FINANCIAL STATEMENTS REVIEW PROGRAMME REPORT 2011

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Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

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EXECUTIVE SUMMARY

The Listing Division has completed its review of listed issuers' published financial reports for compliance with the disclosure requirements of the Listing Rules and accounting standards. This is our third published report which summarises our key observations and findings from our review.

We reviewed 100 reports of issuers covering the annual, interim and quarterly reports released between October 2009 and April 2011. During the review process, we issued 91 letters to issuers that contained more than 340 enquiries and observations. Our enquiries requested explanations and information about the accounting treatment adopted or clarifications on possible non-compliance or omitted disclosures.

Where the omitted disclosures were regarded as less significant or material, we requested issuers to confirm in writing that the required disclosures will be rectified in their future financial reports.

Based on the responses to our enquiries made during our review, except for three cases which have been referred to the Financial Reporting Council to consider further enquiry and investigation of possible accounting and auditing irregularities, there were no significant breaches of the Listing Rules or accounting standards that would render the financial statements misleading or would require their restatement or warrant disciplinary action to be taken.

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

The major findings and recommendations from our review are:-

- Additional information should be presented in financial reports to provide a better understanding of the nature and impact of significant events or material balances and transactions;

- Analysis of remuneration paid to auditors, in respect of audit and non-audit services should be improved;

- Discussions in the Management Discussion and Analysis should be consistent with the financial statements and should provide an additional useful narrative to explain the company's performance and financial position;

- Improvements in connected and related party disclosure were noted but there is room for further improvement;

- Disclosures provided on financial instruments, and in particular convertible bonds, require improvement;

- There appear to be different interpretations of the relevant accounting standards on acquisitions and whether they should be treated as an acquisition of a "business" or treated as an acquisition of "assets and liabilities";

- Clearer explanations should be provided where there is some evidence that there is "control" in an investee but where the investee is accounted for as if control does not exist;

- Disclosure of assumptions and methods to arrive at fair values of investment properties, including the qualification and experience of valuers, should be improved;

- Segment information should be balanced and consistent with information disclosed elsewhere in the financial reports; and

- Benchmarks together with other procedures should be in place for determining when disclosures should be provided.

We encourage directors and other persons responsible for financial reporting to take note of the matters discussed in this report. They should also review and regularly improve their existing financial reporting systems to ensure that information contained in financial reports provide entity specific, relevant and material information that will be useful to users in making economic decisions.

BACKGROUND

1. As part of the Exchange's regulatory function, the Listing Division operates a Financial Statements Review Programme (the "FSRP") which reviews, on a sample basis, issuers' published periodic financial reports. The FSRP covers issuers' quarterly, interim and annual reports.

2. The objective of the FSRP is to monitor compliance with the requirements of the Main Board Rules and GEM Rules and, in parallel, to monitor compliance with the relevant disclosure requirements of the Companies Ordinance, and the applicable accounting standards, including Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board (the "IASB"). The review also covers samples to check compliance by issuers incorporated in the Mainland that have elected to adopt Accounting Standards for Business Enterprises ("CASBE") issued by the Ministry of Finance of the People's Republic of China.

3. In order to enhance transparency and improve the quality of financial disclosures in periodic financial reports, we regularly publish our report of key observations and findings from our review programme. The purpose of the report is to increase issuers' awareness of the possible pitfalls in the preparation of periodic financial reports so that they may learn from the experience of others and to improve the quality of their future reports.

Scope of financial statements review programme

4. A risk-based approach is adopted in selecting issuers for the FSRP. The selection criteria include:-

   (a) Impact - issuers where an instance of major non-compliance might adversely affect the reputation of the Hong Kong equity market as a whole.

   (b) Probability - issuers where is a possible higher risk of misstatement or misapplication of financial reporting standards due to the existence of features that may indicate higher risk including where an issuer has any of the following characteristics:-

   - experienced significant changes in its net assets
   - newly listed
   - subject to complaints concerning compliance with the Listing Rules
   - issued with a qualified or modified auditors' report
   - subject to a frequent change of auditors or engaged a small accounting firm as its auditors

   (c) Random - a number of cases are selected at random so that any issuer may be selected for review.

5. We included an industry theme and for this review period we chose companies whose major or principal business involved property construction or investment in properties.

6. In our review we also included a general accounting theme on segment information disclosures as a new accounting standard on the subject had become effective.

7. We reviewed 100 Reports released by issuers between October 2009 and April 2011 and issued 91 letters to issuers that contained more than 340 enquiries or observations.

8. Of all the cases reviewed during the period, 99 were subsequently closed after considering the responses received to our letters and one case remains outstanding awaiting further clarification and information from the issuer. The Division has referred three cases to the Financial Reporting Council (the "FRC") for consideration of further enquiry or investigation.

FINDINGS

9. This is our third published report which summarises our key observations and findings from our review. The findings mentioned do not include all areas in which we raised comments or asked questions.

10. It is the primary responsibility of the directors to prepare accurate and complete financial reports. In this regard, directors and persons responsible for financial reporting should stay alert to changes to the Listing Rules, accounting standards and other regulatory disclosure requirements. They should also review and continuously improve their systems and checklists to ensure that all the required disclosures are made.

FINDINGS REGARDING THE LISTING RULES

11. Table 1 below highlights the key areas where issuers need to pay particular attention:-

Table 1: Findings relating to Listing Rules disclosures

Area	MB Rules	GEM Rules	No. of issuers
Disclosures relating to significant events, balances and transactions	Rule 2.13	Rule 17.56	55
Auditors' remuneration	Appendix 23	Appendix 16	22
Management Discussion and Analysis	Appendix 16	Chapter 18	17
Disclosures required under the Hong Kong Companies Ordinance	Appendix 16	Chapter 24 Chapter 25	13
Connected and related party disclosures	Chapter 14A Appendix 16	Chapter 20 Chapter 18	12
Corporate Governance Reports	Appendix 14 Appendix 23	Appendix 15 Appendix 16	8
Financial reports using CASBE	Appendix 16	Chapter 18	2

Our observations and recommendations

Disclosures relating to significant events, balances and transactions

12. Main Board Rule 2.13(2) (and its GEM Rules equivalent) requires that "*the information contained in the document must be accurate and complete in all material respects and not be misleading or deceptive*". Moreover the "*Conceptual Framework for Financial Reporting 2010*" issued by the HKICPA states that the objective of financial statements is to provide financial information that is useful to users in making economic decisions. Paragraph 112(c) of Hong Kong Accounting Standard (HKAS) 1 (Revised) "*Presentation of Financial Statements*" further requires companies to provide information which is relevant to an understanding of the financial statements by way of inclusion of necessary additional notes to the financial statements.

13. Similar to our last review, we continue to note that disclosures relating to significant events or material balances and transactions mentioned in some reports were too brief or were simply described as "other receivables/payables" or "deposits paid". Analysis of their nature and whether any of the balances were related to connected parties or related parties were not disclosed. This is an area which requires further attention and improvement.

14. During our review, we requested issuers to provide information and explanations on the relevant significant balances or transactions to better understand their nature and impact on the issuers concerned. Based on the responses to our enquiries, we were pleased to note that there was no apparent breach of the Listing Rules or accounting standards relating to notifiable, connected and related party disclosures. Nevertheless, issuers should bear in mind that the absence of information on material balances and transactions make periodic financial reports less useful to their readers and may possibly be viewed as non-compliance with the relevant Listing Rules or accounting standards. In particular, paragraph 15 of HKAS 1 (Revised) requires that annual financial statements should show a true and fair view. The absence of material and relevant information may mean that the true and fair view objective is not met.

Auditors' remuneration

15. There were three issuers which overlooked the disclosure requirement under paragraph 2(h) of Appendix 23 to the Main Board Rules (equivalent to section M of revised Appendix 14 "*Corporate Governance Code and Corporate Governance Report*") (and its GEM Rules equivalent) which requires an analysis of remuneration paid to its auditors, in respect of both audit and non-audit services, to be disclosed in the corporate governance report. We noted that there were a further 12 cases where issuers did not disclose the nature of non-audit assignments. The original purpose of these disclosures is to provide some information concerning the degree of independence of the auditors.

16. In 10 instances, we also observed that the amount of auditors' remuneration relating to audit services stated in corporate governance reports were not in agreement or reconciled to the related amount disclosed in the financial statements.

17. Issuers are reminded that in respect of each significant non-audit service (for example, fees for preparing an accountants' report for an initial public offering document) details of the nature of the service and the fees paid should be disclosed separately in the corporate governance report. Any amount paid/payable not recognised in the income statement should be disclosed separately. Moreover, any sums, including out-of-pocket expenses, paid/payable to the auditor should be regarded as forming part of the relevant "remuneration".

Management Discussion and Analysis (MD&A)

18. From our review, 13 issuers overlooked some of the minimum disclosure requirements under paragraphs 32(1) to 32(12) of Appendix 16 to the Main Board Rules (and its GEM Rules equivalent), for example, disclosure of the foreign currencies in which borrowings were made and the currencies in which cash and cash equivalents were held.

19. We observed that five issuers should have provided more meaningful and useful discussions in their MD&As. These issuers experienced substantial fluctuations in turnover, operating results and net asset values during the reporting period but merely repeated information presented in the financial statements in narrative form without additional analysis and explanations.

20. We also noted that certain issuers had previously announced a significant event, for example, the acquisition of a material subsidiary or other assets, but the financial effect of these significant transactions were not discussed in the annual report. It was therefore not clear whether the relevant transaction had been completed and reflected in the financial statements.

21. We noted a few cases where information provided outside the financial statements appeared to contradict or was inconsistent with the information included in the financial statements. Issuers should ensure that all the information included in periodic financial reports is accurate and complete in all material respects and should identify and remove any inconsistencies. Auditors also have a responsibility. Hong Kong Standard on Auditing 720 *"The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements"* issued by the HKICPA requires that the auditors review information accompanying the financial statements.

Disclosures required under the Hong Kong Companies Ordinance

22. In our view, the financial statements of the issuer itself as a separate legal entity are different from the group or consolidated financial statements of the listed group. Main Board Rule 13.46(2) (and its GEM Rules equivalent) makes this distinction and states that *"In the case of an overseas issuer or a PRC issuer … Such issuer shall send to … every member of the issuer … a copy of … its annual report including its annual accounts and, where the issuer prepares group accounts, its group accounts, together with a copy of the auditors' report thereon …, not less than 21 days before the date of the issuer's annual general meeting and in any event not more than four months after the end of the financial year to which they relate"*.

23. Paragraph 28 of Appendix 16 to the Main Board Rules (and its GEM Rules equivalent) requires that an issuer (whether or not it is incorporated in Hong Kong) shall include in its annual report disclosures required under certain provisions of the Companies Ordinance, including information required under the Tenth Schedule.

24. Although we have highlighted this issue in our previous reports, we continue to note instances where issuers incorporated outside Hong Kong do not provide some of the disclosures required under the Tenth Schedule of the Hong Kong Companies Ordinance as referred to in the Listing Rules; in particular, the balance sheet of the issuer itself, investments in subsidiaries, amounts due from subsidiaries and movements in the company's reserves.

Connected and related party disclosures

25. We were generally pleased to note improvements in this area as the number of omissions was less than observed in the samples reviewed last year. There were three cases where issuers omitted to include a narrative statement in their annual reports (Main Board Rule 14A.38 / GEM Rule 20.38) on whether their auditors had confirmed that continuing connected transactions:-

    - had received the approval of the issuer's board of directors;
    - were in accordance with the pricing policies of the issuer, if the transactions involved provision of goods or services by the issuer;
    - had been entered into in accordance with the relevant agreement governing the transactions; and
    - had not exceeded the cap disclosed in previous announcement(s).

26. There were four cases where an issuer did not disclose whether its related party transactions constituted connected transactions as defined under the Listing Rules (paragraph 8(3) of Appendix 16 to the Main Board Rules and its GEM Rules equivalent). We also noted that there was one case that omitted to make the disclosures required under both the above Rules.

27. In June 2010, the HKICPA issued Practice Note 740 *"Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules"* ("Practice Note") which was developed in consultation with the Exchange and staff at the Securities and Futures Commission. The purpose of the Practice Note is to provide guidance to auditors and issuers on their respective responsibilities and to promote consistency in annual reporting. The Practice Note is effective for reporting on continuing connected transactions for annual reports ending on or after 31 December 2010. Of the relevant cases reviewed, six annual reports for the year ended 31 December 2010 included a clear statement on the work performed by the auditors in accordance with the following illustrative example included in paragraph 102 of the Practice Note:-

> "*The Company's auditor was engaged to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements* [HKSAE] *3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The auditor has issued his unqualified letter containing his findings and conclusions in respect of the continuing connected transactions disclosed by the Group in page [ ] of the Annual Report in accordance with [Main Board Listing Rule 14A.38][GEM Listing Rule 20.38]. A copy of the auditor's letter has been provided by the Company to The Stock Exchange of Hong Kong Limited."*

28. We however noted three cases where issuers only provided a brief statement in their annual reports and an example of the wording was:-

> "*Pursuant to Rule 14A.38 of the Listing Rules, the Board engaged an independent auditor to perform certain <u>agreed upon procedures</u> in respect of the above continuing connected transactions of the Group. The auditor has reported the factual findings on these procedures to the Board."*

29. We would like to point out that issuers should ensure that the annual review of continuing connected transactions complies with HKSAE 3000 and follows the guidance in Practice Note 740. Moreover, the work is an assurance engagement rather than an agreed-upon procedures engagement. Issuers are also encouraged to provide more information in their annual reports to ensure that readers understand the nature of the engagement and the work performed by their auditors.

30. In respect of non-exempt connected transactions under Main Board Rule 14A.31 (and its GEM Rules equivalent), two issuers overlooked the need to disclose the particulars of the relevant connected transactions in their annual reports required under Main Board Rule 14A.45 and paragraph 8(1) of Appendix 16 to the Main Board Rules (and its GEM Rules equivalent).

Corporate Governance Reports

31. The majority of the Corporate Governance Reports reviewed complied with most of the mandatory disclosure requirements under Appendix 23 to the Main Board Rules (Appendix 16 to the GEM Rules). However, some findings included:-

- no disclosure of the number of meetings and the individual attendance record of directors at meetings of the remuneration committee/ nomination committee;
- no detailed description of the work performed by the remuneration committee/ nomination committee; and
- limited descriptions of the emolument policy and long-term incentive schemes, as well as the basis for determining the emoluments paid to directors.

Financial reports using CASBE

32. Four Mainland incorporated issuers elected to prepare their 2010 financial statements under CASBE and additional issuers have announced that they will adopt CASBE for their 2011 financial statements. Financial statements prepared under CASBE, like other published financial reports, are subject to selection and review under our FSRP. We were pleased to note that for those selected in this year's review, although some disclosures were omitted, they were not material to the financial statements as a whole and the issuers confirmed that the required disclosures will be rectified in their future annual reports.

General guidance on financial reporting matters

33. This section contains some additional useful general guidance and reference materials on financial reporting matters that issuers should be aware of in preparing their periodic financial reports.

New and revised Rules and Code on Corporate Governance

34. In October 2011 the Exchange published its *"Consultation Conclusions on Review of the Corporate Governance Code and Associated Listing Rules"* and finalised the amendments to the Corporate Governance Code (as renamed) ("Code"). Issuers are reminded that the revised Code will become effective on 1 April 2012. In its first interim/half year or annual report covering a period after 1 April 2012, issuers must state, in that report, whether it has, for that period, complied with the Code Provisions (CPs) in the revised Code as well as those of the former Code. Issuers nevertheless may adopt the revised Code at a date earlier than 1 April 2012. Further details, including a summary of the revised Rules and Code and their implementation dates, are available at:-
http://www.hkex.com.hk/eng/newsconsul/hkexnews/2011/111028news.htm

35. All directors and company secretaries including those responsible for financial reporting matters should familiarise themselves with the revised Rules and Code.

Disclosure in investment circulars regarding potential impairment of goodwill arising on acquisitions

36. We observed that in a few cases where an acquisition was made during the year a material impairment loss on goodwill was made in the annual financial statements. This appeared to be due to different valuation methodologies used for the investment circular issued at the time of the acquisition and that used in preparing the annual financial statements. Sometimes it was due to changes in management assumptions adopted in determining the fair values of the assets and liabilities of the acquired company.

37. We would remind issuers that significant write downs shortly after an acquisition could cause confusion. Issuers are reminded to improve disclosures made in their investment circulars. Any potential significant impairment of goodwill or other assets required under the accounting standards should be considered by the issuers' auditors before the release of the investment circular. We therefore suggest that it would normally be more cost effective and expedient if the reporting accountant for the investment circular is also the auditor of the issuer's annual financial statements. To enable readers to understand the possible impact of an acquisition on the financial position and results of the group, we also recommend that sufficient details concerning the method and assumptions used in the valuation of a target company should be included in the investment circular. The reasons for any significant changes in value should be provided in the subsequent annual report.

Retention of books and records relating to major disposals

38. The reliability of financial reporting is dependent on the effectiveness of the internal control systems that an entity has put in place. A basic feature of internal controls over financial reporting is that proper books and records are kept.

39. We observed that some financial statements were issued with a modified auditors' report and the reason for the modification was the auditors' inability to obtain and examine the books and records of a disposed business or subsidiary when they performed their annual audit.

40. We believe that extra care and attention at the planning stage of a significant disposal transaction could prevent an audit modification or qualification. If an issuer plans to dispose of a material business or a subsidiary it should make early arrangements so that its auditors are able to verify the disposal transaction before the books and records of the business or subsidiary disposed of are released to the buyer. This should prevent the annual financial statements of the issuer from being qualified because of the non-availability of audit evidence. Issuers should expect to be in a position to respond to queries on whether arrangements have been put in place to ensure that the transaction can be readily and properly audited.

Acceptance of Mainland Standards and Mainland Audit Firms for Mainland Incorporated Companies Listed in Hong Kong

41. The Exchange announced its decision on 10 December 2010 to accept Mainland accounting and auditing standards and Mainland audit firms for Mainland incorporated companies listed in Hong Kong. The new rules provide Mainland incorporated issuers with an option to prepare their financial statements using Mainland accounting standards and have them audited by endorsed Mainland audit firms using Mainland auditing standards. The related Listing Rule amendments came into effect on 15 December 2010. Further details are available at:-
http://www.hkex.com.hk/eng/newsconsul/hkexnews/2010/101210news.htm

42. Pursuant to the Joint Declarations between the HKICPA and the China Accounting Standards Committee and the Chinese Auditing Standards Board on 6 December 2007, there is a mechanism to ensure effective ongoing convergence of the accounting and auditing standards between Mainland and Hong Kong. We encourage Mainland incorporated issuers that elect to adopt CASBE to stay alert on the progress on convergence. Useful information is available on the HKICPA's website at:-
http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/mainland-standards-convergence/

FINDINGS REGARDING ACCOUNTING STANDARDS

43. Table 2 below summarises the key findings and observations relating to accounting standards. Except for three referrals made to the FRC, upon receipt and consideration of the responses from the issuers, there were no significant breaches of accounting standards noted that would render the financial statements misleading or warrant investigation or enforcement action. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

Table 2: Findings relating to Accounting Standards

Area	Accounting Standards	No. of issuers
Disclosures on financial instruments including convertible bonds	HKAS 32 HKAS 39 HKFRS 7	28
Business combinations	HKFRS 3 AG 5	26
Interim financial reporting	HKAS 34	23
Investments in subsidiaries, associates and joint ventures	HKAS 27 HKAS 28 HKAS 31	21

Area	Accounting Standards	No. of issuers
Presentation of financial statements	HKAS 1	18
Impairment of assets	HKAS 36	17
Mining activities	HKAS 16 HKAS 38 HKFRS 6	5
Accounting for government grants and subsidies	HKAS 20	3
Revaluations of assets regarded as deemed cost	HKFRS 1	1
Non-current assets held for sale	HKFRS 5	1

Our observations and recommendations

44. The following key areas require attention and improvement:-

Disclosures on financial instruments including convertible bonds

45. Same as last year, many issuers did not provide the following disclosures on financial instruments to make the financial statements more meaningful and useful:-

- key terms of financial instruments (paragraph 7 of HKFRS 7 "*Financial Instruments: Disclosures*"), for example, contractual interest rates;

- methods and assumptions applied by management in determining fair value, particularly those that relied on other observable inputs (hierarchy level 2) or unobservable data (hierarchy level 3), and changes in the assumptions used from those adopted in the previous year (paragraphs 25 to 30 of HKFRS 7); and

- details of the accounting treatment adopted. For example, where there is an amount recognised in equity on initial recognition of a convertible bond an explanation of adjustments or transfers between reserves made on the redemption of the convertible bonds.

46. Under the current accounting standards, unrealised gains and losses on financial instruments stated at fair value through profit or loss are immediately recognised in the income statement, while fair value changes on financial instruments classified as available-for-sale investments are recognised and accumulated in other comprehensive income ("OCI") and subsequently reclassified to the income statement upon impairment or disposal.

47. During our review we noted that in respect of available-for-sale investments adjustments were separately identified and presented in OCI in accordance with HKAS 1 (Revised), however, in some cases amounts relating to available-for-sale investments in the income statement were simply described as "gain/loss on disposal" or "impairment loss". It was therefore difficult to understand or trace fair value movements of available-for-sale investments and whether they had been previously recognised in OCI and recycled to the income statement in the current period.

48. We noted that many issuers were involved in the use of convertible bonds. There were 25 issuers that had convertible bonds either as investors or bond issuers and our observations and recommendations are summarised in paragraphs 49 to 55 below.

<u>Investment in convertible bonds</u>

49. We observed that four issuers invested in convertible bonds. Two issuers recognised their convertible bonds as available-for-sale debt investments while the other two recognised their convertible bonds as financial assets at fair value through profit and loss.

50. We noted that one issuer, which held listed convertible bonds as available-for-sale investments, appropriately measured the investments at fair value but the fair value of the convertible bonds was not based on the market price. Instead, the fair values of the listed convertible bonds and their components were determined with reference to a valuation performed by a firm of independent professional qualified valuers using a valuation model. We believe that when observable current market prices of listed convertible bonds are available these should be used rather than non-observable valuation models. If available market data is not used the reasons should be explained.

51. Paragraph 48A of HKAS 39 *"Financial Instruments: Recognition and Measurement"* states that *"The best evidence of fair value is quoted prices in an active market"* and we believe issuers should consider whether it is appropriate to adopt an internal valuation technique when current market data is available.

<u>Issuers of convertible bonds</u>

Debt and equity components

52. Paragraph 28 of HKAS 32 *"Financial Instruments: Presentation"* requires obligations under convertible bonds to be normally bifurcated into debt and equity components. We observed that 16 issuers recognised their convertible bonds as containing both a debt component and an equity component. However, only seven of these issuers clearly disclosed how they determined the conversion was "fixed-for-fixed" to justify the accounting treatment adopted. We recommend that such disclosure is best practice and issuers should also disclose the major terms and clauses of the convertible bonds.

Re-measurements to fair value

53. We observed that few issuers disclosed additional details on how the fair value of convertible bonds was determined, such as the specific valuation model adopted and the major inputs and the assumptions used. We noted that one issuer did not include an accounting policy for the convertible bonds it issued.

54. We recommend that issuers should clearly disclose the accounting policy adopted and the risks and exposures arising from the convertible bonds they issue so that users of financial statements are able to evaluate their significance to the entity's financial position and performance.

55. Issuers are also reminded that exposure to convertible bonds may result in significant volatility in their reported results which may trigger obligations to announce price sensitive information under Main Board Rule 13.09 and GEM Rule 17.10.

Business combinations

Accounting for acquisitions of subsidiaries as "businesses" or "assets"

56. We noted that there appear to be different interpretations of HKFRS 3 (Revised) "*Business Combinations*" concerning when there is an acquisition of a "business" and when there is an acquisition of an asset. During our review 21 issuers acquired a major shareholding in another company, but the transactions were described as being accounted for as an "acquisition of assets and liabilities" instead of an "acquisition of a business". The major effect of accounting for such acquisitions as the "acquisition of assets and liabilities" is that the consideration is allocated to individual identifiable assets and liabilities and no goodwill is recognised. We observed that this often arose in cases where the target company held mining or other property related assets. In its reply to our enquiry one issuer stated that the subsidiaries "*were not considered to be businesses at the time of their acquisition because … They were merely shell companies holding plots of land – they were acquired solely because of such land holdings … They did not have any material operations*".

57. A few of these acquisitions constituted very substantial acquisitions under the Listing Rules. We observed that at the time of preparing the investment circulars the pro forma financial information indicated that the transaction was accounted for as a business combination under HKFRS 3 (Revised) and estimated goodwill was recognised. However, the issuers did not explain in their subsequent financial statements why the transaction was later accounted for as an asset acquisition.

58. Most of these issuers nevertheless appropriately presented details of the assets and liabilities acquired but we noted a few cases where the issuers did not provide any further information about the acquisitions in their annual financial statements.

59. Issuers are reminded of the requirements of paragraph 112(c) of HKAS 1 (Revised) which requires financial statements to include additional notes deemed necessary to explain the impact of significant transactions.

Business combinations under common control

60. Business combinations under "common control" fall outside the scope of HKFRS 3 (Revised). Although there is no specific HKFRS or IFRS equivalent that addresses the appropriate accounting treatment for common control acquisition transactions, during our review we observed that five issuers applied the principles under Hong Kong Accounting Guideline 5 *"Merger Accounting for Common Control Combinations"* ("AG 5") in accounting for acquisitions under common control. One of these issuers adopted AG 5 as a result of a group reorganisation in connection with the initial public offering its shares. The remaining cases related to the acquisition of subsidiaries or businesses from their controlling shareholders subsequent to their listing.

61. In applying merger accounting they restated all their comparative figures "as if" the business combination had been completed on the earliest date of the periods being presented. Only three of them disclosed additional useful and relevant information such as the effect of the merger by balance sheet line-by-line items in their financial statements for past financial years.

62. The absence of a detailed IFRS on common control acquisitions may result in diversity in practice and issuers should carefully consider the appropriate accounting treatment for common control acquisitions. We believe that AG 5 principles should only be applied to special once-off circumstances such as in preparing financial statements in the year of an initial public offering and should not normally be applied for acquisitions made after listing.

Profit or performance guarantees

63. Two issuers stated in their investment circulars relating to an acquisition that a profit or performance guarantee was provided by the vendors. However, information on whether the guarantee had been met subsequently was not disclosed in their annual financial statements.

Pricing of the company's shares used in acquiring a subsidiary

64. One issuer did not use the published price of the company's shares at the date of the completion on the exchange of shares as the cost of a business combination (paragraph 37 and related paragraph B64(f) of HKFRS 3 (Revised)), and no explanation was given on why the published price was not used. Based on the reply to our enquiry, the issuer explained that the price of the consideration shares in the sales and purchase agreement was determined after arm's length negotiations between the seller and the issuer. It also stated that the difference between the agreed price and published price was not significant and such difference did not have any significant impact. We believe that disclosures of not using the published price should have been included in the financial statements.

Interim financial reporting

65. Similar to our last review, instances were noted where there were less than expected disclosures on the nature and amount of material items (paragraph 16(c) of HKAS 34 "*Interim Financial Reporting*") and the effects of changes in the group structure (paragraph 16(i) of HKAS 34). For example, no analysis or commentary was given in some interim reports to enhance the understanding of the events and circumstances that led to significant impairments made for trade receivables.

66. Some issuers adopted an accounting policy to re-measure their assets and liabilities to fair value. We noted that many recognised material fair value gains or losses on re-measuring financial instruments and investment properties but disclosures about the assumptions and methods used to arrive at their fair values were not disclosed. Although it is not an explicit requirement under the current HKAS 34 to disclose the basis of determining fair value adjustments made in interim reports, preparers are encouraged to follow the disclosure requirements of other relevant HKFRS such as HKAS 40 "*Investment Property*" and HKFRS 7, to explain valuation movements in their interim reports where the changes in values are significant.

Investments in subsidiaries, associates and joint ventures

67. We noted that some issuers did not clearly demonstrate how they had "control" over an investee when they did not hold more than 50% equity interest in an investee (paragraph 41(a) of HKAS 27 (Revised) "*Consolidated and Separate Financial Statements*". These issuers only provided a generic description in their financial statements that the investee was regarded as a subsidiary because "*the Group has control over its financial and operating policies*". We noted one case where the issuer consolidated an investee when it did not have any equity interest in the investee.

68. We also noted some cases where investee companies were not consolidated although other information presented appeared to indicate that they were controlled by the issuer. For example, one issuer accounted for an investment in which it had over 50% equity interest as "loans and receivables" in accordance with HKAS 39 and measured it at amortised cost rather than adopt HKAS 27 (Revised). Although our enquiry concluded that the accounting treatment could not be considered as non-compliance with accounting standards, we considered that disclosure in the financial statements should have been expanded to provide a better understanding of the accounting treatment.

69. Paragraph 13 of HKAS 27 (Revised) sets out the criteria which indicate whether "control" exists. Directors should consider the overall substance of a contractual arrangement and not merely its legal form in determining whether there is control. In certain circumstances management needs to exercise significant judgment and in these cases issuers are encouraged to provide additional disclosures to explain the reasons for the judgments made.

70. Issuers are reminded that similar considerations on assessing the overall substance of arrangements should also be applied in determining whether an issuer has "significant influence" or "joint control" over an investee. HKAS 28 *"Investments in Associates"* and HKAS 31 *"Interests in Joint Ventures"* provides some guidance and examples of indicators of "significant influence" and "joint control".

71. We also observed that it was not always clear whether the financial information of associates and jointly controlled entities used for incorporating into the issuer's consolidated financial statements was prepared using accounting policies in conformity with the accounting policies adopted by the issuer (paragraph 26 of HKAS 28 and paragraph 28 of HKAS 31). As a matter of good practice, we recommend that there should be explicit disclosure in annual reports that adjustments were made to conform the associates and jointly controlled entities' accounting policies to the group's accounting policies.

72. Two issuers did not disclose the summarised financial information of their material associates and jointly controlled entities, including the aggregate amount for current assets, long-term assets, current liabilities, long-term liabilities and income and expenses as required under paragraph 37(b) of HKAS 28 and paragraph 56 of HKAS 31.

73. The current HKAS 31 allows the use of the "proportionate consolidation method" or the "equity method" to account for jointly controlled entities. During our review, a number of issuers chose to use proportionate consolidation. Issuers are reminded that with the new HKFRS 11 *"Joint Arrangements"*, which will be effective for accounting periods beginning on or after 1 January 2013, the use of the proportionate consolidation method will no longer be permitted. Moreover, the HKICPA has recently issued HKFRS 11 and HKFRS 12 *"Disclosure of Interests in Other Entities"* which introduces revised rules for accounting and disclosure of associates and joint ventures. Issuers are recommended to review these new standards so that they are able to apply them when they become effective.

Presentation of financial statements

74. Paragraph 112(c) of HKAS 1 (Revised) requires an entity to provide additional disclosures when compliance with the specific requirements in HKFRS is insufficient to enable users of financial statements to understand the impact of material balances and transactions or other significant events on the entity's financial position and performance. This requirement continued to be frequently overlooked and 17 issuers did not provide the required additional information in their financial statements.

75. Two companies did not provide a description of the nature and purpose of each reserve held within equity (paragraph 79(b) of HKAS 1 (Revised)). We also noted that it was not always clear what circumstances gave rise to material movements in capital reserves; for example, there was no explanation of why there was a significant debit balance in capital reserves or no reason was given for a significant movement in capital reserves.

Impairment of assets

76. Explanations on the events and circumstances that led to the recognition of material impairment losses on goodwill or other assets (paragraph 130(a) of HKAS 36 *"Impairment of Assets"*) tended to be short and generic.

77. Five issuers did not provide the information required under paragraph 134(d) of HKAS 36, including key assumptions (e.g. discount rate and growth rate, period covered by financial budgets, etc.) used by the management in measuring "value in use". Issuers are reminded that key assumptions used in valuations should be reasonable and supportable and should reflect current circumstances and market conditions. Information on methods and assumptions used in valuations, together with comparative information, is relevant to provide readers with a better understanding of the reasons for year-to-year changes in values.

78. As also highlighted in our last report, although in some financial reports there were indications of possible impairment (paragraph 9 of HKAS 36) we noted 14 cases where there were no detailed explanations on why no impairment of a material asset was made. For example, where subsidiaries, associates and joint ventures suffer recurring operating losses this raises concerns on the carrying value of the investments.

Mining activities

79. During our review we observed an issuer acquired exploration rights through a business combination and the accounting policy for the rights was to state them at valuation less any impairment losses without amortisation. There was no disclosure of key assumptions adopted in determining the valuation of the exploration rights at initial recognition and for their re-measurement in subsequent reporting periods. It was unclear whether there was reasonable certainty that the exploration rights would be converted into “mining rights” which would appear to be necessary to justify their re-measurement at the end of each reporting period. It also appeared that an active market did not exist for the exploration rights, which is a prerequisite for an intangible asset to be carried at revalued amounts (paragraph 75 of HKAS 38 “*Intangible Assets*”). As a result, the case was referred to the FRC for further enquiry and an investigation of possible non-compliance is in progress.

80. We noted that two issuers classified their mining rights together with other mining development assets such as property, plant and equipment. In another three cases, we observed that the companies appropriately disclosed the carrying amounts of their exploration rights and mining rights under separate asset categories.

81. In some cases, we observed that the contractual periods of certain exploration/mining rights had expired or were to expire shortly after the year end. We therefore recommend issuers to make disclosures on their ability to extend exploration/mining rights including evidence to support their assessment to enable readers better understand how the issuer has determined the estimated life of their exploration/mining rights to support their carrying values.

Accounting for government grants and subsidies

82. Three cases were noted where disclosure of the nature and purpose of government grants or subsidies, including details of the conditions attached to them, were less than expected. There was one case where the issuer recognised a government grant as deferred income at the time of receipt but subsequently adjusted and recognised the full amount in the income statement. Our enquiry revealed that the change in accounting treatment was due to clarification from the local government that the grant was an unconditional gift.

83. It is important that issuers should understand the nature and the conditions attached to government grants at the time of receipt and, where necessary, they should seek clarification from the grantor to ensure the accounting treatment adopted is appropriate.

Revaluations of assets regarded as deemed cost

84. HKFRS 1 (Revised) *"First-time Adoption of Hong Kong Financial Reporting Standards"* was amended in the *"Improvements to HKFRS 2010"* to allow a first-time adopters of HKFRS to use an event-driven fair value measurement of assets and liabilities to be regarded as their "deemed cost". This should eliminate one of the major differences between CASBE and HKFRS financial statements. During the year one issuer reviewed took advantage of the amendment.

Non-current assets held for sale

85. We noted one case where a disposal was not yet completed for over five years and the related assets and liabilities were separately presented as "held for sale" and only a brief generic statement was disclosed in its financial statements. Although paragraph 9 of HKFRS 5 *"Non-current Assets Held for Sale and Discontinued Operations"* states that an extension of the period required to complete a sale does not preclude an asset or disposal group from being classified as held for sale if the delay is caused by events beyond an entity's control, an issuer should provide an update of progress and its expected completion date which is required under paragraph 41(b) of HKFRS 5.

Guidance on accounting standards

86. This section contains general guidance and reference materials relating to compliance with accounting standards.

87. We note that paragraph 31 of HKAS 1 (Revised) states that *"An entity need not provide a specific disclosure required by an HKFRS if the information is not material"*. Based on the responses to our enquiries, issuers sometimes explained that certain disclosures were omitted because they were not material or significant. We believe that materiality is a key concept that should be adopted when deciding whether or not certain accounting standard disclosures should be provided in financial statements. As judgment is always required in assessing materiality, issuers should develop benchmarks together with other procedures on quantitative and qualitative aspects of materiality in their reporting systems so that they are consistently applied in the preparation of their financial statements.

88. The IASB and HKICPA have recently issued IFRS/HKFRS 10 *"Consolidated Financial Statements"*, IFRS/HKFRS 11, IFRS/HKFRS 12, and the consequential amendments to IAS/HKAS 27 (Revised 2011) *"Separate Financial Statements"* and IAS/HKAS 28 (Revised 2011) *"Investments in Associates and Joint Ventures"*. These will become effective for annual accounting periods beginning on or after 1 January 2013. The changes introduced by these standards must be applied retrospectively. The major changes include among other things; the removal of proportionate consolidation for joint ventures and a new single control model under IFRS/HKFRS 10 for determining whether an investee will be required to be consolidated. Issuers should prepare for the changes and may find it useful to refer to the HKICPA's *"Staff summary of financial reporting standards"* to obtain an overview of the main features of the new and revised standards. Details are available at:-
http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/staff-summary/

89. We would also like to remind issuers that when an entity applies a new accounting policy retrospectively, paragraphs 10(f) and 39 of HKAS 1 (Revised) requires <u>three</u> statements of financial position, that is, as at the end of the current period, at the end of the required comparative period, and at the beginning of the required comparative period. Issuers should take early action to evaluate how the requirements of the new standards will affect their future interim reports and annual financial statements. We also encourage issuers who are planning a major acquisition to consider the impact of these revised standards when entering into an acquisition.

90. The HKICPA undertakes a continuous review of published financial statements of listed companies and publishes its observations in its Quality Assurance Department's annual report. Its findings include common pitfalls encountered by others in preparing annual financial statements and the report is available on the HKICPA's website at:-
http://www.hkicpa.org.hk/en/standards-and-regulations/quality-assurance/professional-standards-monitoring/publications-reference/

91. Moreover, the FRC has the power to enquire into issuers on financial reporting matters. In addition to looking into complaints received from the public and other regulators and reviewing listed companies' financial statements that have been issued with a modified or qualified auditor's report, commencing from 2011 the FRC also undertakes a financial statements review programme. Further information relating to the FRC's work is available on the FRC's website at:-
http://www.frc.org.hk/en/index.php

FINDINGS REGARDING SPECIAL REVIEW THEME – ACCOUNTING BY PROPERTY COMPANIES

92. In this year's review, we chose as the industry theme issuers whose major or principal activities included property construction or investment in properties. The review focused particularly on the accounting treatment adopted for investment properties (and more specifically, investment properties under construction) to determine whether there was compliance with applicable Listing Rules and accounting standards. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

93. Amendments to HKAS 40 were introduced by *"Improvements to HKFRS"* issued in October 2008 and the changes were effective for annual periods beginning on or after 1 January 2009. The amendments to HKAS 40 bring investment properties under construction within the scope of the investment property standard and require such properties to be measured at fair value unless the fair value cannot be reliably determined.

Our observations

94. In total, 37 property companies were reviewed and these issuers complied with the amendments to HKAS 40. Included in the companies reviewed, 18 issuers appropriately recognised changes in fair values of investment properties under construction as a change in accounting policy. Our other observations are summarised below.

<u>Accounting policy for revenue recognition</u>

95. We noted that most issuers included only a brief and generic accounting policy on when revenue is recognised from the sale of properties. Examples included the following:-

> *"Revenue from sale of properties is recognised when the significant risks and rewards of ownership of properties are transferred to the buyers"*

> *"Revenue from sale of properties in the ordinary course of business is recognised when the respective properties have been completed and delivered to buyers."*

<u>Accounting policy for investment properties</u>

96. Except for two property companies which adopted the cost model for investment properties, all the other property companies reviewed adopted the fair value model. 24 issuers clearly stated that they accounted for investment properties under construction using the same accounting policy adopted for completed investment properties.

97. We observed that those that adopted the cost model did disclose their fair values as required under paragraph 79(e) of HKAS 40.

98. Most of the issuers that adopted the fair value model for investment properties carried out revaluations on an annual basis. The issuers usually disclosed the names of the independent professional valuers who performed the valuation but one issuer did not provide the name or qualifications of the valuers. We observed that some issuers did not disclose the methods and key assumptions used in determining fair values. We also noted in two cases that the movement of fair values appeared to be inconsistent with the market trend. For example, although the general movement in values for the property market was on the increase, the issuers recorded a downward change or did not record any fair value change and no explanation was provided.

Disclosures on specific properties

99. We noted that there was incomplete disclosure of the requirements (paragraph 23 of Appendix 16 to the Main Board Rules and GEM Rule 18.23) regarding properties held for development or sale or property investments which exceeded 5% of the percentage ratios as defined under Main Board Rule 14.04(9) and GEM Rule 19.04(9).

100. In the case of property held for development and/or sale, some of the following disclosures were sometimes omitted: -

- an address sufficient to identify the property, which generally should include the postal address, lot number or further identifying designation such as that registered with the appropriate government authorities in the jurisdiction in which the property is located;
- if in the course of construction, the stage of completion as at the date of the annual report;
- if in the course of construction, the expected completion date;
- their existing use (e.g. as shops, offices, factories or residential purposes, etc.);
- the site and gross floor area of the property; and
- the percentage interest in the property.

101. In the case of property held for investment, some of the following disclosures were omitted: -

- an address sufficient to identify the property as mentioned above; and
- the existing use.

102. We also observed that only a few issuers disclosed other useful information about their investment properties under construction, such as whether there were early arrangements made for the use of the properties and whether any early lease agreements had been entered into.

Investment properties held under an operating lease

103. Most properties in Hong Kong and the Mainland are under operating leases as the land is required to be returned to the government at the end of the lease term, unless the lease is extended. Therefore, purchases of properties situated in Hong Kong and the Mainland are normally treated as investment property under an operating lease.

104. Issuers should note that paragraph 34 of HKAS 40 requires that *"When a property interest held by a lessee under an operating lease is classified as an investment property …; the fair value model shall be applied."* Although there are different interpretations of the accounting standard, we believe that under HKAS 40 issuers should normally use the fair value model for accounting for investment properties held under operating leases.

105. One issuer that adopted the cost model for investment properties did not disclose where its properties were situated. All the other issuers reviewed had investment properties situated in Hong Kong and/ or the Mainland. We noted that except for two issuers where investment properties were relatively insignificant to the company as a whole, all the issuers properly complied with paragraph 6 of HKAS 40 by accounting for investment properties under operating leases using the fair value model.

Investment properties under construction

106. We observed that descriptions of investment properties were less than expected; for example, some issuers did not disclose amounts relating to completed investment properties separately from amounts relating to investment properties under construction. We also noted that only 10 out of the 18 issuers reviewed that had investment properties under construction disclosed the estimated completion date of their development projects.

107. Moreover, of the 18 issuers that had investment properties under construction only some disclosed information regarding the basis of determining fair values and the key assumptions adopted. Some mentioned that the valuations were based on the direct comparison approach with reference to comparable transactions assuming that the investment properties under construction would be completed. These assumptions also took into account estimated future costs of development. However for some companies, we noted that the valuation was only based on the existing condition of the property which sometimes was represented by the holding of a plot of land.

Our recommendations

108. We recommend that for financial statements to be useful to its readers, issuers should list their significant properties together with disclosure of the carrying amounts of each property or groups of properties to indicate their relative importance to the company. There should normally be only one accounting policy adopted for accounting for all investment properties and we would recommend issuers to separately disclose the different valuation methods used where this is required by the company's circumstances.

109. We noted that only one issuer disclosed the movement of "completed investment properties at fair value", "investment properties under development at fair value" and "investment properties under development at cost". It also clearly stated the reasons why the fair value method or the cost method was chosen. This was a good example of thoughtful disclosures to provide useful information to readers.

110. Issuers may consider adopting columnar presentation for their disclosures along the lines of the following appropriately modified for the company's specific circumstances:

Investment Properties	**At fair value**		**At cost**	
	Completed properties	**Properties under construction**	**Completed properties**	**Properties under construction**
	HK$'000	HK$'000	HK$'000	HK$'000
At the beginning of the year	*xxx*	*xxx*	*xxx*	*xxx*
- additions / (disposals)	*xxx*	*xxx*	*xxx*	*xxx*
- fair value changes during the year	*xxx*	*xxx*	*n/a*	*n/a*
At the end of the year	*xxx*	*xxx*	*xxx*	*xxx*

Note - Investment properties that are carried at cost should be distinguished from those carried at fair value (paragraph 78 of HKAS 40)

111. We recommend that issuers should disclose the specific method used for determining fair values and the key assumptions used. This information may include details of the hierarchy used for valuations discussed under paragraphs 72, 76, 81 and 86 of HKFRS 13 *"Fair Value Measurement"*. These may include:

- quoted price for an identical item in an active market;
- use of other observable inputs such as the quoted price for an identical property in a market that is not active, or the quoted price for a similar asset in an active market;
- use of a valuation technique (for example, discounted cash flow projections or income capitalisation); and
- the choice of valuation method chosen for each major property or group of properties (for example, by geographical region or location which may reflect the availability of market data).

112. We also recommend issuers to expand disclosures on the accounting policy adopted for revenue recognition by reference to criteria set out in paragraph 14 of HKAS 18 *"Revenue"*. Possible disclosures could include the following examples we saw during our review, and preferably a combination of them appropriately modified for the company's specific circumstances.

<u>Example A</u>

"Revenue from sale of completed properties is recognised upon the latter of the signing of sale and purchase agreements or the issue of the occupation permit by the relevant government authorities, which is taken to be the point in time when the risks and rewards of ownership of the property have passed to the buyer."

<u>Example B</u>

"Revenue from sale of properties in the ordinary course of business is recognised when <u>all</u> of the following criteria are satisfied:

- *the significant risks and rewards of ownership of the properties are transferred to the buyers;*
- *neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the properties are retained;*
- *the amount of revenue can be measured reliably;*
- *it is probable that the economic benefits associated with the transaction will flow to the Group; and*
- *the costs incurred or to be incurred in respect of the transaction can be measured reliably."*

113. Issuers should also clearly explain when risks and rewards have passed to buyer to support the recognition of sales. We noted that some property companies provided temporary guarantees to the banks of the buyers of their properties. Issuers should disclose the extent of their involvement in the guarantees; for example, the timing of release of the guarantees which should normally be upon issue of the building ownership certificates and the transfer of title to the buyers to support the recognition of revenue. Issuers should also disclose details of any termination or re-purchase clauses in their sales agreements that may allow termination or return of the property to the issuer as these also have implications on whether and when revenue can be recognised.

114. Finally, the IASB is considering changes to the accounting for "Leases" which will have significant implications on companies that have operating leases both as lessees and lessors. Under the proposals, a lessee will be required to recognise in its balance sheet a "right-of-use" asset and also a liability to make future lease payments from the commencement date of a lease. This approach is substantially different to that currently required under HKAS 17 *"Leases"* which requires a lessee to account for a leased asset either by recognising an asset and a liability ("finance leases") or recognising regular lease payments as they are made ("operating leases"), depending on whether there has been a transfer of substantial "risks and rewards" of ownership of the asset. Issuers are encouraged to participate in the development of this accounting standard and to submit their comments to the IASB.

FINDINGS REGARDING GENERAL ACCOUNTING REVIEW THEME – SEGMENT INFORMATION

115. The specific accounting standards theme chosen for this year's programme was compliance with the accounting standard dealing with segment information. Unless otherwise specified, HKFRS and their paragraph numbers referred to in this section correspond to those in IFRS.

116. We were encouraged that the level of compliance for issuers reviewed was generally satisfactory. The key findings and observations together with our recommendations are set out below.

117. HKFRS 8 *"Operating Segments"* replaced HKAS 14 *"Segment Reporting"* and became effective for accounting periods beginning on or after 1 January 2009. HKFRS 8 requires operating segment information to be disclosed on the same basis as information is used by the chief operating decision maker in assessing a company's operating performance and making decisions on the allocation of resources.

118. Some disclosures in HKFRS 8 are conditional and examples include:-

- segment analysis of assets and liabilities will be required *"if such amounts are regularly provided to the chief operating decision maker"* (paragraph 23 of HKFRS 8)

- information of geographical segments will not be required if *"the necessary information is not available and the cost to develop it would be excessive"* (paragraph 33 of HKFRS 8)

Our observations

119. We observed that 83 issuers disclosed segment information for more than one segment and the remaining 17 issuers reported one single segment.

Disclosure of segment information by business lines

120. A majority of the issuers determined operating segments by business lines and disclosed the types of products and services from which each reportable segment derived its revenue. We noted that issuers usually presented detailed segment income statements but the presentation of full segment balance sheets was less common.

121. 39 issuers disclosed geographical segments but only 17 issuers explained how they determined their geographical segment analysis.

122. Most of the issuers properly complied with the disclosure requirements set out in paragraphs 20 to 34 of HKFRS 8 concerning details of segment information. However, there were minor omissions in disclosures as follows:-

- Nine issuers did not mention whether the segment analysis was prepared based on the information submitted to and reviewed by the chief operating decision maker and they did not disclose the factors or criteria used to identify their reportable segments.

- One issuer did not disclose in its interim report segment information on total assets for which there had been a material change from the amount disclosed in the last annual financial statements which is required under paragraph 16(g)(iv) of HKAS 34.

123. We also observed that some companies, including issuers that had a single reportable segment, did not disclose the entity-wide information required by the standard, that is, information about its products and services, geographical areas and major customers which is required under paragraphs 31 to 34 of HKFRS 8.

<u>Segments classified as "Others" and "Unallocated items"</u>

124. We observed that 26 issuers had a segment classified as "Others" and noted that the amounts of revenue, profit or loss, assets, and liabilities in the segment were generally not significant to the group as a whole. However, only 18 issuers explained what businesses were included in the "Others" segment and why they were so aggregated.

125. Half of the issuers reviewed had significant amounts included under "unallocated items" in terms of income, expenses, assets, or liabilities. Some of the issuers explained the nature of the balances, which mainly included general corporate income and expenses, central administrative costs, financing income and costs, and head office assets and liabilities.

126. We noted that one issuer presented a complete allocation of all items in the income statement and statement of financial position into relevant segments. This was a good example of disclosure of segment reporting as it provided useful information and a better understanding of each segment's performance to readers.

<u>Consistency of the Management Discussion and Analysis with Segment Information</u>

127. We noted that all issuers provided information of operational analysis in their Management Discussion and Analysis report concerning the segment disclosure included in their financial statements. However, some issuers did not further explain the reasons for the fluctuations revealed in the segment information in their Management Discussion and Analysis report. We also noted that some issuers did not provide additional useful narrative information such as market trends, industry specific information in the Management Discussion and Analysis or explanations on their performance during the financial period.

Our recommendations

128. We recommend that issuers should consider what information should be provided to the chief operating decision maker as it provides readers of financial statements an indication to what information is used to manage the business. Issuers should consider segment analysis of all its assets and liabilities to show all the resources employed in generating the segment results. This will also assist management in the proper pricing of its products and services.

129. Information about business activities that are relatively small or immaterial may be combined and disclosed as "Other segments" so long as there is a brief description of the business activities included in the category.

130. We recommend that all issuers should provide an explanation on how they determine and prepare their geographical segments to enable readers have a better understanding of the information and whether geographical spread is important to its long term operations.

131. Finally, segment information should be balanced and consistent with information disclosed elsewhere in the financial reports. For example, the Management Discussion and Analysis should be consistent with segment information presented in the financial statements.

CONCLUSION

132. As accounting standards are consistently being developed and revised, directors and other persons responsible for the financial reporting function need to constantly stay alert to the changes. We encourage issuers to participate in the development and formulation of accounting standards and to submit their comments on discussion papers and exposure drafts issued by the accounting-setting bodies. It is important that issuers should regularly review and, where needed, update their financial reporting systems to ensure that information that is presented in their financial reports is specific, relevant and material, and is in compliance with the disclosure requirements, and will be useful to users in making economic decisions.

- End -