

Hong Kong Capital Markets Update

ISSUE 2017-03 | August 2017



Summary of the Hong Kong Stock Exchange's review of listed issuers' financial reports

On 14 July 2017, the Hong Kong Stock Exchange (the "Exchange") published its eighth [report](#) of the Financial Statements Review Programme (FSRP), under which the Exchange reviews published quarterly, interim and annual reports for compliance with the disclosure requirements of the Main Board Listing Rules (and the equivalent GEM Listing Rules), the accounting standards and the relevant disclosure requirements of the Companies Ordinance (Cap. 622) (the "New CO").

This report summarises key findings from the FSRP, where 100 periodic financial reports released by listed issuers between February 2016 and April 2017 are selected on a risk-based approach. For the industry review theme this year, the Exchange also discusses its findings from the annual reports of 19 selected issuers whose major or principal activities include retail and consumer goods businesses.

The Exchange encourages listed issuers to take note of the matters discussed in the report in order to ensure that their finance departments have the necessary resources and training to perform their financial reporting role.

Key findings and recommendations

Providing management commentary that is useful for investors

Listed issuers should provide clear, understandable and entity-specific management commentary in the Management Discussion and Analysis (MD&A) and Business Review, including key areas where listed issuers are expected to:

- Provide adequate explanation of performance and properly identify reasons for fluctuations in profit or loss
- Provide commentary on significant balances and transactions that are unusual or material
- Discuss principal risks in the environment which are specific to the listed issuers and explain how these risks are being managed and mitigated
- Present key performance indicators (KPIs) and non-Hong Kong Financial Reporting Standards (HKFRS) measures without bias and with no greater prominence than HKFRS financial information, and with a clear definition and reconciliation to the relevant amounts in the financial statements.



Most commonly omitted or incomplete disclosures

- Some of the minimum disclosures required by paragraph 32(1) to 32(12) of Appendix 16, include:
 - The group's liquidity and financial resources
 - The currencies in which borrowings are made and in which cash and cash equivalents are held
 - Significant investments held, their performance during the financial year and their future prospects
 - Comments on segmental information, such as developments within the segment and changes in revenue and margins
 - Details of the number of employees and remuneration policies
- Reconciliations to HKFRS financial information when non-HKFRS KPIs were used in the Business Review under Schedule 5 of the New CO
- Nature and impact of significant events on material balances and transactions

- Company-level statement of financial position
- Auditors' remuneration (including non-audit services)
- Directors' permitted indemnity provisions
- Basis upon which the ageing analysis of accounts receivable and accounts payable were presented
- Directors' emoluments
- Financial statements with modified opinions issued by auditors
- Financial reports using China Accounting Standards for Business Enterprises.

Financial statements with modified opinions issued by auditors

Listed issuers are reminded to enhance their disclosures in annual reports regarding auditors' modified opinion. In respect of scope limitation, listed issuers should disclose the following matters:

- Reasons leading to the modified audit opinion
- The relevant information or evidence requested by the auditors
- Reasons why the issuer cannot provide the requested information or evidence to the auditors
- The audit committee's view, including their review on major judgemental areas and any disagreement with management
- The actions that have been taken by the directors to address the modified opinion.

Judgements in determining control or significant influence

Listed issuers should disclose significant judgements and assumptions they have made in determining whether or not they have control of or significant influence over another entity, in particular, when the results contradict those under the percentage threshold of 50 percent of the voting rights for control assessment and 20 percent for the significant influence.

Rigorous assessment on impairment of assets

Listed issuers should ascertain the adequacy of asset impairment testing and ensure assets are carried at no more than their recoverable amount. One of the indications of impairment is when the carrying amount of the listed issuer's net assets is more than its market capitalisation. In carrying out impairment testing, management of listed issuers are required to perform proper analysis, rather than solely rely on professional valuers or other experts, and to exercise judgement on the reasonableness of key assumptions applied in the impairment testing.



Disclosures for asset impairment loss or reversal of impairment loss

Upon the recognition or reversal of an impairment loss, listed issuers should disclose information in accordance with paragraph 130 of HKAS 36. The Exchange reminds issuers that:

- The description of events and circumstances that led to the recognition or reversal of the impairment loss should be case-specific and closely related to the issuer
- The recoverable amount and whether the recoverable amount is its fair value less costs of disposal or value in use should be disclosed
- If the recoverable amount is fair value less costs of disposal, the issuers shall disclose the measurement, valuation technique, and key assumptions of the fair value
- If the recoverable amount is value in use, the issuer shall disclose the discount rate used in both the current estimate and previous estimate of values in use.

Paragraph 134 of HKAS 36 requires relevant information for each cash-generating unit to which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated is significant. In particular, the Exchange reminds the listed issuers to disclose:

- Whether the cash-generating unit's recoverable amount is determined based on value in use or fair value less costs of disposal
- The key assumptions made when estimating the recoverable amount
- How key assumptions are determined, including whether they reflect past performance or, if appropriate, are consistent with external sources of information
- The growth rate used to extrapolate cash flow projections and the discount rate applied to cash flow projections
- If any, the details of change in the basis of calculation of the recoverable amount together with the reasons for the change.

Impact of applying key HKFRSs in issue but not yet effective

As the three major new HKFRSs¹ will soon become effective, the Exchange is expecting issuers to progressively provide more entity-specific qualitative and quantitative information about the application of the new standards in their upcoming interim and annual financial statements.

¹. HKFRS 9 *Financial Instruments*, HKFRS 15 *Revenue from Contracts with Customers*, and HKFRS 16 *Leases*



Disclosures for New Accounting Standards

In respect of possible impacts of applying new or amended HKFRSs in issue but not yet effective, the Exchange:

- Recommends providing a complete list of HKFRSs issued but not yet effective
- Requires stating that other than those that have been discussed, all other HKFRSs issued but not yet effective are not likely to have a significant impact on their financial statements
- Expects to see more entity-specific qualitative and quantitative information progressively shown in the upcoming interim and annual financial statement for HKFRS 9, 15 and 16
- Encourages the disclosure of the implementation of other new standards, such as HKFRS 17 *Insurance Contracts*
- Encourages consulting professional advisors and closely monitoring developments in relation to the implementation of these standards.

Segment reporting

Listed issuers are expected to report operating segment information on the same basis as those included in the MD&A in terms of segments presented and measures disclosed. Operating segment information should be provided “through the eyes of management” and disclosed according to the information used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

Most retail and consumer goods issuers under review have diverse operations and operate in various geographical locations. They are reminded to disclose entity-wide revenue information by products/services, and by geographical area, as well as their reliance on major customers, even though there is only a single reportable segment.

New auditors' reporting

Listed issuers are reminded to pay greater attention to the sections in the annual reports (e.g. financial statements and MD&A) to which key audit matters (KAMs) are related. Any KAMs disclosed in the audit report should normally be on the basis that those matters are already disclosed in other sections of the annual report by the issuers. In addition, the audit committee of the issuer should have in-depth discussions with their auditors on KAMs, going concern issues and other significant events. Finally, listed issuers are reminded to ensure that the other information included in the annual report is complete and provided to the auditors prior to the date of the audit report.

The recommendations by the Exchange are based on specific information disclosed in the published reports of selected listed issuers. It should be noted that the recommendations for enhanced disclosures set forth in the Exchange's report may not represent a complete list of the minimum disclosures required under the relevant accounting standards. Listed issuers are encouraged to consult their auditors or professional advisors to ensure proper application of the accounting and disclosure requirements.

If you have any questions about the matters discussed in this publication, please feel free to contact the following partners in our Capital Markets Advisory Group:

Paul Lau
Partner,
Head of Capital Markets
KPMG China
T: +852 2826 8010
E: paul.k.lau@kpmg.com

Katharine Wong
Partner,
Capital Markets Advisory Group
KPMG China
T: +852 2978 8195
E: katharine.wong@kpmg.com

kpmg.com/cn

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, a Hong Kong partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.