting is more than merely a compliance exercise. Clear and concise financial reporting is an effective communication tool through which issuers should provide investors with the information they need to make informed investment decisions.

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