

REVIEW OF DISCLOSURE IN
ISSUER'S ANNUAL REPORTS TO
MONITOR RULE COMPLIANCE

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Review of Disclosure in Issuers' Annual Reports to Monitor Rule Compliance Report 2014

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EXECUTIVE SUMMARY

The Listing Department reviews issuers' annual reports as part of its ongoing monitoring and compliance activities. This is the third published report which presents our findings and recommendations.

We have examined issuers' annual reports with a focus on Rule compliance, issuers' corporate conduct and their disclosure of material events and developments. In our review of an issuer's disclosure we consider not only the disclosure in the annual report, but also the consistency and materiality of disclosure in its corporate communications (for example, announcements and circulars) over time.

Our review covered the following areas:

- Fund raisings through issue of equity / convertible securities and subscription rights
- Updates on material changes after acquisitions
- Results of performance guarantees on acquisitions
- Significant changes to issuers' financial performance
- Adoption of HKFRS 10 / IFRS 10
- Biological assets
- Issuers listed in 2012 and 2013
- Periodic disclosure of mining or petroleum assets under Main Board Chapter 18 / GEM Chapter 18A

A majority of the areas we reviewed were subjects of previous reviews, and we note improvements in the disclosures in annual reports in all of these areas. We also note a reduction in cases involving possible material breaches of the Rules. We are pleased that issuers have considered our previous guidance¹ to enhance disclosures and improve their accountability to shareholders.

¹ See our [2012 Review Report](#) and [2013 Review Report](#).

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We highlight below areas where issuers can continue to improve their disclosures:

- (a) *Equity fund raising* – as a matter of good corporate governance, issuers conducting equity fund raisings should clearly disclose their intended use of the proceeds at the time of the fund raisings, and report back to shareholders on how these proceeds were actually applied in their annual reports.
- (b) *Significant changes to issuers' financial performance* – issuers with reliance on key customers should provide more in-depth discussion about the details of the key customers and their relationships, and where applicable, the reasons for any significant overdue receivables, how the issuers enforced their credit policy, and the details of any impairment provisions or subsequent settlements.

Issuers that experienced material changes in trade receivables should provide more in-depth discussion about any discrepancy from the issuer's stated credit policy (for example, longer debtors' turnover days than the general credit period, extended credit period granted to certain customers with their profile and relationships), any subsequent settlement of receivables after the year-end date, and the issuer's follow-up actions on any overdue receivables.

- (c) *Newly listed issuers* – newly listed issuers publishing profit warning announcements under the Inside Information Provisions should ensure that the information represents material developments subsequent to the date of the prospectus that has not been disclosed by the issuer. Where an issuer wishes to provide the market with additional information about its financial position after listing and this information is not inside information, it should ensure that such information is meaningful and specific, and not a restatement of information already available in the prospectus (for example, disclosure of specific financial figures). Furthermore, issuers should select headline categories that appropriately describe the nature of the information.

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I. INTRODUCTION

1. An annual report should provide material and relevant information about an issuer's financial results and position, and assist investors to assess its past performance and future prospects.
2. As a general principle, disclosure in annual reports should be clear, straightforward, and provide a qualitative analysis that complements and explains quantitative information in the related financial statements. There should be a balanced discussion of all major aspects of the issuers' businesses, including both positive and negative circumstances, in the "management discussion and analysis" section (**MD&A**). Better disclosure improves transparency and promotes a fair, orderly and informed market.
3. As part of our monitoring of issuers' activities, we review annual reports with a particular focus on issuers' Rule compliance, corporate conduct and disclosure of material events and developments. In our review of an issuer's disclosure we consider not only the disclosure in the annual report, but also the consistency and materiality of disclosure in its corporate communications (for example, announcements and circulars) over time. Our review of issuers' disclosure over time helps us identify cases of potentially misleading disclosure in corporate documents, issues with directors' role in safeguarding corporate assets, and possible corporate misconduct.
4. The Rules and applicable accounting standards set out the minimum information an issuer must include in its annual report. An issuer should provide additional information that is relevant to investors according to its own circumstances. In our review, we also considered whether issuers adopted our guidance from our previous annual report reviews. Where appropriate, we have requested issuers to make further disclosures by way of announcements, or in subsequent financial reports. Through this review and our enquiry and follow up process, issuers have improved the quality of their disclosures in annual reports and compliance with the Rules.

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5. This report presents our findings and recommendations from our review. Our review covers all issuers (excluding collective investment schemes listed under Main Board Chapter 20)² in the following eight areas:
- Fund raisings through issue of equity / convertible securities and subscription rights (Part IIA)
 - Updates on material changes after acquisitions (Part IIB)
 - Results of performance guarantees on acquisitions (Part IIC)
 - Significant changes to issuers' financial performance (Part IID)
 - Adoption of HKFRS 10 / IFRS 10 (Part IIE)
 - Biological assets (Part IIIA)
 - Issuers listed in 2012 and 2013 (Part IIIB)
 - Periodic disclosure of mining or petroleum assets under Main Board Chapter 18 / GEM Chapter 18A (Part IIIC)
6. This review is separate from our Financial Statements Review Program (the **FSRP**). The FSRP reviews the periodic financial reports published by issuers for compliance with both financial reporting standards and the disclosure of financial information requirements under the Listing Rules.
7. In this report, "Rules" refer to both Main Board (**MB**) Rules and Growth Enterprise Market (**GEM**) Rules.

² Including all annual reports issued for the financial year ended between December 2013 and November 2014.

II. FINDINGS ON SPECIFIC AREAS OF DISCLOSURE

A. Fund raisings through issue of equity / convertible securities and subscription rights

8. Issuers are required under the Rules³ to announce details of their equity fund raisings, including the terms and size of the equity issuance and the proposed use of proceeds. Shareholders may give issuers a general mandate to issue securities subject to the Rule requirements⁴, or a specific mandate to issue securities on particular terms and for specific uses set out in a circular. Issuers are also required to report to shareholders on the fund raisings conducted during the financial year in their annual reports.
9. In our 2013 Review Report, we recommended that for issuance of securities under general mandates, issuers should disclose clearly the reasons for the fund raisings and the proposed use of proceeds in the announcements. Issuers should avoid, where possible, generic descriptions. To provide accountability to shareholders, issuers should provide meaningful updates in their annual reports⁵ on the actual use of proceeds, including details of the application and where applicable, a breakdown of how the funds were allocated among different uses.
10. For issuances of securities under specific mandates, we reminded issuers that they should confirm in the annual reports whether the funds raised were applied in accordance with the specified uses described in the circulars, and provide details on how the proceeds were actually applied⁶.

Scope

11. We reviewed announcements and annual reports of 327 issuers that conducted 488 equity fund raisings during the financial year. Our review included 283 placings under general mandates, 118 placings under specific mandates, and 87 pre-emptive issues including rights issues and open offers. These transactions raised an aggregate of HK\$176.1 billion.
12. We reviewed the disclosures about issuers' proposed and actual use of proceeds in the announcements and the annual reports. For convertible securities and subscription rights, we also reviewed the disclosures about the conversion and subscription of equity securities during the financial year.

³ MB Rule 13.28 / GEM Rule 17.30.

⁴ Under a general mandate (MB Rule 13.36(2) or GEM Rule 17.41(2)) the share issuance must not exceed 20% of the issuers' share capital; the issue price may not be at a discount of 20% or more to the market price.

⁵ Paragraph 11 of Appendix 16 to the MB Rules / GEM Rule 18.32 requires disclosure in the annual report about issuers' equity issues, including, among others, the use of proceeds.

⁶ Under Paragraph 32 of Appendix 16 to the MB Rules / GEM Rule 18.41, an issuer should discuss in its annual report its significant events during the financial year.

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Findings

General mandate issue

13. We note an improvement in issuers' disclosures in both announcements and annual reports. In about 40% of the cases (2013: 20%), issuers disclosed in the announcements specific details about the proposed uses of proceeds. In the remaining cases, issuers described the proposed use of proceeds to be for general working capital or future business developments. We also note that a majority of issuers that were involved in repeated equity fund raisings within the same financial year also disclosed with specific details the actual uses of proceeds from previous fund raisings in their announcements.
14. About 59% of issuers (2013: 20%) provided updates on the application of the funds raised in their annual reports. These issuers either (a) confirmed that the funds raised were utilized in accordance with the specific uses described in the announcements; or (b) where the funds were proposed to be used for general working capital and/or further business development, provided details of the actual application of the proceeds (example, repayment of debts, expansion of sales network, acquisition of assets, administrative expenses). In the remaining 41% of issuers, issuers generally updated shareholders on the application of the funds raised after our enquiry.

Specific mandate issue and pre-emptive offer

15. About 78% of issuers disclosed in their annual reports that the proceeds were applied in the manner described in the circulars, representing a decline from last year where substantially all issuers made the confirmation. However, 49% of issuers (2013: 33%) disclosed further details on the actual application of proceeds, particularly in circumstances where the proceeds were intended for general business development.
16. We remind issuers that they should clearly disclose their intended uses of the proceeds at the time of the equity fund raisings, and report back to shareholders on how these proceeds were actually applied in their annual reports.

Convertible securities / warrant issues

17. 90 issuances involved convertible securities, and 52 issuances involved warrants with rights to subscribe for shares of the issuers. We reviewed the announcements, monthly / next day returns and annual reports of these issuers.
18. Paragraphs 10(1) and 10(2) of Appendix 16 to the MB Rules / GEM Rules 18.11 and 18.12 require an issuer to disclose in its annual report (a) specific details relating to convertible securities, options, warrants or similar rights issued during the financial year; and (b) particulars of any exercise of conversion or subscription rights during the financial year. Our review confirms that issuers have generally complied with the disclosure requirements.

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B. Updates on material changes after acquisitions

19. The Rules require issuers to announce material acquisitions, publish an investment circular and seek shareholders' approvals for these acquisitions. In addition, issuers should disclose in the MD&A section information about the acquired businesses, including material trends and significant events during the year⁷.
20. In 2013, we identified a small number of cases with significant asset impairments where (a) the issuers did not timely announce the material changes to the newly acquired businesses; and (b) the information disclosed in the investment circulars might have been incorrect or incomplete. We also recommended better disclosures about circumstances involving material asset impairments; such disclosures would enable shareholders to understand the basis for the impairments and the prospects of the business.

Scope

21. 216 issuers announced or completed at least one material acquisition in their last two financial years. There were 255 acquisitions, including 88 very substantial acquisitions and 167 major acquisitions, of which 85 involved acquisitions from connected persons. Of these 255 acquisitions, we identified 17 cases where material impairments were made on the acquired assets during the financial year under review. We also identified 19 cases where issuers recorded a material impairment of assets acquired over two years ago. Of these 36 cases, four cases involved acquisitions from connected persons.
22. We reviewed the annual report disclosure about the development of the acquired businesses, in particular, any significant changes to the value of intangible assets and goodwill. We also reviewed the valuation reports on the assets, and considered whether:
 - (a) the information disclosed in the original investment circular was materially accurate;
 - (b) any material change to the acquired business was timely announced; and
 - (c) any impairment to assets was properly made and whether the annual report discussed matters that gave rise to the impairment.

⁷ See MB Chapter 14 / GEM Chapter 19 for requirements applicable to material acquisitions, and Paragraph 32 of Appendix 16 to the MB Rules / GEM Rule 18.41 for all disclosure requirements for annual reports.

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Findings

23. We note an improvement in Rule compliance and disclosures compared with last year. In all 36 cases where issuers recorded significant asset impairments, the impairments resulted from events which happened after the acquisitions. We reviewed these issuers' announcements and were generally satisfied that these issuers had informed the market of developments by way of business updates and/or profit warning announcements.
24. We identified one case where the issuer recorded material asset impairments shortly after the acquisition, after discovering that the expected contracts from customers, which were major assumptions in the pre-acquisition valuation of the business, failed to materialize. This led to questions about whether the directors had properly performed due diligence and applied the necessary degree of skill, care and diligence in the course of the acquisition. We have taken appropriate actions in this case.

Valuation

25. HKAS 36⁸ requires a reporting entity to perform an annual impairment test on its goodwill and intangible assets with an indefinite useful life. Of the 36 cases with material impairments, over 74% were supported by valuations prepared by external valuers. We reviewed these valuation reports and the disclosures in the annual reports.
26. In our 2013 Review Report, we recommended that issuers should improve disclosures about circumstances involving material asset impairments. Such disclosures would enable shareholders to understand the basis for the impairments and the prospects of the business. Where the asset impairment is supported by an independent valuation, an issuer should disclose details about: (a) the value of the inputs (for example, the projected cash flow, discount rate and growth rate) used in the valuations together with the basis and assumptions; (b) the reasons for any significant changes in the value of the inputs and assumptions from those previously adopted; (c) the valuation method and the reasons for using that method; and (d) an explanation of any subsequent changes in the valuation method used.
27. Our review indicates an improvement in disclosures compared to last year. Issuers adopted the recommendations in our 2013 Review Report and generally discussed the reasons for the asset impairments. We also note that the changes in assumptions and inputs used in the valuations were in line with or properly explained by the changes in circumstances leading to the impairment.

⁸ Hong Kong Accounting Standard 36 - Impairment of Assets

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C. Results of performance guarantees on acquisitions

28. As part of the terms of acquisition agreements, some issuers would require the vendors to guarantee the performance of the acquired business. Where the guarantee is not met, the shortfall might be returned to the issuer in the form of compensation, or as an adjustment to the consideration based on an agreed formula.
29. Where the performance guaranteed by a connected person is not met, the Rules⁹ require an issuer to publish an announcement and disclose in its next annual report. We consider equivalent disclosure should be made where the guarantee is provided by an independent party (see our [letter](#) of 22 March 2013).
30. In 2013, we noted that a number of issuers did not strictly enforce the agreement to seek compensation where the acquired businesses did not meet the guaranteed performances. We also identified cases where the compensation arrangement did not appear to serve its stated purpose. We recommended issuers that the acquisition agreements should clearly set out how the performance guarantees would be calculated, the method to determine the compensation and whether they would achieve the intended purposes. Furthermore, issuers should inform shareholders about the performance of the acquired businesses, the outcome of any performance guarantees and how the issuers would enforce the obligations of the vendors under the acquisition agreements.

Scope

31. Our review identified 37 performance guarantees where the guaranteed period ended in the financial year under review, of which 19 performance guarantees were met and 18 performance guarantees were not met. Four performance guarantees were provided by connected persons of the issuers.
32. We reviewed issuers' annual reports and announcements to consider whether the outcomes of the performance guarantees were disclosed, and where the performance guarantees were not met, whether the issuers enforced the obligations of the guarantors.

⁹ See MB Rules 14A.62 and 14A.63 / GEM Rules 20.60 and 20.61. Such disclosures include the shortfall and any adjustment in the consideration, whether the connected person has fulfilled its obligations under the guarantee, whether the issuer has exercised any option to sell the acquired company or business back to the connected person and the reasons, and the independent non-executive directors' opinion on whether the connected person has fulfilled its obligations.

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33. Our review indicates that issuers' disclosures about the results of performance guarantees have improved. Issuers generally followed our recommendation and disclosed the outcome of performance guarantees in annual reports or announcements. These disclosures included information on whether the performance guarantees were met, and if not, whether and how the guarantors fulfilled their obligations under the terms of the agreements.
34. Of the 18 cases (including one case involving a connected person) where the performance guarantees were not met, all except three issuers were compensated by the guarantors in accordance with the terms in the acquisition agreements and appropriate disclosures were made.
35. Of the remaining three cases, we note that in two cases that the issuer took appropriate actions: (a) in one case the issuer took legal action to demand payment after the vendor failed to compensate the issuer according to the agreement; and (b) in the second case the issuer revised the guaranteed amounts and extended the guaranteed period, and explained the reasons for amending the original terms.
36. In the third case the issuer negotiated the settlement terms with the vendor only after the guarantee was not met, as the original agreement did not provide terms of compensation. Issuers are reminded to ensure the enforceability and clarity of the performance guarantees when negotiating acquisition agreements.

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D. Significant changes to issuers' financial performance

37. Paragraph 32 of Appendix 16 to the MB Rules / GEM Rule 18.41 requires disclosures on the discussion and analysis of an issuer's performance and the material factors underlying its results and financial position. The disclosure should emphasize trends and identify significant events or transactions during the year under review. The MD&A section provides information for shareholders to appraise an issuer's performance and prospects.
38. In recent years we continue to note occasions where the media, analysts and/or short sellers publish negative reports on individual companies, making allegations about accounting irregularities and questioning the credibility of the issuer's business models. These reports would challenge the consistency of issuers' published information, or highlight the discrepancies compared to industry peers or other publicly available information.
39. We consider that issuers can make better disclosure in the annual reports to allow investors to better assess their business models and financial performance. In our 2012 and 2013 Review Reports, we recommended disclosures in the following areas: (a) significant changes in revenue and/or profit margin during the financial year under review; (b) reliance on a small number of key customers and material changes in trade receivables; and (c) abnormal effective tax rates or significant tax balances.

Scope

40. We reviewed the annual reports of 39 Mainland issuers with characteristics cited in paragraph 39 above. Our review also covered these issuers' corporate communications (including announcements and circulars), media and research reports and other information in the public domain.

Findings

41. We note some improvement in the MD&A disclosures of the issuers under review, in circumstances where there are significant changes in revenue and/or profit margin, and in the discussions on tax positions. We also note that issuers with reliance on key customers and issuers that experienced material changes in trade receivables can provide more in-depth discussion in these areas.

Significant growth in revenue and/or profit margin

42. Half of the issuers with significant growth in revenue and/or profit margin during the financial year provided a detailed explanation of the reasons for the fluctuation, including:
 - (a) an industry overview covering changes to laws and regulations, technology advancement in the market and market landscape (for example, market share, overall industry trend), and an analysis of the impact on the issuer's future performance; and

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- (b) an update on the implementation of the issuer's previously announced business strategy, including benefits achieved, associated costs, etc., and the impact of the acquisitions during the financial year on the issuer's current year's profitability (including details of cost saving on enlarged group, more effective allocation of production capacities).
43. However, some issuers provided generic disclosures which did not explain how the issuers' particular circumstances led to the fluctuations, some simply repeated the financial information in narrative form.
44. We remind issuers that they should provide meaningful explanation of the key factors giving rise to the material changes in revenue and/or profit margin. Paragraphs 52(i) and (ii) of Appendix 16 to the MB Rules / GEM Rules 18.83(1) and (2) recommend additional MD&A disclosures¹⁰. As suggested in the 2013 Review Report, an issuer should:
- (a) include an overview of its industry and business to assist shareholders to better understand how it had performed compared to its industry peers. The discussion should focus on the trends and analyze the impact on the issuer's future performance;
 - (b) update on material changes to its operation (for example, product mix, business model), and how these changes have contributed to the issuer's performance during the financial year; and
 - (c) provide integrated information about its financial results and position, such as analysis and explanation of any unusual movements in account balances (for example, trade receivables) and/or key performance indicators, particularly areas where the movements deviated from the issuer's financial results.

Reliance on a small number of key customers and material changes in trade receivables

45. Paragraph 52(viii) of Appendix 16 to the MB Rules / GEM Rule 18.83(8) recommends an issuer to give an account of its key relationships with employees, customers, suppliers and others on which its success depends¹⁰.

¹⁰ Issuers should note that the recently amended Rules require disclosure in the directors' report of an analysis of financial key performance indicators and an account of key relationships with employees, customers, suppliers and others on which their success depends. See [consultation conclusions](#) on "Review of Listing Rules on Disclosure of Financial Information with Reference to New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/ Housekeeping Rule Amendments" published by the Exchange in February 2015. The new Rules are effective for accounting periods ending on or after 31 December 2015.

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46. Only a minority of issuers with key customers discussed their relationships with customers in their annual reports. These discussions followed our suggested disclosures set out in the 2013 Review Report, including:
- (a) the background of the major customers, the length of relationship with the issuer and the percentage of revenue from these customers during the financial year and its comparative period;
 - (b) a detailed description of the products and/or services sold to the major customers;
 - (c) the credit terms granted to major customers and whether they are in line with, or more favourable than, those granted to other customers, and detailed terms and conditions of any long-term agreements;
 - (d) the subsequent settlement of trade receivables with major customers after the year end date, and if the balances have not yet been settled, whether any provisions are necessary or the reasons why no provisions have been made; and
 - (e) the risks associated with reliance on major customers, and measures undertaken by issuers to mitigate such risks.
47. However, a majority of issuers with reliance on key customers did not disclose the details of those key customers and their relationships. Areas where disclosures were particularly lacking included reasons for significant overdue receivables, how the issuers enforced their credit policy, details of subsequent settlement of such overdue receivables, provisions for impairments and the basis for such (or a lack of) provisions for overdue amounts.
48. We also note that a majority of issuers with material changes in trade receivables, overdue balances or debtors' turnover days provided analysis and explanations about the reasons for the fluctuations. However, a few issuers failed to adequately explain the reasons for such fluctuations and subsequent settlement in their annual reports. We have provided guidance to these issuers.
49. We reiterate our recommendation to provide an analysis and explanation of material fluctuations in trade receivables set out in the 2012 Review Report, which may include any discrepancy from the issuer's stated credit policy (for example, longer debtors' turnover days than the general credit period, extended credit period granted to certain customers with their profile and relationships), any subsequent settlement of receivables after the year-end date, and the issuer's follow-up actions on any overdue receivables.

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Effective tax rates and tax balances

50. A majority of issuers with material changes in tax liabilities or material tax balances have provided an analysis on the changes in tax positions. However, a small number of issuers under review recorded a significant increase in tax balances or a change from a tax credit position to a tax expense position despite continuous net losses, and failed to adequately explain the reason for these changes. We have provided guidance to these issuers.
51. Tax rates and abnormal effective tax rates or balances continue to be areas targeted by short sellers in questioning the credibility of an issuer's financial results. We remind issuers to provide a more meaningful analysis to allow readers of annual reports to better understand the impact of a tax holiday and reduced tax rate, and reiterate recommended disclosures set out in our 2012 Review Report:
- (a) the reasons for the discrepancies and the significant changes in tax balances;
 - (b) the range of tax rates applicable to the major operating subsidiaries and the effective period of the tax holiday and reduced tax rates; and
 - (c) the names of major operating subsidiaries enjoying such tax benefits and their profit contributions to the group.

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E. Adoption of HKFRS 10/ IFRS 10

52. Hong Kong Financial Reporting Standard (**HKFRS**) 10 / International Financial Reporting Standard (**IFRS**) 10, entitled *Consolidated Financial Statements*, were issued in 2011 and apply to annual periods beginning since 1 January 2013.
53. HKFRS 10 / IFRS 10 establish new guidance on the principle of control (which is the basis for consolidation) to determine whether an investor / issuer controls an investee and whether the investee should be consolidated as a subsidiary of the issuer. The accounting standards require an issuer to disclose an assessment of the financial impact of HKFRS 10 / IFRS 10 on its accounts once this assessment is made.
54. The Rules govern the activities of the issuer group, including its subsidiaries. Under MB Rule 1.01 / GEM Rule 1.01, a subsidiary of an issuer includes an entity which is consolidated into the issuer's consolidated financial statements as a subsidiary under the HKFRS or IRFS. As a result, the adoption of HKFRS 10 / IFRS 10 may have various Rules compliance implications for issuers. We issued a [guidance letter](#) in 2013 (the **2013 Letter**) to assist issuers about compliance with the Rules following the adoption of HKFRS 10 / IFRS 10.
55. In the 2013 Letter, we reminded issuers of their obligation to assess the impact of any new subsidiary on their continuing compliance with the Rules. The requirements include disclosure of inside information under Inside Information Provisions, and compliance obligations related to notifiable and connected transactions requirements, share option schemes, spin-off, etc.

Scope

56. We reviewed issuers' annual reports to consider the sufficiency of disclosure on their adoption of HKFRS 10 / IFRS 10 and their assessment on any financial impact to their accounts. We also assessed any non-compliance of the Rules as a result of the adoption of HKFRS 10 / IFRS 10.

Findings

57. Issuers have disclosed their assessment and any financial impact as a result of the adoption of HKFRS 10 / IFRS 10. We note that a small number of issuers concluded that the adoption of HKFRS 10 / IFRS 10 resulted in consolidation of new subsidiaries. All of them disclosed in their annual reports the impact of the consolidation of new subsidiaries on their financial statements. We have not identified any non-compliance with the Rules.

III. FINDINGS ABOUT RULE COMPLIANCE BY SPECIFIC TYPES OF ISSUERS

A. Biological assets

58. Issuers engaging in agricultural activities are subject to material risks relating to the valuation of biological assets. These issuers may record significant fluctuations in their asset value and/or profitability as a result of unrealized fair value gain/ loss arising from the valuation of biological assets. The presentation of this information should be clear to investors.
59. In 2013, we noted that issuers could improve disclosures in the annual reports on details about the valuations that supported the value of the biological assets. A large majority of issuers engaged valuers and experts to perform site inspections and prepared the valuations. We recommended disclosures on the qualification of valuers / experts; valuation methodology and assumptions; material inputs, including bases and assumptions used in the valuation; and sensitivity analysis. We also noted that guidance letter ([HKEx-GL46-12](#)) is applicable to issuers in providing material information about the agricultural activities, biological assets and their valuations in their annual reports.

Scope

60. We identified 23 issuers¹¹ (2013: 25 issuers) with material biological assets as at the financial year end. These issuers were engaged in agricultural, forestry and animal breeding activities. We reviewed these issuers' annual reports, the valuation reports and/or expert reports on the biological assets, and considered whether they have disclosed sufficient information.

Findings

61. A large majority of issuers in this year's review followed our guidance and improved their disclosures.

Qualifications of valuers

62. Over 88% of issuers engaged external valuers to prepare the valuations. Around half of these issuers also engaged experts to assist the valuers to perform verification work on physical existence and quality of the biological assets. Over 90% of issuers followed our guidance and disclosed the qualifications of valuers and experts. Issuers generally disclosed the background of the valuers and experts, their professional qualifications and/or relevant experience, confirmed their independence and provided assessments on their competence.

¹¹ Two issuers discontinued/disposed of their operation with material biological assets.

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Valuation methodology

63. The valuations of biological assets were based on either market approach (eight cases) or income approach (ten cases) with five cases used both methods in the valuations. Substantially all issuers disclosed the basis for selecting the particular valuation methods.

Material inputs, including bases and assumptions used in the valuation

64. Substantially all issuers disclosed details of the valuations, compared to last year where issuers made limited or no disclosure:
- (a) The issuers provided qualitative discussion on the key assumptions, such as political, legal and economic conditions. They are usually general assumptions commonly adopted in valuations.
 - (b) For valuations using income approach, issuers disclosed key parameters used, including discount rates, growth rates and yield.
 - (c) Where there were material fluctuations in the fair value of biological assets from the previous years, the issuers provided details of the change in fair value (for example, additions, feeding costs, sales or death, fair value changes due to price or exchange rate) and explanation for the change.
 - (d) Over 90% of issuers disclosed the bases used to verify the physical existence of biological assets (for example, site visit and reliance on third party experts). Some issuers also disclosed the sampling basis and the coverage of samples.

Sensitivity analysis

65. Around 71% of the issuers (2013: 14%) using income approach included sensitivity analysis on key inputs to the valuations. Common variables included unit price, discount rate, yield and growth rate.

License/ rights/ permits to carry out the agricultural activities

66. Around 43% issuers engaging in agricultural activities required specific license to carry out the relevant activities. All these issuers disclosed the relevant details of licenses including the type of licenses required, the expiry dates of the licenses and the application or renewal status (if applicable).

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B. Issuers listed in 2012 and 2013

67. We reviewed the annual reports of 102 issuers listed in 2013 (newly listed issuers) and 64 issuers listed in 2012 (recently listed issuers). We considered their Rule compliance and annual report disclosure in the following areas:
- (a) outcome of profit forecasts and material changes in financial results;
 - (b) changes in the use of IPO proceeds; and
 - (c) undertakings provided by the major shareholders.

Findings

68. Issuers generally complied with the Rules and no material non-compliance were noted.

Outcome of profit forecasts and material changes in financial results

69. MB Rule 13.09 / GEM Rule 17.10 requires an issuer to publish an announcement immediately where it is required under the Inside Information Provisions to announce inside information¹². This would normally include material changes to its financial condition or the performance of its business. Further, MB Rule 13.24B / GEM Rule 17.26A requires that if, during the profit forecast period, an event occurs which would have caused any profit forecast assumptions to have been materially different or if an unanticipated event materially affects the profit forecast, the issuer shall promptly announce such an event and its likely impact on the profit forecast.
70. Approximately 18% of newly listed issuers reported profit forecasts in their prospectuses and all but two met the profit forecast. In the remaining cases, we reviewed the listing document and the announcements made by the issuers and were satisfied with the disclosures made by the issuers to update their shareholders on the changes.

¹² Inside information means specific information that (a) is about (i) the corporation; (ii) a shareholder or officer of the corporation; or (iii) the listed securities of the corporation or their derivatives; and (b) is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities (Section 307A(1) of the Securities and Futures Ordinance).

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71. Approximately 16% of newly listed issuers published profit warning announcements in respect of their first financial year after listing (2013: 19%). These profit warnings were on average published within one month after their interim/ year end (2013: one month). In all except one case, the reasons for the material changes in the issuers' results were already disclosed in the listing documents. These included one-off listing expenses; increases in operational costs; and/or slowdown of economic growth. The profit warning announcements did not provide new or material information to the public and based on our review of the movements in share prices and trading volume after the announcements, did not appear price sensitive.
72. In one case we noted a material deterioration in the issuer's results. There was a question on whether the change in financial performance might have been known at an earlier date and should have resulted in a profit warning announcement on an earlier date. We have taken appropriate action in the circumstance.
73. Profit warnings are normally published to alert investors to a significant change in the expected profitability of a listed issuer for the current period. A newly listed issuer is expected to disclose information about any material change (or expected change) to its financial position since the track record period in the prospectus. The prospectus forms the basis for investors to make an informed assessment about the issuer, and should contain all material information about the issuer up to the date of the prospectus. Accordingly, where subsequent to listing, a newly listed issuer publishes a profit warning announcement (under the Inside Information Provisions) about a deterioration in its financial position, that information should represent material developments subsequent to the date of the prospectus that has not been disclosed by the issuer.
74. Where an issuer wishes to provide the market with additional information about its financial position after listing and this information is not inside information, it should ensure that such information is meaningful and specific and not a restatement of information already available in the prospectus (for example, disclosure of specific financial figures). Furthermore, issuers should select headline categories that appropriately describe the nature of the information¹³.

Changes in the use of IPO proceeds

75. Five issuers announced changes in the use of the IPO proceeds shortly after listing. We reviewed the prospectuses and announcements and considered that these issuers had properly announced and explained the reasons for the changes in the use of the proceeds. They either re-allocated the uses among the originally disclosed uses, or for business expansions disclosed in the prospectus. We have not identified any material deviations to the proposed uses of proceeds which were not in line with the issuers' businesses.

¹³ For example, where an announcement does not contain inside information, issuers should not select the headline category "Inside Information".

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Undertakings provided by the major shareholders

76. MB Rule 8.10 / GEM Rules 11.04 states that a director must disclose details of his interests in any business which competes or is likely to compete with the issuer. In addition, it is common for major shareholders of listing applicants to provide non-competition undertakings to delineate the listed business from their personal businesses.
77. 86 issuers (2013: 47 issuers) were given non-competition undertakings (NCUs) by their major shareholders in relation to the issuers' businesses.
78. Based on our review and enquiries, there was no Rule compliance issue. However, approximately 25% of the issuers did not disclose in the annual reports that their major shareholders complied with the NCUs (2013: 26%). We recommend that issuers should disclose confirmations of compliance in their annual reports.

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C. Periodic disclosure of mining or petroleum assets under MB Chapter 18 / GEM Chapter 18A

79. Under MB Rules 18.14 to 18.18 / GEM Rules 18A.14 to 18A.18, Mineral Companies and non-Mineral Companies¹⁴ must give an update on resources and reserves in their annual reports. Mineral Companies must also disclose details of their exploration, development and mining production activities, and a summary of expenditures incurred in such activities in their annual reports. Our guidance letter ([HKEx-GL47-13](#)) sets out recommended disclosures in those areas.
80. In 2013, we identified some areas where issuers made insufficient disclosures:
- (a) *Annual updates on resources and reserves* – over half of the issuers that reported changes to their resources and reserves estimates did not discuss the reasons for the change;
 - (b) *Exploration, development and mining production activities* – a majority of Mineral Companies that conducted exploration, development and mining production activities did not provide information on their exploration and development activities. Further, most Mineral Companies failed to provide details of new contracts and commitments during the period, and
 - (c) *Expenditures incurred* – a majority of Mineral Companies did not make an informative discussion about their exploration, development and mining production expenditures.

Scope

81. We reviewed the annual reports of 43 Mineral Companies and 45 non-Mineral Companies, and considered their compliance with the Rule requirements and the guidance letter.

Findings

82. This year disclosures by both Mineral Companies and non-Mineral Companies were more informative and covered the areas discussed in the Rules and the guidance letter.
83. There were a few cases where issuers did not provide discussions on (a) details of further work done on drilling programs, and/or assumptions adopted which supported the change in resources and reserves estimates; and (b) exploration and development activities. These issuers provided further information to investors by way of supplemental announcements after our review.

¹⁴ A non-Mineral Company refers to an issuer that publicly disclosed information about resources and / or reserves under MB Rule 18.15 / GEM Rule 18A.15.

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IV. CONCLUSION

84. A majority of areas we reviewed were subjects of previous reviews, and we note improvements in the disclosures in annual reports in all of these areas. We also note a reduction in cases involving possible material breaches of the Rules. We are pleased that issuers have considered our previous guidance to enhance disclosures and improve their accountability to shareholders. Through this review and our enquiry and follow up process, issuers have improved the quality of their disclosures in annual reports and compliance with the Rules.

- End -

