Charltons - Hong Kong Law Newsletter - 17 September 2013

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# Hong Kong Law Issue 204

## Exchange provides Guidance On Confirmations Required for Accountants’ Reports, Pro Forma Financial Information And Profit Forecasts

The Stock Exchange of Hong Kong Limited (the **Exchange**) has issued guidance letter [HKEx-GL58-13](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/iporq/Documents/gl58-13.pdf) ([see archive](gl58-13.pdf)) (**Guidance Letter GL58-13**) which provides guidance on confirmations required on accountants’ reports, pro forma financial information and profit forecasts in Application Proofs[[1]](#footnote-26) and subsequent draft listing documents. Guidance Letter GL58-13 was issued to complement the Securities and Futures Commission’s (**SFC**) new sponsor regulation regime, which will take effect on 1 October 2013.

### Submission requirements of the Listing Rules

Guidance Letter GL58-13 notes Main Board Rule 9.03(3) (GEM Rule 12.09) which requires (i) a new listing applicant to submit the Application Proof and all other relevant documents when making the listing application to the Exchange; and (ii) all submitted information must be substantially complete with the exception of certain information that can only be finalised at a later time.

### Requirements on submission of financial information in the Application Proof

Subject to relief under Guidance Letter HKEx-GL6-09A (*please refer to our* [*newsletter*](/newsletters/hklaw/en/2013/203/nl-hklaw-20130916-203.html)), Guidance Letter GL58-13 states that following financial information (collectively, “**Reports**”), in final form (or at the very least, in an advanced form) must also be submitted to the Exchange when submitting the Application Proof:

1. a signed copy of each of the accountants report on historical financial information;
2. a signed copy of the reporting accountants’ report on the pro forma financial information; and
3. a signed copy of the reporting accountants’ report on profit forecast (if any)

Further, Guidance Letter GL58-13 states that reporting accountants must confirm to the sponsor, the Exchange and the SFC that no significant adjustment is expected to be made to the draft Reports based on the work done as of the date of the confirmation. If there is a delay in the listing timetable that results in the Reports being updated, a similar confirmation must be provided to the SFC at the time when the updated financial information is being submitted. A suggested template of the reporting accountants’ confirmation is provided in the appendix to Guidance Letter GL58-13.

## Exchange Provides Guidance on Management Discussion and Analysis on Historical Financial Information in Listing Documents

The Exchange has published guidance letter [HKEx-GL59-13](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/iporq/Documents/gl59-13.pdf) ([see archive](gl59-13.pdf)) (**Guidance Letter GL59-13**) relating to contents of the management discussion and analysis (**MD&A**) on the historical financial information in listing documents. Guidance Letter GL59-13 was also issued to complement the new sponsor regulation regime of the SFC.

While general requirements relating to contents of MD&As are set out under the Listing Rules, the Companies Ordinance (Cap. 32 of the Laws of Hong Kong) and the SFC’s *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*, Guidance Letter GL59-13 provides further guidance including (i) general principles which should be observed in preparing MD&As; and (ii) guidance and principles on specific disclosures generally found in MD&As. Such further guidance are designed to ensure MD&As provide meaningful discussion and analysis of the applicants’ financial information to help investors understand the applicants’ past performance, present position and future prospects.

The Exchange expects applicants to follow the requirements set out in Guidance Letter GL59-13 when preparing listing applications. MD&As in Application Proofs[[2]](#footnote-33) which do not comply with the requirements of Guidance Letter GL59-13 would not be considered by the Exchange to be substantially complete, as required under the Listing Rules.

### General guidance and principles

Guidance Letter GL59-13 states that while financial statements disclose the financial effects of *past* events, MD&A is necessary in listing documents to allow investors to see the applicant through the eyes of management. In this regard, the MD&A should provide, *inter alia*, (i) information on non-financial measures of performance; and (ii) discussion of future prospects and plans of the applicant, together with analysis of main trends and factors that are likely to affect its performance, position and prospects.

Guidance Letter GL59-13 further states that MD&As should be clear, concise, insightful, consistent with information contained in the financial statements and have a balance of information across all major businesses and segments. Listing applicants are encouraged to make use of tables, charts and diagrams to ensure clear, concise and precise disclosure and to include cross-references to other relevant sections of the listing document to avoid unnecessary duplication of information.

### Guidance and principles on specific disclosure

Guidance Letter GL59-13 provides guidance and principles on specific disclosures generally found in the MD&A including disclosures on:

* key factors affecting the results of operations;
* critical accounting policies and estimates;
* review of historical results, financial position and cash flows; and
* liquidity and capital resources

Guidance on these specific disclosures as provided in Guidance Letter GL59-13 are briefly summarised below.

#### Key factors that affect the results of operations

This part of the MD&A should highlight the key events or factors that management considers most important in driving the changes in the applicant’s operating results, financial position and cash flows and should contain the following information where appropriate:

* economic and regulatory factors that affect the relevant industry and market of the applicant;
* the applicant’s lines of business, locations of operations, principal products and services and product mix;
* the applicant’s business processes and how the applicant creates value, earns revenue and income and generate cash; and
* significant relationships, opportunities, challenges and risks that are likely to affect the applicant.

Listing applicants should avoid overly detailed descriptions and repeated information from the “Business” section of the listing document.

#### Critical accounting policies and estimates

The MD&A should disclose the listing applicant’s critical accounting policies, accounting estimates and assumptions made in applying these policies. It should supplement and not duplicate the description of accounting policies disclosed in the notes to the financial statements which may be too generic. For critical accounting estimates and assumptions (e.g. estimate of useful life and residual value of property), the applicant should disclose:

* the procedures and methods used by management in making accounting estimates;
* the accuracy of past estimates compared to the actual results;
* any changes to past estimates or assumptions; and
* the reasons for any likely change to estimates or underlying assumptions in the future.

#### Review of historical results, financial position and cash flows

This part of the MD&A should provide information on the quality and possible variability of the listing applicant’s historical financial results, financial position and cash flows. The information in this part should provide clear descriptions of an applicant’s financial and non-financial performance, such that it is indicative of the future performance and management’s assessment of its prospects, how resources that are not presented in the financial statements affected the applicant’s operations, how non-financial factors have influenced the financial statements and explanations for the significant items in the financial statements and their material fluctuations during the track record period.

Further, Guidance Letter GL59-13 suggests that:

1. the effects of significant global conditions or events such as disasters, financial crises or political unrest should be discussed in terms of actual and potential impact on the applicant’s operations, financial position, performance and cash flows only; and
2. the inclusion of a summary of key financial ratios during the track record period and a management discussion of material fluctuations of these ratios would give investors a better understanding of the applicant’s performance and permit them to make easier comparisons with industry peers.

Guidance Letter GL59-13 states that the following specific disclosures should be included in this part of the MD&A:

* details of related party loans, advances, guarantees and/or pledges of securities to/from the applicant;
* details of material related party transactions during the track record period as defined under the Listing Rules (e.g. whether they were on an arm’s length basis and whether they distort the applicant’s track record results);
* the applicable tax rate and any preferential tax treatments, tax benefits or special tax arrangements and when they expire (if any expire within one year, that information should be included in the “Risk Factors” section of the listing document);
* whether the applicant has paid all relevant taxes;
* details of any disputes or unresolved tax issues with the relevant tax authorities; and
* post-balance sheet events including share subdivision, share consolidation and the declaration and payment of dividends.

#### Liquidity and capital resources

This part of the MD&A should disclose an applicant’s ability to generate cash and meet existing and future cash requirements including the following information:

* historical information on sources of cash flow and significant expenses;
* the amounts and certainty of cash flows;
* the existence and timing of capital expenditures and commitments;
* expected changes in the mix and relative cost of capital resources;
* indications of which balance sheet or income or cash flow items should be considered in assessing liquidity;
* prospective information regarding sources of and needs for capital; and
* material covenants relating to outstanding debts, guarantees or other contingent obligations.

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1. Substantially complete draft listing document submitted to the Exchange together with a listing application form for listing of equity securities [↑](#footnote-ref-26)
2. Substantially complete draft listing document submitted to the Exchange together with a listing application form for listing of equity securities [↑](#footnote-ref-33)