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HONG KONG STOCK EXCHANGE ISSUES NEW AND UPDATED GUIDANCE LETTERS

On 24 January 2014, the Hong Kong Stock Exchange published the following new and updated Guidance Letters:

- Disclosure requirements for IPO cases – Disclosure of material changes in financial, operational and/or trading position after trading record period (HKEx-GL41-12);
- Simplification Series – Disclosure in listing documents for IPO cases – the “Summary and Highlights” section (HKEx-GL27-12);
- Guidance on indebtedness, liquidity, financial resources and capital structure disclosure in listing documents and sponsor’s confirmation on working capital sufficiency statement (HKEx-GL37-12);
- Guidance on the financial information for the trading record period expected in the first draft listing document for listing applications (HKEx-GL6-09A);
- Gambling activities Undertaken by Listing Applicants and/or Listed Issuers (HKEx-GL71-14);
- Disclosure of Directors, Supervisors and Senior Management section in listing documents (HKEx-GL62-13);
- Guidance on the accounting and disclosure requirements for acquisitions of subsidiaries and businesses conducted during or after the trading record period (HKEx-GL32-12); and
- Guidance on Connected Transaction Rules (HKEx-GL70-14).

The following is a summary of the updates made.

DISCLOSURE OF MATERIAL CHANGES IN FINANCIAL, OPERATIONAL AND/OR TRADING POSITION AFTER TRADING RECORD PERIOD (HKEx-GL41-12)

Guidance Letter 41-12 provides guidance on IPO prospectus disclosure of material changes in financial, operational and/or trading position after the trading record period. The amendments made are as follows.

Previous Requirements (now deleted)	Updated Requirements
<p>Qualitative and quantitative disclosure in a separate section of the Summary and other relevant sections of the prospectus to give significant highlights to investors (paragraph 4.3).</p> <p>In relation to deterioration in an applicant's financial performance, disclosure of selected figures of updated, key financials and/or operating data (e.g. revenue, gross profit/loss margin, sales volume etc.) in the prospectus (paragraph 4.3).</p>	<p>Either qualitative or quantitative disclosure with commentary on how the adverse changes including but not limited to those set out in paragraph 4.2 of the guidance letter affect the financial, operational and/or trading position after the trading record period.</p> <p>Where an applicant discloses quantitative information relating to its financial performance after the track record period other than net profit/loss (e.g. revenue, gross profit, etc.), this non-profit forecast financial information should be reviewed by the reporting accountants, and a statement must be included in the listing document that the non-profit forecast financial information has been reviewed by the reporting accountants.</p>

DISCLOSURE IN THE "SUMMARY AND HIGHLIGHTS" SECTION OF IPO LISTING DOCUMENTS (HKEx-GL27-12)

GL27-12 provides guidance on disclosure in the "Summary and Highlights" section of listing documents.

Updated Requirements

Reflecting the amendments to GL41-2, Attachment 1 to GL27-12 which provides guidance (but not a prescriptive checklist) on the information which should typically be included in the "Summary and Highlights" section, has been amended to require disclosure of qualitative information or quantitative information with commentary relating to the applicant's financial performance and profitability (e.g. revenue, gross profit/loss, gross profit/loss margin, and/or operating data such as average selling price and sales volume). Where an applicant discloses quantitative information relating to its financial performance after the track record period other than net profit/loss (e.g. revenue, gross profit etc.), this non-profit forecast financial information should be reviewed by the reporting accountants, and a statement must be included in the listing document that the non-profit forecast financial information has been reviewed by the reporting accountants. An applicant with material changes in its financial, operational and/or trading position after the trading record period should refer to GL41-12 for the additional disclosures.

GUIDANCE ON INDEBTEDNESS, LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE DISCLOSURE IN LISTING DOCUMENTS AND SPONSOR'S CONFIRMATION ON WORKING CAPITAL SUFFICIENCY (HKEx-37-12)

GL37-12 provides guidance on listing document disclosure of indebtedness, liquidity, financial resources and capital structure and the requirement for sponsors to confirm working capital sufficiency. The amendments largely reproduce the Exchange's letters to practitioners issued on 21 July 2008 and 5 October 2009 and GL37-12 now supersedes those letters.

Updated Requirements

Liquidity disclosure: additional items for applicants with net current liabilities etc.

As previously, paragraph 4.4 sets out additional disclosure items for applicants with net current liabilities, negative operating cash flows for most of the track record period, significant capital commitments, high gearing ratios, and/or significant reclassification of long-term debt to short term debts.

The first of these (at paragraph (a) of paragraph 4.4) is disclosure of the basis, with specific reference to the applicant's facts and circumstances, upon which the directors form the view that the listing applicant can meet the working capital requirements for at least the next 12 months from the date of the listing document under Paragraph 36 of Part A of Appendix 1 to the Listing Rules. The updated GL37-12 has deleted the previous requirement for disclosure of whether the reporting accountants concur with the directors' view, and the basis for such concurrence or non-concurrence. Disclosure is still required of whether the sponsor concurs with the directors' view and the basis for such concurrence or non-concurrence.

Sponsor's confirmation on working capital sufficiency statement at time of submission of Application Proof

Paragraph 4.5A previously provided that at the time of submission of a listing application and an Application Proof:

- i) the sponsor is required to provide a final or an advanced draft confirmation that the working capital sufficiency statement in the Application Proof has been made by the directors after due and careful enquiry;
- ii) the sponsor is expected to have reviewed the working capital forecast memorandum and must be satisfied with the bases and assumptions used in the preparation of the working capital forecast; and
- iii) the sponsor is **not** required to confirm that (a) the persons or institutions providing finance have stated in writing that such facilities exist or (b) or will be available at the time of listing if the confirmation can be given without such written facilities.

The only change to paragraph 4.5A is the deletion of paragraph (b) in paragraph (iii) above.

DISCLOSURE OF FINANCIAL INFORMATION FOR THE TRADING RECORD PERIOD EXPECTED IN THE FIRST DRAFT LISTING DOCUMENT (HKEx-GL6-09A)

A new footnote has been added to the provisions regarding disclosure of stub period financial information in the accountants' report or the Application Proof. Footnote 1 notes that Hong Kong Accounting Standard 34 "Interim Financial Reporting" allows disclosure of condensed financial statements or complete set of financial statements in interim financial reports. It then provides that for the purposes of the stub period financial information required under GL6-09A, both condensed financial statements or complete set of financial statements are acceptable provided that they comply with the requirements of Notes 1 to 3 to paragraph 4 of the Guidance Letter.

GAMBLING ACTIVITIES UNDERTAKEN BY LISTING APPLICANTS AND/OR LISTED ISSUERS (HKEx-GL71-14)

GL71-14 reproduces the Exchange's News Release of 11 March 2003 in relation to whether a listing applicant involved in the operation of gambling activities is suitable for listing and whether a listed issuer can invest in a company involved in the operation of such activities.

According to the guidance letter, it is not contrary to the public interest if a listing applicant or listed issuer is involved in the operation of a gambling activity that is lawful under the Gambling Ordinance. This requires that:

- the gambling activity takes place **outside** Hong Kong; and
- the bookmaking transactions and the parties to the transactions must be outside Hong Kong.

In addition, the gambling activity must not violate any applicable laws in the areas where the gambling activity operates.

The guidance letter also covers the disclosure requirements and the requirements where a company is found to engage in activities contrary to the Gambling Ordinance after listing permission is granted or after acquisition of its shares by a listed issuer.

DISCLOSURE OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT SECTION OF LISTING DOCUMENTS (HKEx-GL62-13)

Guidance Letter 62-13 provides guidance on disclosure in the “Directors, Supervisors and Senior Management” section of listing documents. The amendments are as follows:

- the “Relevant Requirements” section now additionally refers to:
 - i) Main Board Rule 3.08 (GEM Rule 5.01) which states that the Exchange expects directors to fulfil fiduciary duties and to have duties of skill, care and diligence to a standard at least commensurate with the standard under Hong Kong law (paragraph 2.2);
 - ii) Main Board Rule 3.09 (GEM Rule 5.02) which requires every director of a listed issuer to satisfy the Exchange that he has the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as a director of a listed issuer (paragraph 2.3); and
 - iii) The Companies Registry’s “A Guide on Directors’ Duties” which provides guidance on the duties of directors of listed companies and is available on the Companies Registry’s website (paragraph 2.7);
- a statement that a listing applicant’s directors are expected to fulfil the requirements under the Guide on Directors’ Duties and that directors who fail to do so may be considered in breach of the Listing Rules (paragraph 2.8);
- the disclosure of the academic background of directors, supervisors and members of senior management is now additionally required to include disclosure of “whether the courses attended were long distance learning or online courses”. As previously, disclosure must be made of the names and locations of universities or colleges which are accredited by competent accreditation bodies and a newly added footnote provides that if the institutions are not so accredited, the sponsor should advise a listing applicant to remove references to the academic accreditation bodies from the listing document or disclose the fact that the academic accreditation bodies are not authorised to grant accreditation. Previously, these requirements were dealt with under sponsors’ requirements to verify the accreditation of universities under paragraph 3.3, which has now been deleted; and
- a statement that directors which were not appointed during the track record period should not be included in the table of directors’ remuneration in the accountants’ report (new paragraph 3.4)

GUIDANCE ON ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR ACQUISITIONS OF SUBSIDIARIES AND BUSINESSES CONDUCTED DURING OR AFTER THE TRADING RECORD PERIOD AND STUB PERIOD COMPARATIVE (HKEx-GL32-12)

The information regarding stub period comparison included in the Guidance Letter mainly includes information contained in the Exchange’s News Release regarding Clarification of certain Listing Rules provisions relating to financial disclosure in listing documents and circulars first published on 11 November 2004.

The updated guidance letter refers in the section on requirements to:

- Main Board Rule 4.28 (GEM Rule 7.30) which requires that where a listing applicant has acquired or proposes to acquire any businesses or companies that would be classified as a major subsidiary under that rule, pro forma financial information prepared in accordance with Main Board Rule 4.29 (GEM Rule 7.31) in respect of the enlarged group should be disclosed in the listing document (new paragraph 3.3);

- Main Board Rule 4.13 (GEM Rule 7.17) which requires that the relevant accounting standards to be used by new applicants and listed issuers for the preparation of financial information for inclusion in accountants' reports will normally be those current in relation to the last financial year reported on and, wherever possible, appropriate adjustments must be made to show profits for all periods in accordance with such standards (new paragraph 3.4); and
- The need to consider the impact of new and revised International Financial Reporting Standards or Hong Kong Financial Reporting Standards on the preparation of accountants' reports, profit forecasts, pro forma information and other financial information for inclusion in listing documents and circulars (new paragraph 3.5).

Pro forma financial information relating to acquisition of major businesses or subsidiaries

New paragraph 4.14 of the guidance letter states that where any of the percentage ratios calculated in accordance with Main Board Rule 4.28 (GEM Rule 7.30) represents 5% or more but less than 100%, an applicant should disclose, as a minimum, a pro forma statement of assets and liabilities of the enlarged group. Where any of the percentage ratios is 100% or more, a new applicant should disclose, as a minimum, a pro forma balance sheet, a pro forma income statement and a pro forma cash flow statement of the enlarged group.

Guidance relating to stub period comparatives

New paragraph 4.15 refers to the requirement of the Main Board and GEM Listing Rules to include in accountants' reports certain financial information, including stub period comparatives for income statements and cash flow statements. Listing documents or circulars should contain a discussion and analysis of a group's performance during the years or periods covered by an accountants' report. The Exchange considers that an analysis of a group's historical financial performance, material trends and seasonal fluctuations between different financial years or periods is important to enable investors to make informed investment decisions. The Exchange considers that the inclusion of stub period comparatives is necessary to allow such analysis.

Paragraph 4.16 states that all financial information for all periods included in an accountants' report is required to be audited except for the stub period comparatives, although these may be audited. Where the sub period comparatives are unaudited, at a minimum, a review opinion for the stub period comparatives should be included in the accountants' report and the unaudited financial information must be clearly identified as unaudited. A review of stub period comparatives by reporting accountants must comply with the International Standards on Review Engagements 2410 "Review of Interim Financial Information performed by the Independent Auditor of the Entity" issued by the International Auditing and Assurance Standards Board or Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants.

GUIDANCE ON CONNECTED TRANSACTION RULES (HKEX-GL70-14)

New Guidance Letter GL70-14 sets out in a guidance letter the Guide on Connected Transaction Rules previously published in the Exchange's News Release of 20 April 2012.

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