

## FINANCIAL ANALYSIS IN HONG KONG

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# **Financial Analysis in Hong Kong**

**Qualitative Examination of Financial Statements  
for CEOs and Board Members**

(Second Edition)

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***Financial Analysis in Hong Kong:  
Qualitative Examination of Financial Statements  
for CEOs and Board Members (Second Edition)***

By Benny K. B. Kwok

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# Preface to the Second Edition

Welcome to this second edition!

*Financial Analysis in Hong Kong (Second Edition)* is a product of experience, chapter review and correspondence with scholars, students, business executives and other professionals, as well as an update reflecting the changes in practices, guidelines, standards and legislations since the first edition in 2008.

As an ongoing process to enhance this title, a vocation education programme based on the first edition was developed during 2008–09. Indeed, seven cycles of Certificate in Financial Analysis in Hong Kong were held by The Chinese University of Hong Kong during 2009–11. Well over a hundred of executives and non-finance professionals have successfully completed the programme with the award of certificates.

Based on the encouraging feedback, some concepts are clarified and new relevant materials are included. Such collaborative effort of enhancement should help to ensure the needs of today's qualitative examination of financial statements are met by reading this book.

## **Why Has This Book Been Written and Updated?**

Sixteen years have lapsed since China's resumption of sovereignty over Hong Kong. Capitalism remains flourishing, and Hong Kong continues its role as a world-class metropolis. Capitalism depends on the prosperity of corporations which requires supports from investors, workers, customers, suppliers, governments and the general public. Financial reporting maintains a channel of visible communication between corporations and the outside world, and the integrity, stability and transparency of such a regime have helped us to succeed in the global economy.

Not surprisingly, financial reporting as a highly regarded profession consists of acute technicalities and codified messages. Analysing the

financials unlocks these messages and reveals corporations' performances and positions. *Financial Analysis in Hong Kong (Second Edition)* is written as a tribute to the business and financial analysis profession. Although it is by no means a comprehensive textbook covering the entire spectrum of subjects in business, finance and accounting, it provides an overview of the financial reporting and analysis regime, as well as an in-depth study of certain important analytical techniques required for such purpose.

Credible financial analysis counts on information from different sources and channels. The primary source comes directly from corporations' annual reports which generally contain the financial highlights for the year, the report of the directors and auditors, the key financial statements such as statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows, as well as the notes to the financial statements. However, simply reviewing corporations' annual reports is not enough. In order to take a broader view, analysts generally pursue other sources of information, such as researching on the corporation's background and business, holding interviews with corporate executives or government officials, and carrying out surveys on the market and economic trends.

### **Why Do We Bother with Financial Analysis?**

To many laypersons, financial statements are in a foreign language; but, equipped with basic financial analytical techniques, things can be made clear. The laws, accounting standards and other regulations have provided a clear set of instructions on how to prepare credible and understandable financial information. Analysts need to go beyond a basic understanding of the financial information and develop a mentality of making intelligent interpretation and comparison. Financial analysis is a crucial but yet frequently overlooked prerequisite for good commercial decisions. In today's fast-moving globalized economy, making commercial decisions has become part of our everyday life. From a private investor assessing the potential return of his/her investments to multibillion dollars' worth of merger and acquisition decision, analysing the financials would shed light on the true financial performance and position on which commercial decisions are based.

## What Is This Book About?

*Financial Analysis in Hong Kong (Second Edition)* has a total of ten chapters and six appendices. Chapter 1 gives a brief introduction to the regulatory framework of financial reporting in Hong Kong. The functions of accounting and auditing in financial analysis are discussed in Chapter 2, as followed by an overview of the key components of financial statements in Chapter 3. Accounting ratios and their significance in financial analysis are evaluated in Chapters 4 and 5 respectively. The importance of corporations' lifeblood, i.e. cash, to financial analysis is discussed in Chapter 6. The quality of profits and governance and how they affect corporations' results are set out in Chapters 7 and 8 respectively. Chapter 9 involves drawing up common-size financial statements, identifying trends from the financials, studying a corporation's cost structure and applying common sense to some analytical matters. Chapter 10 considers various factors affecting financial analysis from the macro-environmental perspective.

Information, primarily extracted from the annual reports, about certain corporations have been cited throughout *Financial Analysis in Hong Kong (Second Edition)*. Appendix I sets out the basic details about those corporations. Titles of the prevailing standards of financial reporting and auditing in Hong Kong are listed in Appendices II and III respectively. Appendix IV tabulates those listed companies containing modified audit opinions and/or explanatory paragraphs in recent years. Appendix V extracts certain relevant aspects from the audited financial statements of the five corporations. A series of discussion questions are added at the end of each chapter so as to stimulate thoughts and debates. Some key points in addressing these discussion questions are set out in Appendix VI.

## Who Should Read This Book?

Corporations record and present data in the form of financial statements and other reports as an effective channel of communication to the outside world. Some of the readers of financial statements are untrained in the subject and require guidance to see how the figures fit together and to unveil the truth beneath the surface of financial statements. Without the unnecessary use of accounting and financial jargons, *Financial Analysis in*

*Hong Kong (Second Edition)* seeks to give a clear and concise referencing guidance for the analysis of corporations' financials in Hong Kong.

One does not necessarily need to be a financial analyst in order to make use of corporations' financials. *Financial Analysis in Hong Kong (Second Edition)* is primarily designed for CEOs, bankers, journalists, lawyers, accountants, business managers, board members and other professionals who need to read, understand and interpret corporations' financial statements and other related matters. It can also be an invaluable reference tool for directors to improve their professionalism and contributions to the boards on which they serve. Academics and business students will see *Financial Analysis in Hong Kong (Second Edition)* as an alternative and inspiring way of seeing how corporations' financials may be analysed.

Benny K. B. Kwok  
July 2013

## Acknowledgements

I am very fortunate to have received extensive feedbacks, suggestions and encouragements from friends, colleagues and clients during my writing of this second edition.

I acknowledge the permission by the five corporations, of which the financial statements were extracted and reproduced in this second edition.

My sincere thanks go to The Chinese University of Hong Kong, for the continued trusts and supports on me in developing a certificate programme based on this book. My sincere appreciation also goes to my editor, Mr. Brian Yu at The Chinese University Press, for his editing skill and tireless hours to make this second edition a reality.

I am also thankful to my forensic analyst, Ms. Angela Chong, for her assistance in technical updates, editorial changes and graphic illustrations.

Obviously, my acknowledgements in the first edition are still relevant and are shown below:

“Completing three titles along with developing a professional practice in six years, among other things in life, have been a great challenge to me . . . which, I hope, will turn into a distinguished achievement through the success of *Financial Analysis in Hong Kong*.

“I am grateful to many persons who helped me in various ways and would like to thank one of my students at The Chinese University of Hong Kong, Ms. Brenda Chan who is a certified public accountant and a chartered secretary, for diligently researching with me during the preparation of this book. Special thanks go to Ms. Shirley Cheung, an analyst, for inspiring me with ideas and typing my drafts so patiently and enthusiastically every step of the way.

“I am also indebted to every annual report I have read, every general meeting I have attended, every CEO or analyst I have talked

with, the fifteen professional bodies I have qualified with and the nine listed corporations I have made reference to.”

Benny K. B. Kwok  
July 2013

## About the Author

Benny K. B. Kwok is one of the world's most renowned forensic accountants and experts in litigation support, dispute analysis and fraud investigation. He is the author of two other authoritative titles—*Forensic Accountancy* (2002/2008, 1<sup>st</sup> and 2<sup>nd</sup> Editions) and *Accounting Irregularities in Financial Statements* (2005)—published and in print worldwide.

During the 1980s and 1990s, Mr. Kwok worked in a British bank, the British Government and the Big-Four accounting firms. He is the Chairman of Benny K. B. Kwok Forensic Expert, the Director of AIP Partners CPA Limited and the Director of Funing Property Management Limited.

Over the years, Mr. Kwok has attended arbitration hearings, disciplinary proceedings as well as trials at the District Court and the High Court, on civil and criminal cases, as an expert witness to give evidence in respect of accounting, commercial and financial matters. Mr. Kwok has also acted as a single joint expert duly appointed by the High Court in civil proceedings.

Mr. Kwok is a Certified Public Accountant in Hong Kong and a Chartered Accountant in the United Kingdom (both with practising certificates and at fellow member statuses). Throughout his career, Mr. Kwok has been awarded with professional qualifications beyond the traditional accountancy field. Mr. Kwok has a unique combination of expertise with qualifications awarded by the following professional institutions or statutory bodies:

- Association of Certified Fraud Examiners, USA
- Australian Institute of Company Directors
- Australian Marketing Institute
- Chartered Institute of Building, UK
- Chartered Institute of Journalists, UK
- Chartered Institution of Water and Environmental Management, UK

- Hong Kong Institute of Directors
- Hong Kong Institute of Certified Public Accountants
- Hong Kong Institute of Human Resource Management
- Hong Kong Institute of Marketing
- Hong Kong Institute of Surveyors
- Housing Managers Registration Board, Hong Kong
- Institute of Chartered Accountants in England and Wales
- Royal Institution of Chartered Surveyors, UK
- Surveyors Registration Board, Hong Kong
- Taxation Institute of Hong Kong

Mr. Kwok currently sits on two tribunals—the Solicitors Disciplinary Tribunal (Legal Practitioners Ordinance) and the Obscene Articles Tribunal (Control of Obscene and Indecent Articles Ordinance)—and was the Member of the Board of Review (Inland Revenue Ordinance) for six years. Mr. Kwok is the Honorary Professor of SWP Linux Training and Development Centre and the School Councillor of West Island School, and held a number of community appointments over the years, including the Honorary Treasurer of the Association of Certified Fraud Examiners and the Examiner for the CPA Qualification Programme of the Hong Kong Institute of Certified Public Accountants.

Mr. Kwok has presented more than 100 lectures or seminars for the Government of the Hong Kong Special Administrative Region, the Chinese University of Hong Kong, the University of Hong Kong, the Hong Kong Polytechnic University, the Hong Kong Institute of Certified Public Accountants, the Hong Kong Institute of Surveyors, the Law Society of Hong Kong and many other institutions. He has had more than 100 articles featured in various journals and daily newspapers published throughout the world including the Hong Kong Institute of Bankers, the Hong Kong Institute of Housing, the Law Society of Hong Kong, the Institute of Chartered Accountants in England and Wales, the Chinese Institute of Certified Public Accountants, the Hong Kong Institute of Certified Public Accountants, the CPA Australia and the Hong Kong Confederation of Insurance Brokers.

Mr. Kwok's official website is: [www.forensic.hk](http://www.forensic.hk).

# Abbreviations

AAC	AAC Technologies Holdings Inc.
AB	Accounting Bulletins
AG	Accounting Guidelines
AGM	annual general meeting
BE	break-even
CEO	Chief Executive Officer
CMMB	CMMB Vision Holdings Limited
CO	Companies Ordinance
CPA	certified public accountant
CPI	Consumer Price Index
CVP	cost-volume-profit
EBIT	earnings before interest and tax
EBITA	earnings before interest, tax and amortization
EBITDA	earnings before interest, tax, depreciation and amortization
ED	executive director
EPS	earnings per share
FIFO	first-in-first-out
FRC	Financial Reporting Council
GDP	gross domestic product
GEM	growth enterprise market
GRI	Global Reporting Initiative
HKAS	Hong Kong Accounting Standards
HKCC	HKFE Clearing Corporation Limited
HKEx	Hong Kong Exchanges and Clearing Limited
HKFRS	Hong Kong Financial Reporting Standards
HKICPA	Hong Kong Institute of Certified Public Accountants
HKSA	Hong Kong Standard on Auditing
HKSAR	Hong Kong Special Administrative Region
HKSCC	Hong Kong Securities Clearing Company Limited
HSBC	The Hongkong and Shanghai Banking Corporation Limited

IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
INED	independent non-executive director
IR	Integrated Reporting
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance
ISO	International Organization for Standardization
Ka Shui	Ka Shui International Holdings Limited
LIFO	last-in-first-out
Neo-Neon	Neo-Neon Holdings Limited
OCF	operating cash flow
One Media	One Media Group Limited
PBIT	profits before interest and tax
PBITDA	profits before interest, tax, depreciation and amortization
PBT	profits before tax
P/E	price earnings ratio
PESTE	politics, economics, society, technology and environment
PESTEL	politics, economics, society, technology, environment and legal
PRC	People's Republic of China
R&D	research and development
ROCE	return on capital employed
SA8000	Social Accountability 8000
SEOCH	Stock Exchange Options Clearing House Limited
SFC	Securities and Futures Commission
SFCO	Securities and Futures Commission Ordinance
SFO	Securities and Futures Ordinance
SME-FRF	Small and Medium-sized Entity Financial Reporting Framework
SME-FRS	Small and Medium-sized Entity Financial Reporting Standard
SSAP	Statements of Standard Accounting Practice
STEELED	social, technological, economic, environmental, political, legal, ethical, demographical
STEER	socio-cultural, technological, economic, ecological, regulatory
SWOT	strengths, weaknesses, opportunities, threats
US-GAAP	Generally Accepted Accounting Principles in the USA

## **Regulatory Framework of Financial Reporting in Hong Kong**

This chapter introduces some important laws and regulations governing financial reporting in Hong Kong and includes the following sections:

- Statutory and Professional Requirements
- Government of the Hong Kong Special Administrative Region
- Stock Exchange of Hong Kong Limited
- Securities and Futures Commission
- Hong Kong Institute of Certified Public Accountants
- Financial Reporting Council

Financial analysis refers to the review and evaluation of corporations' financial statements and other financials. As part of the annual reports, financial statements are prepared by corporations in accordance with the regulatory framework. In order to carry out an effective analysis of financial statements, analysts should possess a general understanding of the regulatory framework of financial reporting.

### **Statutory and Professional Requirements**

Financial reporting demonstrates the ways a corporation's financial results and positions are reported to its owners, lenders, management and other stakeholders (such as customers, suppliers, employees, governments and regulators). In Hong Kong, there are statutes as well as professional rules and regulations to govern financial reporting. Authorities in charge of enforcing the regulatory framework of financial reporting include the

Government of the Hong Kong Special Administrative Region (the Government of the HKSAR), the Stock Exchange of Hong Kong Limited (the Stock Exchange), the Securities and Futures Commission (SFC), the Hong Kong Institute of Certified Public Accountants (HKICPA) and the Financial Reporting Council (FRC).

Many of the statutory and professional requirements are mandatory, such as:

- the Companies Ordinance (CO) and the Inland Revenue Ordinance (IRO);
- the Rules Governing the Listing of Securities (the Listing Rules) and the Rules Governing the Listing of Securities on the Growth Enterprise Market (the GEM Rules), both issued by the Stock Exchange; and
- Hong Kong Financial Reporting Standards (HKFRS) issued by the HKICPA.

These mandatory requirements are often cited as the preparation or compliance basis for many financial statements. According to page 47 of Ka Shui's 2011 annual report, “. . . These financial statements have been prepared in accordance with HKFRSs, accounting principles generally accepted in Hong Kong and the applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and by the Hong Kong Companies Ordinance.”

Similarly, page 39 of CMMB's 2011 annual report describes that “The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance.”

This kind of declarations or statements can be found in most, if not all, of the relevant corporations applicable to the Hong Kong financial reporting regulatory framework. In fact, it is a requirement under both the CO and the HKFRS.

There are other publications which are advisory only, such as Accounting Guidelines (AG) and Accounting Bulletins (AB) issued by the HKICPA, trade and industry best practices as well as publications of the

International Accounting Standards Board (IASB) and other influential accounting standard setting bodies.

A commonly recognized term, generally accepted accounting principles (GAAP), represents rules from all authoritative sources governing accounting, but GAAP has no statutory or professional significance in Hong Kong. GAAP is used extensively in the legislations in the USA, and in essence GAAP in USA is similar to the standing of HKFRS in Hong Kong. GAAP is a dynamic concept consistently being reviewed and adapted in response to changing business priorities and economic environments. GAAP goes far beyond rigid rules and principles, and anticipates emerging contemporary accounting practices.<sup>1</sup>

In some cases, HKFRS does not provide adequate guidance to account for certain types of transactions, and the corporations, under such circumstances according to HKAS 8, shall develop and apply an accounting policy that results in information that is:<sup>2</sup>

- relevant to the economic decision-making needs of users; and
- reliable so as to:
  - represent faithfully the financial position, financial performance and cash flows of the corporation;
  - reflect the economic substance of transactions (not merely the legal form);
  - are neutral, i.e. free from bias;
  - are prudent; and
  - are complete in all material respects.

## **Government of the Hong Kong Special Administrative Region**

Hong Kong is a Special Administrative Region of the People's Republic of China. Intervention by the Government of the HKSAR in the financial markets has generally been kept low, and the markets are largely self-regulated. Limited liability companies are the most common form of business in Hong Kong. Other forms of business, such as sole proprietorships and partnerships, also produce financial statements (which may follow a similar set of requirements as limited liability companies). Indeed, the Business Registration Ordinance requires every person who

carries on a business in Hong Kong to apply for business registration within one month from the date of commencement of the business, and to display a valid Business Registration Certificate at the place of business. However, business registration is not for regulating business activities or to serve as a licence to trade. In this book when a differentiation is not necessary, we use “corporations” to represent all kinds of businesses reporting under the CO, the Listing Rules, the GEM Rules and/or HKFRS for financial analysts to follow.

Companies are legal entities registered under the CO which contains detailed provisions regarding the keeping of accounting records, the content of financial statements and the audit of Hong Kong incorporated companies. Although the Government of the HKSAR has the power to establish detailed accounting rules and standards, such responsibility is left with the self-regulator of accountants, i.e. HKICPA, via the development and issue of HKFRS. The overriding requirement on financial reporting under the CO is that the financial statements should give a true and fair view of the company’s state of affairs and its profit or loss.<sup>3</sup> The Tenth Schedule of the CO is primarily concerned with the specific disclosure requirements in financial statements.

Any person (or corporation) carrying on business in Hong Kong must observe the IRO. The Inland Revenue Department (IRD) of the Government of the HKSAR is responsible for administering the IRO and the Rules and Regulations made under the IRO. The IRO sets out the basis and scope of various tax charges and the requirements for keeping business records and financial statements, but it does not specify any detail on financial statements. The Financial Secretary of the Government of the HKSAR is in charge of the Government Budget and is responsible under the Public Finance Ordinance for laying before the Legislative Council each year the Government’s estimates of revenue and expenditure. In the annual budget speech, the Financial Secretary presents budgetary proposals and moves the Appropriation Bill, which gives legal effect to the annual expenditure proposals contained in the Budget. Corporations’ tax liabilities are calculated and discharged according to the IRO and the annual budget announcements by the Government of the HKSAR. Page 77 of One Media’s 2011/2012 annual report states that “Hong Kong profits tax has been provided at the rate of 16.5% (2011: 16.5%) on the estimated assessable

profit during the year ended 31<sup>st</sup> March 2012.”

Banks and insurers are subject to the disclosure requirements set out in Part III of the Tenth Schedule of the CO as well as the Banking Ordinance or the Insurance Companies Ordinance which mean more lengthy disclosure. For example, banks in Hong Kong must fully comply with the Banking (Disclosure) Rules made under the Banking Ordinance.<sup>4</sup>

### ***General Financial Reporting Requirements under the Companies Ordinance***

In general, shareholders own the company, and directors are in charge of its corporate governance and business activities. Private company refers to a company of not more than 50 members with certain restrictions over the transfer and subscription of shares. Public companies usually refer to those listed on the Stock Exchange.

Every company is required to prepare:<sup>5</sup>

- a balance sheet (which is equivalent to a statement of financial position under HKFRS) which gives a true and fair view of the state of affairs of the company as at the financial year-end; and
- a profit and loss account (which is equivalent to a statement of comprehensive income under HKFRS) which gives a true and fair view of the profit or loss of the company for the financial year.

The requirement for a true and fair view overrides all other accounting requirements of the CO and HKFRS. If the company is a parent company of a group, consolidated financial statements must also be prepared unless the company is itself a wholly-owned subsidiary of another company.<sup>6</sup> Companies are required to maintain proper books of account, so as to show at any time a true and fair view of the state of the company's affairs and to explain its transactions.<sup>7</sup> Such books must include details of receipts and payments, sales and purchases of goods, and the assets and liabilities of the company.<sup>8</sup> The books of account must be kept for seven years from the end of the financial year to which they relate. Financial statements must be approved by the board of directors.<sup>9</sup>

The independent auditor's report on page 31 of One Media's 2011/2012 annual report states that “The directors of the Company are

responsible for the preparation of consolidated financial statements that give a true and fair view accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance. . . . In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31<sup>st</sup> March 2012, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with requirements of the Hong Kong Companies Ordinance.<sup>9</sup> More details about audit opinion are discussed in Chapter 2, whilst the responsibilities of directors and auditors are further discussed in Chapters 2 and 8 respectively.

Audited financial statements of a public company must be presented to the shareholders at the annual general meeting (AGM) and the financial statements should be made up to a date falling not more than 6 months before the AGM.<sup>10</sup> A copy of the audited financial statements, auditors' report and directors' report in the company's annual return should be filed to the Registrar of Companies within 42 days following the AGM.<sup>11</sup> In the case of a private company, the financial statements should be made up to a date falling not more than 9 months before the date of the AGM.<sup>12</sup> A private company is not required to include the audited financial statements, auditors' report or directors' report in the annual return to the Registrar of Companies.<sup>13</sup>

Where the shareholders of a private company agree to apply Section 141D, the financial statements do not need to follow certain sections of the CO.<sup>14</sup> In particular, the financial statements are required to show a true and correct view (instead of a true and fair view) of the state of the company's affairs at the financial year-end and of its profit or loss for that financial year, and the Eleventh Schedule (rather than the Tenth Schedule) of the CO is required to be complied. Accordingly, Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) instead of HKFRS may be followed.

### ***Overseas Companies***

Companies incorporated overseas may operate in Hong Kong. In fact, many companies listed on the Stock Exchange are incorporated in the

Mainland China, Bermuda and the Cayman Islands, i.e. overseas (or China) companies subject to Part XI of the CO. For example, AAC and CMMB are incorporated in the Cayman Islands. If an overseas company is also a private company, it is largely exempt from the CO. However, audited financial statements are generally required for taxation purposes under the IRO.

### ***General Book-Keeping Requirements under the Inland Revenue Ordinance***

The IRO requires a person carrying on business in Hong Kong to keep sufficient records of the income and expenditure so as to readily ascertain the assessable profits.<sup>15</sup> Large multinational corporations usually have their own tax departments in supporting and giving advice on the tax planning and compliance issues. Some other corporations may outsource these functions to tax representatives. To ensure compliance, business records should include:

- the books of account recording receipts and payments, or income and expenditures;
- the underlying documentation necessary to verify the entries in the books of account;
- a record of the assets and liabilities of the business; and
- a daily record of all sums of money received and expended by the trade together with supporting details.

However, all these requirements relate to record-keeping rather than financial reporting. In fact, the IRO does not cover the preparation basis or disclosure items of financial statements. Nevertheless, corporations' tax returns must be supported by appropriate tax computations and audited financial statements.

## **Stock Exchange of Hong Kong Limited**

In accordance with the Securities and Futures Ordinance (SFO), Hong Kong Exchanges and Clearing Limited (HKEx) owns and operates the Stock Exchange and Hong Kong Futures Exchange Limited (Futures Exchange) and three clearing houses which are wholly-owned subsidiaries of HKEx.<sup>16</sup>

The Stock Exchange is the primary regulator of companies listed on the Main Board and the Growth Enterprise Market (GEM) Board regarding trading matters. Companies listed on the Main Board follow the Listing Rules, whereas companies listed on the GEM Board are required to comply with the GEM Rules. The Futures Exchange operates and maintains a futures market in Hong Kong, and regulates participants with respect to trading matters. The three clearing houses provide services for the clearing and settlement of securities, stock option transactions and transactions on the Futures Exchange. While the Stock Exchange remains the frontline regulator of listed companies, matters regarding takeovers, share repurchase and privatization are the responsibilities of the SFC.

### ***General Financial Reporting Requirements for Companies Listed on the Main Board***

Other than those requirements set out in the CO, the IRO and HKFRS, there are additional disclosure requirements for companies listed on the Main Board, both in respect of annual financial reporting and half-yearly financial reporting.<sup>17</sup> According to the HKEx's statistics,<sup>18</sup> there are 1,355 listed companies on the Main Board in the third quarter of 2012. Companies listed on the Main Board are required to send their annual reports (including audited financial statements) to every member within three months (or four months applicable to financial reporting periods ending on or after 31 December 2010) after the year-end, and not less than 21 days before the date of the AGM.

The Listing Rules require the presentation of certain financial information disclosures in the notes to financial statements including:

- maturity profile of borrowings;
- directors' emoluments on a named basis;
- employees' emoluments by bands;
- pension schemes;
- credit policy and aged analysis of accounts receivable; and
- aged analysis of accounts payable.

Companies listed on the Main Board are required to publish their final results in the newspapers on the next business day after the approval by the

board of directors and to submit electronic copies of announcements for parallel publication on the HKEx website.

A Main Board listed company is required to issue an interim report (for the first six months of a financial year) not later than two months after the interim period end in accordance with HKFRS.<sup>19</sup> All companies with a primary listing on the Main Board are required to prepare financial statements in accordance with HKFRS or IAS. Listed companies adopting IAS are required to explain the relevant financial effect of material differences between IAS and HKFRS which is becoming largely irrelevant due to the harmonization between the two sets of standards (except for those incorporated in the Mainland China before 1 April 2001). Overseas companies with a secondary listing on the Main Board are permitted to use the GAAP in the USA (US-GAAP).

The Stock Exchange has recently amended the Listing Rules allowing Mainland China incorporated issuers to prepare their financial statements using the accounting standards of Mainland China; and allowing the audit firms of Mainland China vetted, nominated and endorsed by the Ministry of Finance of China and the China Securities Regulatory Commission to service these issuers using the auditing standards of Mainland China. Compliance costs for Mainland China companies listed in Hong Kong are expected to reduce.

According to page 42 of AAC's 2011 annual report, ". . . the company was incorporated and registered as an exempted company with limited liability, the Cayman Islands under the Companies Law of the Cayman Islands with its shares listed on The Stock Exchange of Hong Kong Limited (the 'Stock Exchange')." Page 45 states that "The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange and by the Hong Kong Companies Ordinance."

Page 40 of One Media's 2011/2012 annual report states that "The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRSs') issued by the International Accounting Standards Board ('IASB'), requirements of the Hong Kong Companies Ordinance and applicable disclosure requirements of the Listing Rules."

### ***General Financial Reporting Requirements for Companies Listed on the GEM Board***

The financial reporting requirements for companies listed on the GEM Board are principally set out in the GEM Rules<sup>20</sup> which are tighter but similar to the Listing Rules. There are some specific disclosures only applicable under the GEM, such as the amount of disclosure of directors' emoluments by each director on an anonymous basis. The deadlines to publish annual and quarterly/six-monthly reports are within three months and 45 days after the respective year-/period-end on the Stock Exchange's website. All companies listed on the GEM Board are allowed to prepare financial statements in accordance with HKFRS or IAS. Companies except for property development investment companies listed on the New York Stock Exchange or Nasdaq of the USA are permitted to use US-GAAP.

According to the HKEx's statistics,<sup>21</sup> there are 178 listed companies on the GEM Board in the third quarter of 2012. Unfortunately, the GEM Board has not been a very active market, and its liquidity is low compared to other second-tier stock markets such as AIM in London and Nasdaq in New York.

### **Securities and Futures Commission**

The SFC was established by the Securities and Futures Commission Ordinance (SFCO) as an independent statutory body outside the civil service, responsible for regulating the securities and futures markets in Hong Kong. In 2003, the SFCO and nine other securities and futures related ordinances were consolidated into the Securities and Futures Ordinance (SFO). To avoid conflict of interest and to ensure a level playing field, HKEx (and the Stock Exchange) is regulated by the SFC. The SFC is also responsible for handling investigations and disciplinary matters, including complaints and disputes, and is empowered to inspect the books and records of any registered person and to conduct special investigations as regard to any person involved with securities.

The SFC has six operational divisions (Corporate Finance, Enforcement, Intermediaries Supervision, Licensing, Investment Products and Supervision of Markets) and two supporting divisions (Legal Services

Division and Corporate Affairs Division). The duties of the six operational divisions are as follows:<sup>22</sup>

- Corporate Finance Division is responsible for the dual filing functions in relation to listing matters, administrating the Takeovers and Mergers Code and Share Repurchases Code, overseeing the Stock Exchange's listing-related functions and responsibilities, and administrating securities and company legislation.
- Enforcement Division is responsible for conducting market surveillance to identify market misconduct, undertaking inquiry into alleged breaches of relevant ordinances and codes, and instituting disciplinary procedures for misconduct.
- Intermediaries Supervision Division is responsible for devising and administrating licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervising and monitoring intermediaries' conduct and financial resources, and regulating the public marketing of investment products.
- Licensing Division is responsible for license corporations and individuals seeking to conduct business in Hong Kong in regulated activities requiring a licence under the SFO, issue codes and guidelines concerning the competence and suitability of corporations and individuals to be licensed, monitor ongoing compliance with licensing requirements by licensees and related parties.
- Investment Products Division is responsible for liaising with other divisions in doing so, with particular emphasis on the Mainland China and market development, developing and implementing codes and guidelines to set up a platform for authorization applications of investment products so as to facilitate market growth and product innovation, regulating and approving investment products offered to the public, monitoring disclosures and continuing compliance of authorized investment products.
- Supervision of Markets Division is responsible for supervising and monitoring activities of the exchanges and clearing houses, encouraging development of the securities and futures markets, promoting and developing self-regulation.

## **Hong Kong Institute of Certified Public Accountants**

The HKICPA, established by the Professional Accountants Ordinance, is responsible for administrating and regulating the accounting profession in Hong Kong. The HKICPA issues standards and guidelines of accounting practices in order to:

- develop high quality, understandable and enforceable accounting standards in the public interest;
- promote the use and rigorous application of those standards;
- promote, support and enforce compliance with those standards; and
- converge accounting or financial reporting standards with International Financial Reporting Standards (IFRSs) issued by the IASB.

### ***Hong Kong Financial Reporting Standards***

Accounting or financial reporting standards generally refer to HKFRS, which include Hong Kong Accounting Standards (HKAS) and their interpretations, and are the most authoritative source of accounting principles generally accepted in Hong Kong. HKFRS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in financial statements. HKFRS are discussed in more detail in Chapter 2. The authority of HKFRS is based on the HKICPA's requirement over its members to observe HKFRS in the preparation and auditing of financial statements.

Accounting or financial reporting standards in the UK were the basis for standards in Hong Kong until 1993. Since then, accounting or financial reporting standards are referenced to IASB. In 2004, the HKICPA introduced new HKAS that are converged with standards and interpretations issued by the IASB. These new HKAS have become effective from 2005 and, as a consequence, the corresponding previous standards (so-called Statements of Standard Accounting Practice or SSAP) have been superseded.

To witness the changeover from SSAP to HKFRS, corporations are required to spell out the changes and their effects on the financial statements from 2005 to 2006. Many annual reports published in 2006

stated the adoption of the new/revised Hong Kong Financial Reporting Standards (HKFRS), Hong Kong Accounting Standards (HKAS) and Interpretations (collectively, ‘new HKFRSs’) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), effective for accounting periods starting in 2005 and thereafter. The changes in accounting policies and its effect on the financial statements were also summarized by those corporations.

A full list of HKFRS currently in issue is set out in Appendix II. The HKICPA is developing accounting standards to achieve convergence with the IFRS. The HKICPA is committed to promoting and supporting compliance with HKFRS, and this responsibility is evidenced by the association of its members’ names with such financial statements in the capacity of auditors, directors or other officers. The HKICPA may look into any non-compliance by its members. The HKICPA also issues the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) for certain companies within the qualifying criteria. Compliance with the SME-FRF is necessary in order for those financial statements to give a “true and correct view” in accordance with section 141D of the CO.

Since May 2010, certain companies in Hong Kong have another option in their financial reporting compliance. With a view to easing the reporting burden of “Private Entities”, the HKICPA issued the Hong Kong Financial Reporting Standard for Private Entities (HKFRS for Private Entities) as a financial reporting option for Private Entities. Private Entities is defined in HKFRS for Private Entities as entities that:

- do not have public accountability; and
- publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

Companies are not mandated to adopt the HKFRS for Private Entities even if they are eligible to do so. The scope and applicability of HKFRS, Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard remain unchanged.

The HKFRS for Private Entities is based on the International Financial Reporting Standard for Small and Medium-sized Entities.