



cutting through complexity

BETTER BUSINESS REPORTING

A practical guide to the business review

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A practical guide to the business review

The business review: An evolutionary step towards better business reporting

It is widely recognised that narrative reporting has an essential role to play in providing a broader perspective on business performance alongside the financial statements. The new requirement to present a business review and the HKICPA's related guidance are the latest in a series of regulatory initiatives aimed at improving the relevance of narrative reports for shareholders and other stakeholders.

In this practical guide to the business review, our aim is to help in your journey towards better business reporting. We introduce the new requirements, as well as showing how a business review can both embrace the HKICPA's guidance and meet the Listing Rule requirements and recommendations relating to the management discussion and analysis (MD&A).

But before we start, it is worth remembering that the new business review is just one of the initiatives aimed at improving business reporting by listed companies over the next few years. The key developments are set out in the timeline below – each of these can be seen as an evolutionary, rather than revolutionary, step on the journey towards better business reporting.

For example, from 2015 the business review is required to include a description of the principal risks and uncertainties facing the company or group. This is a step up from the recommended disclosure item previously found in the Listing Rules. However, going forward into 2016 we expect even more robust reporting on this topic in the Corporate Governance Report, as a result of amendments to the

Corporate Governance Code.

Similarly, the new business review requirements include a requirement to discuss the entity's environmental policies and key relationships that impact on the company's or group's development, performance and position. This can be seen as forerunning the Environmental, Social and Governance (ESG) reporting consultation that is expected to be issued later in 2015.

Therefore, rather than simply complying with a disclosure checklist, we would encourage companies to think more broadly and look ahead. Considering the business review disclosure in conjunction with the broader reporting on ESG and risk matters and vice versa can help ensure that the messages provided to the market are consistent over time, within one report and across various reports. Extra benefits can also come from starting early and focusing your efforts across the business. This allows time for proper consideration of shareholder needs and can also be an efficient way to reduce compliance cost.



What’s the new legal requirement?

One of the key changes introduced by the new Hong Kong Companies Ordinance (Cap. 622 or CO) is to require all Hong Kong incorporated companies to include a “business review” in their directors’ report, unless they are specifically exempt under section 388 of the CO¹. This requirement is stated in section 388 of the CO, while the minimum contents for a business review are set out in Schedule 5 to the CO. The full text of Schedule 5 has been reproduced below for easy reference.

Schedule 5 disclosure requirements for the business review

Sch 5.1	A directors’ report for a financial year must contain a business review that consists of– a) a fair review of the company’s business; b) a description of the principal risks and uncertainties facing the company; c) particulars of important events affecting the company that have occurred since the end of the financial year; and d) an indication of likely future development in the company’s business.
Sch 5.2	To the extent necessary for an understanding of the development, performance or position of the company’s business, a business review must include– a) an analysis using financial key performance indicators; b) a discussion on – i. the company’s environmental policies and performance; and ii. the company’s compliance with the relevant laws and regulations that have a significant impact on the company; and c) an account of the company’s key relationships with its employees, customers and suppliers and others that have a significant impact on the company and on which the company’s success depends.
Sch 5.3	This Schedule does not require the disclosure of any information about impending developments or matters in the course of negotiation if the disclosure would, in the directors’ opinion, be seriously prejudicial to the company’s interests.
Sch 5.4	This Schedule has effect in relation to a directors’ report required to be prepared under section 388(2) [i.e. a consolidated directors’ report] as if a reference to the company were a reference to– a) the company; and b) the subsidiary undertakings included in the annual consolidated financial statements for the financial year.
Sch 5.5	In this Schedule – <i>key performance indicators</i> (關鍵表現指標) means factors by reference to which the development, performance or position of the company’s business can be measured effectively.

¹ Section 388(3) and (4) of the CO sets out 3 categories of companies which are exempt from preparing a business review. These are as follows:

- 1) wholly owned subsidiaries of another body corporate in the financial year as defined in section 357(3);
- 2) companies which fall under the “reporting exemption” i.e. companies which meet one or more of the size and/or approval requirements set out in section 359 for private companies and companies limited by guarantee; and
- 3) private companies whose shareholders have passed a special resolution at least 6 months before the year-end exempting the company, in accordance with the conditions set out in section 388(3)(c) and (4).

The business review is part of the directors’ report – boards and audit committees are responsible for ensuring that the picture of the business is one they recognize

Other than these brief requirements in Schedule 5, there is no further indication in the CO as to the expected contents of the business review.

As a result, the HKICPA, at the invitation of the Companies Registry, has issued Accounting Bulletin 5 (“AB5”) to provide further guidance on the preparation and presentation of the business review, following the approach taken in the UK to this topic – more on this in the next section of this guide.

Applicability of Schedule 5 to listed issuers

Paragraph 28 of Appendix 16 to the Main Board Listing Rules (“App 16.28”), as amended in February 2015², requires all listed issuers, whether or not they are incorporated in Hong Kong, to comply with Schedule 5, consistent with the HKEx’s level playing field principle. The HKEx has set an effective date of years ending 31 December 2015 for these amendments. Before that date, compliance with Schedule 5 is optional for non Hong Kong incorporated issuers, creating a short transitional period when the requirements may differ depending on whether the issuer is incorporated in Hong Kong or overseas.

In addition, listed issuers and other entities claiming compliance with the disclosure requirements of the Listing Rules, still need to ensure that the MD&A information disclosed in the annual report includes commentary on each of the matters specifically identified in App 16.32 (or the equivalent GEM Rule). They may also choose to comply with App 16.52 (or the equivalent GEM Rule) which sets out recommended additional disclosure which issuers are encouraged to disclose in their annual reports.

These specific MD&A items align well with the core content elements and other matters required by Schedule 5 and therefore we expect that most issuers will include them within the business review, rather than disclosing them elsewhere in the annual report. In this guide we highlight these required and recommended commentary items amongst the discussion of the content elements as applicable. We have also included for easy reference the full text of these paragraphs in Appendix 1 to this guide, together with an index of where these items are discussed in this guide.

Key areas of change that we encourage listed issuers to focus on:

The impact of Schedule 5 on listed issuers will depend on the extent to which the issuer went beyond the minimum requirements in their MD&A’s in prior years. However, we would encourage all listed issuers to revisit the content and structure of their reporting to ensure it continues to align with the information needs of the shareholders. Areas to focus on would include:

- **More rigorous descriptions of business model and strategy** to provide shareholders with an understanding of the processes, relationships and resources that the business depends on – and the strategy for developing and preserving business capability over the longer term.
- **Complementing as well as supplementing the financial statements** by providing additional financial and non-financial information which may be relevant to the shareholders’ evaluation of past results and assessment of future prospects.
- **Improved selection and presentation of performance measures** which are relevant to an understanding of business achievements, prospects and capabilities.
- **Better linkage within the MD&A and between the MD&A and other elements of the report** to promote understanding and to bring together relevant information in a cohesive way.

But the most important thing to remember is that each business review should be unique and authentic – shareholders will be unimpressed and skeptical at any signs that the business review is boilerplate or otherwise lacking in credibility.

Boards and audit committees have a particular role to play here in ensuring that the picture of the business presented is one that they recognize. This is emphasized by the legal requirement that the business review forms part of the directors’ report, whether directly or by specific cross-reference to the MD&A discussion within the annual report.

² On 6 February 2015, the HKEx issued its Consultation Conclusions on the *Review of Listing Rules on Disclosure of Financial Information with reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments* to update the Listing Rules for the new Companies Ordinance disclosure requirements. Amendments to the Listing Rules were included as an appendix to the Consultation Conclusions. These amendments are mandatory for financial years ending on or after 31 December 2015. This guide is based on these updated Listing Rules.

Preparing a business review: Overall considerations

Given the high level nature of the requirements set out in the legislation, directors are free to decide on a format and level of information that would make most sense in the company’s circumstances. In this section of our guide, we consider how the guidance issued by the HKICPA, Accounting Bulletin 5, is relevant to meeting this challenge. We also consider report focus and materiality, the concept of linkage and the importance of planning ahead, involving the right depth and breadth of experience and asking the right questions to produce a high quality business review.

Relevance of Accounting Bulletin 5

Accounting Bulletin 5 *Guidance for the Preparation and Presentation of a Business Review under the Hong Kong Companies Ordinance Cap. 622* (“AB5”) was developed by the HKICPA at the invitation of the Companies Registry and was issued in July 2014. It is intended to assist entities in preparing and presenting a business review that complies with the requirements of Schedule 5 and that provides useful information for members of the company.

The guidance, which is not mandatory, was based on guidance originally developed in the UK, given similarities in the reporting requirements. The Hong Kong guidance was written with the requirements of non-public companies in mind (particularly those companies which have not previously prepared a business review) but it also represents minimum best practice for all companies required to prepare a business review. This guide takes a similar approach.

AB5 begins by recapping on the obligation under the Companies Ordinance to prepare a business review. It then contains the following main sections:

- Guiding principles for the preparation and presentation of a business review
- Guidance on each of the four content elements required by Schedule 5
- Implementation guidance which illustrates a range of financial and non-financial KPIs

It is important to note that the HKICPA’s guidance does not prescribe a mandatory structure for the report. Instead, it offers a basis for ensuring that the report provides a holistic

assessment of past performance, the current state of the business, and its future prospects.

In this section of our guide, we introduce AB5’s guiding principles. In later sections we look at the areas of content required by law in the context of the HKICPA’s guidance and the related requirements of the Listing Rules, in particular focusing on the role of KPIs and linkage.

AB5’s guiding principles

AB5 identifies a number of guiding principles to be considered when preparing and presenting a business review. These are set out in the box below.

Directors should bear these guiding principles in mind throughout the planning and drafting of the business review. It may also be useful to refer to them as the benchmark for the directors’ assessment of adequacy of the business review, when the board performs an overall review prior to approval of the directors’ report.

Guiding principles for the preparation and presentation of a business review (AB5.15)

- 1) The review should set out an analysis of the business through the eyes of the board of directors
- 2) The scope of the review should be consistent with the scope of the financial statements
- 3) The review should complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure
- 4) The review should be understandable
- 5) The review should be balanced and neutral, dealing even-handedly with both good and bad aspects

AB5 sets out principles and guidance relevant for companies of any size

Principles (1) and (2) are closely related to the legal requirements: as explained in our section on those requirements, the business review is part of the directors’ report and therefore it needs to reflect how the directors see the business. Also, it is a requirement of Schedule 5 that if the business review is attached to consolidated financial statements, then it should reflect the business of the group as a whole, i.e. it should be consistent with the scope of the consolidated financial statements.

Principles (3), (4) and (5) deal with qualitative aspects of the business review. We consider that these principles are fundamental to all business reviews, irrespective of the size of the company or group, to ensure that the business review is a useful addition to the annual report and presents a fair picture of the business to the company’s shareholders and other interested parties. Here are some of the key reasons why we hold this view:

Complementing and supplementing

If a business review simply summarises or repeats information which is already found in the financial statements then it has minimal added value for the shareholder. For a business review to be useful it needs instead to complement and supplement the financial statements. This is explained in AB5 as follows:

- In complementing the financial statements, the business review provides useful financial and non-financial information about the business and its performance that is not reported in the financial statements but which, in the directors’ judgement, may be relevant to the members’ evaluation of past results and assessment of future prospects.
- In supplementing the financial statements, the business review provides additional explanations of amounts recorded in the financial statements; and/or explains the conditions and events that shaped the information contained in the financial statements. (AB5.18-19)

Understandability

Clearly information cannot be useful if it is not understandable. In fact, information may even be harmful if it is easily misunderstood by the reader. AB5 highlights the following key matters to pay attention to in order to ensure that the business review is understandable:

- The business review should include only relevant information on material matters – the inclusion of too much information may obscure judgments and will not promote understanding.
- Where additional information is discussed elsewhere in the annual report, or in other reports, cross-referencing to those sources will assist the reader.
- Readers should be able to assess the reliability of information presented – where relevant, directors should explain the source of the information and the degree to which it is objectively supportable.
- The writing style should be clear and readily understandable.
- It should be clear to the reader how any KPIs have been computed and the source of data used in the calculation.

Much of this is common sense if the preparer of the business review keeps in mind the readers’ perspective and has a genuine wish to share information with them. But it can nevertheless be a challenge to find the right balance of compliance and communication when drafting a business review to be included in a statutory annual report. Some additional matters to think about in this regard relating to focus, materiality and linkage are discussed later on in this section. Also, as part of our closer look at the content elements, we give examples of how to present KPIs clearly and how to link information to increase understandability.

Biases must be resisted in the business review – it is part of a statutory document to be given to shareholders

Balanced and neutral

The principle that the business review should be “balanced and neutral, dealing even handedly with both good and bad aspects” is often easier said than done. In any self-assessment, there is a natural tendency to emphasize the successes and gloss over the not-so-flattering aspects of the period or activity under review. This tendency can also be present in marketing communications, intended to boost a company’s or person’s image.




These biases must be resisted in the preparation of the business review given that this is part of a statutory document to be presented to shareholders. As AB5 advises, the directors should ensure that members are not misled as a result of excessive focus on favourable

information or the omission of any significant information on unfavourable aspects (AB5.25). This will require companies to be transparent by discussing their weaknesses and challenges, as well as their successes, to a consistent level of materiality.

As AB5 points out, one way to fight the biases is to present KPIs and other information consistently from one year to the next – this approach works well provided that relevant and meaningful KPIs have been chosen in the first place. This is discussed further on pages 14 to 20.

Another way that a company may present a “balanced and neutral” view of the business is to provide a summary of the status of key projects/initiatives during the year compared to strategies or previously discussed plans – this is illustrated in the following example, as well as in the examples on pages 9 and 20.

Example of assessing performance against strategy:

Business Strategy	How we did in 2015	
Invest in online growth Invest in growth from our online business, through improving UK services		Progress: We have added Same-Day, Evening, Sunday and Next-Day to Store delivery services to UK customers to respond to customer demand for faster and more predictable deliveries. In the UK market our average sales per active customer ¹ per month increased by 10.3% in the first 6 months after the launch, with an increase of 12.7% in the frequency of on-line ordering by these active customers which can be linked to the improved delivery services. These measures are approximately 10% more than we had expected for this first launch period and customer feedback has continued to be positive.
People Improve staff engagement, to realise the value to our business of a committed workforce		Progress: We measure staff engagement using a range of indicators including staff turnover, sick days, customer feedback and the use of an independent survey company which benchmarks our employees’ responses on a 6-monthly survey against a range of other comparable companies. During 2015 improvements in these measures were noted and fell within the ranges set for this year in line with our five-year people strategy. In particular, our key indicator of engagement, being the annualized rate of staff turnover, improved from 18% in 2014 to 15% in 2015 for staff that had completed at least one year with the group.
Supply chain management Control our logistics from source to store, allowing us to monitor our inventory more efficiently		Progress: The opening of our new European distribution centre has been delayed until Q2 2016, 6 months behind schedule. The centre is a core part of our plan to reshape our warehouse network and should enable us to reduce overall inventory levels and wastage while maintaining the same time-interval between order placement and shelf deployment at our stores. However, completion of the construction has been delayed by the extreme weather conditions experienced in the early onset of winter in 2015. We estimate that the disruptions to the construction schedule caused by the weather have increased the overall costs of the construction by 15%. The structure is now at an advanced stage and we anticipate completion no later than May 2016.

¹A customer is considered “active” once a 2nd order is placed online within 4 weeks of the 1st order, and is considered “inactive” if the customer has not placed an order in the last 4 weeks.

 **Target achieved in 2015**
 **On plan**
 **Target missed in 2015**

The significance of information will depend to a large extent on how far it helps shareholders form their own views of future business prospects

Report focus

The business review forms part of the statutory reporting by directors to the members of the company. The members’ needs are therefore paramount when considering what information should be included in the business review.

Boards may have a general picture of shareholder priorities through their ongoing shareholder dialogue. However, it is important that, when considering what to include in the business review, they do not merely respond to past levels of interest. The emphasis of the guidance in AB5 is on the business telling its story – directors are responsible for identifying and sharing information that they consider ought to be relevant to shareholders’ decisions.

In applying this guidance, the directors will generally need to consider whether the information in question is relevant to either:

- 1) Shareholders’ voting decisions; or
- 2) Shareholders’ investment decisions (i.e. buy / sell / hold).

It is also important to recognise that whilst many financial reporting disclosures are necessarily focused on historical events, shareholders will generally view business value from the perspective of its future earnings prospects. They will need information that can help them assess this.

That does not mean that directors need to provide projections. However, the usefulness of information in the business review will depend to a large extent on how far it helps shareholders form their own views of future business prospects.

For example, to assess past success and the potential earnings impact of a strategy centred on developing a particular segment of the customer base, shareholders would need performance information which has a similar degree of segmentation. If the reported performance measures are in aggregate, or segmented in a different way, then the shareholders’ needs are not being met.

Materiality

The application of materiality is particularly important in a principles-based framework. The key is to find a balance between providing enough information for the review to be useful, but not overwhelming the reader with excessive detail, which obscures the key messages.

The guidance in AB5 reminds us that when judging whether information is material, directors should consider both qualitative and quantitative aspects in the particular circumstances. Factors to be taken into account include the legality, sensitivity, normality and potential consequences of a transaction or event and the parties involved. For example, the monetary amount at which an item becomes material may be significantly lower for fines and penalties, than it would for “business as usual” items.

In practice, directors of listed companies should be familiar with making these judgment calls, whether in respect of announcements of price sensitive information or more generally in the preparation of annual reports and other investor communications. Specifically in respect of the business review, materiality links with the shareholder focus: the aim is to provide shareholders with relevant information that is useful for making resource allocation decisions and assessing the directors’ stewardship.

When can material information be excluded?

There is no general exemption for information which the directors may consider to be commercially sensitive. However, Schedule 5 allows a company not to disclose any information about “impending developments or matters in the course of negotiation”, if such disclosure would, in the directors’ opinion, be “seriously prejudicial” to the company’s (or group’s) interests.

The safe harbours set out in Section 307D of the Securities and Futures Ordinance (Cap. 571) which permit a company to withhold disclosure of inside information under specified circumstances, have a similar objective. However, Section 307D sets out more detailed requirements.

It is not yet clear how these two pieces of legislation will work together in practice. Therefore we advise directors to obtain legal advice in this regard.

Context and linkage

In order for information to be useful it needs to have context. Consider this simple piece of factual information: sales grew by 20% in 2014. From this the shareholder learns nothing they couldn't already work out from looking at the income statement and they are unable to judge whether this is a good or poor performance from this statistic alone.

The informational value of this statistic is instantly increased if the reader is given any one or more of the following pieces of contextual information:

- How much did sales grow in each of the last few years?
- What was the goal for this year?
- How well did our competitors do?
- Do we expect this trend to continue next year?

Linking information is a key way to provide this context and provide a more holistic picture, for example:

- Linking information between the content elements within the business review
- Linking between the business review and other parts of the annual report
- Linking over time with information contained in previous business reviews

Linkage between the content elements

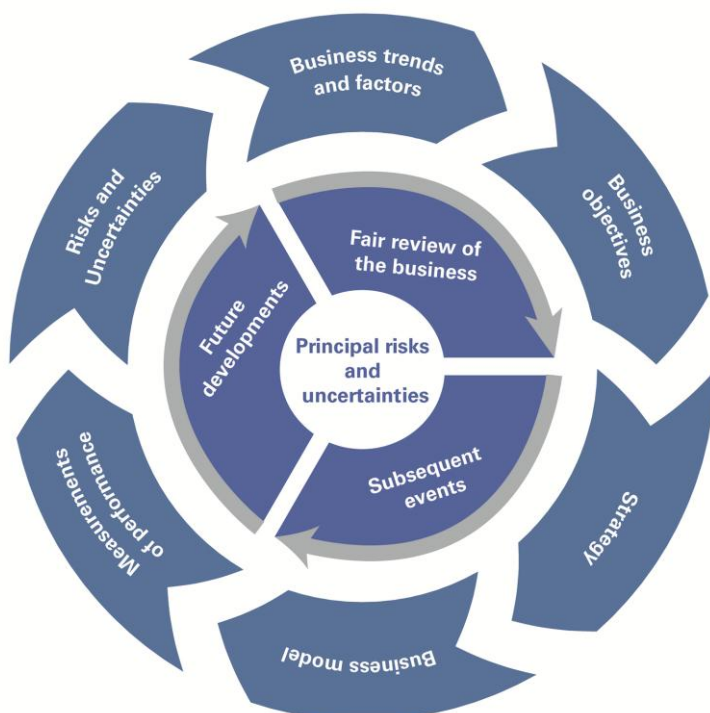
As a reminder: Schedule 5 states that a business review should consist of the following four broad content elements:

- 1) Fair review of the business;
- 2) Subsequent events;
- 3) Likely future developments; and
- 4) Principal risks and uncertainties.

If issues raised in relation to one content element are followed up in the other elements, this can provide readers with an objective analysis of how the business is making progress in managing each matter. This may be particularly relevant for the discussions of risks and future developments, for example as follows:

Example – linkage of content elements:

Alpha Ltd highlights in its business model description that 40% of its revenues are currently derived from maintenance and support provided to its existing user base. Alpha's discussion of business trends identifies that specialist support providers are increasingly competing for this revenue stream. This discussion links to Alpha's strategy which explains that it has responded by promoting whole-life service contracts. Although this is currently a small part of overall revenue, KPIs are provided to show the proportion of renewals switching to this alternative structure as useful information when assessing future prospects.



Linking information – within the business review, within the annual report and over time – is a key way to provide context and a more holistic picture

Linkage between the business review and other parts of the annual report or other reports

To support an annual report that is concise, it is likely that companies will see a greater need for linking various reports or aspects within the annual report to avoid unnecessary repetition.

Better linkage will also drive consistency within the annual report. In particular, providing reconciliations or explaining adjustments can help to demonstrate that any adjusted information in the directors’ report serves to complement and supplement the financial statements, rather than being “inconsistent” with those financial statements.

This distinction is important as the company's auditor has a new duty under section 406(2) of the Companies Ordinance to consider whether the information in a directors' report for a financial year is consistent with the financial statements for that year. If the auditor considers that the directors’ report is not consistent, then the auditor is required to state that opinion in the auditor's report and may bring that opinion to the members' attention at a general meeting.

Linkage over time

Providing comparative information is a widely accepted practice in annual reports. However, this information is only useful if it enables users to draw meaningful conclusions about trends. Its ability to do this can be improved by:

- **Identifying meaningful data points:** for long term, steady businesses historical information covering 5 or even 10 years at annual intervals may be useful, but for fast changing businesses it may be more informative to show data points every half year, or even more frequently than that, over the most recent past.
- **Complementing the data by explaining the extent to which it is in fact comparable:** if circumstances have changed over the data period, then users need additional contextual information to minimize the risk of misinterpreting the data. For example, it can be useful to know whether growth in revenue is volume or price driven, whether organic or from acquisitions, or comes simply from changes in accounting policies. The focus should be on providing a mixture of data and balanced and neutral commentary, rather than simply data in isolation.

Example of a transparent way to link achievements during the year to short and longer term strategies:

What we said we would do in 2015	What we did in 2015	What we plan to do in 2016	Plans beyond 2016
Reduce customer churn rates by 5% <i>*Customer churn rates are measured as the percentage of customers who do not renew their contracts over the total number of customers under that contract type</i>	Our customer churn rates decreased by 8% during the year which we believe is the result of the launch of our new bundling packages which provide consumers with greater flexibility	We plan to launch new smart phone plans in 2016. These plans will offer increased data allowance and unlimited voice and SMS across all Asian markets and some selected non-Asian markets	We aim to simplify our pricing plans, to give clear visibility to our customers. We also plan to invest \$ 50 million in our online platform, over the next 5 years, in order to acquire new, and retain existing, customers
Consolidate our network engineering teams across borders in order to maximise cost efficiency	We were unable to complete the consolidation of our network engineering teams on time, as we have been faced with some unexpected regulatory pressures.	We plan to complete the consolidation of our network engineering teams by the 2 nd quarter of 2016	Compared to our cost base in 2015, we aim to reduce our operating costs by 20% by 2020 as a result of the consolidation of our networking engineering team, by unifying our IT management and simplifying our business model across markets

Planning ahead

The traditional approach to annual report preparation has entailed allocating responsibility for each element of the report to separate parts of the organisation. It may be time to rethink this approach. Presenting a consistent business-wide story will require a more joined-up approach and advance planning. Approaches could include one or more of the following actions:

- 1) Establish a cross-functional team to develop the report on an integrated basis. Ensure that this team is chaired by someone who is sufficiently senior to cut across any existing reporting silos.
- 2) Develop the “front-end” of the report from the business model by focusing on a ground-up assessment of the features that are most significant to understanding current performance and assessing future prospects. Ensure that the reporting team has the right operational and business strategy representation to do this effectively.
- 3) Regularly adapt the content and structure of the report to reflect evolving business circumstances and strategies. As well as reporting to shareholders on how issues identified previously have developed in the year, continually re-assess the content to ensure that sufficient prominence is given to the most important current and emerging issues.
- 4) Recognize that it may take time to develop meaningful shareholder-focused performance measures. If data for a meaningful measure isn’t available, put a plan in place to address this for future periods. For example, this may include working with industry survey organizations to obtain benchmarking information, tracking social media over an extended period to pick up on trends, or arranging for employee or customer satisfaction surveys to be conducted at regular intervals.

All of the above will contribute to a better quality business review and annual report. But also, perhaps more significantly, if done well these activities may also contribute to better quality information and focus within the organization on setting strategy and measuring progress against clearly defined goals and objectives. If the above are not already well established practices in your organization, now may be a good time to change.

Questions to ask

As we stressed earlier, each business review should be unique and authentic – shareholders will be unimpressed and skeptical at any signs that the business review is boilerplate or otherwise lacking in credibility.

In order to achieve this quality outcome, those involved in pulling together the business review need to challenge themselves continually:

- at the outset, think about what you are aiming to achieve and plan how you are going to get there;
- during the drafting stage, focus on fact-finding across the full scope of the topics to be covered and make sure there is clear understanding of the matters that need to be discussed; and
- at the final review stage, reflect on how well the review paints a picture of the business that the board recognizes, that is useful to shareholders and fully satisfies the requirements.

To help with meeting these challenges, we have included throughout the remainder of this guide some suggested questions to ask – these have been collected together in Appendix 3 for easy reference. These questions may be particularly useful to think about during the drafting and final review stages. To kick off, here are some questions for the planning stage:



Key questions to ask when planning ahead:

- Have we put together a team with enough insight into top management’s strategy to ensure the review is useful and authentic?
 - Has the annual report compared well in the past with information being communicated through other channels (such as investor presentations) or could it be improved this year to reduce gaps?
 - How well does last year’s MD&A stand up against AB5’s guiding principles? For example:
 - How well did it complement and supplement the financial statements?
 - How far did management go to provide balanced and neutral information?
 - How easy was it to understand?Could more be done this year on any of these aspects to improve the usefulness for shareholders?
 - What are the new topics that need to be discussed in this year’s review, compared to last year’s MD&A? Where is the information for these topics and will we be able to find comparative information as well?
-

The content elements

1. Setting the scene and explaining the year under review

The requirement to give “a fair review of the business” deals with companies’ (or groups’) assessments of how they have performed during the year and their financial position at the end of it. The review should be in the context of the business objectives, strategies and business model and provide relevant information necessary for an understanding of the development, performance or position of the business.

In practice we expect this first content element to form the majority of the business review. AB5.31 identifies the following 4 topics to be covered in this “fair review of the business”:

- 1) A description of the business and the external environment in which it operates
- 2) An analysis of the performance of the reporting entity for the year under review and the financial position of the reporting entity as at the end of that period using financial KPIs which complement or supplement the financial statements
- 3) A discussion on the reporting entity's environmental policies and performance and the reporting entity's compliance with the relevant laws and regulations that have a significant impact on the entity
- 4) An account of the reporting entity's key relationships with its employees, customers and suppliers and others that have a significant impact on the entity and on which the entity's success depends

The first of these topics sets the scene for the rest of the business review. Topics 2, 3 and 4 then fill out the “fair review” of the business with information that demonstrates compliance with Schedule 5.2’s requirement to give this information “to the extent necessary for an understanding of the development, performance or position of the company’s [or group’s] business”.

Taken together, these topics overlap with the general requirement in App 16.32 to include a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position. There are also specific disclosure items required or recommended under Appendix 16 which we would expect to see included in this part of the business review. These are highlighted in the following discussion using the abbreviation “App 16”.

The remainder of this section of our guide looks at each of these 4 topics in turn:

1) Description of the business and the external environment in which it operates

The business review should provide “a description of the business and the external environment in which the reporting entity operates, as context for the directors’ discussion and analysis” (AB5.31(a))

A clear description of the objectives, strategy and business model can help the review as a whole to stay focused on the most significant drivers of business value. It can also provide quantitative and qualitative context to help shareholders assess the impact of matters on the business as they arise.

A well written business model description should also give shareholders greater confidence that the rest of the review addresses all material aspects of the business.

Good business model and strategy descriptions provide the foundation for a good business review

Basic information: factual description of the business and its environment

This description provides a foundation for the rest of the review, so it is important that the picture painted is one that is recognised by the board, and consistent with the operational realities of the business.

In a well written business review such a description would provide an understanding of:

- the industry or industries in which the company or group operates;
- its main products/services;
- its main categories of customers;
- its main business processes;
- its main distribution methods; and
- the structure of the business and its economic model, including an overview of the main operating facilities and their location. (AB5.32).

It would also include a description of the resources that are significant to the entity’s operations, consistent with the recommended disclosure requirement in App 16.52(iii) to disclose the principal drivers of performance.

Examples of key resources used in the business could include:

- corporate reputation and brand strength,
- natural resources,
- assembled workforce,

- distribution or supply chain networks,
- research and development projects,
- intellectual capital, licenses, patents, copyrights and trademarks. (AB5.33).

A transparent business review would also go further and discuss features of the external environment which are significant to the business’s success. These could include the entity’s major markets and competitive position within those markets, and the significant features of the legal, regulatory, macro-economic and social environment that influence the business.

For example, a reporting entity may disclose the fact that it has significant operations in a certain country currently experiencing difficult economic or political environment, or conversely a country experiencing high growth, either of which circumstances could have a significant impact on the future development and performance of the business.

The discussion of the external environment could extend to the recommended disclosure item set out in App 16.52(iv) relating to trends in the issuer’s industry and business.

It can be difficult to focus this description at the right level of detail. Getting the right people involved in the drafting process can help here. In particular, the involvement of segment management can help keep the description grounded in the operational realities of the business.

Setting out clearly the objectives and strategies of the business, measuring performance against them and giving some indication about future plans provides transparency which investors and analysts would appreciate

Additional information: objectives, strategies and competitive advantages

In a well written business review, the description of the business helps shareholders to focus on those aspects of the company’s (or group’s) business model that differentiate it from others in the sector.

The difficulty is: where to draw the line between (a) helping shareholders understand the business and (b) revealing too much sensitive information which could erode the entity’s competitive advantage? This is an important matter for directors to consider and decide for themselves. Reluctance to reveal too much is understandable. However, setting out clearly the objectives and strategies of the business, measuring performance against them and giving some indication about future plans may provide transparency which investors and analysts would appreciate.

In this regard, AB5.34 states that the description of the business “may” refer to the objectives of the business to generate or preserve value over the longer term. These objectives may be defined in terms of financial or non-financial performance measures. This guidance is consistent with the recommended disclosure requirement in App 16.52(iii) to disclose a discussion of the issuer’s purpose and corporate strategy.

We sometimes see business objectives described in generic terms – for example ‘to generate shareholder returns’, or ‘to increase customer satisfaction’. Descriptions of this nature convey limited information to shareholders – few businesses would disagree with these.

A more helpful approach is to describe the board’s objectives for the business itself – for example, it may be to become the market leader in a specific segment, or to establish technological leadership in a particular sector. Such specific identification of the board’s objectives can be key to producing a consistent and focused business review.

 **Key questions to ask about ...**

Factual information about the business:

- Does the description of the business align with the board’s view of the significant business value drivers?
- Where different segments of the business have different operating characteristics or performance drivers, is this clear enough?
- Has sufficient detail been provided about the business so that shareholders can assess the potential impact of matters raised elsewhere in the report?

Any discussion about objectives and strategy:

- Are the stated objectives business-specific? For example, becoming the market leader in a specific segment, rather than generic aims such as maximising shareholder return
 - Does the description of the strategy address the short, medium, and longer term priorities for the business?
 - Is there enough linkage of stated objectives and strategies to the analysis of performance and other content elements?
-

We would expect this section of the business review to be a combination of narrative explanation and a range of well chosen KPIs

2) Analysis of the performance for the year and the financial position at the end of it using KPIs

The business review should provide “an analysis of the performance of the reporting entity for the year under review and the financial position of the reporting entity as at the end of that period using financial KPIs which complement or supplement the financial statements” (AB5.31(b))

The requirement to provide an analysis of how the business has performed during the year and its financial position at the end of the year is consistent with the general requirement in App 16.32 to include a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position.

In this regard, minimum required disclosure items under App 16.32 include commentary on the following:

- The capital structure of the group in terms of the maturity profile of debt and obligation, type of capital instruments used, currency and interest rate structure (App 16.32(2))
- Significant investments held and their performance during the year (App 16.32(4))
- Details of material acquisitions and disposals of subsidiaries, associates and joint ventures in the course of the year (App 16.32(5))
- Segment information – this may cover changes in the industry segment, developments within the segment and their effect on the results of that segment. It may also include changes in the market conditions, new products and services introduced or announced and their impact on the group’s performance and changes in revenue and margins (App 16.32(6)).

In addition, App 16.52 recommends disclosure of the following items:

- An overview of trends in the listed issuer’s industry and business (App 16.52(iv))
- Receipts from and returns to shareholders (App 16.52(vi)).

These requirements are consistent with AB5 which also adds that when discussing how the business has performed during the year, the focus should be on those business segments that are relevant to an understanding of the development and performance of the reporting entity as a whole and the ability of the reporting entity to generate cash to meet known or probable cash requirements and to fund growth (AB5.37).

Consistent with the complementing and supplementing guiding principle, the analysis in the business review should avoid simply repeating or summarizing information which can be found in the financial statements.

Instead, we would expect this section of the business review to be a combination of narrative explanation of key features of the performance, financial position and cash flows in the financial year, together with a range of well chosen financial and non-financial KPIs which demonstrate the trends in the performance and key ratios over a period of time.

For example, this discussion would refer to changes in market conditions which have had a significant impact on the development and performance of the reporting entity during the period, or the introduction of new products and services which are significant to the future prospects of the business. In addition, the business review should draw attention to material changes in accounting policies which have resulted in significant changes in the measurement of KPIs during the financial year under review due to changes in input data.

When drafting this part of the business review, bear in mind the overall considerations discussed on pages 4 to 10 of this guide relating to the guiding principles in AB5, focus, materiality, context and linkage.

These points apply not only to the narrative discussion in the fair review content element. They also apply specifically to the KPIs selected and presented as part of that review – as explained and illustrated in the following discussion:

The KPIs disclosed should be those that are effective in measuring delivery of strategies and managing the business

Using KPIs to explain performance

Even if this had not been an explicit requirement of Schedule 5, we would normally expect a company to include financial, and where appropriate, non-financial KPIs in its business review in order to provide clear and useful information to the user. Looking at the drivers of performance identified in the business model description that are critical to the future operation of the business may help to focus the performance measures on the most relevant matters. Some areas where KPIs may have a role to play include:

- Assessing progress against the business’s strategy and objectives
- Measuring the financial performance and position of the business during the year under review
- Providing objective measures for the discussion on compliance with environmental policies, laws or regulations, or relationships with customers, suppliers, employees or significant others
- Monitoring principal risks and uncertainties and progress made in managing those risks
- Quantifying trends or factors affecting the future of the business where practicable.

Specifically, App 16.32(10) requires a listed issuer to disclose its gearing ratio and App 16.52(i) and (ii) recommend disclosure of efficiency indicators (e.g. return on equity, working capital ratios) and industry specific ratios, if any, for the last five financial years.

In addition to compliance, KPIs can be used to demonstrate how management is working to develop and protect shareholder value over an extended period. Well chosen KPIs may therefore be able to help reduce the risk of excessive focus by investors and analysts on short-term earnings measures by giving them more meaningful measures to think about.

Despite this potential reward, a recent KPMG International survey highlighted the gap between the key drivers of business value, and the performance measures being reported (see table below). The survey also highlighted that many of the non-financial measures being provided were derived from existing statutory or other disclosure requirements instead of being selected for their relevance to investors.

Companies reporting on key business value drivers

	identified as a top three value driver ⁽¹⁾	companies providing a related KPI
Operational	66%	21%
Customer focus	56%	7%
Supply chain	42%	8%
Brand & reputation	42%	2%

Note: (1) Audit committee members identifying the area as one of their top three drivers of business value.

Source: The KPMG survey of business reporting: KPMG International, 2014.

These results indicate that for many companies there is considerable room for improvement. Now may be a good time for directors to take a fresh look at the performance measures currently being reported and to re-evaluate whether they continue to provide relevant information to shareholders.

KPIs selected should be relevant, rather than focusing only on those that show the business in a favourable light

Financial vs non-financial KPIs

Schedule 5 specifically refers to an analysis using “financial” KPIs. These typically use data which can be found in the financial statements, or can be reconciled to the financial statements. For example, the gearing ratio required by App 16.32(10) would generally be calculated using information from the statement of financial position.

Financial KPIs can also be derived from a mixture of both financial and non-financial data – one obvious example being sales or rental income per square foot. Other KPIs could be entirely non-financial, such as carbon dioxide emissions or measures of customer or employee satisfaction.

Such mixed or non-financial measures complement the financial statements and, if chosen well, are useful in communicating information about the performance and future prospects of the business. For example, employee turnover, % of qualified staff or spend per employee on training could be useful measures for businesses highly dependent on a trained workforce, and might usefully be disclosed as part of the account of the group’s key relationships with its employees. More examples can be found in the implementation guidance attached to AB5 – for easy reference an index of these examples is included as Appendix 2 to this guide.

Selecting balanced and neutral KPIs

Care should be taken to select KPIs which are relevant to the development, performance or position of the reporting entity’s business, rather than focusing only on those that show the business in a favourable light.

As discussed earlier, one way to fight the biases is to present KPIs and other information consistently from one year to the next – this approach works well provided that relevant and meaningful KPIs have been chosen in the first place.

Another way is to compare KPIs to forward-looking targets which had been set in previous periods. This provides useful information provided that appropriate targets were chosen previously.

Well chosen targets will be those that will be a good indicator of the success of management’s efforts in directing the business if met. For example, in a highly competitive environment where the group is more of a price-taker, rather than a price-maker, meaningful forward-looking targets might focus on volume measures (such as occupancy rates or cubic metres shipped) rather than on monetary targets, or focus on net margins rather than gross revenues.

Meaningful targets might also be relative, rather than absolute, such as maintaining market share or above average returns compared to industry peers.

In other words, for a target to be meaningful, meeting or getting close to achieving the target needs to be something within management’s influence and intention, at least at the time that the target was set. This helps shareholders see the business through the eyes of the directors and provides a strong basis for an assessment of subsequent performance.

Presenting KPIs in a meaningful way

To maximize the usefulness of KPIs, it is important that they are presented in a way that is consistent with the “understandability” and “balanced and neutral” guiding principles.

These principles are inter-linked: in a well written business review, KPIs are presented in a way that enhances their informational value and conveys the key messages efficiently. Key matters to consider when judging the quality of the presentation are as follows:

- Will the reader correctly understand how the KPI has been computed?
- Will the reader correctly understand the relevance of the KPI to the topic under discussion?
- Is there sufficient contextual information to enable the reader to interpret the KPI and draw conclusions from it?
- How straightforward will it be for the reader to reach these understandings? Could a less diligent reader be misled by the presentation?

In a well written business review, KPIs are presented in a way that enhances their informational value and conveys the key messages efficiently

For example, understandability is increased when the basis of computation and, if relevant, the source of data is explained or reconciled to the financial statements – for example, the basis on which the gearing ratio is computed is a required disclosure under App 16.32(10) and the basis of computation of efficiency indicators and industry specific ratios is a recommended item under App 16.52(i) and (ii).

The informational value is also improved if KPIs are presented over an extended period of time, particularly if meaningful data points are chosen and the information is complemented by narrative explanation. If the method of calculation has been changed compared to previous

years, this should also be highlighted.

How the KPIs are presented visually is also important. They can, of course, be presented in a simple narrative format. However, they can be made far more impactful using other formats, so long as that format conveys the information in an unbiased way.

For example, one way to present KPIs may be in a tabular format. Tabular presentations of performance data can reduce the risk that key data is ‘lost’ in the narrative discussion and can include information which explains why the business is using a particular indicator. This is shown in the following example of typical revenue KPIs used in the hotel industry:

Example of KPIs presented in a tabular format:

	Occupancy Rates	Average daily rate (ADR)	Revenue per available room (RevPAR)
Measurement	Total number of rooms sold divided by Total number of rooms available	Total room revenue divided by Total number of rooms sold	Total room revenue divided by Total number of available rooms
Significance	Occupancy measures the utilization of our hotels’ capacity. It reflects both supply and demand and therefore it is important for us to monitor our occupancy in order to gain a sustainable competitive advantage. Occupancy levels also help us determine achievable ADR levels as demand for hotel rooms increases or decreases.	ADR measures average room price attained by a hotel and ADR trends provide useful information concerning the pricing environment and the nature of the customer base of a hotel or group of hotels. ADR is a commonly used performance measure in the industry, and we use ADR to assess pricing levels that we are able to generate by type of customer, as changes in rates have a different effect on overall revenues and incremental profitability than changes in occupancy.	This KPI is one of the most important of all ratios because the measure incorporates both room rates and occupancy. It provides a convenient snapshot of how well our group is filling its rooms, as well as how much it is able to charge.
	Occupancy rates (%) + 4.78% 2015 : 70.2% (2014: 67%)	ADR (HK\$) - 10.77% 2015 : 2,501 (2014: 2,803)	RevPAR (HK\$) - 6.50% 2015 : 1,756 (2014: 1,878)

Another way to present this information may be through the use of graphs, charts and other data graphics, as illustrated in the examples below. This approach can be useful for any measures where the trend in the measure or the relative position as a proportion of the business or compared to benchmarks is particularly meaningful and it can be used instead of, or in addition to, traditional

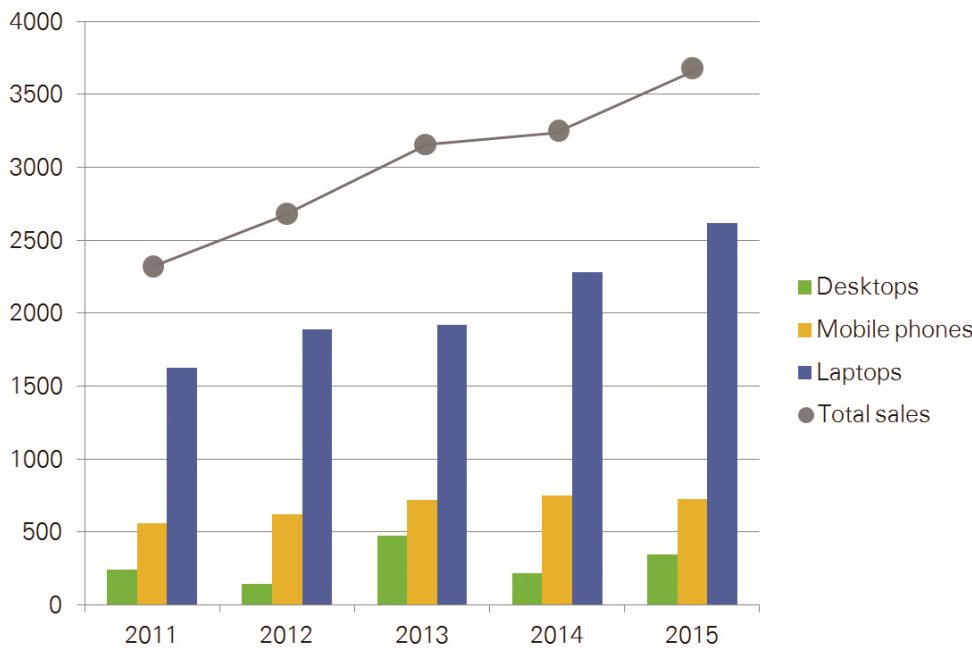
numerical tables of absolute values.

In each of the examples illustrated below we would expect the graph or chart to be accompanied by narrative discussion highlighting the key points shown in the data and giving additional contextual information which explains the performance or position shown.

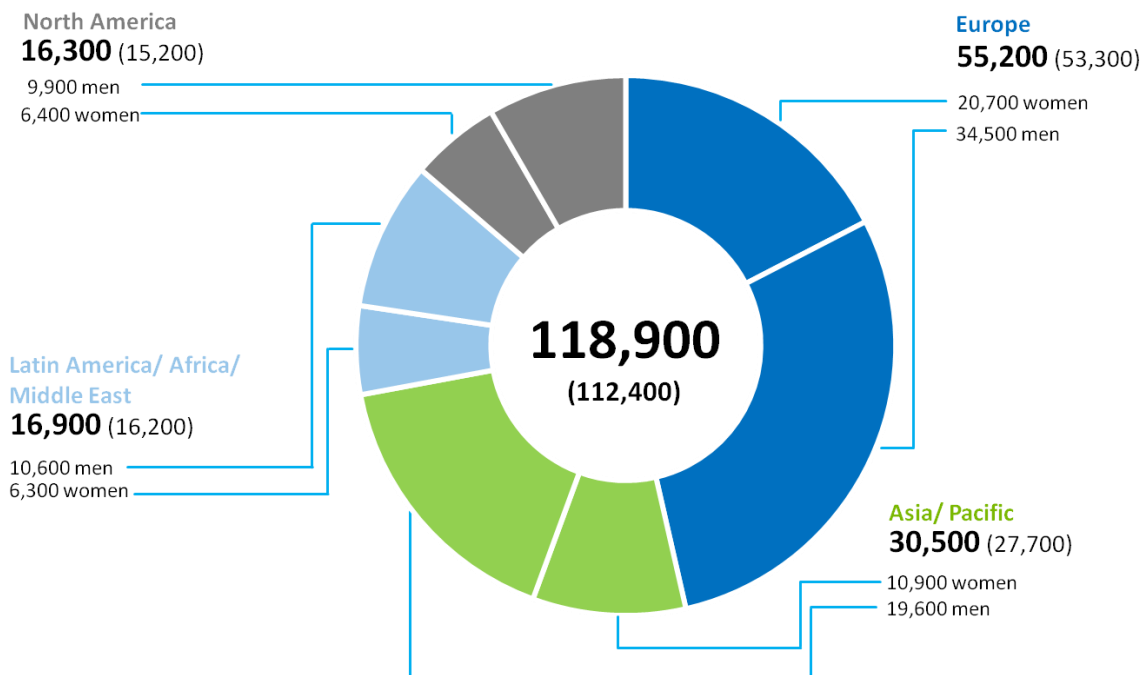
Examples of KPIs presented graphically:

(1) Example of clustered bar chart showing absolute monetary amounts per product category over time, together with an indication of the trend in the total amount of sales over that period

(\$million)



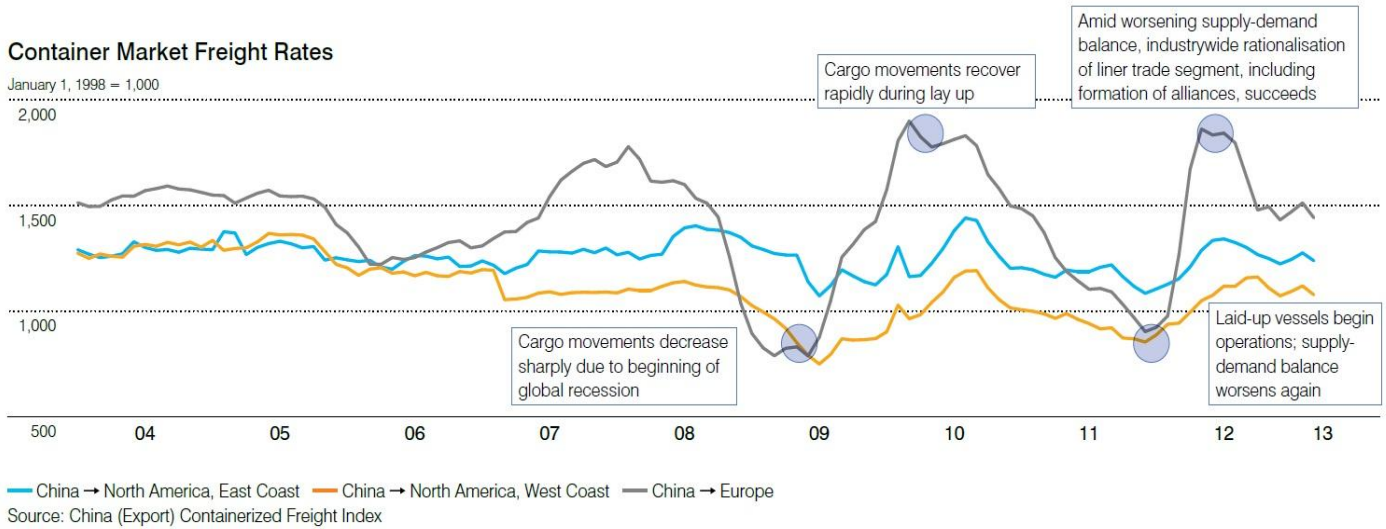
(2) Example of analyses of employee data as a proportion of total workforce with comparatives and footnote explaining change in basis of calculation



Values rounded to the nearest hundred and represent average employees during 2015 (2014 figures are shown in brackets). As of 2015 interns are no longer accounted for in the data. 2014 figures have been restated for this change in composition.

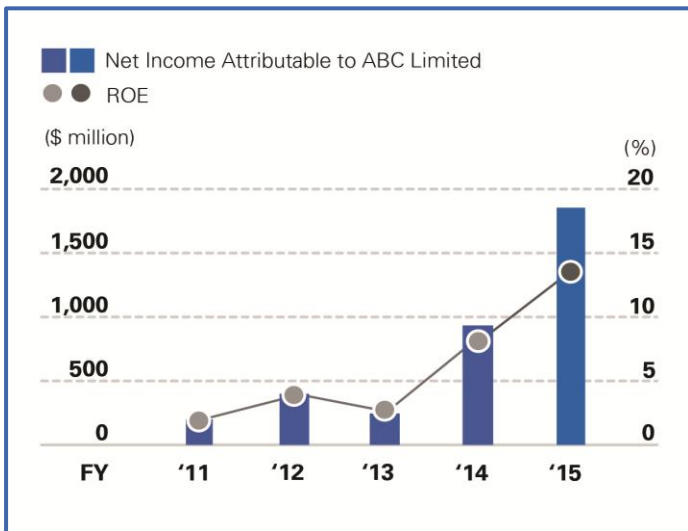
A practical guide to the business review

(3) Example of line chart using external data and annotated for key events

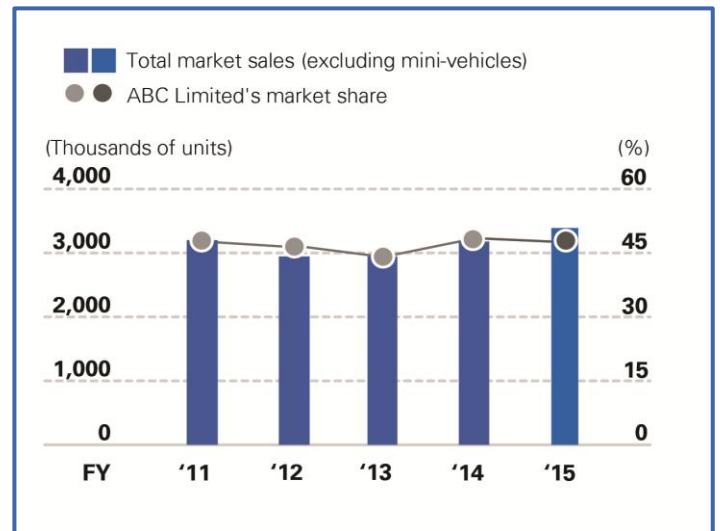


(4) Examples of bar charts using dual vertical axes to compare and contrast two data sets

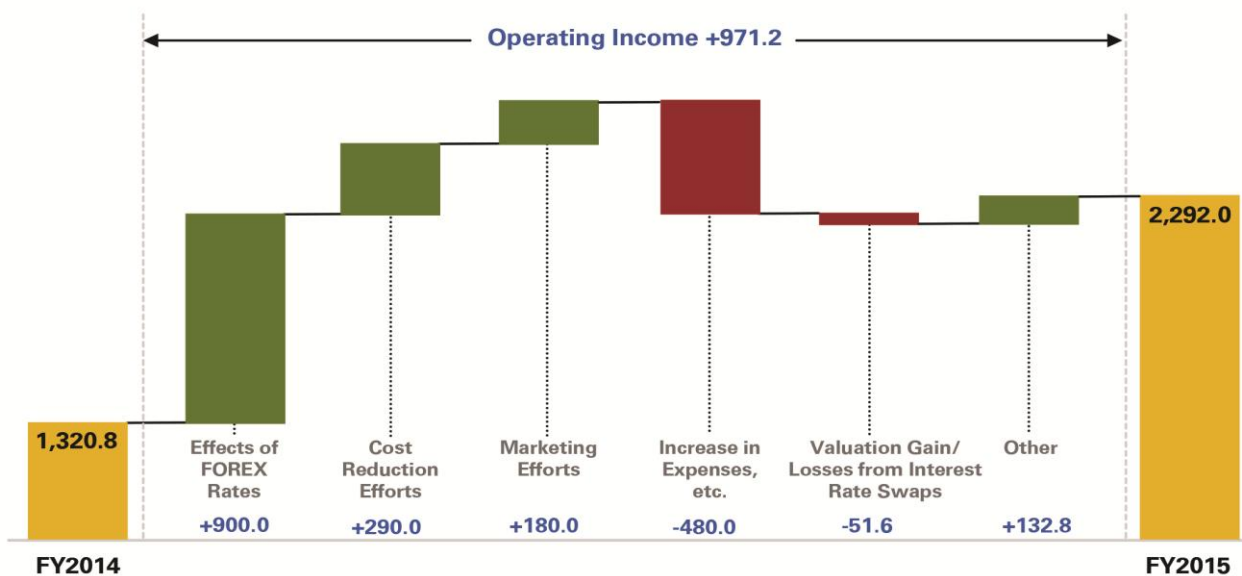
(a) Net income and return on equity



(b) Volume sales and market share



(5) Example of graphical reconciliation from prior year operating income to current year absolute amounts



Linking KPIs with strategies and future targets

Companies may also consider making their business objectives and strategies measurable by linking them to relevant KPIs. This can be achieved either by cross-referencing to another section in the report where a more detailed analysis of the KPIs can be found, or by describing the KPIs – and how they help measure progress against a specific strategic objective – in the discussion of the business objectives itself.

To elaborate on this, a company may also refer to ongoing targets for each KPI in order to demonstrate how future success will be measured relative to its current performance. The assessment of likely future developments is discussed in more detail in Section 3 of this guide.

An example of how KPIs could be discussed in the context of strategies and targets is provided below:

Key questions to ask about KPIs:

- Are the KPIs selected for disclosure consistent with those used by the board to assess the business? For example, do the measures address progress in managing the critical resources on which the business depends?
- Do the measures address the specific part of the business affected by the issue, rather than being provided on an aggregate basis for the business as a whole?
- Are the measures selected and presented in accordance with the “balanced and neutral” guiding principle? For example, are they presented consistently over time to show key trends?
- Are the measures presented in a way which is understandable? For example, is the basis of computation and the source of data clear and have they been given enough context by being linked to other information, such as strategy and future plans?

Example of how to link KPIs to future priorities of the business:

Strategic priority	Key performance indicator	Target for 2015	Actual performance			Performance for 2015	Target for 2016
			2015	2014	2013		
Loyal and satisfied customers To increase customer satisfaction and build long-lasting relationships.	Customer satisfaction survey “Overall satisfaction” score (being the proportion of extremely satisfied customers across current account and savings) from an annual independent survey of approximately 5,000 customers.	58% Target exceeded	60%	55%	48%	Since the roll out of a new customer-service based training programme in 2013 we have seen a significant improvement in our customer satisfaction score, reducing the gap between us and the top 3 peers.	To be one of the top 3 in peer group
			(Average of top 3 peers)				
			(62%)	(62%)	(60%)		
Consistent profitability and a strong balance sheet To focus on cost discipline and achieve operating efficiencies in order to maintain the capacity to invest in the future.	Loan loss rate Defined as total annualized loan impairment divided by gross loans and advances to customers and banks held at amortised cost at the balance sheet date	65 bps Target missed	72 bps	70 bps	77 bps	We saw higher levels of write-offs in the home loans recovery book and the impact of one large name in the commercial property portfolio. Further discussion of the performance of our loan portfolio can be found on pages [•] to [•].	68 bps
	Cost-to-income ratio Defined as total operating expenses, excluding provisions and charges, divided by total operating income.	50% Target met	50%	51%	54%	We remained focused on cost discipline as we managed higher operational and regulatory costs while continuing to invest significantly in the business. Cost increases were offset by a continued improvement in net interest income.	48%

Take care to focus on these matters in the business review only to the extent that is relevant and material to the shareholders’ assessment of the business

3) Discussion on environmental policies, compliance with laws and regulations and 4) An account of key relationships

To the extent necessary for an understanding of the development, performance or position of the reporting entity’s business, the business review should include:

- *a discussion on the company’s (or group’s) environmental policies and performance and compliance with the relevant laws and regulations that have a significant impact on the company (or group) (Sch 5.2(b)); and*
- *an account of key relationships with employees, customers and suppliers and others that have a significant impact on the company (or group) and on which its success depends (Sch 5.2(c)).*

Previously⁴ App 16.52 included the following recommended commentary items:

- “a discussion on the listed issuer’s environmental policies and performance, including compliance with relevant laws and regulations”; and
- “an account of the listed issuer’s key relationships with employees, customers, suppliers and others, on which its success depends”.

Therefore, for some listed issuers, these requirements in Schedule 5 will not be new. However, we would encourage all listed issuers to revisit the content and structure of their reporting to ensure it is sufficient for the purposes of Schedule 5.

Schedule 5 requires a discussion of these matters “to the extent necessary for an understanding of the development, performance or position of the company’s [or group’s] business”. It also specifically requires that directors identify those laws and regulations and key relationships that “have a significant impact on the company” (or group) and, in the case of relationships, “on

which the company’s [or group’s] success depends”.

Care should therefore be taken to focus on these matters in the business review only to the extent that is relevant and material to the shareholders’ assessment of the business’s performance and future prospects. If the directors wish to include more detail on these matters, e.g. in accordance with The Environmental, Social and Governance Reporting Guide (Appendix 27 to the MBLR)³, then it is advisable to consider developing separate reports to which the business review can cross-refer.

Set out below are some examples of topics that may be covered in the business review to satisfy Schedule 5’s requirements. To ensure that the business review remains concise, this analysis can be enhanced by the inclusion of some relevant KPIs as illustrated on the previous pages of this guide and in the discussion below.

Discussion on environmental policies and compliance with relevant laws and regulations

It is important to note that the scope of this disclosure requirement is not just limited to typical “green” issues. In addition to a discussion on policies and performance on environmental issues, Schedule 5 requires that directors identify those laws and regulations that “have a significant impact on the company” (or group). Examples of topics to be covered in this discussion could include:

- environmental issues such as greenhouse gas emissions, management of hazardous wastes and efficient use of scarce resources;
- relevant laws and regulations on providing a safe working environment;
- relevant standards, laws and regulations on health and safety of products and services provided to customers, compensation for defective products/services and/or data privacy; and

³ The Environmental, Social and Governance Reporting Guide was issued by the HKEx as an Appendix to the Main Board Listing Rules (Appendix 27). According to App 16.53, issuers are encouraged to include the information set out in Appendix 27 in the annual report regarding the same period covered in the annual report or as a separate report. The Note to this paragraph states that where the information is included in a separate report, an issuer is free to report on any period but should consistently report on the same period so that the information can be comparable. However, the Exchange encourages an issuer to report regarding the same period as in the annual report.

⁴ These recommended specific items were deleted from App 16.52 in the February 2015 amendments to the Listing Rules to avoid duplication with the requirements of Schedule 5.

- other legislation, such as the US’s Foreign Account Tax Compliance Act, anti-money laundering legislation or sanctions against certain regimes, all of which impose obligations on the company to ensure that it (or its group) refrains from acting in a manner contrary to public policy.

For example, one company said the following in their annual report about the passenger rights legislation facing the airline industry:

“... European airlines, including our own, have also become subject to air passenger rights legislation whereby airlines may be required to pay compensation to passengers whose flights are delayed more than three hours. Since its introduction, this legislation has cost the Group £19 million in compensation payments. We are actively engaged in lobbying governments in the interests both of our industry and our customers, and reminding them of the importance of travel and tourism as a source of employment and driver of growth.”

In order to comply with the specific disclosure requirement in Schedule 5, it is not enough simply to state that the group is subject to these laws and regulations – the review needs to go further by discussing the group’s *compliance* with those laws and regulations to the extent necessary for an understanding of the development, performance or position of the business. For example, this might involve:

- discussing the measures and controls put in place to ensure compliance with the relevant laws and regulations;
- discussing the extent to which complying with the relevant laws/regulations has had financial or other consequences for the business (such as increased operating costs from carrying out “know your customer” anti-money laundering checks, or reduced passenger demand, when passengers are subject to additional levies on airline tickets); and
- disclosing if the business has been subject to any significant regulatory action such as fines or other penalties imposed for non-compliance, suspension or closure of any activities or refusal of permission.

Key Relationships

Schedule 5 requires companies to give an account of key relationships with their employees, customers, suppliers and others that have a significant impact on the company/group and on which the company’s/group’s success depends. To comply with this requirement it is necessary to take a broad view in considering the extent to which the actions of stakeholders other than shareholders can affect the company’s or group’s performance and thus its value.

For example, relationships with customers, suppliers, distributors, employees, contractors, lenders, creditors and/or regulators could be important to the business’s success, as could the company’s/group’s broader impact on society and the communities affected by its activities. Strategic alliances with other companies can also affect the performance of the company and its value.

AB5.48 gives the following examples of matters that may be included in the business review in this regard:

- policies on employees’ compensation, recruitment, training and development;
- policies on managing environmental and social risks of distribution and supply chain networks; and
- community involvement and contribution in relation to education, environmental concerns, culture, sport and social responsibilities.

KPIs and other data can be used effectively to anchor an account of a relationship objectively. For example, a retailer disclosed the following as one of its 5 customer-focused strategic KPIs in a recent annual report:

2. New customers choose us

29.1% of new loyal customers

Definition: New loyal customers* as a percentage of last year’s loyal customer base

Commentary: We want to build our loyal customer base so in addition to retaining our existing loyal customers, we want to attract new ones. Our investments in the customer offer are designed to create long-term value for new customers too.

* Loyal customers are defined based on their frequency of spend and average weekly spend.

The relevant KPIs will vary depending on the nature of the relationship. For example, if giving an account of the relationship with employees, relevant KPIs could include staff turnover, % of staff with more than 5 years’ service, lost work day frequency rate etc.

KPIs can be used effectively to anchor an account of a relationship in facts and provide at-a-glance information

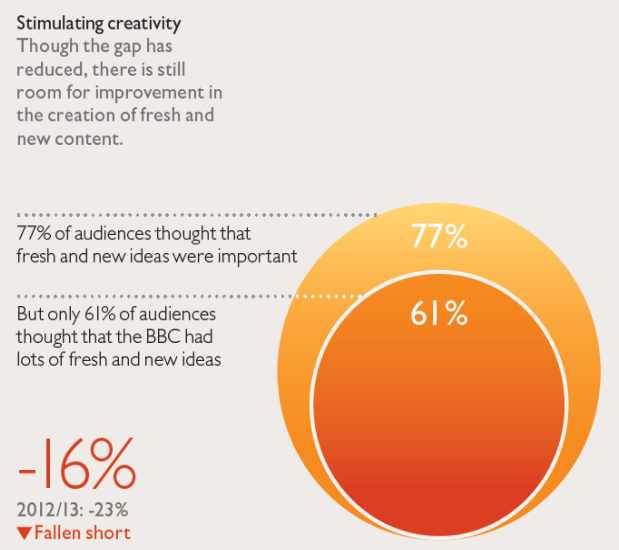
KPIs can also be combined with other measures to provide at-a-glance information which gives insight into the state of a relationship. Examples of charts and graphs with multiple data sets were given earlier in this section and can be used for this purpose. Set out below is a further example from the British Broadcasting Corporation’s (BBC’s) annual report, which demonstrates how a KPI (in their case the answer to the survey question

on whether the BBC had lots of fresh and new ideas) can be compared to information on how important this issue is to their customers in order to assess their own performance. Similar approaches could be used for many other data pairings to complement any narrative account of the state of a relationship. Care, however, needs to be taken to ensure that the pairing is meaningful and that appropriate conclusions are drawn from the data shown, to minimise the risk that the reader is misled.

Extract from the “Understanding audiences” section of the BBC’s 2013/14 annual report:

Stimulating creativity and cultural excellence

An important part of creativity is having fresh and new ideas, and this is something the BBC has been particularly focusing on in recent years. We were therefore pleased to see that this year, for the first time since the survey has been running, the perception that the BBC has plenty of fresh and new ideas increased, from 56% to 61%. However, the BBC’s performance still does not match high audience expectations in this area so, while we welcome the improvement, we will continue to look for more progress. It is likely that some of the improvement is related to the BBC’s newer digital services such as apps, since the main improvement in this score came from 16 to 34-year-olds who are most likely to use them.



In addition:

- App 16.32(7) requires details of the number and remuneration of employees, remuneration policies, bonus and share option schemes and training schemes to be disclosed and commented on; and
- App 16.52(v) recommends disclosure of a discussion on the listed issuer’s policies and performance on community, social, ethical and reputational issues.

This information could be given in this discussion or more generally in the description of the business.

? Key questions to ask about the discussion on environmental policies, laws and regulations and key relationships:

- Does the discussion identify those environmental policies, laws and regulations which have a significant impact on the business and does it include a discussion of the extent of compliance?
- Does the discussion identify and give an account of those relationships on which the company’s/group’s success depends?
- If KPIs have been included in the discussion, are they balanced and neutral and presented in an understandable way?
- Have cross references been included to where further information can be found, where relevant?

The content elements

2. Bringing the story up to date

Schedule 5 requires the business review to provide “particulars of important events that have occurred since the end of the financial year”. This will bring the story up to date and can provide a bridge between the discussion of the year’s performance and position and where the business is heading.

Schedule 5 requires companies to disclose the particulars of important events affecting the reporting entity that occurred after the financial year end and up to the date of the report.

The law is not definitive on how the review should be structured, but in our view it would be logical for this discussion to follow the review of the financial year, as this discussion will update the story of the business to the date of approval of the report.

The review’s discussion should not be limited to financial events – some discussion may be needed on non-financial events if the company considers them to be important to the business.

However, as discussed on page 7 of this guide, Schedule 5 allows a company not to disclose any information about “impending developments or matters in the course of negotiation”, if such disclosure would, in the directors’ opinion, be “seriously prejudicial” to the company’s (or group’s) interests.

The safe harbours set out in Section 307D of the Securities and Futures Ordinance (Cap. 571) which permit a company to withhold disclosure of inside information under specified circumstances, have a similar objective. However, Section 307D sets out more detailed requirements.

It is not yet clear how these two pieces of legislation will work together in practice. Therefore we advise directors to obtain legal advice in this regard.

Complementing and supplementing the financial statements

Although the business review may make reference to where information on post year-end events may be found elsewhere in the annual report, companies should generally be looking to go beyond the disclosures made in their financial statements.

For example, the business review could discuss how the events impact on the performance measures disclosed in respect of the year under review and companies could quantify this impact by updating the affected KPIs. The review may also discuss:

- the likely impact of these important events on the future plans of the business; and
- whether these events have caused management to re-assess the principal risks and uncertainties facing the business going forward.

In addition to this discussion of specific important events, directors may also consider whether it would be useful to provide more general commentary on the direction of the business since year end. This can bridge the gap between the discussion of what happened during the financial year under review and the discussion of the likely future developments of the business.

Key questions to ask when bringing the story up to date:

- Has the company disclosed both financial and non-financial events that are important to the business?
 - If not, has legal advice been obtained on whether it is acceptable to withhold this information from the public?
 - Has sufficient information about the event been given in the business review, including updating the KPIs where applicable and discussing the impact of the event on the future business?
 - Would it be useful to provide more general commentary on the direction of the business since year end and where it is heading?
-

The content elements

3. Explaining the likely future development of the business

Schedule 5 requires the business review to contain an indication of the likely future development in the company’s (group’s) business. In a well written business review, this discussion would address the main trends and factors likely to affect the future development, performance, or position of the business.

Companies may already be discussing the main business trends in their annual reports as this is a recommended disclosure item under App 16.52(iv). However, even those companies complying with this recommended practice item may not be providing sufficient explanations to help readers assess the potential impact of these trends on the business.

Trends and likely future developments can arise from both internal factors (such as the development of new product segments) and external factors (such as changing customer needs and preferences, and emerging threats and opportunities).

In a well written business review, the discussion should go beyond providing high level assessments that might apply to any business in the sector. Instead, companies may consider discussing:

- the likely impact of each trend or factor on their future business and to what extent this depends on factors within or outside their control or influence;
- whether they feel that the identified trend or factor presents new opportunities or threats to the business; and
- how the company is managing any risk exposure relating to each trend or factor identified.

In this regard, App 16.32 requires the following to be disclosed:

- the state of the group’s order book (where applicable) and prospects for new business including new products and services introduced or announced (App 16.32(3));
- future prospects of significant investments held (App 16.32(4)); and
- details of future plans for material investments or capital assets (App 16.32(9)).

In addition, AB5.56 states that the discussion should include comments on short and longer-term funding plans to support the directors’ strategies to achieve the reporting entity’s objectives. The discussion should supplement the information provided in the financial statements by, for example, commenting on any special factors that may have a significant effect on future cash flows.

This could include, for example, the existence and timing of commitments for capital expenditures and other known or probable cash requirements. The discussion on funding should also include details of expected sources of funding in the coming year for the planned material investments or capital assets as required by App 16.32(9). Conversely, where the reporting entity has cash that is surplus to future operating requirements and current levels of distribution, the discussion should include future plans for making use of the excess.

Holding back “seriously prejudicial” information

As discussed in the previous section of this guide, Schedule 5 allows the directors not to disclose any information about “impending developments or matters in the course of negotiation”, if such disclosure would, in the directors’ opinion, be “seriously prejudicial” to the company’s (or group’s) interests.

This exemption may also be relevant in some specific situations to the discussion of the likely future development of the business. However, care should be taken not to misuse this exemption, by taking it too broadly. For example, even where there is a business acquisition in the course of negotiation, shareholder needs may be able to be met by disclosing information about the group’s plans for future expansion or diversification of which this acquisition is a part, without disclosing information which is “seriously prejudicial” to the negotiations.

If the board is considering making use of this exemption, we recommend that you obtain legal advice in this regard.

Linkage

As discussed earlier, companies should also think about linking their future development discussions to their strategies and performance measures where appropriate. There is no prescribed structure for doing this, so companies will need to consider how best to tell the story of how business value is expected to be generated and preserved. Tables, such as those illustrated on pages 9 and 20, might be a useful presentation technique to assist with this.

Companies can also help shareholders assess the impact of the trends and factors identified by providing contextual information. For example, if a trend has been identified affecting a specific customer segment, shareholders will need to understand the size of that segment if they are to model its impact. Ideally this information should already be available from the description of the business model.

There is also a clear commonality between the discussion of further prospects and the principal risks and uncertainties facing the business. Care should be taken to ensure that the discussion of future prospects takes those identified principal risks and uncertainties into account, to present a balanced and neutral discussion of how the directors view the future. This could include their plans to mitigate any negative impacts or take advantage of any opportunities that may arise as the future unfolds. What-if analyses which flex KPIs for a range of possible future outcomes can also provide useful information in this regard.

Including a health warning

AB5.57 advises that given the nature of some forward-looking information, in particular statements that cannot be objectively verified but have been made in good faith, directors may want to include a warning in the review to treat such statements with caution, explaining the uncertainties underpinning such information.

Typically such warnings will be drafted with the assistance of the company’s legal advisers and vary from a boilerplate style of general health warning, to more specific wording which draws attention to the specific risks and uncertainties facing the group. However, these statements all share the same basic intent of conveying the following 3 key messages:

- the discussion and analysis includes forward-looking statements;
- these forward-looking statements reflect current assumptions about future developments based on the directors’ current views; however
- actual outcomes and developments may be different due to risks and uncertainties outside of the directors’ control.

Some companies include a comprehensive health warning statement in a prominent position at the start of their annual report. In such cases it may still be advisable to integrate the above key messages into the discussions of future prospects in the business review, and/or to take particular care to ensure the discussion is understandable in its own right. This is in order to minimise the risk that the reader misinterprets the discussions as reflecting greater confidence in the directors’ ability to predict or control the future than the directors feel themselves.



Key questions to ask about the indication of the likely future developments:

- Does the discussion address the material anticipated changes across the business model, covering changes arising from both management initiatives, and external factors?
 - Do identified trends look beyond those already apparent in the financial statements?
 - Is sufficient detail provided for shareholders to form their own views on the implications of each trend or factor?
 - Does the review contain sufficient warning about the uncertainty of any forward-looking information?
-

The content elements

4. Explaining the principal risks and uncertainties

Schedule 5 requires the business review to include a description of the principal risks and uncertainties facing the company (or group). In a well written business review the description of the principal risks and uncertainties should cover the exposure to negative consequences, as well the directors’ policy for managing principal risks and potential opportunities.

Previously App 16.52(v) included the following recommended commentary item: “a discussion on business risks (including known events, uncertainties and other factors which may substantially affect future performance) and risks management policy”⁵. In addition, App 16.32 continues to require commentary on the following matters that are relevant to the discussion of risk and uncertainties:

- the group’s liquidity and financial resources. This may include comments on the level of borrowings at the end of the period under review, the seasonality of borrowing requirements, and the maturity profile of borrowings and committed borrowing facilities. Reference may also be made to the funding requirements for capital expenditure commitments and authorisations (App 16.32(1));
- details of charges on group assets (App 16.32(8));
- exposure to fluctuations in exchange rates and any related hedges (App 16.32(11)); and
- details of contingent liabilities, if any (App 16.32(12)).

Some form of risk discussions, especially relating to liquidity risk, may therefore already be an established part of many listed companies’ annual reports. But these discussions may well not go far enough, or have the right balance, compared to the new requirement in Schedule 5 to discuss the *principal* risks and uncertainties facing the business. A closer look at the guidance in AB5 may drive further improvement in disclosures in this area:

Guidance in AB5 on identifying risks to disclose

There is an emphasis in AB5 on addressing the full range of business risks irrespective of whether they are financial or non-financial in nature – specifically, AB5.50 mentions reputational, strategic, commercial, operational and financial risks as the types of risk that the business may face.

AB5.50 also lists the following common examples of risks:

- (a) risk of loss of income, for example arising from increased competition affecting market share and/or pricing of products and services, or changes in the market itself;
- (b) risk of increased costs, for example arising from impact of inflation or scarce supply on costs of key resources such as premises, skilled workforce, raw materials;
- (c) risk of loss of asset value, for example arising from the reporting entity’s exposure to price changes in the value of property or commodities held, or exposure to customers’ credit risk or exposure to the risk that inventories may become obsolete due to changes in technology or fashion;
- (d) liquidity risk, for example slowing down in the timing of cash receipts may put pressure on the reporting entity’s ability to meet loan repayment schedules or otherwise increase borrowing costs; and
- (e) risks arising from the reporting entity’s reliance on availability of skilled workforce, key suppliers or providers of finance (such as continuing banking facilities).

⁵ This recommended specific item was deleted from App 16.52 in the February 2015 amendments to the Listing Rules to avoid duplication with the requirements of Schedule 5.

Consistent with App 16.32(1), AB5 also specifically highlights the ability of the reporting entity to fund its current and future operations and stated strategies as an area for discussion of risk. The guidance is consistent with the items listed in App 16.32(1) in this regard, but goes further by flagging covenants with lenders as an extra area where principal risks could lie (AB5.51-52).

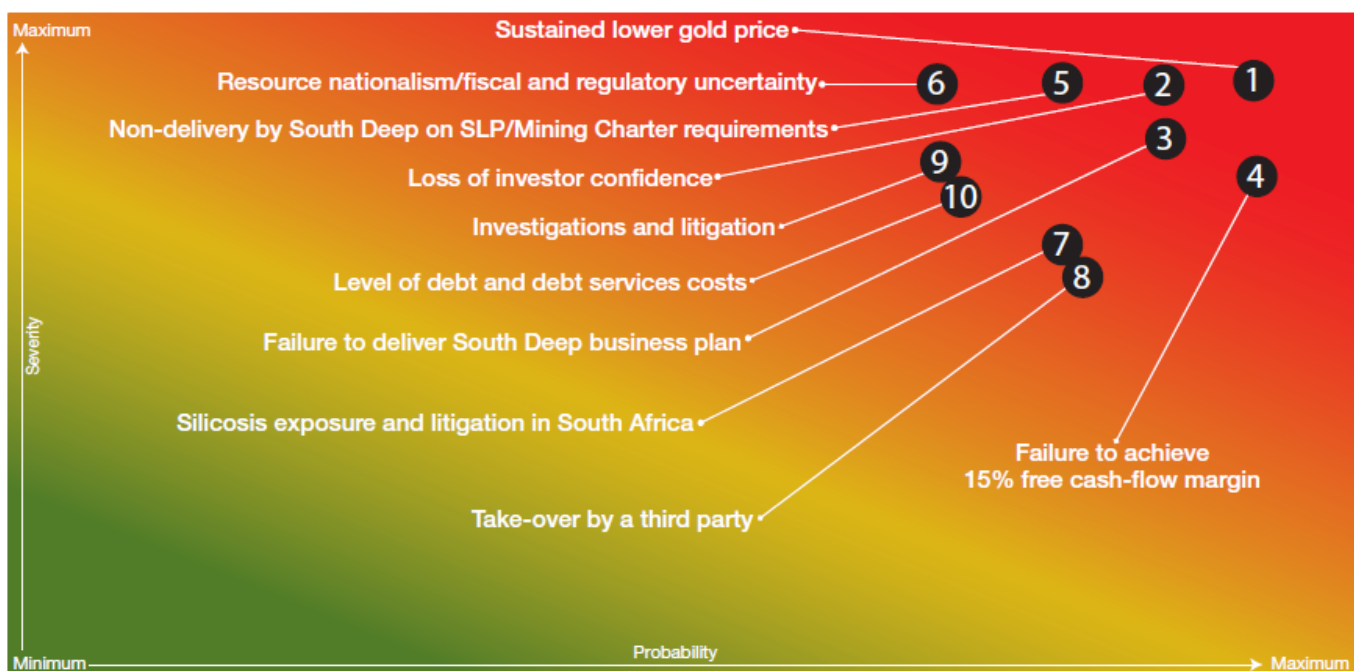
This guidance in AB5 is aimed at those companies preparing business reviews for the first time. Listed issuers would be well advised to consider whether their current risk disclosures match up to this guidance, as well as considering whether the guidance goes far enough given the facts and circumstances of the issuer’s business and its environment.

Reviewing the information planned to be disclosed in respect of the fair review of the business (i.e. the first content element discussed earlier on in this guide), including the discussions of compliance with laws and regulations and key relationships, may identify further matters which are a source of risk for the issuer. Some risks may also link to governance disclosures to explain how the board is monitoring and setting risk appetite and policy.

On the other hand, it is important to ensure that the discussion in the business review is limited to the “principal” risks and uncertainties facing the company or group. Consistent with the principle of materiality, this discussion should focus on those risks which are most relevant to the shareholders’ decisions, and these risks should not be obscured by excessive discussion of other risks that are unlikely to crystallize or, if they did crystallize, would not have a material impact.

One way of demonstrating that you have identified the principal risks facing the group is to use a “heat map”. For example, a South African based gold mining company included the heat map reproduced below in a recent annual report to present its top 10 risks in terms of the likelihood of occurrence and the severity of impact. Although all of these risks appear in the top right hand quadrant of greatest heat, the relative positioning of these 10 risks each to the other on the two axes of probability and severity helps the shareholder distinguish between them. The heat map also helps the shareholder understand that there may be other risks with potential high impact which the company has not disclosed as the directors consider them less likely – this could help the shareholders ask for further information about any potential worst case scenarios if they consider it useful to know.

Example of a heat map which plots risks against severity and probability axes:



Company-specific descriptions, supported by quantitative disclosures, can help shareholders form a view of the potential earnings implications

Presenting risk information in the business review

AB5.49 states that the description of the principal risks and uncertainties should cover the exposure to negative consequences, as well the directors' policy for managing principal risks and any potential opportunities.

Broad descriptions of generic or industry level risks and mitigating actions are unlikely to provide this. Instead, company-specific descriptions, supported by quantitative disclosures can help shareholders form a view of the potential earnings implications. For example, one company said the following in a recent discussion on risk factors:

“We review the oil and gas price assumptions we use to evaluate project decisions and commercial opportunities on a periodic basis. We generally test projects and other

opportunities against a long-term price range of \$70-110 per barrel for Brent crude oil ... While we believe our current long-term price assumptions are prudent, if such assumptions proved to be incorrect it could have a material adverse effect on us. For near-term planning purposes, we stress test the financial framework against a wider range of prices.”

One way to disclose the principal risks concisely may be to present the information in a table, describing the risks themselves and how they are being managed. It may also be useful to link risk descriptions to other parts of the report which set out the strategy and/or provide indicators of progress in managing the risk. This is illustrated in the example below, which describes a principal risk that might be identified by a mining company, and how it links to other components of that company's business review:

Example of how to link the principal risks of the business to other components of the business review:

Risk Description	Link to Strategy	Risk Mitigation	Risk indicators monitored	Impact on future business if mitigation is unsuccessful
Failure to obtain access to a sufficient number of new sites for exploration and commercially viable extraction purposes	Obtaining access to new sites for exploration purposes and identifying new opportunities for commercially viable extraction are key to our strategy to maintain sustainable earnings over the long term.	In each of our major locations we have put in place a team of experienced negotiators to maximize our chances of obtaining access to land on commercially viable terms. These negotiators seek sustained cooperation with local governments and the wider community in order to reduce risks of refusal or protracted legal disputes.	We receive monthly progress reports on status of new opportunities for extraction. We also monitor a range of quantitative measures which indicate significant delays or failure to access land for exploration projects, in order that appropriate action can be authorised.	Failure to obtain access to land for exploration purposes and/or failure to identify new commercially viable extraction opportunities will prevent us from maintaining earnings as our existing projects approach the end of their productive lives. Further details of the proved and undeveloped reserves of our existing projects can be found in our discussion of our business and its future.

As mentioned at the start of this guide, the business review is just the beginning of a series of regulatory initiatives aimed at improving the relevance of narrative reports for shareholders.

One of these initiatives⁶ aims to improve transparency of companies' risk management and internal controls, including an annual review of effectiveness. Given the progressive nature of disclosures around risks, we suggest that companies take this opportunity to revisit their risk management disclosures to ensure cohesive descriptions in the business review and corporate governance reports.

Key questions to ask about the discussion of principal risks and uncertainties:

- Are the risks highlighted the most relevant to an understanding of business prospects – including those relating to success in implementing business strategies?
- Does the report address significant risks arising from both the internal and external environment?
- Do the disclosures link to KPIs and governance explanations that address progress in managing the risk?

⁶ On 19 December 2014, the HKEx issued its new requirements in the *Consultation Conclusions on Risk Management and Internal Control: Review of the Corporate Governance Code and Corporate Governance Report*. The new requirements will apply to accounting periods beginning on or after 1 January 2016 (as illustrated in the timeline on page 1 of this guide).

Overall assessment of the quality of the business review: Questions for boards to ask themselves

As part of the board’s overall assessment before approval, we expect that the directors will be familiar with the proposed contents of the business review and will have raised concerns if anything appeared untoward.

However, as the board is ultimately responsible for the contents of the annual report, we would recommend that the directors also ask themselves the following questions:

- Are we confident that the process for drafting the review was robust enough to ensure that the review is factually accurate?
- Are we satisfied that the content of the review is comprehensive enough to meet the statutory requirements and, where applicable, the requirements of the Listing Rules?
- Do we consider that the review stands up well against the guiding principles set out in AB5 and in particular is it a fair and balanced discussion of our business and its future prospects?
- Do we believe that the review will make a positive contribution to shareholders’ overall understanding of who we are, what we do and why we are worth investing in?

These questions address fundamental assertions which should underpin the approval of any directors’ report which contains a business review. So if the board cannot answer “yes” to each of these questions, then clearly there is work still to be done for this year’s report!

But even if confident enough to approve this year’s report, we would encourage all companies, even the best, to challenge themselves continuously to find new and improved ways to communicate key messages effectively and efficiently to those who need to know. With the benefit of hindsight and feedback, we therefore recommend that each year you ask yourselves one more question:

“ **W**hat can we do better next time? ”

Further information

For easy reference, this guide includes the following appendices which may assist in drafting or improving a business review:

- Appendix 1: Extracts from Appendix 16 to the Main Board Listing Rules (with equivalent paragraph references to the GEM Listing Rules) with an index of where these requirements are discussed in this guide
- Appendix 2: Index of KPIs illustrated in the Implementation Guidance attached to Accounting Bulletin 5
- Appendix 3: A summary of all the questions mentioned in this guide that you may find useful to ask
- Appendix 4: Names and website addresses of the distinguished companies who have received recognition in the recent HKICPA and Hong Kong Management Association report competitions.

In addition, your usual KPMG contact can provide you with copies of the following KPMG publications:

- ***HK Companies Ordinance Checklist on the Business Review for Listed Companies*** – to help companies ensure that the minimum requirements of Schedule 5 and the Listing Rules are met, and to help when assessing the extent to which the business review has taken the guidance in AB5 into account
- ***HK Companies Ordinance Checklist on the Business Review for Non-listed Companies*** – to help companies ensure that the minimum requirements of Schedule 5 are met, and to help when assessing the extent to which the business review has taken the guidance in AB5 into account
- ***The KPMG survey of business reporting*** – to provide an overview of current reporting practice globally and highlight areas where this could be developed to provide shareholders with a better understanding of business performance. This publication is also available from our external website at: www.kpmg.com/betterbusinessreporting
- ***KPMG’s Briefing Note 2 “What’s new for directors’ reports?”*** – to highlight the areas of change and key requirements relating to the directors’ report under the new HK Companies Ordinance. This Briefing Note, along with other Briefing Notes in the series, is also available from our external website at: www.kpmg.com/cn/hk-companies-ordinance

The HKICPA’s ***Accounting Bulletin 5 Guidance for the Preparation and Presentation of a Business Review under the Hong Kong Companies Ordinance Cap.622 (“AB5”)*** can be found on the Institute’s website at <http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/circular/>.

The above is just a selection of the sources of information available. Please contact your usual KPMG contact if you feel we can help in any way with improving your business reporting.

Appendix 1:

Extracts from Appendix 16 to the Main Board Listing Rules⁷

Paragraph 28 (equivalent to Rule 18.07A of the GEM Listing Rules) [emphasis added]:		Discussed in this guide on page ...
App 16.28 (1)	<p>A listed issuer (whether or not it is incorporated in Hong Kong) shall include disclosures required under the following provisions of the Companies Ordinance and subsidiary legislation:–</p> <p>in financial statements</p> <ul style="list-style-type: none"> a) Section 383 – Notes to financial statements to contain information on directors’ emoluments etc.; b) Schedule 4 – Accounting Disclosures relating to: <ul style="list-style-type: none"> (i) Part 1(1) Aggregate amount of authorized loans; (ii) Part 1(2) Statement of financial position to be contained in notes to annual consolidated financial statements; (iii) Part 1(3) Subsidiary’s financial statements must contain particulars of ultimate parent undertaking; (iv) Part 2(1) Remuneration of auditor; and c) Companies (Disclosure of Information about Benefits of Directors) Regulation; and 	3
App 16.28 (2)	<p>in directors’ report</p> <ul style="list-style-type: none"> a) Section 390 – Contents of directors’ report: general; b) Section 470 – Permitted indemnity provision to be disclosed in directors’ report; c) Section 543 – Disclosure of management contract; d) Schedule 5 – Content of Directors’ Report: Business Review; and e) Companies (Directors’ Report) Regulation. <p>28.1 <i>Directors must prepare the directors’ report which complies with section 388 of the Companies Ordinance and the directors’ report must be approved and signed, which complies with section 391 of the Companies Ordinance.</i></p> <p>28.2 <i>Section 390(3)(b) of the Companies Ordinance requires a company to disclose the name(s) of the director(s) of its subsidiaries. Notwithstanding the disclosure provisions in the sub-paragraph 2(a) above, a listed issuer not incorporated in Hong Kong is not required to disclose the name(s) of its subsidiaries’ director(s).</i></p>	3

⁷ On 6 February 2015, the HKEx issued its Consultation Conclusions on the *Review of Listing Rules on Disclosure of Financial Information with reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments* to update the Listing Rules for the new Companies Ordinance disclosure requirements. Amendments to the Listing Rules were included as an appendix to the Consultation Conclusions. These amendments are mandatory for financial years ending on or after 31 December 2015. This guide is based on these updated Listing Rules.

Paragraph 32 (equivalent to Rule 18.41 of the GEM Listing Rules):		
	A listed issuer shall include in its annual report a discussion and analysis of the group’s performance during the financial year and the material factors underlying its results and financial position. It should emphasize trends and identify significant events or transactions during the financial year under review. As a minimum the directors of the listed issuer should comment on the following:–	3, 11, 14
App 16.32 (1)	the group’s liquidity and financial resources. This may include comments on the level of borrowings at the end of the period under review, the seasonality of borrowing requirements, and the maturity profile of borrowings and committed borrowing facilities. Reference may also be made to the funding requirements for capital expenditure commitments and authorisations;	27, 28
App 16.32 (2)	the capital structure of the group in terms of maturity profile of debt and obligation, type of capital instruments used, currency and interest rate structure. The discussion may cover: <ul style="list-style-type: none"> a) funding and treasury policies and objectives in terms of the manner in which treasury activities are controlled; b) the currencies in which borrowings are made and in which cash and cash equivalents are held; c) the extent to which borrowings are at fixed interest rates; d) the use of financial instruments for hedging purposes; and e) the extent to which foreign currency net investments are hedged by currency borrowings and other hedging instruments; 	14
App 16.32 (3)	the state of the group’s order book (where applicable) and prospects for new business including new products and services introduced or announced;	25
App 16.32 (4)	significant investments held, their performance during the financial year and their future prospects;	14, 25
App 16.32 (5)	details of material acquisitions and disposals of subsidiaries, associates and joint ventures in the course of the financial year;	14
App 16.32 (6)	comments on segmental information. This may cover changes in the industry segment, developments within the segment and their effect on the results of that segment. It may also include changes in the market conditions, new products and services introduced or announced and their impact on the group’s performance and changes in revenue and margins;	14
App 16.32 (7)	where applicable, details of the number and remuneration of employees, remuneration policies, bonus and share option schemes and training schemes;	23
App 16.32 (8)	details of charges on group assets;	27
App 16.32 (9)	details of future plans for material investments or capital assets and their expected sources of funding in the coming year;	25
	<p><i>32.1 It is the responsibility of the directors of the listed issuer to determine what investment or capital asset is material in the context of the listed issuer’s business, operations and financial performance. The materiality of investment or capital asset varies from one listed issuer to another according to its financial performance, assets and capitalisation, the nature of its operations and other factors. An event that is “material” in the context of a smaller listed issuer’s business and affairs is often not material to a large listed issuer. The directors of the listed issuer are in the best position to determine materiality. The Exchange recognises that decisions on disclosure require careful subjective judgements, and encourages listed issuers to consult the Exchange when in doubt as to whether disclosure should be made.</i></p>	

App 16.32 (10)	gearing ratio; 32.2 <i>The basis on which the gearing ratio is computed should be disclosed.</i>	15, 16 17
App 16.32 (11)	exposure to fluctuations in exchange rates and any related hedges; and	27
App 16.32 (12)	details of contingent liabilities, if any. 32.3 <i>If the above information required in this paragraph has been disclosed in a business review in the directors’ report as set out in paragraph 28, no additional disclosure is required.</i>	27 3
Paragraph 52 (equivalent to Rule 18.83 of the GEM Listing Rules):		
App 16.52	Issuers are encouraged to disclose the following additional commentary on discussion and analysis in their interim and annual reports: (i) efficiency indicators (e.g. return on equity, working capital ratios) for the last five financial years indicating the bases of computation; (ii) industry specific ratios, if any, for the last five financial years indicating the bases of computation; (iii) a discussion of the listed issuer’s purpose, corporate strategy and principal drivers of performance; (iv) an overview of trends in the listed issuer’s industry and business; (v) a discussion on the listed issuer’s policies and performance on community, social, ethical and reputational issues; and (vi) receipts from, and returns to, shareholders. 52.1 <i>Issuers should also note the recommended disclosures set out in paragraphs Q to T of Appendix 14⁸.</i>	3 15, 17 15 12, 13 12, 14, 25 23, 27 14
Paragraph 53 (equivalent to Rule 18.84 of the GEM Listing Rules):		
App 16.53	Issuers are encouraged to include information set out in Appendix 27 ⁹ in the annual report regarding the same period covered in the annual report, or as a separate report. 53.1 <i>Where the information is included in a separate report, an issuer is free to report on any period but should consistently report on the same period so that the information can be comparable. However, the Exchange encourages an issuer to report regarding the same period as in the annual report.</i>	21

⁸ Paragraphs Q to T of Appendix 14 of the Main Board Listing Rules set out a number of recommended disclosures on corporate governance matters. The areas covered by these paragraphs are:

- Share interests of senior management;
- Investor relations, including details of shareholders and the last shareholders’ meeting;
- Internal controls; and
- Management functions, including the division of responsibility between the board and management.

⁹ Appendix 27 contains the “Environmental, Social and Governance Reporting Guide”.

Appendix 2:

Index of KPIs illustrated in the Implementation Guidance attached to Accounting Bulletin 5

Financial KPIs



- **IG Example 1:** Return on capital employed (ROCE)
- **IG Example 2:** Market share
- **IG Example 3:** Average revenue per user (customer)
- **IG Example 4:** Sales per square foot
- **IG Example 5:** Percentage of revenue from new products
- **IG Example 6:** Cost per unit sold
- **IG Example 7:** Economic capital
- **IG Example 8:** Cash conversion rate




Non-financial KPIs




- Measures relating to the reporting entity's environmental policies and performance and compliance with laws and regulations (paragraphs 44-45):
 - **IG Example 9:** Environmental spillage
 - **IG Example 10:** CO2 emissions
 - **IG Example 11:** Waste
 - **IG Example 12:** Employee health and safety
- Measures relating to the reporting entity's key relationships (paragraphs 46-48):
 - **IG Example 13:** Number of subscribers
 - **IG Example 14:** Number of products sold per customer
 - **IG Example 15:** Customer churn
 - **IG Example 16:** Employee morale
- Other measures that may reflect on the current or future development in the business or the principal risks and uncertainties facing the reporting entity:
 - **IG Example 17:** Products in the development pipeline
 - **IG Example 18:** Reserves
 - **IG Example 19:** Market risk
 - **IG Example 20:** Monitoring of social risks in the supply chain
 - **IG Example 21:** Business continuity management

Appendix 3:

A summary of questions to ask

	<p>The following brings together all the questions we suggest in this guide that you may find useful to ask. This is not intended to be an exhaustive list of things to think about, but may provide some useful prompts either at the planning stage or when reviewing the draft</p>	<p>Discussed in this guide on page ...</p>
<p>Overall considerations</p>	<p> Key questions to ask when planning ahead:</p> <ul style="list-style-type: none"> • Have we put together a team with enough insight into top management’s strategy to ensure the review is useful and authentic? • Has the annual report compared well in the past with information being communicated through other channels (such as investor presentations) or could it be improved this year to reduce gaps? • How well does last year’s MD&A stand up against AB5’s guiding principles? For example: <ul style="list-style-type: none"> • How well did it complement and supplement the financial statements? • How far did management go to provide balanced and neutral information? • How easy was it to understand? <p>Could more be done this year on any of these aspects to improve the usefulness for shareholders?</p> • What are the new topics that need to be discussed in this year’s review, compared to last year’s MD&A? Where is the information for these topics and will we be able to find comparative information as well? <p> Key questions to ask about ...</p> <p><i>Factual information about the business:</i></p> <ul style="list-style-type: none"> • Does the description of the business align with the board’s view of the significant business value drivers? • Where different segments of the business have different operating characteristics or performance drivers, is this clear enough? • Has sufficient detail been provided about the business so that shareholders can assess the potential impact of matters raised elsewhere in the report? <p><i>Any discussion about objectives and strategy:</i></p> <ul style="list-style-type: none"> • Are the stated objectives business-specific? For example, becoming the market leader in a specific segment, rather than generic aims such as maximising shareholder return • Does the description of the strategy address the short, medium, and longer term priorities for the business? • Is there enough linkage of stated objectives and strategies to the analysis of performance and other content elements? 	<p>10</p> <p>13</p>

<p>Explaining the year under review</p>	<p> Key questions to ask about KPIs:</p> <ul style="list-style-type: none"> • Are the KPIs selected for disclosure consistent with those used by the board to assess the business? For example, do the measures address progress in managing the critical resources on which the business depends? • Do the measures address the specific part of the business affected by the issue, rather than being provided on an aggregate basis for the business as a whole? • Are the measures selected and presented in accordance with the “balanced and neutral” guiding principle? For example, are they presented consistently over time to show key trends? • Are the measures presented in a way which is understandable? For example, is the basis of computation and the source of data clear and have they been given enough context by being linked to other information, such as strategy and future plans? 	<p>20</p>
<p>Explaining the year under review</p>	<p> Key questions to ask about the discussion on environmental policies, laws and regulations and key relationships:</p> <ul style="list-style-type: none"> • Does the discussion identify those environmental policies, laws and regulations which have a significant impact on the business and does it include a discussion of the extent of compliance? • Does the discussion identify and give an account of those relationships on which the company’s/group’s success depends? • If KPIs have been included in the discussion, are they balanced and neutral and presented in an understandable way? • Have cross references been included to where further information can be found, where relevant? 	<p>23</p>
<p>Bringing the story up to date</p>	<p> Key questions to ask when bringing the story up to date:</p> <ul style="list-style-type: none"> • Has the company disclosed both financial and non-financial events that are important to the business? • If not, has legal advice been obtained on whether it is acceptable to withhold this information from the public? • Has sufficient information about the event been given in the business review, including updating the KPIs where applicable and discussing the impact of the event on the future business? • Would it be useful to provide more general commentary on the direction of the business since year end and where it is heading? 	<p>24</p>

<p>Explaining the likely future development of the business</p>	<p> Key questions to ask about the indication of the likely future developments:</p> <ul style="list-style-type: none"> • Does the discussion address the material anticipated changes across the business model, covering changes arising from both management initiatives, and external factors? • Do identified trends look beyond those already apparent in the financial statements? • Is sufficient detail provided for shareholders to form their own views on the implications of each trend or factor? • Does the review contain sufficient warning about the uncertainty of any forward-looking information? 	<p>26</p>
<p>Explaining the principal risks and uncertainties</p>	<p> Key questions to ask about the discussion of principal risks and uncertainties:</p> <ul style="list-style-type: none"> • Are the risks highlighted the most relevant to an understanding of business prospects – including those relating to success in implementing business strategies? • Does the report address significant risks arising from both the internal and external environment? • Do the disclosures link to KPIs and governance explanations that address progress in managing the risk? 	<p>29</p>
<p>Overall assessment of the quality of the business review</p>	<p> Questions for boards to ask themselves</p> <ul style="list-style-type: none"> • Are we confident that the process for drafting the review was robust enough to ensure that the review is factually accurate? • Are we satisfied that the content of the review is comprehensive enough to meet the statutory requirements and, where applicable, the requirements of the Listing Rules? • Do we consider that the review stands up well against the guiding principles set out in AB5 and in particular is it a fair and balanced discussion of our business and its future prospects? • Do we believe that the review will make a positive contribution to shareholders’ overall understanding of who we are, what we do and why we are worth investing in? • What can we do better next time? 	<p>30</p>

Appendix 4: Local award winners

Each year, the following annual report competitions take place in Hong Kong:

- **The HKICPA’s Best Corporate Governance Disclosure Awards**, which acknowledges listed companies and public sector/not-for-profit organisations that exemplify the best corporate governance standards in Hong Kong, as reflected in their annual reports; and
- **The Hong Kong Management Association’s (HKMA) Best Annual Reports Awards**, which recognises companies for their exemplary achievement in producing timely, accurate, informative and well-presented annual reports.

For your reference, we have provided a list of those companies – along with a link to their websites – who were commended by the HKICPA and/or the HKMA in their 2014 awards for their well presented corporate governance disclosures and annual reports. Searching out high quality annual reports of companies in comparable businesses or environments, whether listed in Hong Kong or in overseas markets with similar reporting regimes, can be a good source of inspiration for ways to improve your own business reporting.

The full judges’ reports can be found on the HKICPA’s and HKMA’s websites at: <http://www.hkicpa.org.hk/en/about-us/best-corporate-governance-disclosure-awards/> and <http://www.hkma.org.hk/baro-award/introduction.html> respectively.

The HKICPA’s Best Corporate Governance Disclosure Awards – Award winners	The HKMA Best Annual Reports Awards – Award winners
<ul style="list-style-type: none"> • Airport Authority Hong Kong www.hongkongairport.com • China Merchants Bank Co., Ltd www.cmbchina.com • China Minsheng Banking Corp., Ltd www.cmbc.com.cn • China Shenhua Energy Company Limited www.csec.com • CLP Holdings Limited www.clpgroup.com • COSCO International Holdings Limited www.coscointl.com • COSCO Pacific Limited www.coscopac.com.hk • Hang Seng Bank Limited www.hangseng.com • Hong Kong Exchanges and Clearing Limited www.hkex.com.hk • Hong Kong Productivity Council www.hkpc.org • HSBC Holdings plc www.hsbc.com • Hysan Development Company Limited www.hysan.com.hk • Lenovo Group Limited www.lenovo.com • Prudential plc www.prudential.co.uk • Securities and Futures Commission www.sfc.hk • SOCAM Development Limited www.socam.com • The Hongkong and Shanghai Hotels, Limited www.hshgroup.com • The Link Real Estate Investment Trust www.thelinkreit.com • Transport International Holdings Limited www.tih.hk • VTech Holdings Limited www.vtech.com 	<ul style="list-style-type: none"> • Airport Authority Hong Kong www.hongkongairport.com • ANTA Sports Products Limited www.anta.com.hk • CITIC Limited www.citic.com • CLP Holdings Limited www.clpgroup.com • Guodian Technology & Environment Group Corporation Limited www.khjt.com.cn • Hang Seng Bank Limited www.hangseng.com • Hong Kong Exchanges and Clearing Limited www.hkex.com.hk • Hong Kong Housing Society www.hkhs.com • Hong Kong Monetary Authority www.hkma.gov.hk • Hong Kong Productivity Council www.hkpc.org • HSBC Holdings plc www.hsbc.com • Hysan Development Company Limited www.hysan.com.hk • Industrial and Commercial Bank of China Limited www.icbc-ltd.com • Jiangsu Expressway Company Limited www.jsexpressway.com • Mandatory Provident Fund Schemes Authority www.mpfa.org.hk • MTR Corporation Limited www.mtr.com.hk • New World Department Store China Limited www.nwds.com.hk • Next Media Limited www.nextmedia.com/investor • Sa Sa International Holdings Limited corp.sasa.com • Securities and Futures Commission www.sfc.hk • Swire Pacific Limited www.swirepacific.com • The Hongkong and Shanghai Hotels, Limited www.hshgroup.com • The Hong Kong Jockey Club www.hkjc.com • The Hong Kong Polytechnic University www.polyu.edu.hk • The Land Registry www.landreg.gov.hk • The Link Real Estate Investment Trust www.thelinkreit.com • Transport International Holdings Limited www.tih.hk • Tung Wah Group of Hospitals www.tungwah.org.hk • Urban Renewal Authority www.ura.org.hk

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