HKEX
香港交易所

January 2024

Review of Issuers' Annual Reports 2023

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EXECUTIVE SUMMARY

The Listing Division undertakes an on-going programme to review issuers' annual reports as part of its monitoring activities. We adopt a thematic approach, selecting specific areas for review based on results of previous years' reviews and matters considered to be of higher regulatory risks. In our review we consider whether material and relevant information was adequately and sufficiently disclosed to allow shareholders to properly assess the relevant matters reported on and whether the issuers maintain proper internal and financial reporting controls. We also assess issuers' compliance with the Rules and specific accounting standards in financial statements.

In addition to the thematic review, we review issuers' compliance with the annual report disclosure requirements under the Rules.

Findings and Recommendations

We are generally satisfied with the results of our review this year and issuers continued to achieve a high rate of compliance. We highlight below some of our major findings and recommendations:

- **Financial reporting and related controls** (Section II) – A vast majority of the issuers were able to publish their audited financial statements which presented a true and fair view on their financial position and performance by the deadline under the Rules. The failure of the small minorities to do so was commonly attributable to different extent of deficiencies in their financial reporting, risk management and internal control systems. Issuers' management should establish a policy to identify risks emerging from changes in external environment as well as their operations from material corporate actions undertaken. In addition, they should, under audit committees' oversight, develop appropriate control systems to mitigate identified risks and regularly review the adequacy of these systems for timely and accurate financial reporting. For transparency, the review scope, details of significant areas of concern identified and remedial measures implemented, as well as the board's confirmation of the effectiveness of the systems are recommended to be disclosed in the corporate governance reports.

  To ensure timely financial reporting, issuers should properly plan their audit. Audit fees and detailed audit plan should be agreed upon with auditors as early as practicable. Issuers' management should establish a policy to monitor the audit process and escalate audit issues identified to the committees. Audit committees should have sufficient oversight throughout the entire financial reporting process.

- **Material lending transactions** (Section III) – We are pleased to note a substantial decrease in problematic lending transactions and gradual improvement in issuers' disclosure of their money lending activities since we first commenced our review in this area three years ago. We encourage issuers to follow our recommendations provided through individual guidance to issuers, education materials to the market as well as enforcement actions in egregious cases, and to continue improving their disclosure. In particular, money lenders should enhance their disclosure on customer profile, concentration risks and internal controls, whilst non-money lenders should disclose their reasons for lending. Issuers should also put in place appropriate internal controls

commensurate with their operation scale to govern money lending transactions to safeguard shareholders' interests.

This year, we continued to observe isolated cases of non-compliances with the notifiable and/or connected transaction Rules in issuers' money lending transactions. Issuers are reminded that money lending is a form of "financial assistance" which, depending on its materiality and counterparties, might constitute a notifiable and/or connected transaction, irrespective of whether the issuer carries out money lending as a principal business.

- **Financial statement disclosure under accounting standards** (Section V) – From our review, performing valuations in relation to (among others) expected credit losses assessment, fair value measurement and impairment testing was a key challenging area in financial reporting. Issuers' directors must exercise their own judgment to assess the reasonableness of the assumptions and inputs used in the valuations and should not overly rely on valuers. The clarity and transparency of the relevant disclosure are also important to build investor confidence in the reported asset values.

- **Compliance with annual report disclosure requirements** (Section VI) – Issuers continued to achieve a high rate of compliance. Effective from 1 January 2023, the Rules on share option schemes were amended to also govern share award schemes. The amended Rules also require certain additional information to facilitate investors' understanding of the dilution impact of the schemes and matters reviewed by the remuneration committee. A large majority of the issuers reviewed complied with the disclosure requirements under the amended Rules. Some issuers omitted the additional information. Issuers should be mindful of the disclosure requirements under the amended Rules on share schemes and ensure full compliance.

Issuers should take note of our observations and recommendations discussed in this report and follow the guidance in their future annual reports to improve transparency and accountability to investors.

I. INTRODUCTION

1. An annual report should provide material and relevant information about an issuer's financial results and position for investors to assess its past performance and future prospects. As a general principle, disclosure in annual reports should be clear and straightforward, and provide qualitative analysis that complements and explains quantitative information in the 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. Better disclosure improves transparency and promotes a fair, orderly and informed market.

2. The Listing Division undertakes an on-going programme to review issuers' annual reports as part of its monitoring activities. We adopt a thematic approach, selecting specific areas for review based on results of previous years' reviews and matters considered to be of higher regulatory risks. In our review we consider whether material and relevant information was adequately and sufficiently disclosed to allow shareholders to properly assess the relevant matters reported on and whether the issuers maintain proper internal and financial reporting controls. We also assess issuers' compliance with the Rules[1] and specific accounting standards in financial statements. Through this thematic review we aim to identify areas for improvement and make recommendations to promote better governance and disclosure. Sections II to V of this report (**Report**) present results of our thematic review.

3. The Rules prescribe specific information an issuer should disclose in its annual reports. In this review, we assess issuers' compliance with these disclosure requirements. Our findings are set out in Section VI.

4. **Appendix I** contains guidance materials for issuers who conduct money lending transactions, one of the areas for thematic review this year. **Appendix II** sets out the scope and methodology of this year's review.

5. This review covered the annual reports of issuers for the financial year ended between January and December 2022.

[1] In this report, "Rules" refer to both Main Board (**MB**) Rules and GEM Rules.

II. THEMATIC REVIEW ON FINANCIAL REPORTING AND RELATED CONTROLS

6. Under the Corporate Governance Code, directors are responsible for preparing the issuer's accounts and presenting a balanced, clear and comprehensive assessment of its performance. They should ensure the effectiveness of the issuer's risk management and internal controls and adequacy of resources and experience of staff for the financial reporting functions.

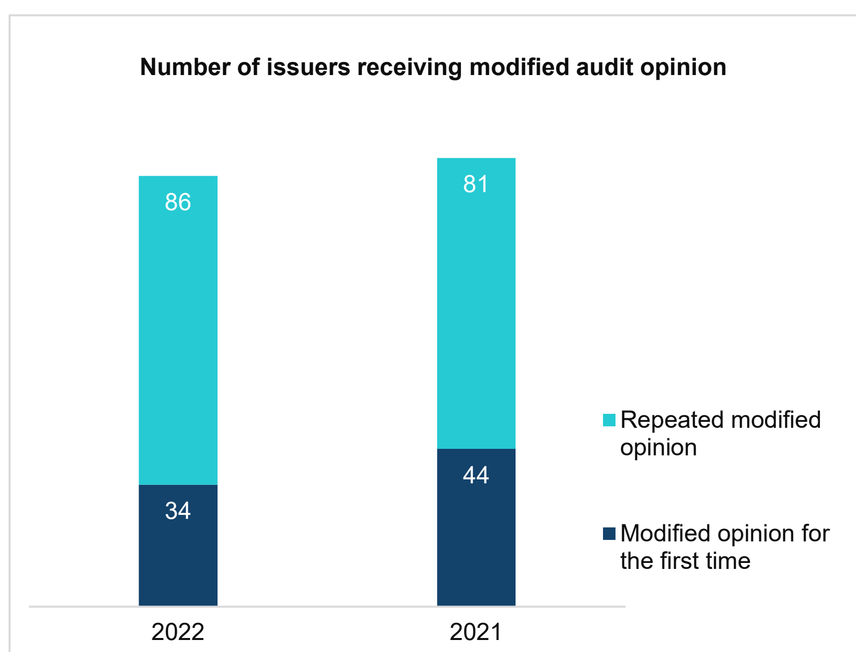
7. The audit committee monitors the integrity of the issuer's financial statements, has an oversight of the issuer's financial reporting system, risk management and internal controls, and reviews the effectiveness of the audit process.

8. Last year, we reviewed issuers who had received modified audit opinions on their financial statements for the 2021 financial year and issuers who had failed to publish financial results for that financial year by the deadline under the Rules. Our review suggested room for improvement in some issuers' financial reporting, risk management and internal control systems. This year, our review continued to focus on these areas.

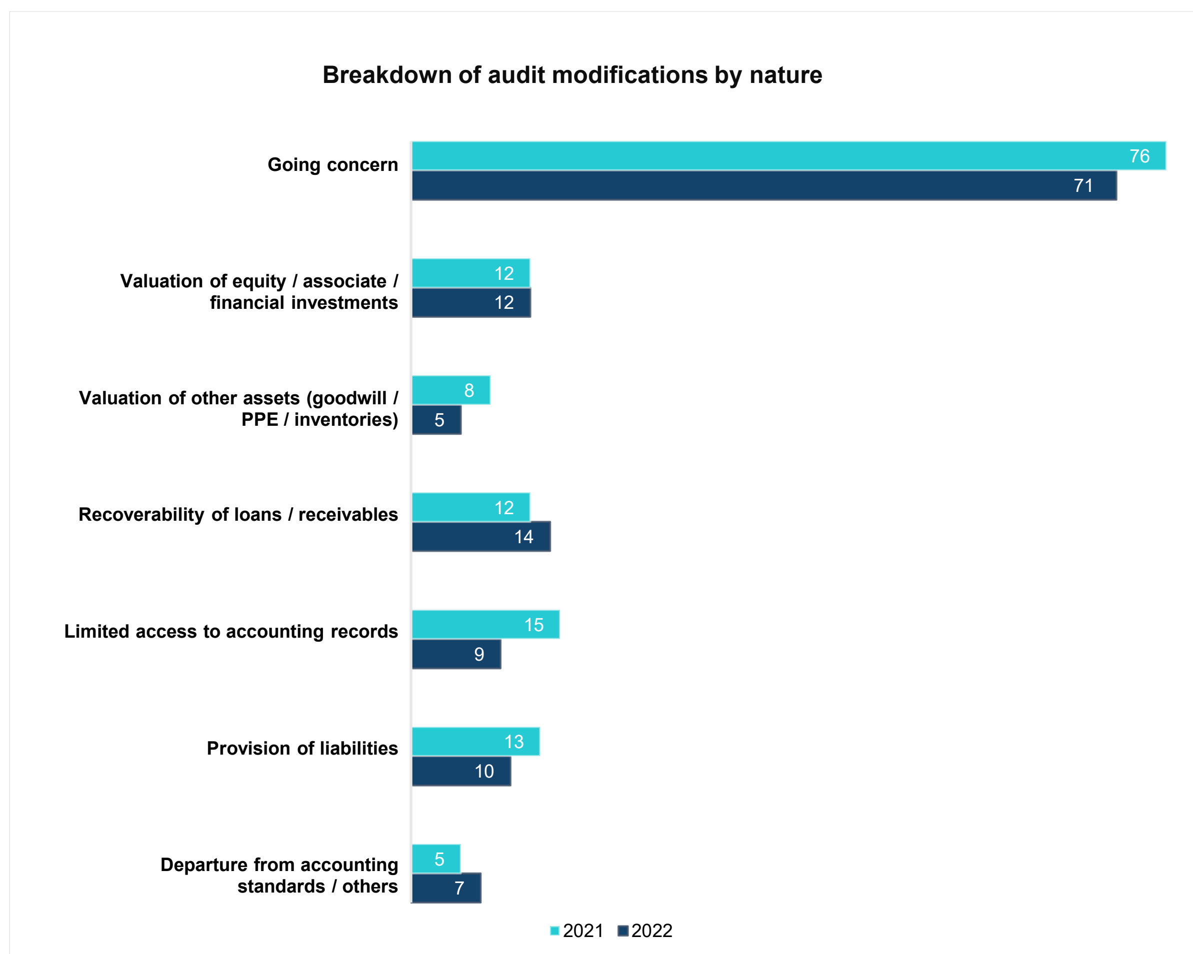
Findings

A. Auditors' modified opinions

9. For the 2022 financial year, 120 issuers (2021: 125) received modified audit opinions on their published financial statements, of which 86 had received modified opinions for two or more consecutive years. The repeated modifications were mainly attributable to delay in implementation of plans to resolve the underlying issues, or alteration of the plans in response to changes in external factors. Having considered the issuers' circumstances and explanations, we did not identify cases where the directors had failed to take reasonable actions to resolve the repeated modifications.



10. Going concern qualifications continued to be the most common audit modifications. Other audit modifications were similar to last year's and mainly related to valuation of assets and limited access to accounting records:



Note: Some issuers had more than one audit issue cited in their modified opinions.

11. *Valuation of assets* – These audit modifications were mainly caused by issuers' inability to satisfy their auditors as to the fairness of the reported asset value by sufficient audit evidence. This was, in many cases, attributable to the lack of proper control procedures or mechanisms in different aspects. For example:

    (i) In assessing the value of investments or recoverability of trade receivables, some issuers lacked internal guidelines that prompt and guide them to properly assess deterioration in the operating environment or financial performance of the investees or debtors, and to document its impact on the value assessment. Consequently, the issuers failed to produce objective and sufficient evidence in the circumstances to support the reported asset value, such as by obtaining up-to-date financial information of their investees or debtors or commissioning a third-party valuation of the collaterals pledged by the debtors; and

(ii) Some issuers lacked policies and control procedures on origination and execution of corporate transactions. For instance, in granting loans or making prepayments, some issuers appeared not having performed adequate credit risk assessment or background search on the counterparties, undertaken proper approval procedures, and maintained relevant documents. The lack of controls caused auditors' doubt about the recoverability of the loans and prepayments and in some extreme cases, the existence, commercial substance and business rationale of the transactions.

12. *Limited access to accounting records* – This modification in many cases stemmed from the lack of policies and control procedures to secure unrestricted access to books and records of investees at the time of, as well as after, making the investments. For instance:

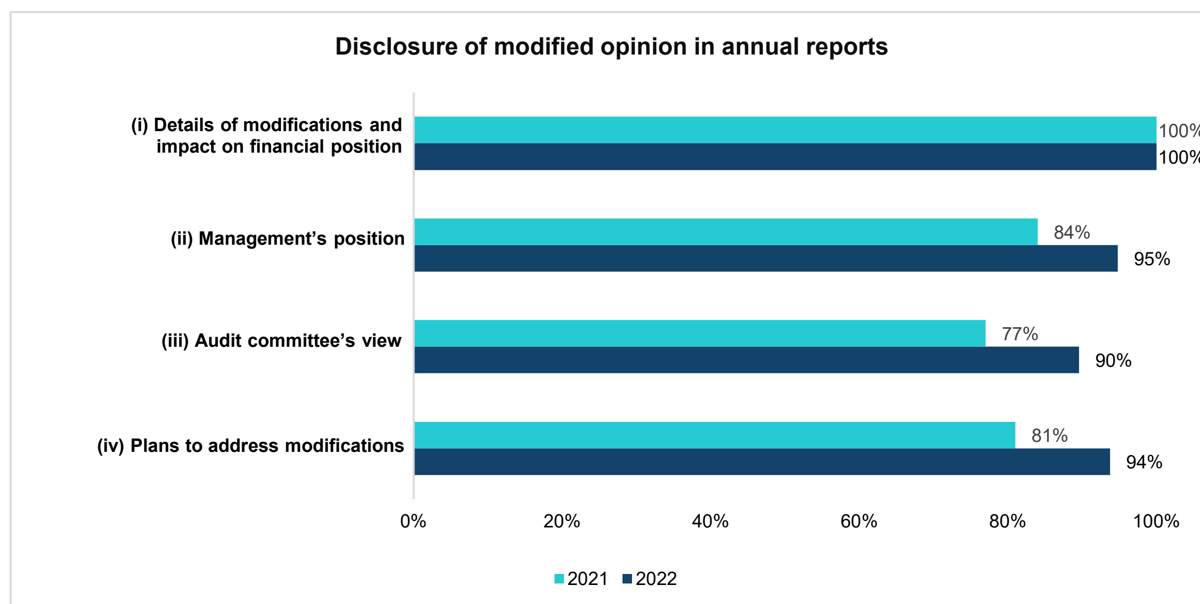
(i) When investing in minority interests in companies or private funds over which the issuers would not have control, some issuers did not demand specific terms in the investment agreements which could afford them and their auditors the rights to obtain the investees' financial information and/or perform necessary audit procedures for annual audit;

(ii) After acquiring the controlling interests in an investee, some issuers failed to change the legal representatives and maintain control over the use of the company chops of the investee. The lack of control and supervision over investees gave rise to auditors' questions whether the issuers indeed had control over the purported subsidiaries, and in turn whether it was appropriate to consolidate them in the issuers' financial statements; and

(iii) In some disposal transactions, the issuers did not arrange for their auditors to audit the disposal targets before completion of the disposals. Subsequently, the purchasers refused to provide any information to the auditors.

Disclosure of modified opinion in annual reports

13. In our previous years' reports, we recommended issuers disclose in their annual report (i) details of the modifications and their impact on the issuer's financial position; (ii) management's position and basis on major judgmental areas and how it is different from that of the auditor; (iii) the audit committee's view including whether it agrees with the management's view; and (iv) the issuer's plans to address the modifications. We are pleased to find that most issuers followed our recommendations.



B. Delay in publication of results

14. For the 2022 financial year, a small number of issuers (73; last review: 85) failed to publish their annual results within the 3-month reporting deadline, resulted in suspension of trading in their securities. The delay was generally attributable to longer time than expected by the issuers to complete the audit. In some of these cases, the issuers encountered audit issues (such as those discussed above) and took additional time to address queries raised by auditors and provide audit evidence.

15. Inadequate audit planning and oversight was a factor contributing to the delay in some of the cases:

(i) *Late audit fee negotiation* – This year, around 85 issuers changed their auditors within four months before their reporting deadlines due to disagreement on audit fee. In some of these cases, the new auditors did not have sufficient time to complete the audit in time.

(ii) *Inadequate planning with new auditors* – A few issuers that had changed auditors did not understand the new auditors' audit approaches and methodologies and underestimated the audit evidence required by the new auditors for auditing the historical financial information (e.g. opening balances). As a result, these issuers were unable to timely provide the necessary audit evidence.

(iii) *Ineffective coordination with experts involved* – Some issuers only engaged the valuers at a late stage of the audit process and the parties could not agree on a work schedule that aligned with the overall audit timetable. This delayed the completion of the audit.

(iv) *Lack of escalation policy* – In some cases, the management did not promptly escalate possible audit issues identified by auditors during the audit process to the audit committees due to lack of escalation policy. The audit committees only became aware of the audit issues from the auditors at a very late stage of the audit. As a result, the committees did not have adequate time to facilitate resolution of these issues.

Recommendations

16. *Internal control* – Modified audit opinions and delay in publications of financial results, in many cases, arose from deficiencies in issuers' financial reporting, risk management and internal control systems. In today's dynamic business environment, issuers face constant changes both externally such as economic conditions, regulations, industry landscape and competition, and internally such as their operations as a result of mergers and acquisitions or other corporate actions. These changes might have a material impact on the issuers' market, operational and compliance risks. Taking note of various control weaknesses discussed above, management should establish a policy to identify emerging risks, develop risk-mitigating controls, and review the control effectiveness on a continuous basis to facilitate timely and accurate financial reporting. The audit committees have the responsibility of overseeing the whole process.

17. *Audit planning and oversight* – Issuers should timely agree on audit fees and audit plans with the auditors. At the planning stage, they should draw the auditors' attention to any material changes to the issuers' risk environments or operating scale during the year. Both parties should agree on the audit approach, supporting documents required and the audit timetable for these changes. When new auditors are appointed, issuers should be mindful of additional time being required for developing the audit plan and performing extra audit procedures on their historical financial information. Management should monitor the audit progress and seek help from the audit committee when necessary.

18. *Disclosure* – We encourage issuers to confirm in the corporate governance reports that the management has reviewed the issuers' risk management and internal control systems[2] and that the board considers the systems to be effective and adequate. The scope of review and details of significant areas of concern identified, including principal risks, internal control deficiencies and remedial measures implemented, are also recommended to be disclosed to support their confirmations.

[2] Code Provision D.2.8 of Appendix C1 to MB Rules / Appendix C1 to GEM Rules.

III. THEMATIC REVIEW ON MATERIAL ASSET IMPAIRMENTS

19. The Rules require an issuer to include in its annual report a "management discussion and analysis" (**MD&A**) of material factors underlying its financial results and position and significant events during the year. Where an issuer recorded a material impairment on its assets, it should discuss the circumstances that led to the impairment.

20. We reviewed issuers' disclosure about material asset impairments in the financial statements and MD&A. In the review, we also considered the reasons for the impairments and compliance with the Rules, including whether the directors have properly discharged their fiduciary duties in safeguarding issuers' assets, and in providing sufficient and timely information to shareholders about these asset impairments.

21. As part of our thematic reviews of material asset impairments in the last two years, we looked at issuers' material lending transactions and, where applicable, material impairments on loan receivables and other issues associated with the lending activities. We also reviewed the information presented by issuers in annual reports about their money lending transactions and provided recommendations to improve disclosure (see **Appendix I**). This year, we reviewed this area again and selected about 300 issuers that reported material loan receivables for the review.

22. Our findings are set out in the following sections:

    A) Material asset impairments (other than loans);
    B) Material lending transactions by money lenders; and
    C) Material lending transactions outside the issuers' ordinary and usual course of businesses.

Findings

A. Material asset impairments (other than loans)

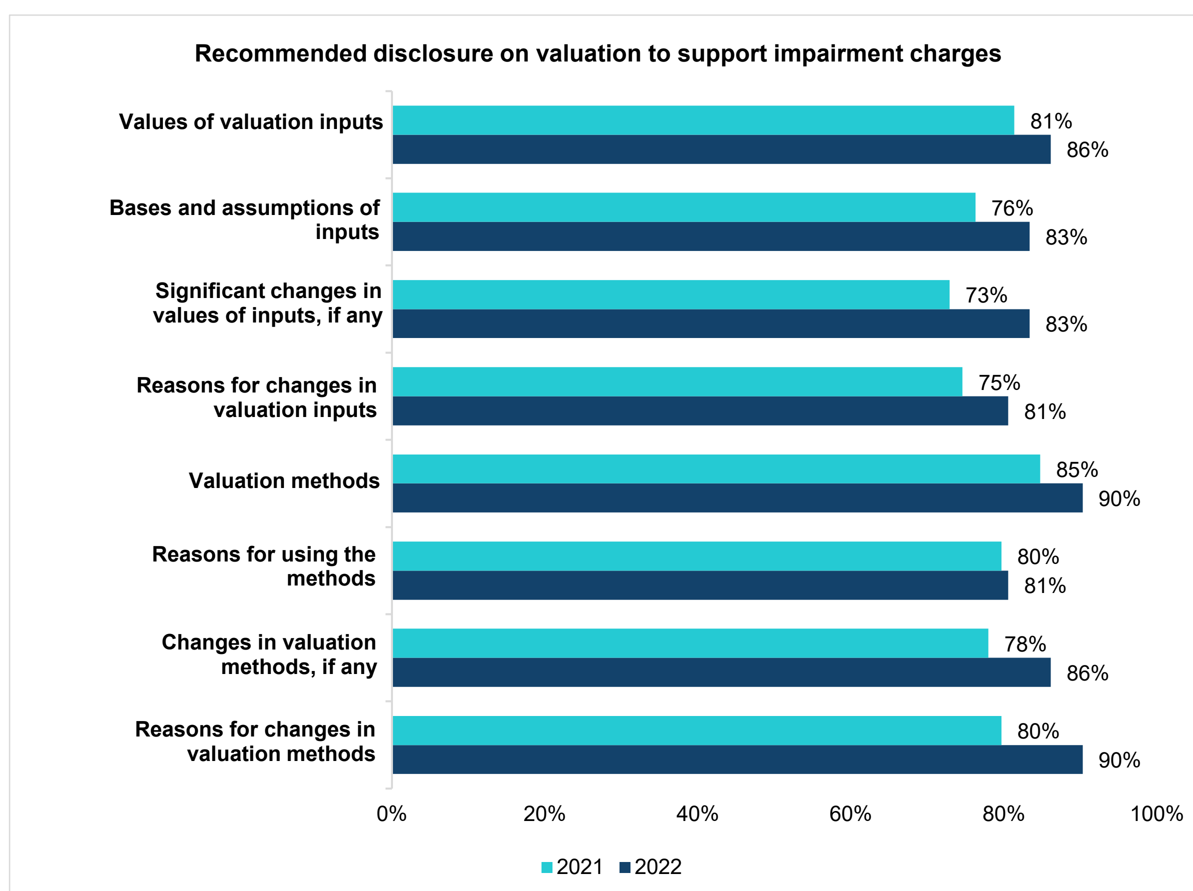
23. *Rule compliance matters* – Our review in general did not identify material issues in this area, saved as below:

    (i) Two issuers recorded material impairments in receivables and deposits respectively shortly after being reported on. The receivables were related to a deferred consideration for an asset disposal while the deposits were made for obtaining exclusive rights to provide certain services. The circumstances of the cases raised questions whether the issuers' directors had properly assessed credit risks of the counterparties and/or incorporated adequate safeguards in the transaction agreements in case of their default, such as requesting collaterals or guarantees for settlement/repayment. Eventually the counterparties did not fulfil their contractual obligations, resulting in substantial losses to the issuers. These cases are currently under our investigations and have been referred to the SFC for their investigations; and

(ii) Some issuers failed to satisfy their auditors as to the fairness of the reported impairment charges and consequently the value of the relevant assets. This resulted in the auditors expressing a modified audit opinion on the issuers' financial statements. Please refer to Section II-A of the Report for the relevant discussion.

24. *Disclosure* – A vast majority of the issuers reviewed have discussed the circumstances that led to the material impairments in the annual reports, and supported the reported impairment amount by valuations or other evidence. One issuer, however, attributed the impairment generally to "the unforeseen business environment in near future" without identifying any specific factors and explaining how they affected the value of the relevant assets. We requested this issuer to make further explanation in a supplemental announcement.

25. In previous years' reviews, we recommended issuers who supported their impairment charges by way of a valuation disclose details of such valuation, including the valuation method and the reason for using that method; details of the values of inputs used together with the basis and assumptions; and explanation on any changes in the valuation method used or the inputs or assumptions. In this year's review, we are pleased to find that most issuers followed our recommendation:



26. In our review, we also considered whether issuers have timely informed the market of material asset impairments by way of announcements under MB Rule 13.09 (GEM Rule 17.10). We are satisfied that in general issuers had announced changes to their financial position arising from asset impairments on a timely basis.

B. Material lending transactions by money lenders

27. About two-thirds of the selected issuers reported money lending as a principal business activity in their 2022 annual reports.

28. *Rule compliance matters* – A small proportion (about 9%) of these money lenders reported material impairments on loan receivables. Among them, a few cases exhibited characteristics that raised questions about directors' conduct and adequacy of the issuers' risk management and internal controls over their lending businesses, for example, impairment of a majority part of the loan shortly after granting; questionable commercial merits of loan terms (e.g. interest rate below the issuer's own financing costs); lack of safeguarding measures (e.g. failure in demanding securities for loans with high credit risks and taking adequate actions to recover overdue loans).

29. Compared to last year, the number of such problematic cases had substantially reduced. These cases are currently under our investigations and were also referred to the SFC for their consideration.

30. Separately, our review of the selected money lenders also found isolated cases of breaches of the notifiable/connected transaction Rules while the issuers conducted lending transactions. We have taken appropriate actions on the non-compliances.

31. *Disclosure* – In last year's review, we note a general improvement in issuers' disclosure of their money lending business in annual reports and provided further disclosure guidance (see **Appendix I**). We are pleased to find that money lenders' disclosure continued to improve this year. We highlight below a few areas that issuers should pay attention to for more informative disclosure:

    (i) Some issuers provided very limited profile information about their customers (e.g. simply stating whether they were individual or corporate customers). They should present particulars with the objective to enable investors to understand the background and assess the quality of the borrowers (e.g. size, industry, credit rating, listed or private companies, etc);

    (ii) The disclosure about concentration risks was insufficient in some cases. Issuers should disclose, for example, the number of borrowers and loans receivables from the five largest borrowers as we recommended, and/or other information which is appropriate in the circumstances for investors to appraise the concentration risks of their loan portfolios; and

    (iii) Certain issuers only disclosed part of the internal control systems over their lending businesses. The disclosure should cover all major aspects of the issuers' lending operations and procedures to allow investors to have a holistic understanding and evaluation of the adequacy of the controls.

C. Material lending transactions outside the issuers' ordinary and usual course of businesses

32. The remaining one third of the issuers reviewed did not carry out money lending as a principal business. In many cases, the loans were incidental to these issuers' business operations, including providing loans or advances to associated companies or joint ventures; making advances to customers or suppliers; and providing financial assistance as part of acquisition or disposal transactions.

33. *Rule compliance matters* – About 13% of these non-money lenders reported material impairments on loan receivables. We have reviewed the circumstances that had led to the impairments and did not identify potential misconduct by the issuers' directors.

34. Similar to our observations from reviewing money lenders, we found isolated cases of non-compliances with the notifiable and/or connected transaction Rules by non-money lenders in granting loans. These issuers generally attributed the non-compliances to unfamiliarity with the Rules or inadvertent oversight. Some of these cases indicated potential weaknesses in the issuers' internal controls in monitoring corporate actions to ensure regulatory compliance, whilst a few also revealed other control deficiencies, such as lack of documentation. We have taken or will take appropriate actions against these issuers.

35. *Disclosure* – Non-money lenders' disclosure has improved, and most of them have disclosed major terms of the loans. However, a significant number of issuers failed to disclose the reasons for providing the loans. As money lending is not a part of their principal businesses, non-money lenders should provide more transparency on the business rationale for lending the corporate funds. Please see **Appendix I** for the disclosure guidance.

Recommendations

36. This is the third year we reviewed issuers' material lending transactions in conjunction with our thematic review of material asset impairments. Through our guidance provided to issuers individually, market education materials[3] as well as enforcement actions (such as public censure) taken against issuers and/or their directors in egregious case, we are pleased to observe heightened market awareness of the matter, as reflected in a substantial decline in problematic lending transactions identified and notable improvement in disclosure over the periods.

37. We encourage issuers to take note of the findings presented in the Report and continue improving their governance over material lending transactions and related disclosure. In particular,

    (i) In conducting money lending transactions, directors should assess the commercial rationale and whether the use of corporate funds for lending is in line with the issuer's overall business strategy and direction; and whether the terms of the lending are fair and reasonable and in shareholders' interests;

[3] Including reports on review of issuers' annual reports and Listed Issuer Regulation Newsletters.

(ii) Directors and audit committees should ensure that issuers have effective risk management and internal control systems to monitor lending transactions. **Appendix I** sets out examples of issuers' control measures in different aspects of the money lending operations based on our observations. Issuers should design and put in place suitable internal control measures commensurate with the scale and complexity of their lending activities;

(iii) Issuers are reminded that money lending is a form of "financial assistance" which, depending on its materiality and counterparties, might constitute a notifiable and/or connected transaction[4] under the Rules. This is regardless of whether money lending is carried out in the issuer's ordinary and usual course of businesses. Issuers (including money lenders) should be mindful of the relevant Rule requirements when contemplating and executing money lending transactions; and

(iv) Issuers are encouraged to take note of the common disclosure deficiencies discussed above. In particular, money lenders should enhance their disclosure of customer profile, concentration risks and internal controls, whilst non-money lenders should disclose reasons for their lending.

[4] Under MB Rule 14.04(1)(e) (GEM Rule 19.04(1)(e)), only banking companies or securities houses that provide financial assistance in their ordinary and usual course of businesses are exempted.

IV. THEMATIC REVIEW ON NEWLY LISTED ISSUERS (LISTED IN 2021 AND 2022)

38. We monitored newly listed issuers' post-listing activities and compliance with the Rules, and reviewed their disclosure in announcements and annual reports.

39. This year, we reviewed 96 and 89 issuers listed in 2021 and 2022 respectively. We highlight our findings in the following areas:

    A) Post-listing developments;
    B) Changes in the use of IPO proceeds and/or business plans;
    C) Profit alerts and material changes in financial results;
    D) Non-compliances with the Rules after listing; and
    E) Fulfilment of undertakings provided before listing.

A. Post-listing developments

40. In recent years, the SFC and the Exchange have been addressing issues related to companies seeking a listing on the Exchange for purposes that may not align with public interests, for example, "shell" creations where controllers sought listings of their businesses with the intention of disposing of their listing platform to new investors for eventual backdoor listings of the investors' businesses, or arrangements to artificially satisfy the initial listing requirements or facilitate market manipulation of the shares at a later date[5]. While the Exchange has amended the Rules to address these issues[6], we continue to closely monitor newly listed issuers for red flags suggestive of these activities.

Findings

41. As backdoor listings may involve a series of arrangements over time, we reviewed whether the newly listed issuers conducted activities including (i) disposals of controlling interests by the original controlling shareholders; (ii) material acquisitions of new businesses and/or material disposals of original businesses; and (iii) reallocation of IPO proceeds to new businesses.

42. In this review, we identified that two issuers, both listed in 2021, were involved in one or more of the above-mentioned corporate activities:

    (i) The controlling shareholders of one issuer disposed of their controlling interests in that issuer; and

    (ii) The other issuer proposed to conduct a material acquisition of new businesses and reallocated IPO proceeds to the new businesses. We ruled the material acquisition to be a reverse takeover and the issuer aborted the proposal.

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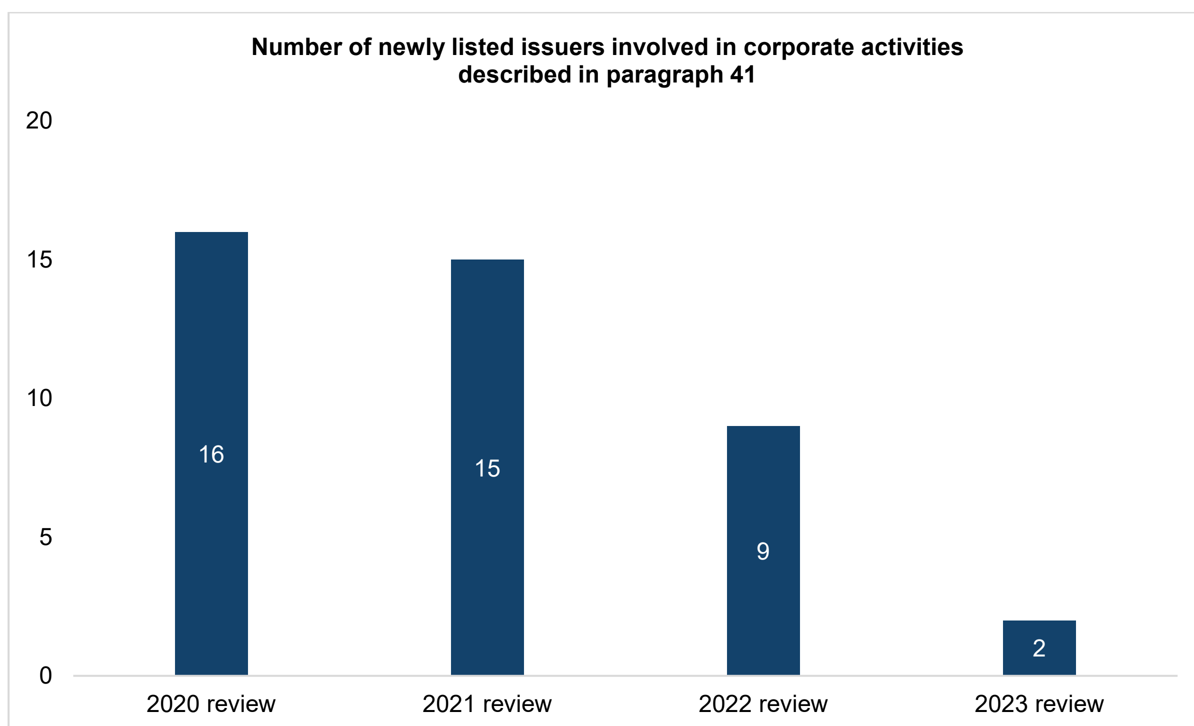
[5] See The SFC and HKEX joint statement on IPO-related misconduct dated 20 May 2021.
[6] See consultation conclusion on backdoor listing, continuing listing criteria and other Rule amendments dated 26 July 2019 and consultation conclusion on review of the GEM and changes to the GEM and Main Board Listing Rules dated 15 December 2017.

43. The number of newly listed issuers involved in one or more of the aforesaid corporate activities has been decreasing since the amendment of the backdoor listing Rules in 2019. However, given backdoor listings may take place through a series of corporate activities over a period of time, we will continue to monitor these issuers' corporate activities and take actions where appropriate to address issues on backdoor listings.



B. Changes in the use of IPO proceeds and/or business plans

44. The disclosure in a prospectus on use of IPO proceeds indicates how a newly listed issuer intends to deploy resources and implements its business plans. This is relevant information for investors to make their investment decisions in the new issue. Where an issuer changes its proposed use of proceeds or business plans shortly after listing, such changes should be timely announced, with the reasons thereof clearly explained.

45. In previous years, we reported cases involving arrangements conducted shortly after listing and changes in the use of IPO proceeds that were inconsistent with the issuers' stated business plans and lacking proper disclosure, for example:

(i) Issuers investing a material part of their IPO proceeds in private entities or wealth management projects associated with the IPO professional parties or their associates;

(ii) Upfront payments to consultants, distributors, marketing promoters or other parties that were disproportionate to their purported purposes; and

(iii) Mainland property management issuers providing funds to related parties or pledged deposits to guarantee their liabilities without proper disclosure.

46. Our investigations revealed that certain arrangements lacked commercial rationale and resulted in substantial losses for the issuers. The arrangements also suggested failure of the directors to safeguard corporate assets and shareholders' interests, resulting in public censure of some issuers and their responsible directors. In some cases, the issuers were also found to have breached the notifiable and/or connected transaction Rules in making the relevant arrangements, for which we have taken, or will take, appropriate regulatory actions.

Findings

47. This year, we identified two cases involving arrangements conducted shortly after listing and changes in use of IPO proceeds that were inconsistent with the issuers' business plan stated in the prospectus and post-listing disclosures (last review: four):

(i) One issuer used a material part of its IPO proceeds to provide interest-free loans to a friend of an executive director and substantial shareholder, and make substantial payments for consulting fees, project fees and deposits without supporting documents or commercial rationale; and

(ii) One issuer made a significant upfront payment to a consulting firm for potential acquisitions before entering into any acquisition agreements. It was also revealed that the upfront payment was refunded to the issuer before the end of the financial period and deposited to the consulting firm again afterward without apparent reasons.

48. The above arrangements raised concerns whether the directors have fulfilled their fiduciary duties to safeguard corporate assets and shareholders' interests and whether the issuers have put in place sufficient internal controls. We will take appropriate actions against these issuers.

49. In addition, 14 newly listed issuers reallocated funds among different intended uses stated in the prospectuses or to other initiatives relating to the existing businesses (last review: 12). The changes were generally attributed to changes in business strategies or current business needs. We were generally satisfied that the changes were timely announced and adequately explained.

C. Profit alerts and material changes in financial results

50. A prospectus contains historical and forward looking information that reflect the issuer's financial position and outlook. Where material events after listing lead to material changes in an issuer's financial performance and a profit alert announcement is published, the announcement should quantify the potential financial impact and use clear and concise language. An issuer should refrain from publishing profit alert announcement that merely repeats facts previously disclosed in the prospectus.

51. Last year, we identified one case reporting a substantial decline in profits after listing due to failure to account for certain professional fees committed before listing. Subsequently, we took disciplinary actions against the directors for their failure to monitor the issuer's financial position regularly.

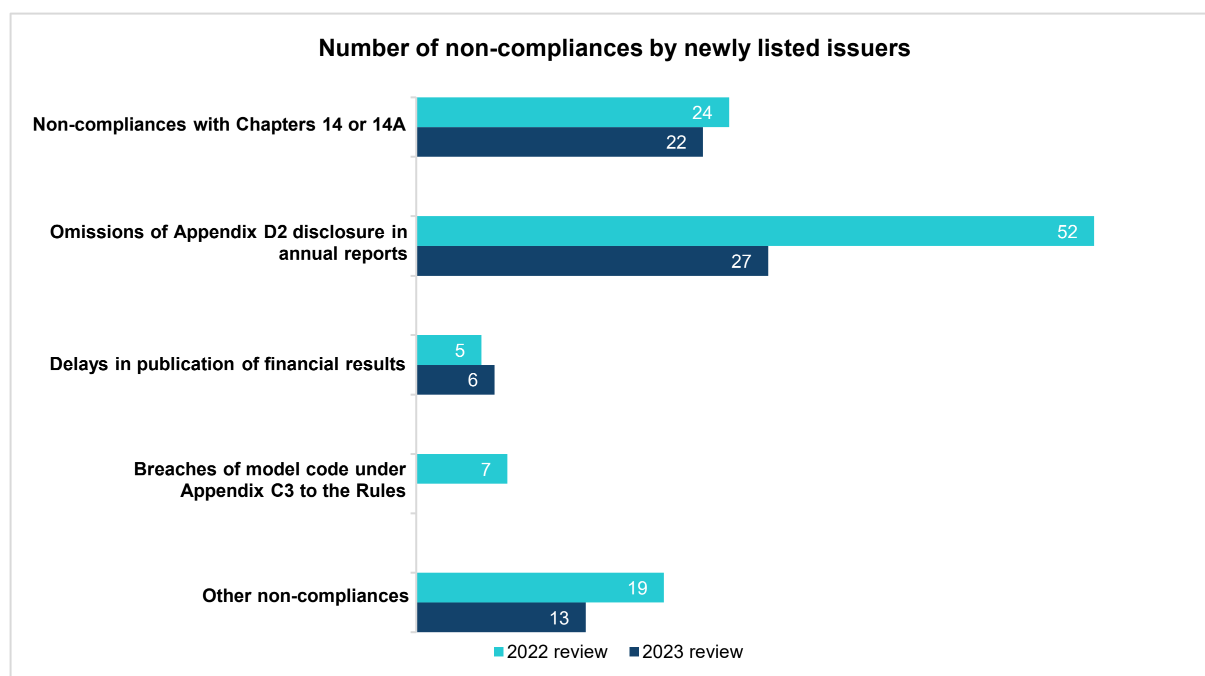
Findings

52. About 20 newly listed issuers reported material changes to their financial results (last review: 12). We were generally satisfied that these issuers, where required, have published profit alert announcements on a timely basis and followed our guidance on disclosure.

D. Non-compliances with the Rules after listing

53. We recorded 68 non-compliances with the Rules by 59 newly listed issuers. These non-compliances are summarised below:

Findings



Note: 2023 review covered issuers listed in 2021 and 2022. 2022 review covered issuers listed in 2020 and 2021.

54. This year, we continued to identify cases of non-compliances with notifiable or connected transaction Rules, including:

 (i) Failure to announce subscriptions of wealth management products or investments in investment funds. Such investments constitute acquisitions under the notifiable transaction Rules (see FAQ 057-2019); and

 (ii) Failure to comply with the connected transaction Rules when advancing loans to connected persons, or exceeding the agreed annual caps on continuing connected transactions.

55. These non-compliances with the notifiable or connected transaction Rules were mainly attributed to misunderstanding on the application of the Rules or insufficient oversight. A few issuers did not consult their compliance advisers before entering into the transactions. These issuers have subsequently implemented measures to enhance their internal control policies over compliances with the Rules.

E. Fulfilment of undertakings provided before listing

56. In specific cases, newly listed issuers undertook to disclose in their annual report regulatory updates on contractual arrangements for restricted businesses in the PRC. Some Chapter 19C secondary listed issuers also undertook to seek and obtain shareholders' approvals in general meetings to amend their constitutional documents to provide shareholder protection as required by the Rules[7].

57. Some major shareholders of newly listed issuers provided non-competition undertakings to issuers to delineate their businesses from those of the issuers. These issuers have undertaken to make relevant disclosure in annual reports to the effect that the major shareholders have fulfilled the undertakings.

Findings

58. Majority of the issuers have fulfilled their undertakings. A few issuers omitted making disclosure of their non-competition undertakings in annual reports. They subsequently disclosed the omitted information by way of announcements.

Recommendations

59. Newly listed issuers are reminded of their listing obligations regarding accountability and transparency to shareholders. Directors should ensure the issuers have effective infrastructure and controls which can enable them to timely identify material corporate developments (such as material changes in financial performance and position, business plans and directions, use of IPO proceeds as well as material corporate transactions or incidents) and make disclosure promptly.

60. Issuers should be mindful of the Listing Rule implications on different types of transactions, such as subscription for wealth management products or provision of loans to other parties where non-compliances were commonly observed. Directors should take note of the compliance pitfalls highlighted in the Report and devoted adequate staff or other resources to ensure compliance.

61. Chapter 3A of the MB Rules (Chapter 6A of the GEM Rules) require newly listed issuers to consult their compliance advisers on specified matters[8]. We note in several non-compliance cases that the issuers failed to consult their compliance advisers on the relevant transactions or corporate matters in advance and consequently breached the Rules. We remind newly listed issuers of this Rule obligation and urge them to well utilise these compliance resources and seek guidance from their compliance advisers from time to time where necessary.

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[7] Formerly MB Rule 19C.07 and now the Core Standards under Appendix A1 of the MB Rules.

[8] Issuer should consult their compliance advisers (i) before the publication of any regulatory announcements, circulars or financial reports; (ii) before any proposed notifiable or connected transactions or share issuances and repurchases; and (iii) before any changes in the uses of IPO proceeds.

V. THEMATIC REVIEW ON ISSUERS' FINANCIAL STATEMENT DISCLOSURE UNDER ACCOUNTING STANDARDS

62. We conducted a review on 300 issuers' financial statements with a view to encouraging a high standard of financial disclosure and focused on compliance with the applicable accounting standards[9].

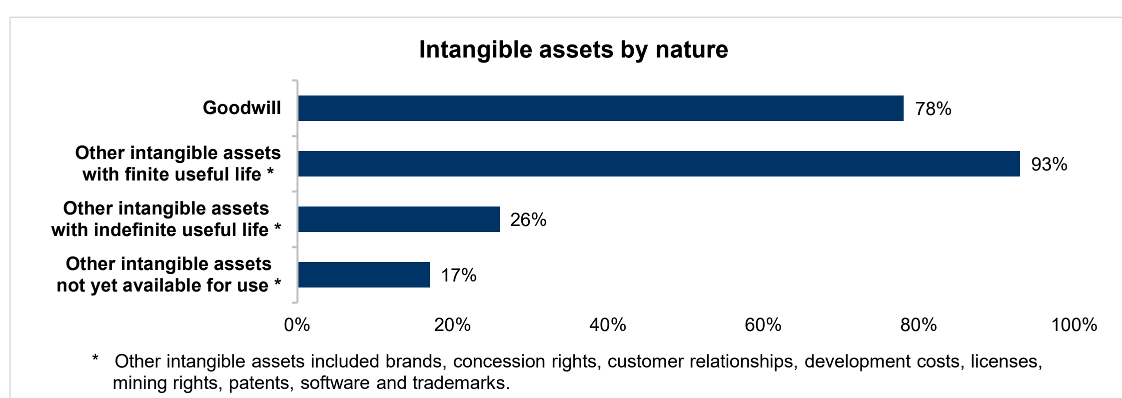
63. In general, we are pleased with the quality of financial disclosure and the issuers' positive response to our enquiry, except for two cases that were referred to the Accounting and Financial Reporting Council (the **AFRC**) for consideration. Where disclosure was insufficient but not material to the financial statements as a whole, issuers had confirmed that the required information would be provided in their future financial reports.

64. This section focused on the disclosure under HKFRS[10]. We set out below the common areas identified from our review and serve as reminders for issuers in preparing their financial statements.

A. Material intangible assets

65. In our review, 46 issuers had material intangible assets and most of these issuers' financial statements had complied with the disclosure requirements[11]. Our observations are summarised below:

    (i) The issuers had one or more intangible assets and were across different business sectors (including consumer discretionary, healthcare, information technology, telecommunications and utilities). They disclosed the reasons to support their intangible assets with indefinite useful lives. In some cases, the issuers further mentioned that such assessment had been reviewed annually. For those cases involving minimal amortisation charges, the issuers also disclosed the balance of intangible assets not yet available for use as at the reporting date.



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[9] Notes 2.1 and 2.6 to paragraph 2 of Appendix D2 to the MB Rules / GEM Rules 18.04 and 18.06.

[10] Unless otherwise specified, Hong Kong Financial Reporting Standards (**HKFRS**) and their paragraph numbers referred to in this section correspond to those in International Financial Reporting Standards (**IFRS**). The observations in this section are not exhaustive, readers should read the full HKFRS/IFRS to understand the relevant requirements and implications.

[11] Hong Kong Accounting Standard (**HKAS**) 36 "Impairment of Assets" paragraphs 126-137 and HKAS 38 "Intangible Assets" paragraphs 118-128.

(ii) In relation to the impairment testing, most cases determined the recoverable amounts of the cash-generating units (**CGUs**) based on value in use by using discounted cash flow (**DCF**) method. The quantitative inputs (including budget periods, discount rates and terminal growth rates) and the qualitative information of the underlying key assumptions were disclosed. A few issuers further elaborated how the cash flow projections linked with the CGUs' latest business developments (e.g. the expected product launch date) instead of merely providing boilerplate descriptions, such as based on *"past experience"* and *"external information sources"*.

(iii) We are pleased to note that many issuers had enhanced their impairment test disclosure by incorporating one or more recommended items (see below) in our previous Reports.

Our recommended disclosure on material intangible assets

The following additional information in the MD&A and financial statements (where appropriate) is recommended:

- Provide additional quantitative data of key assumptions (other than discount rate and terminal growth rate as required under accounting standards, e.g. gross and net margins), comparative information in the previous year and the explanation of significant changes to underlying assumptions;
- Provide a negative statement indicating that reasonably possible change in the key assumptions on which the management had based its determination of the CGU's recoverable amount would not cause an impairment loss;
- Provide the recoverable amount of the CGU and the headroom available;
- Highlight whether the impairment assessment is based on a valuation by an independent professional valuer; and
- Provide details of further development of the CGU or segment, such as business plan and contracts with new customers in the coming year and their impact on the revenue and margins.

66. Given the current economic uncertainty and market volatility, issuers should timely revisit and update the financial budgets and assumptions used in the impairment testing, which should reflect the management's best estimates and available market information as at the reporting date. The clarity and transparency of their disclosure are also important to build investor confidence in the reported asset values[12].

[12] Issuers should take note that the International Organization of Securities Commissions published its *"Recommendations on Accounting for Goodwill"* for issuers, audit committees and auditors in December 2023, which aimed at enhancing the reliability, faithful representation and transparency of goodwill recorded and disclosed in the financial statements.

B. Material Level 3 financial assets

67. Most issuers complied with the disclosure requirements[13] and had engaged independent valuers to perform the valuations in relation to their investments in unlisted equities, funds and debt instruments. We note the following:

    (i) The common valuation techniques were DCF method (income approach) and comparable company valuation multiples (market approach). A wide range of significant unobservable inputs were used in the valuations (such as weighted average costs of capital, terminal growth rates, expected rates of return, price-to-book value/earnings/sales multiples and discounts for lack of marketability). Nearly all issuers provided the quantitative information of these inputs and a narrative description about the sensitivity.

    (ii) Another valuation technique was the adjusted net asset method, which involved the use of a combination of valuation approaches and techniques to measure the fair values of investees' individual assets and liabilities.

68. Performing Level 3 valuation under the current market conditions can be challenging. We remind issuers' directors on their fiduciary duties and duties of skill, care and diligence under MB Rule 3.08 (GEM Rule 5.01) that they must exercise their own judgment[14] to assess the reasonableness of the valuation techniques and underlying unobservable inputs[15] and should not overly rely on valuers. They should obtain sufficient and timely information from investees (such as latest financial data, updates on operations and business plans, recent share transactions) for measuring fair values and provide robust disclosure on Level 3 measurement.

C. Business combinations

69. For the issuers conducted business combinations in 2022, most of them complied with the disclosure requirements[16]. Our key findings are set out below:

    (i) We made enquiry to some issuers to request additional information for those transactions involved complex arrangements (e.g. profit guarantees, contingent considerations and derivative instruments) and/or recognised significant goodwill and intangible assets. Based on the issuers' disclosure and response, no significant issue identified (except in one case mentioned below). Most of them had engaged independent valuers to measure the fair values of identified assets, liabilities and contingent considerations at the acquisition date.

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[13] HKFRS 13 "Fair Value Measurement" establishes a fair value hierarchy that prioritises the inputs to valuation techniques used to measure fair value into three levels: unadjusted quoted price (Level 1), observable inputs (Level 2) and unobservable inputs (Level 3). The disclosure requirements are set out in HKFRS 13 paragraphs 91-99, in which more extensive disclosure is required for Level 3 measurement.

[14] Issuers should read the SFC's published guidance in relation to valuations in corporate transactions: (i) Guidance note on directors' duties in the context of valuations in corporate transactions (issued in May 2017); and (ii) Statement on the Conduct and Duties of Directors when Considering Corporate Acquisitions or Disposals (issued in July 2019).

[15] Issuers are encouraged to read the IFRS Foundation's educational material *"Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments"*, which provides a non-exhaustive list of the common oversights when applying the valuation techniques.

[16] HKFRS 3 "Business Combinations" paragraphs 59-63 and B64-B67.

(ii) In that one case, the acquisition involved a contingent consideration obligation, and the number of consideration shares to be issued by the issuer would be adjusted downward in the event of a shortfall of the profit guarantee provided by the vendor. Such obligation was recognised as an "equity" instead of a "financial liability" in the financial statements. It appeared that the arrangement did not meet the fixed-for-fixed criteria and the treatment was not in line with the requirements of HKFRS. We referred this case to the AFRC for consideration.

70. Directors are primarily responsible for preparing the financial statements which give a "true and fair view". The boards and their management should familiarise themselves with accounting requirements. When entering into complex transactions, they should have more in-depth discussion with their auditors and valuers at an early stage to prevent any unintended accounting errors and regulatory consequences.

71. Issuers can refer to Guidance Letter GL116-23 published in October 2023 for guidance on disclosure of the basis of consideration and business valuations in notifiable transactions.

D. Revenue

72. From our review, the issuers generally provided the required disclosure[17]. Our key observations are highlighted below:

(i) Majority of the issuers provided disaggregated revenue into two or three types of categories, and the most common types were: (a) major products and services; (b) geographical regions; and (c) timing of revenue recognition (i.e. at a point in time or over time). Many issuers included the disaggregated revenue information as part of their segment reporting[18], to enable investors to better understand how that revenue related to the segment results and other information provided in the segment disclosure (e.g. costs of goods sold, expenses and assets used).

(ii) Some issuers disclosed that they had made significant judgments and estimates in their revenue recognition, such as: (a) principal versus agent consideration; (b) estimation of the progress towards satisfaction of an over-time performance obligation; and (c) allocation of a stand-alone selling price to each distinct performance obligation in a bundled contract. We observed a case with prominent disclosure on its revenue recognition policy (i.e. recognised revenue on a gross or net basis for different customer contracts) with reference to its respective roles and responsibilities as a principal or an agent, and how these linked to the requirements of HKFRS 15.

73. Issuers should continuously enhance the quality of their disclosure and provide tailored information based on their own circumstances, in particular the implications of their specific business models or arrangements should be clearly explained in their accounting judgments, estimates and policies.

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[17] HKFRS 15 "Revenue from Contracts with Customers" paragraphs 110-129 and B87-B89.
[18] HKFRS 8 "Operating Segments".

E. Credit risk disclosure on trade receivables

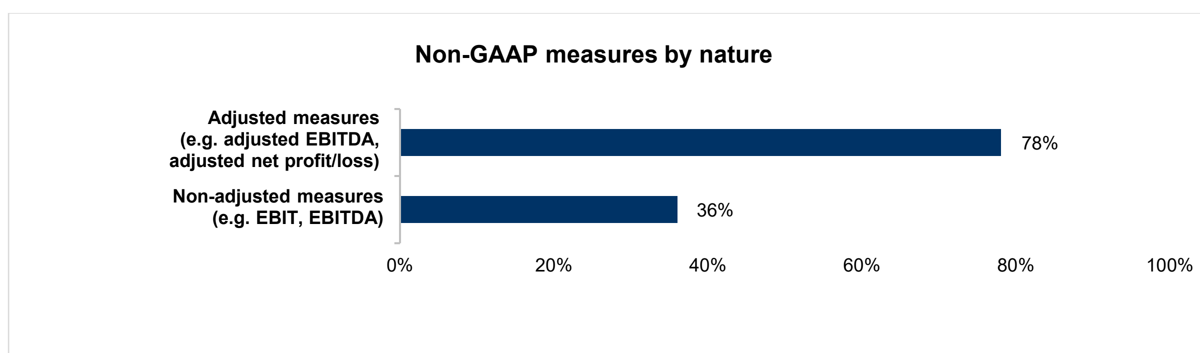
74. Most issuers applied the simplified approach[19] in measuring expected credit losses (**ECL**) on trade receivables and the disclosure was relatively more extensive than other financial assets, including: (i) percentages of the balances concentrated in the largest customer and top five customers; (ii) balances that were credit-impaired and assessed individually; and (iii) loss rates and/or provision matrices (e.g. by past due status) on the balances assessed collectively.

75. Notwithstanding the above, the qualitative information could be improved. For example, the disclosure about loss rate determination appeared to be generic. For the current loss rates calculated based on the historical loss rates and adjusted to reflect *"current and forward-looking information"*, it would be helpful if the issuers could clearly explain the reasons where there was a significant change in the loss rates from the previous year.

76. The disclosure requirements on credit risk and ECL assessment are more objective based. As such, issuers should carefully consider their circumstances and determine: (i) how much detail to disclose; (ii) how much emphasis to place on different aspects of the disclosure requirements; (iii) the appropriate level of aggregation or disaggregation; and (iv) whether shareholders and investors need additional explanations to evaluate the quantitative information disclosed.

F. Presentation of non-GAAP measures

77. In this year's review, 76 issuers used the non-GAAP measures[20] as a complement to the GAAP financial information in their annual reports.



[19] HKFRS 9 "Financial Instruments" requires a three-stage general approach for measuring impairment and a simplified approach for certain financial assets such as trade receivables with no significant financing component. The disclosure requirements are set out in HKFRS 7 "Financial Instruments: Disclosures" paragraphs 35A-35N and B8A-B10.

[20] Non-GAAP measures are numerical measures of historical performance, financial position or cash flow that are not GAAP measures based on HKFRS, IFRS or other accounting standards that are accepted by the Exchange.

78. The non-GAAP measures should not be presented with greater prominence than the GAAP information. We observed that: (i) it was common in the financial highlights section to disclose the GAAP information together with the non-GAAP measures (in tables or graphs with definitions and comparatives); (ii) the GAAP information was usually presented as the starting point when discussing the issuers' performance in the MD&A section; and (iii) a few issuers added a label *"non-GAAP measure"* to bring greater clarity to their disclosure.

79. In a few cases, we made enquiry to the issuers for clarification on their non-GAAP measures. For example: (i) the term *"adjusted"*, or the reconciliation was omitted; and (ii) the adjusting items (e.g. share-based payment expenses, fair value changes and listing expenses) had not been clearly explained (e.g. simply described as *"non-cash"*, *"one-off"* or *"non-recurring"* as a whole). It would be helpful if the issuers could provide an explanation of the nature of each adjusting item.

80. Under the current economic conditions, it is particularly important for issuers to follow our guidance[21] and take a holistic approach to ensure the non-GAAP measures present a fair and balanced view of their performance, position and cash flow. The audit committees, as gatekeepers, should monitor the integrity of issuers' non-GAAP disclosure.

Key consideration when presenting non-GAAP measures

- **Definitions** – Non-GAAP measures should be defined (by reflecting their composition) and explained the basis of calculation. They should be appropriately labeled (e.g. *"adjusted net profit (non-GAAP measure)"*) to distinguish from GAAP measures.
- **Reasons for presenting non-GAAP measures** – Issuers should justify why the information is useful and provides additional value to investors (e.g. non-GAAP measures are commonly used in their industries or peers).
- **Prominence** – Issuers should ensure prominence of GAAP measures over non-GAAP measures (e.g. GAAP loss for the year should be presented immediately before *"adjusted net loss (non-GAAP measure)"*).
- **Reconciliation and nature of adjustments** – The quantitative reconciliation should begin with GAAP measures and be reconciled to non-GAAP measures with reconciling items derived from the financial statements reported in GAAP (when a reconciling item cannot be extracted directly from the financial statements, show how this figure is calculated). Issuers should explain the nature of each adjusting item and remove any adjusting item which is considered as normal, recurring, cash operating expenses necessary to their business operations (e.g. impairment of trade receivables relating to issuers' normal businesses).
- **Comparatives** – Issuers should consistently present non-GAAP measures for comparative periods.

[21] Our guidance on non-GAAP measures is set out in GL103-19 and the Guide for New Listing Applicants (Chapter 3.11 paragraphs 17-21). The guidance should also apply to listed issuers which present non-GAAP measures in any documents pursuant to the Rules (e.g. financial reports, announcements and circulars).

G. Key audit matters and financial statement disclosure

81. We are pleased with the consistency of information between the issuers' financial disclosure and the KAMs[22] reported by their auditors in our review this year. Majority of the auditors' reports disclosed one to three KAMs. The most common KAMs related to the asset impairments or valuations, which involved significant management judgments and estimation uncertainty and therefore typically required the auditors' attention. Another common KAM was revenue recognition because it was presumed as a fraud risk under the auditing standards and involved complexity of applying HKFRS 15 in practice (e.g. long-term contracts, complicated arrangements).

Top five KAMs
• Impairment of non-financial assets (e.g. goodwill, intangible assets, property, plant and equipment, right-of-use assets) • ECL of trade and other receivables • Level 3 fair value measurements (e.g. financial assets and investment properties) • Net realisable value of inventories, properties under development and held for sale • Revenue recognition

82. Issuers should pay particular attention to the clarity of their financial disclosure for those areas covered by KAMs to assist investors in better understanding of the risky areas. Audit, along with financial reporting, plays a critical role in driving issuers' good corporate governance. Issuers and their audit committees should communicate with their auditors about the audit plan and areas of audit focus well in advance of the financial year-end[23] and use their best endeavours to address the issues raised by the auditors in a timely manner. Doing so may minimise the possibility of last minute surprises.

[22] Hong Kong Standard on Auditing 701 "Communicating Key Audit Matters in the Independent Auditor's Report" defines key audit matters (**KAMs**) as *"Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance."*

[23] In July 2023, the AFRC published *"Audit Focus – Effective Planning: The Key to High-Quality Audits"* to stress the importance of effective audit planning and set out its clear expectations that auditors, management and audit committees must fulfil their respective statutory duties, roles and responsibilities during the audit planning process. Issuers are encouraged to read the AFRC's publications, available at its website (https://www.afrc.org.hk/).

VI. ISSUERS' COMPLIANCE WITH ANNUAL REPORT DISCLOSURE REQUIREMENTS

83. Appendix D2 of the MB Rules (Chapter 18 of the GEM Rules) sets out specific information issuers must disclose in annual reports. In this section, we report on issuers' compliance with these disclosure requirements. Based on issuers' disclosure in annual reports and announcements, we also reviewed issuers' compliance with other relevant requirements of the Rules.

84. The Rules reviewed are categorised as follows:

    A) Share schemes;
    B) Continuing connected transactions;
    C) Fundraisings through issue of equity / convertible securities and subscription rights;
    D) Significant investments;
    E) Results of performance guarantees after acquisitions; and
    F) Other annual report disclosure.

Findings

85. Overall, issuers achieved a high rate of compliance. Over 99% of issuers achieved a compliance rate of 90% or above on all the disclosure items under Appendix D2 of the MB Rules (Chapter 18 of the GEM Rules). For identified omissions, we followed up with issuers and, where appropriate, requested them to make supplemental disclosure. We are pleased to note that issuers that omitted disclosure in last year's annual reports have generally disclosed as required this year.

86. Sections A to F below show the rates of issuers' compliance with individual disclosure Rules under the respective categories. Issuers should take note of the common omissions identified and ensure full compliance in future reporting.

A. Share schemes

87. Effective from 1 January 2023, Chapter 17 of the MB Rules (Chapter 23 of the GEM Rules) was amended to also govern share award schemes[24]. Accordingly, the disclosure requirements for share option schemes also apply to share award schemes.

88. The amended Rules also impose additional disclosure requirements relating to information that would facilitate shareholders' assessment of the dilution impact of share schemes (e.g. options and awards available for grant under the scheme mandates, number of options and awards granted during the year divided by weighted average number of issued shares for the year) and matters reviewed by remuneration committee.

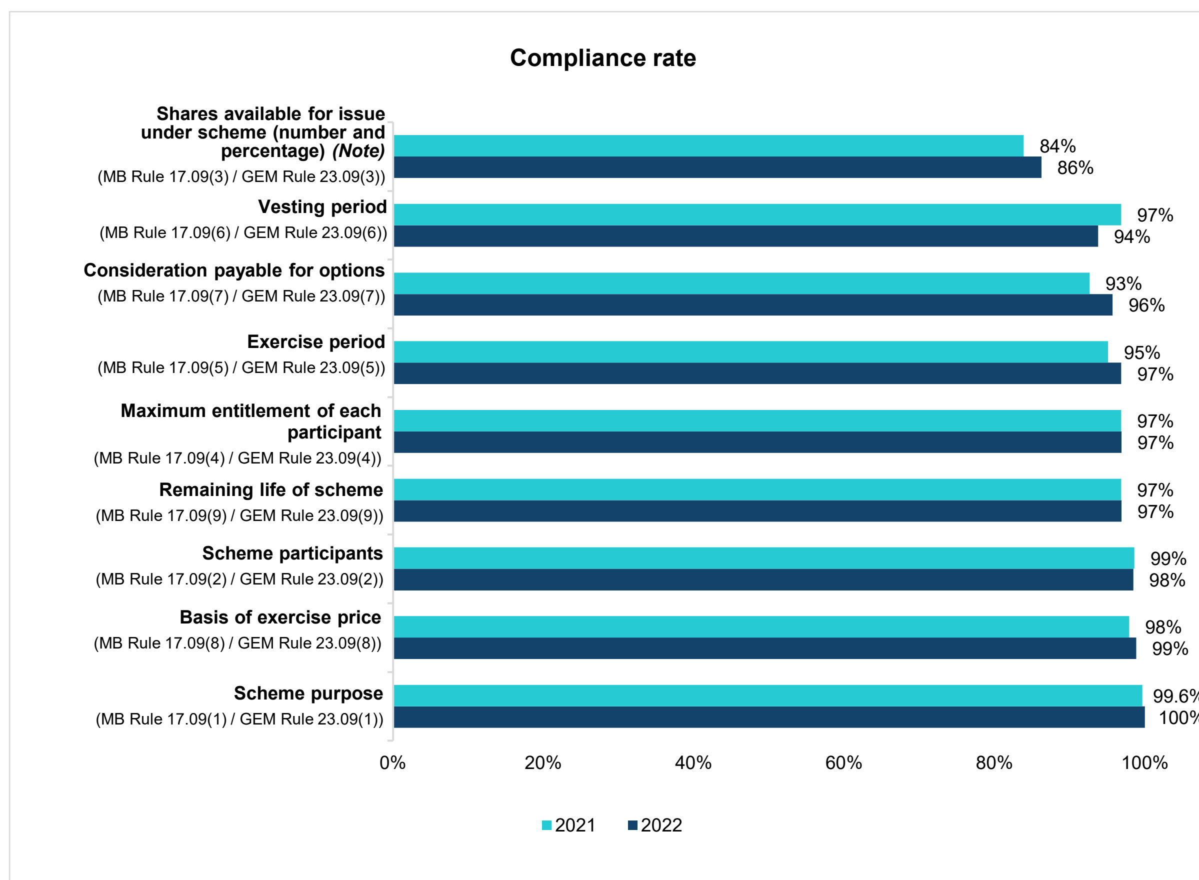
89. A large majority of the issuers reviewed complied with the disclosure requirements under the amended Rules. Some issuers omitted the aforesaid additional information.

[24] The disclosure requirements under the amended Rules apply to annual reports published on or after 1 January 2023.

90. Issuers are reminded to ensure full compliance with the disclosure requirements under the amended Rules on share schemes.

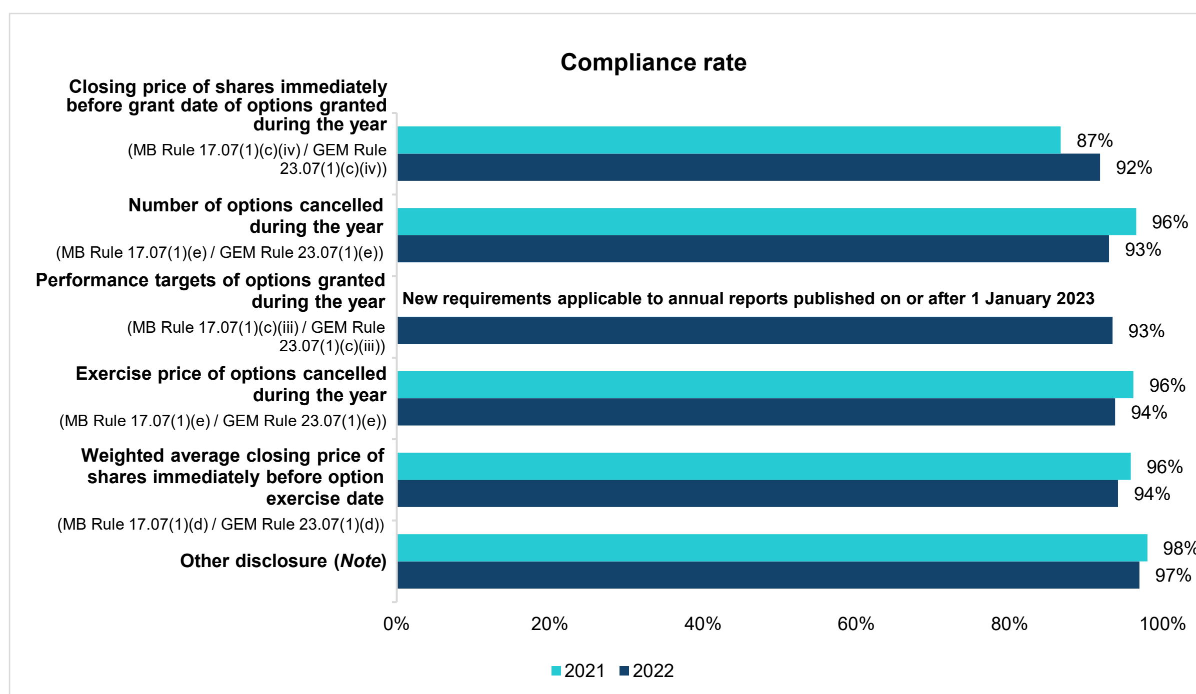
Share option schemes

(i) Terms of schemes



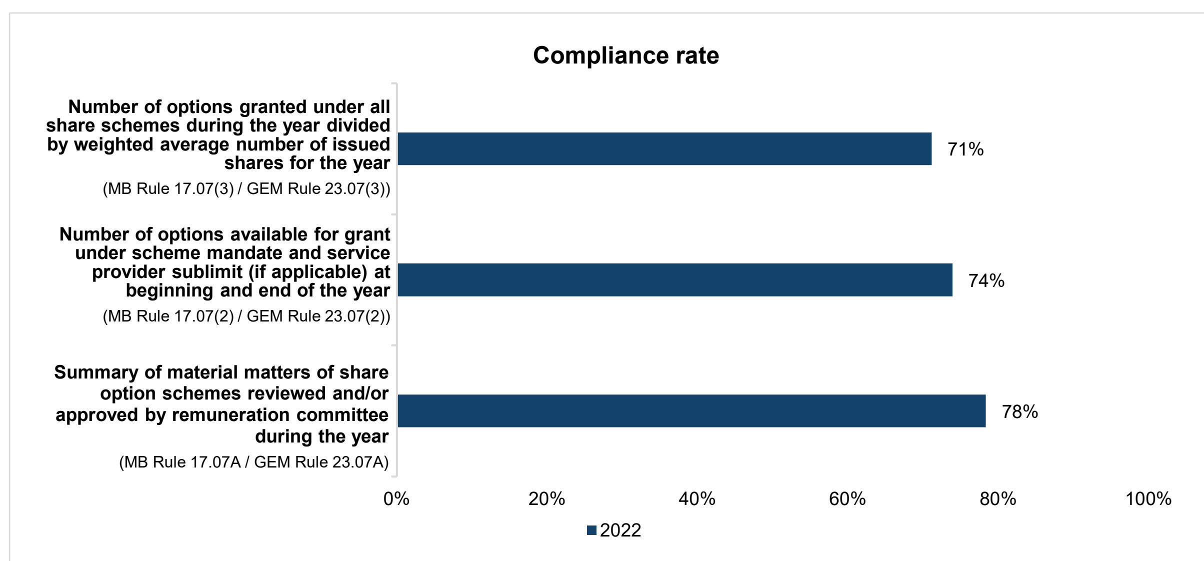
Note: Some issuers did not fully comply with this Rule as they failed to take into account shares available for issue in respect of options granted under the scheme but not yet exercised in their disclosure.

(ii) Movement of share options



Note: Other disclosure included date of grant, vesting period, exercise price, exercise period for options granted during the year and outstanding options, fair value of options at the date of grant and accounting policy adopted, number of options granted and lapsed during the year, number of options outstanding at the beginning and at the end of the year, number of options and exercise price of options exercised during the year, and name of grantee or a description of each category of grantees. The percentages refer to the average compliance rate of these disclosure items for each year.

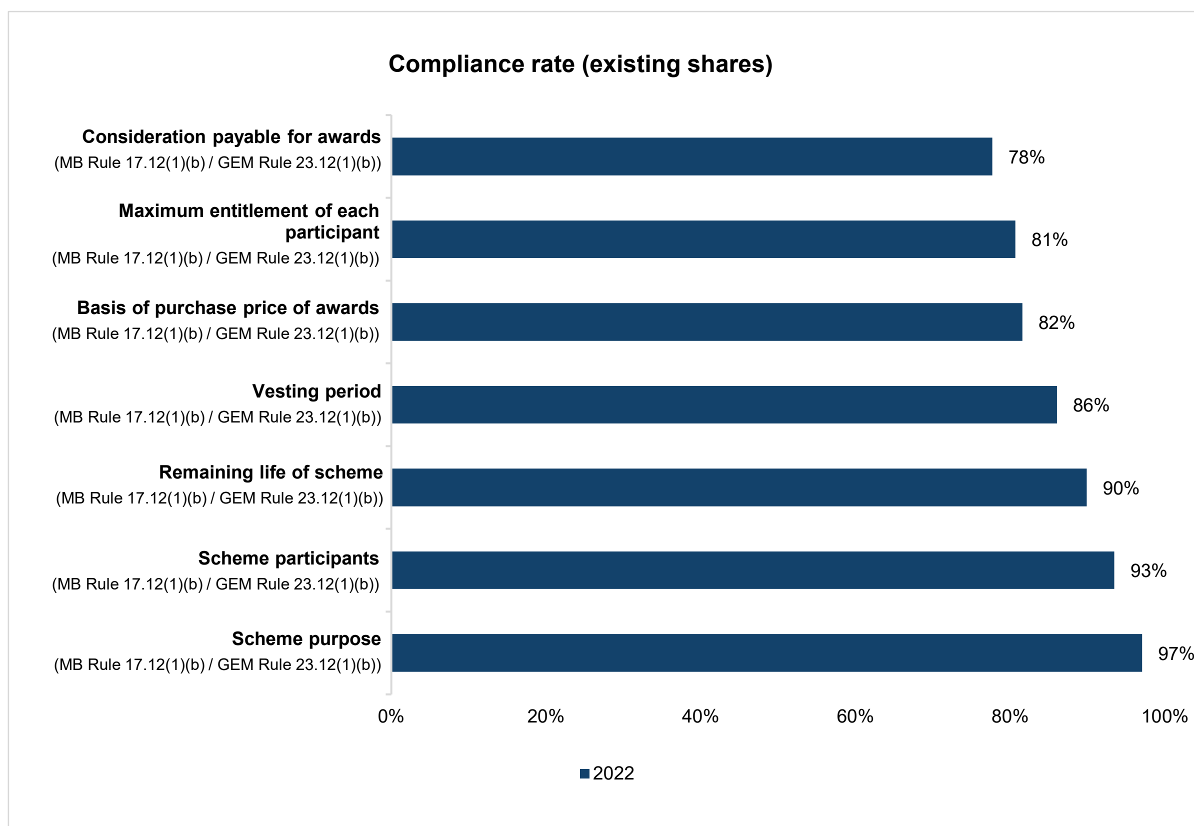
(iii) Additional disclosure requirements for new shares (being new requirements applicable to annual reports published on or after 1 January 2023)

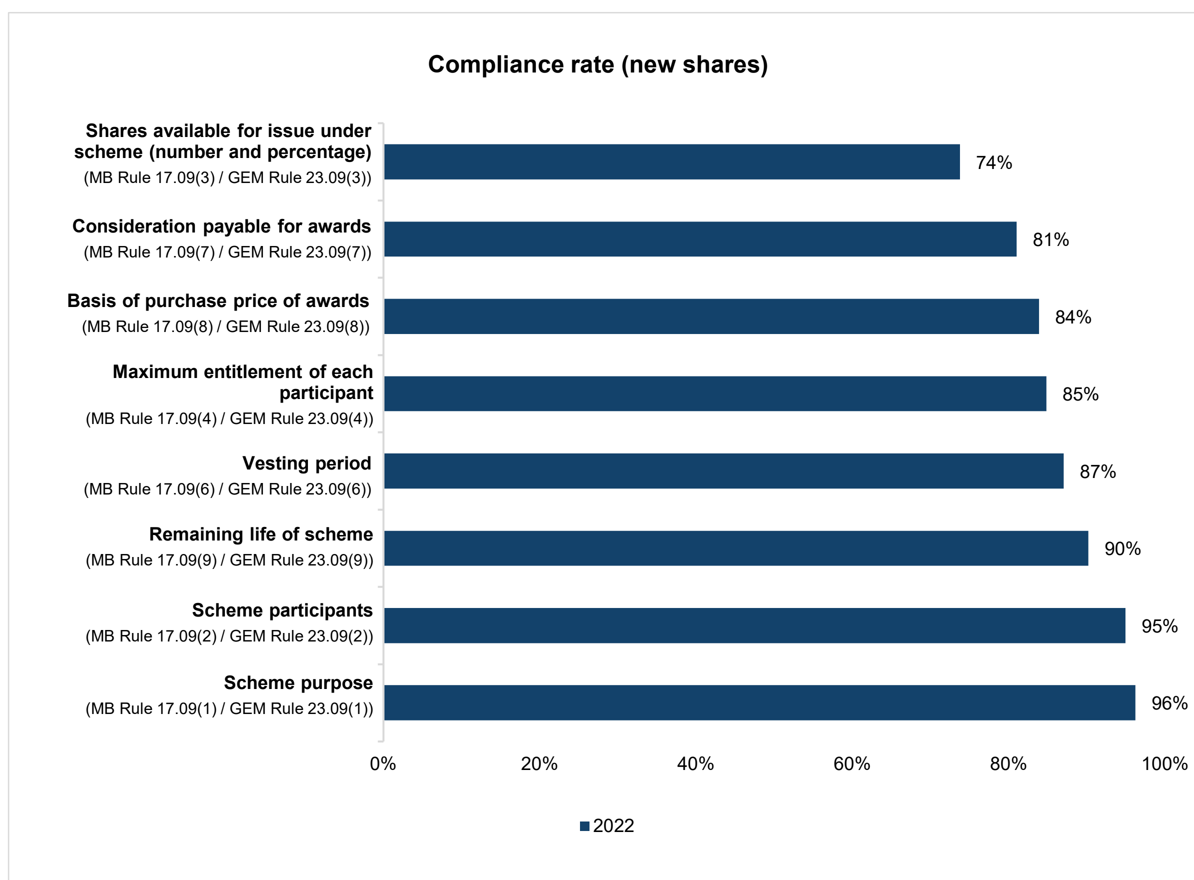


Share award schemes

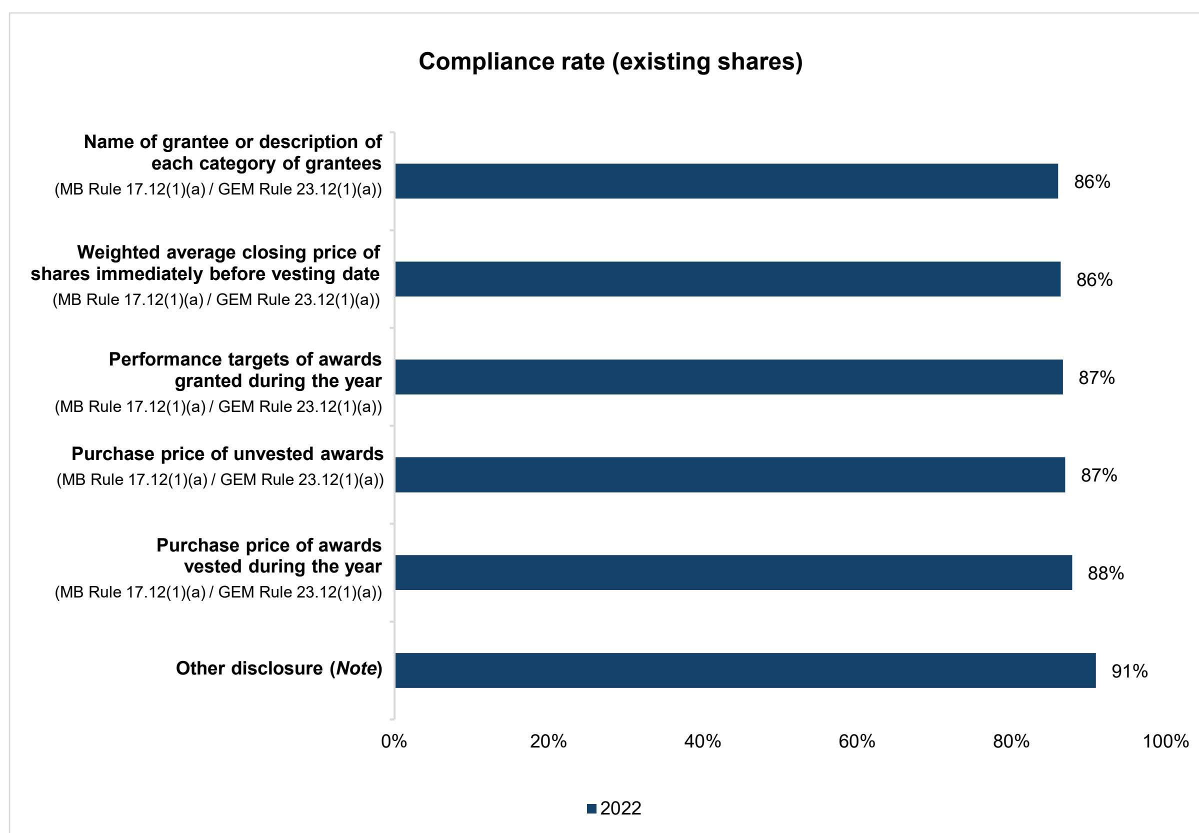
91. The following disclosure requirements on share award schemes are applicable to annual reports published on or after 1 January 2023:

(i) Terms of schemes

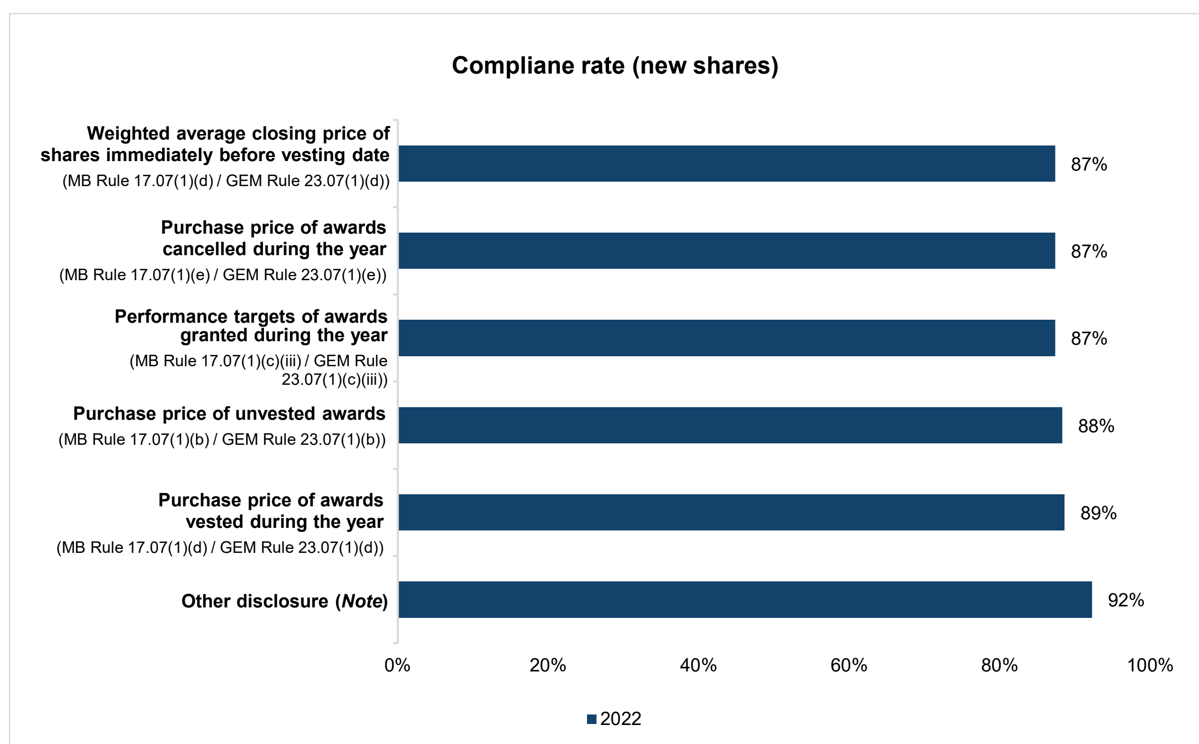




(ii) Movement of share awards

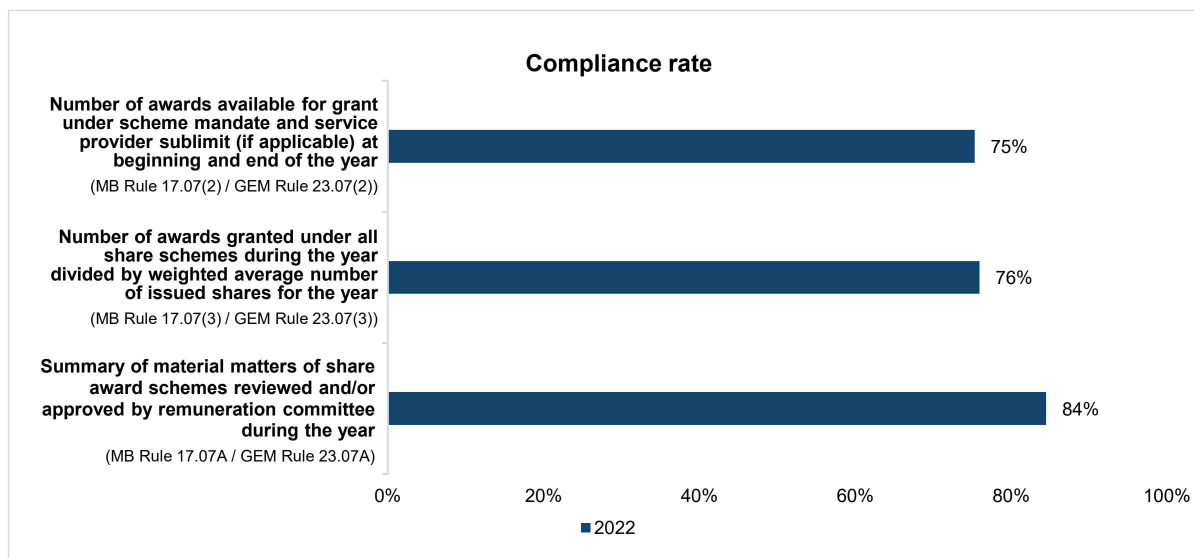


Note: Other disclosure included date of grant, vesting period for awards granted during the year and unvested awards, fair value of awards at the date of grant and accounting policy adopted, closing price of the shares immediately before the award grant date and purchase price for awards granted during the year, number of awards granted, vested, cancelled and lapsed during the year, number of unvested awards at the beginning and at the end of the year, and purchase price for awards cancelled during the year. The percentages refer to the average compliance rate of these disclosure items for each year.

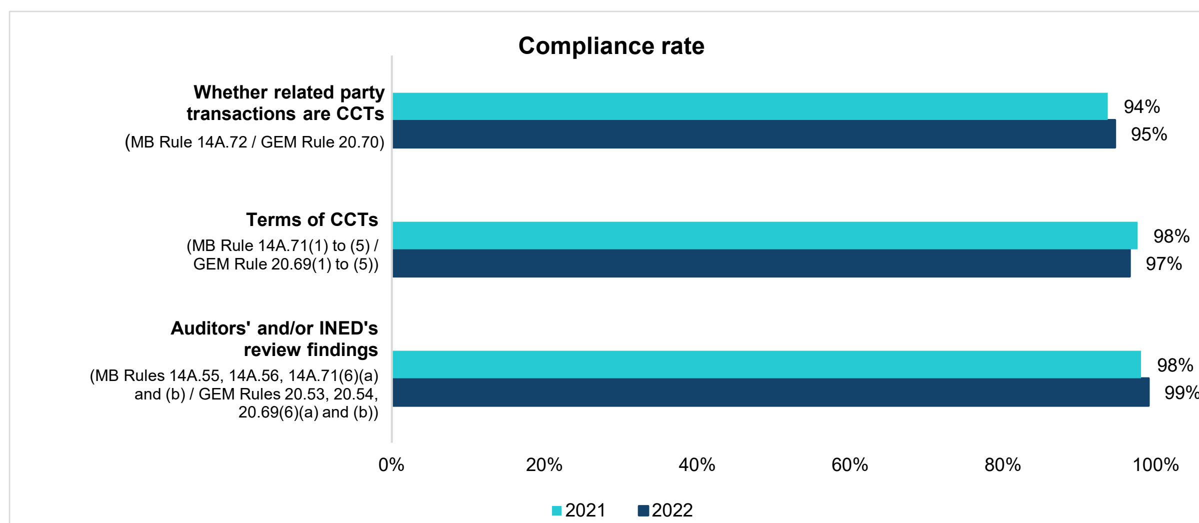


Note: Other disclosure included date of grant, vesting period for awards granted during the year and unvested awards, fair value of awards at the date of grant and accounting policy adopted, closing price of the shares immediately before the award grant date, purchase price for awards granted during the year, number of awards granted, vested, cancelled and lapsed during the year, number of unvested awards at the beginning and at the end of the year, and name of grantee or a description of each category of grantees. The percentages refer to the average compliance rate of these disclosure items for each year.

(iii) Additional disclosure requirements for new shares



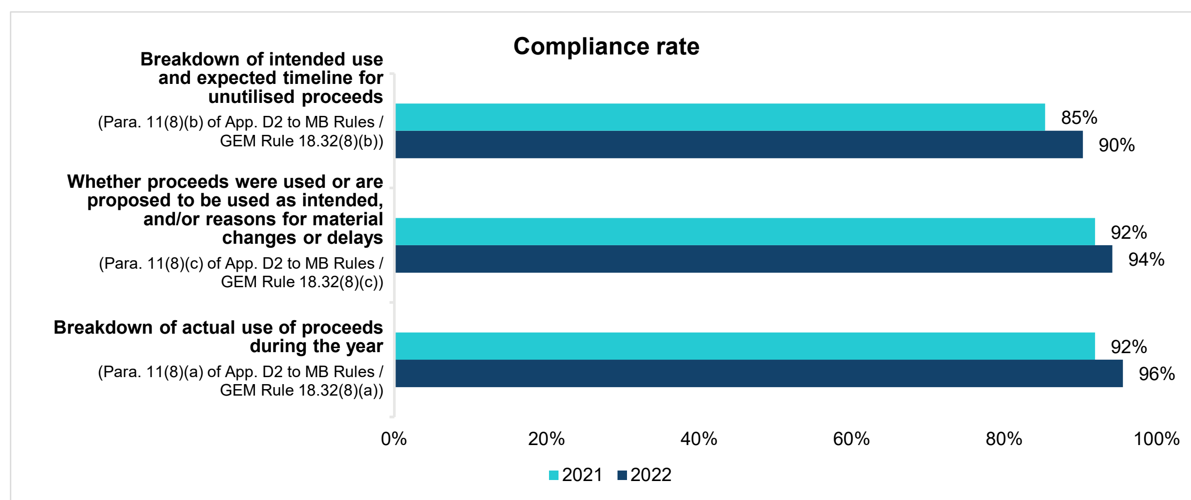
B. Continuing connected transactions



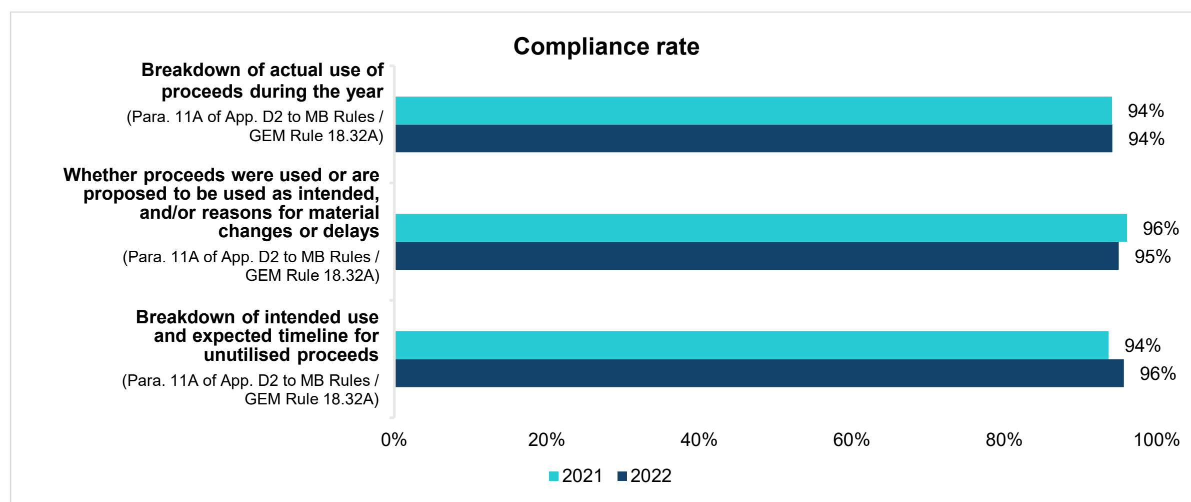
92. In our monitoring we identified one case where the continuing connected transactions of the issuer exceeded the annual caps approved by independent shareholders. We have taken appropriate action against the issuer.

C. Fundraisings through issue of equity / convertible securities and subscription rights

Proceeds from current year's fundraising



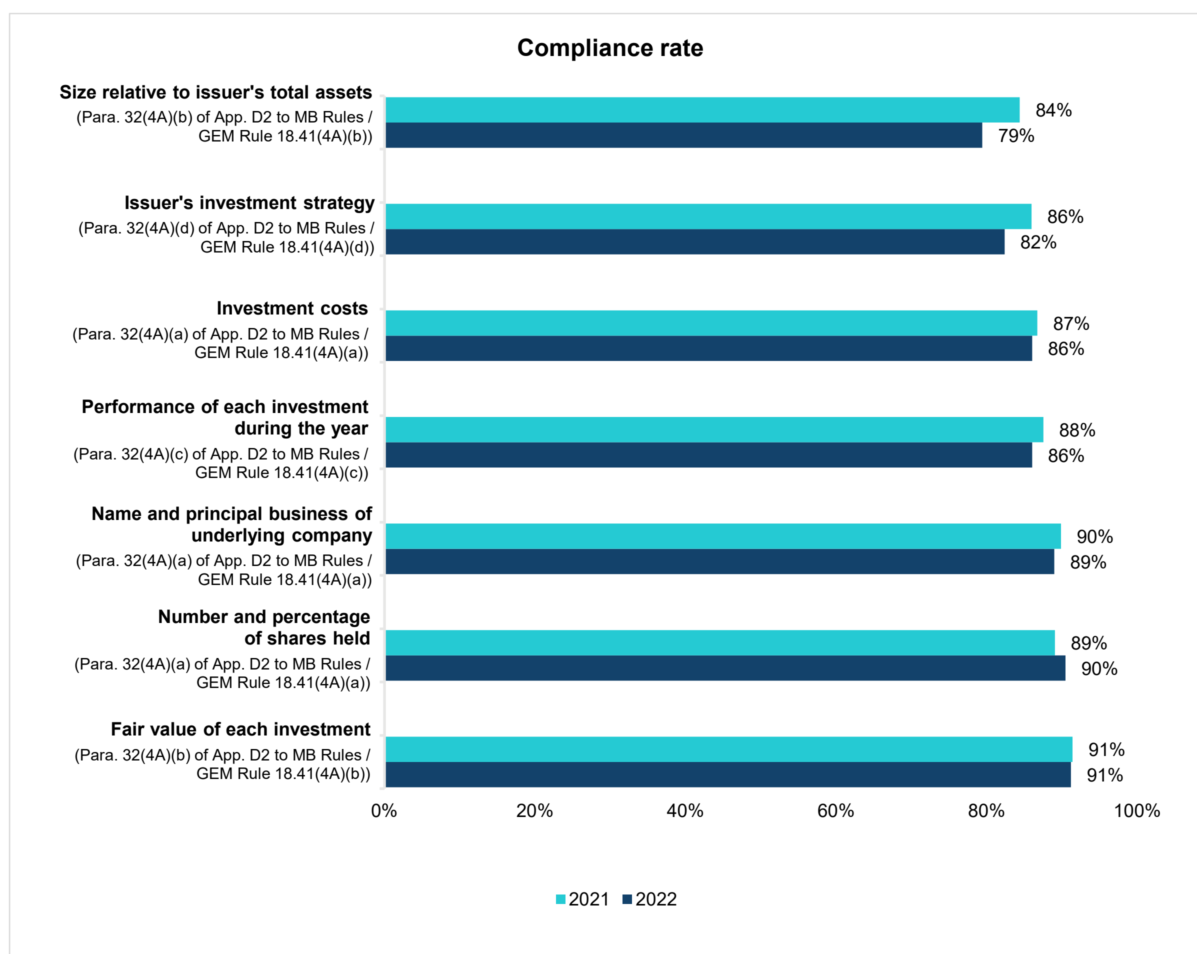
Proceeds brought forward from previous years



93. Some issuers (less than 10%) reported material changes in the use of proceeds from their fundraisings in their annual reports. The changes were generally attributable to unexpected changes in market conditions or prolonged outbreak of COVID-19 pandemic. We were generally satisfied that adequate disclosure on the reasons for the changes have been made in issuers' annual reports and announcements, where appropriate[25].

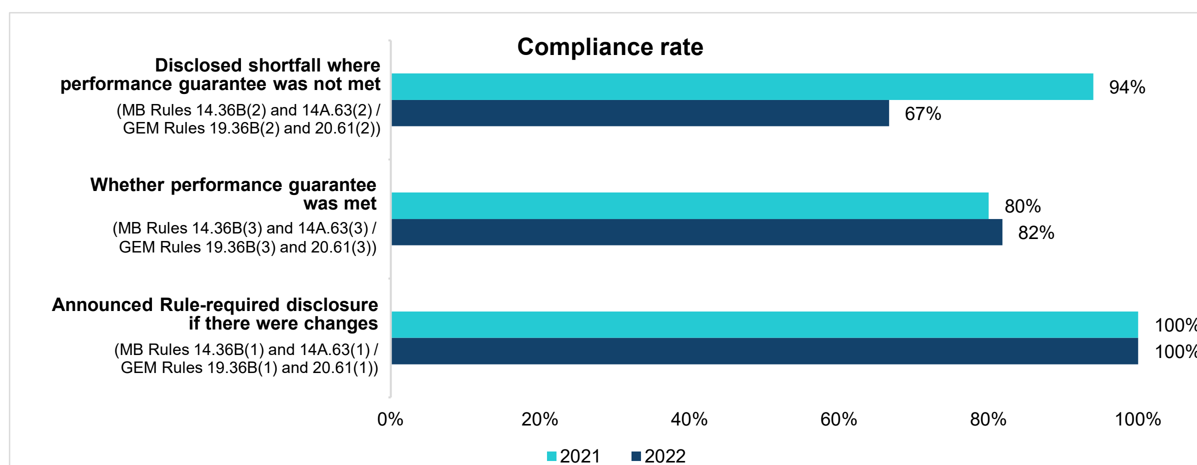
[25] See separate comments on our review of newly listed issuers in Section IV of this report.

D. Significant investments



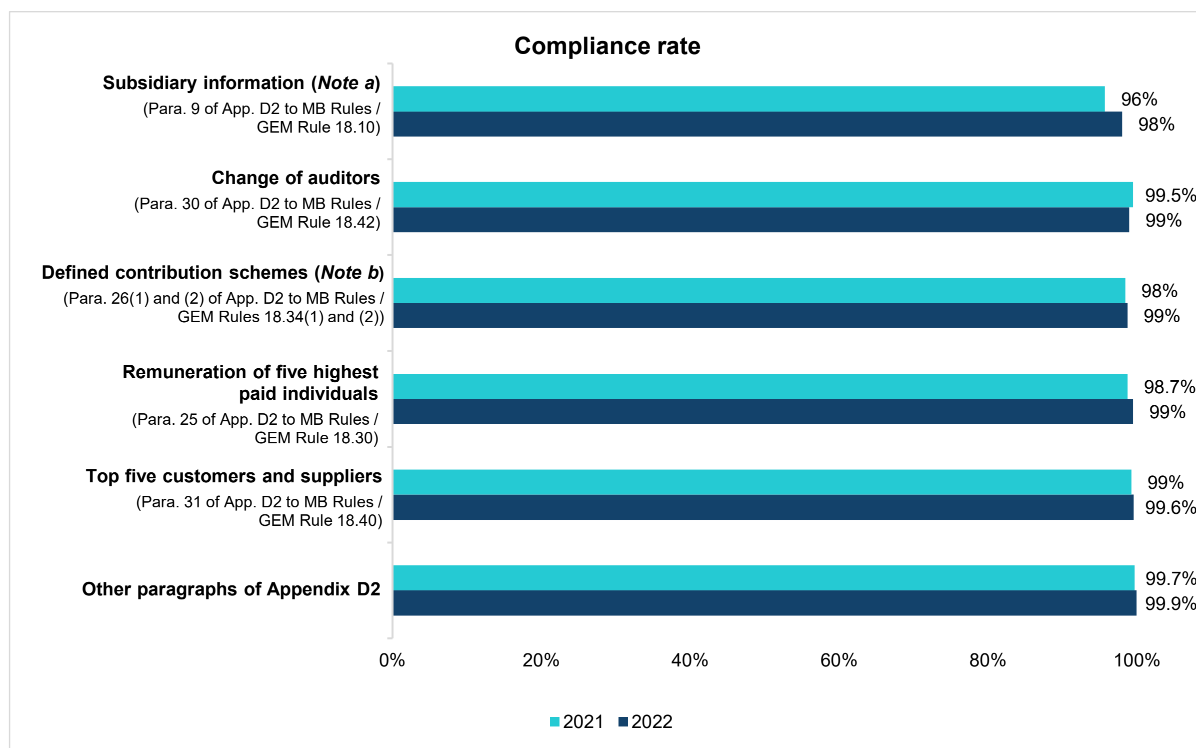
94. In our monitoring we identified isolated cases where issuers failed to comply with the notifiable transaction Rules when acquiring investment products. Issuers should note that acquisitions of wealth management products are transactions under the Rules subject to announcement and/or shareholders' approval requirements. They may refer to FAQ_057-2019 for guidance.

E. Results of performance guarantees after acquisitions



95. In addition to disclosure, we have considered directors' actions where the performance guarantees were not met. Based on our review, we were satisfied that the directors of the relevant issuers have taken appropriate actions to enforce the guarantees to safeguard shareholders' interests.

F. Other annual report disclosure



Notes:

(a) The common omissions mainly included information on the principal country of operation of subsidiaries and the legal form of subsidiaries established in the PRC, such as whether they are wholly owned foreign enterprises, contractual joint ventures or cooperative joint ventures.

(b) The common omissions mainly included details of whether forfeited contributions may be used by the employer to reduce the existing level of contributions.

APPENDIX I: GUIDANCE MATERIALS FOR ISSUERS CONDUCTING MONEY LENDING TRANSACTIONS

A. Recommended disclosure in annual reports

1. Issuers that reported money lending as a principal activity are recommended to disclose, at a minimum, the following in their annual reports:

   - Description of the issuers' business models, including the nature of lending services provided; customer profiles; risk management policies (including credit approval processes and credit risk assessment policies); and loan impairment policies;

   - Breakdowns of the loan portfolios, including the total outstanding loan receivables and number of borrowers; major terms of the loans (e.g. maturity profiles, interest rates, collaterals and/or guarantees obtained); breakdowns of loans by categories (e.g. types of borrowers, loan products or collaterals); size and diversity of borrowers (e.g. loans receivables from the five largest borrowers); and ageing analysis of the outstanding loans; and

   - Discussion of the movements of impairments or write-offs of loan receivables and the basis of impairment assessments, including assessments of impairments on material loans. Issuers should develop appropriate and supportable estimates to assess the recoverability of the loans to support the impairment assessments under the relevant accounting standards.

2. Generally, issuers (regardless of whether they operate money lending as a principal business) should disclose:

   - Details of the loan receivables, including major terms;

   - Reasons for granting the loans and how they meet the issuers' business strategies; and

   - Discussion of any material impairments or write-offs of the loan receivables and the basis of impairment assessments.

B. Examples of internal control measures for lending transactions

Pre-loan assessment	• Due diligence – understand borrowers' legal and financial status and ultimate beneficial owners (**UBOs**): - Obtain supporting document to verify borrowers' identities and financial status (e.g. financial statements and income proof). - Identify borrowers' UBOs and any relationships of borrowers and their connected persons. - Check the existence and value of collaterals (e.g. conduct site visits and obtain valuation reports) and encumbrances (e.g. any charges or mortgages against collaterals). • Credit assessment – assess borrowers' profile and credit risks to ascertain their repayment capacity: - Designate personnel with appropriate experience and expertise to perform risk assessment. • Renewal of loans – obtain up-to-date due diligence information, and perform credit assessment again before renewals.
Loan grant	• Loan execution – ensure loan terms would reasonably reflect the borrowers' credit risks and the issuers' financing cost. • Loan approval – set clear levels of approval for loans with different amounts, with designated authorised persons for each approval limit. • Fund release – ascertain all approvals are complete before fund release (e.g. cross-check for approvals and fulfilment of contractual terms by designated team).
Post-loan monitoring	• Monitor whether borrowers make timely repayments, and fulfil financial covenants during the life of the loan (e.g. obtain periodic financial information of the borrowers).
Loan recovery	• Follow up promptly on late repayments, and liaise with borrowers for settlement. • Consider enforcing securities and take legal actions for overdue debts.
Documentation	• Maintain proper records throughout loan processes.

APPENDIX II: SCOPE AND METHODOLOGY OF REVIEW

1. We review annual reports of all listed issuers (excluding collective investment schemes). This year’s review covers annual reports for the financial year ended between January and December 2022.

Thematic review on selected areas and related disclosure

2. We adopt a thematic approach and select specific areas for review based on the results of previous years and areas considered to be of higher risks. The following table sets out areas covered in, and bases of selection of issuers for, the review:

Financial reporting and related controls
All issuers that: (i) received modified audit opinions on their published financial statements *(120 issuers[26])*; and (ii) failed to publish their annual results before the 3-month reporting deadline *(73 issuers)*.
Material asset impairments
For material asset impairments (other than loans): All issuers that recorded material impairments on their assets or businesses, including assets or businesses previously acquired *(30 issuers)* and assets other than acquired assets *(42 issuers).*
For material lending transactions: All issuers that: (i) reported money lending as a principal activity in their annual reports *(202 issuers)**; and (ii) conducted lending transactions outside their ordinary and usual course of businesses and reported (a) loan receivables exceeding 8% of their total asset values*; or (b) significant loan impairments *(88 issuers)*. *Remark (*): Regardless of whether material impairments were recorded on the loan receivables.*
Newly listed issuers
All issuers that were listed in 2021 and 2022, excluding transfers of listing from GEM to Main Board *(185 issuers).*
Issuers’ financial statement disclosure under accounting standards
300 issuers, based on a risk-based approach. The key selection criteria included where an issuer: (i) had material intangible assets together accounted for 25% or more of its total assets; (ii) had material level 3 financial assets together accounted for 20% or more of its total assets; (iii) experienced significant changes in net assets; (iv) was newly listed; and/or (v) was the subject of complaints concerning compliance with the Rules.

[26] Excluding 34 issuers (2021: 32) that were long suspended companies at the time they published the financial statements for 2022.

Review of issuers' compliance with annual report disclosure requirements

3. The following table sets out areas covered in, and bases of selection of issuers for, the review:

Share schemes
All issuers that (i) operated share option schemes and granted options in the financial year *(255 issuers)* or (ii) operated share award schemes *(458 issuers).*
Continuing connected transactions (CCTs)
All issuers that (i) failed to fully comply with the CCT Rules in the last two financial years *(95 issuers)* or (ii) were listed in 2021 or 2022 and reported CCTs in their annual reports *(110 issuers)*.
Fundraisings through issue of equity / convertible securities and subscription rights
All issuers that (i) conducted equity fundraisings during the financial year *(514 issuers)* or (ii) reported unutilised proceeds brought forward from equity fundraisings conducted in previous financial years *(737 issuers).*
Significant investments
All issuers that (i) had securities investments reported in their financial statements which in aggregate accounted for 20% of more of their total assets as at the financial year end date and (ii) had an investment in an investee company with a value of 5% or more of their total assets as at the financial year end date *(136 issuers).*
Results of performance guarantees after acquisitions
All issuers that were provided with performance guarantees by vendors in previous business acquisitions and the guarantee period ended in the financial year under review (*66 issuers*).
Other annual report disclosure under Appendix D2 of the MB Rules (Chapter 18 of the GEM Rules)
All issuers. The review was performed by an artificial intelligence model covering more than 390,000 disclosure records and involving more than 155 disclosure Rules.

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