

## HKEx GUIDANCE LETTER

HKEx-GL32-12 (March 2012) (Updated in January, March and October 2014)

<b>Subject</b>	<b>Guidance on the accounting and disclosure requirements for (A) acquisitions of subsidiaries and businesses conducted during or after the trading record period; and (B) stub period comparatives</b>
<b>Listing Rules and Regulations</b>	<b>Main Board Rules 4.04(2), 4.04(4), 4.05A, 4.13 and 4.28 GEM Rules 7.03(2), 7.03(4), 7.04A, 7.17 and 7.30</b>
<b>Related Publications</b>	<b>HKEx News Release (11/11/2004) Listing Decisions HKEx-LD78-1 (superseded by this Guidance Letter in October 2014) and HKEx-LD85-1</b>
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**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.*

### 1. Purpose

1.1 The purpose of this letter is to provide guidance and clarification on the accounting and disclosure requirements:-

(A) in respect of subsidiaries or businesses acquired or agreed/ proposed to be acquired by a new listing applicant during or after the trading record period under the following rules:-

- Main Board Rules 4.04(2) and 4.04(4) (GEM Rules 7.03(2) and 7.03(4));
- Main Board Rule 4.05A (GEM Rule 7.04A); and
- Main Board Rule 4.28 (GEM Rule 7.30) (collectively the “**Relevant Rules**”); and

(B) for stub period comparatives required to be presented in an accountants’ report in a listing document or circular and covered by a review opinion issued by reporting accountants<sup>1</sup> (*Updated in January 2014 and October 2014*).

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<sup>1</sup> Extracted from HKEx News Release on “Clarification of certain Listing Rules provisions relating to financial disclosure in listing documents and circulars” first published on 11 November 2004.

2. Repealed.

### 3. Relevant Requirements

- 3.1 Main Board Rules 4.04(2) and 4.04(4) (GEM Rules 7.03(2) and 7.03(4)) (“Rules 4.04(2) and (4)”) require a new listing applicant to include in its accountants’ report the results and balance sheets of any subsidiary or business acquired, agreed to be acquired or proposed to be acquired since the date to which its latest audited accounts have been made up in respect of each of the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document, or since the incorporation of such subsidiary or the commencement of such business if this occurred less than three years (two years for GEM applicants) prior to such issue, or such shorter period as may be acceptable to the Exchange for Main Board applicants<sup>2</sup>.
- 3.2 Main Board Rule 4.05A (GEM Rule 7.04A) (“Rule 4.05A”) requires that, where a new listing applicant has acquired any material subsidiary or business during the trading record period<sup>3</sup> and such an acquisition, if made by a listed issuer, would have been classified at the date of application as a major transaction<sup>4</sup> or a very substantial acquisition<sup>5</sup>, it must disclose pre-acquisition financial information on that material subsidiary or business from the commencement of the trading record period (or if the material subsidiary or business commenced its business after the commencement of the trading record period, then from the date of commencement of its business) to the date of acquisition. Pre-acquisition financial information on the material subsidiary or business must normally be drawn up in conformity with the accounting policies adopted by the new listing applicant and be disclosed in the form of a note to the accountants’ report or in a separate accountants’ report.
- 3.3 Main Board Rule 4.28 (GEM Rule 7.30) (“Rule 4.28”) states that where a new applicant has acquired or proposes to acquire any businesses or companies which would at the date of application or such later date of acquisition be classified as a major subsidiary as defined in this Rule, pro forma financial information prepared in accordance with the Main Board Rule 4.29 (GEM Rule 7.31) in respect of the enlarged group should be disclosed in its listing document (*Added in January 2014*).
- 3.4 Main Board Rule 4.13 (GEM Rule 7.17) 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 (*Added in January 2014*).
- 3.5 The Exchange reminds new applicants, listed issuers and their advisers 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 (*Added in January 2014*).

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<sup>2</sup> See Main Board Rules 8.05A, 8.05B and 23.06.

<sup>3</sup> See Main Board Rule 4.04(1) and GEM Rule 7.03(1)(a).

<sup>4</sup> See Main Board Rule 14.06(3) and GEM Rule 19.06(3).

<sup>5</sup> See Main Board Rule 14.06(5) and GEM Rule 19.06(5).

## 4. Guidance

4.1 Set out below is our guidance in relation to the matters in paragraph 1.1. A summary of our guidance on Rules 4.04(2) and (4) and Rule 4.05A is also set out in Attachment 1.

### **(A) Guidance Relating to Acquisitions**

#### *Scope*

4.1A For the avoidance of doubt:-

- (i) acquisitions of business include acquisitions of associates and any equity interest in another company. However, the Relevant Rules generally do not apply to acquisitions of assets; and
- (ii) the trading record period for the purpose of the Relevant Rules includes the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document **and** the stub period reported on by the reporting accountants in conformity with Main Board Rule 8.06 (GEM Rule 11.11) (*Updated in October 2014*).

4.2 Rules 4.04(2) and (4): These rules apply to any subsidiary and business acquired, agreed to be acquired or proposed to be acquired after the trading record period, including:-

- (i) where an applicant has entered into an acquisition agreement after the trading record period which will not be completed at listing. Where this is the case, provided that the applicant has disclosed all information as required under Rules 4.04(2) and (4) in its listing document, completion of the acquisition after the applicant's listing will not be subject to Chapters 14 and 14A of the Main Board Rules (Chapters 19 and 20 of the GEM Rules) unless there are material changes to the acquisition; and
- (ii) an intention to acquire a specific subsidiary or business, even if there is no legally binding agreement. For the avoidance of doubt, if the applicant enters into a legally binding agreement in respect of such an acquisition after its listing on the Exchange, it still must comply with the relevant Listing Rules (including Chapters 14 and 14A of the Main Board Rules (Chapters 19 and 20 of the GEM Rules) (*Updated in October 2014*).

4.3 Rule 4.05A: This rule applies to acquisitions of a material subsidiary or business during the trading record period.

4.3A Rule 4.28: This rule applies to any business or company acquired or proposed to be acquired after the trading record period (including those set out in paragraphs 4.2(i) and (ii) above) which would be classified as a major subsidiary as defined in this rule (*Added in October 2014*).

4.4 *Moved to paragraph 4.1A in October 2014.*

### *Size test*

- 4.5 Rules 4.04(2) and (4): These rules do not have a materiality threshold. This means that irrespective of the size of the subsidiary or business acquired, agreed to be acquired or proposed to be acquired after the trading record period, the applicant must include in its listing document the financial information of the relevant subsidiary or business for the trading record period.
- 4.6 Rule 4.05A: The rule is applicable if the size of the subsidiary or business being acquired would have been classified at the date of application as a major transaction or a very substantial acquisition (i.e. 25% or more). The total assets, profits and revenue for the most recent financial year of the trading record period of the subsidiary or business being acquired should be compared to those of the applicant for the same financial year. If the financial year of the subsidiary or business being acquired is not coterminous with that of the applicant, the total assets, profits and revenue for the most recent financial year of the subsidiary or business should be compared to those of the applicant for the most recent financial year of its trading record period (*Updated in October 2014*).

An example of applying the size test under Rule 4.05A: An applicant's trading record period covers year 1, year 2 and year 3 and it acquires a subsidiary during year 2. For the purpose of the size test, the total assets, profits and revenue of the subsidiary for year 3 should be compared to those of the applicant for year 3.

- 4.6A Rule 4.28: All acquisitions or proposed acquisitions of businesses or companies since the date to which the latest audited accounts in the accountants' report of the applicant have been made up should be aggregated. If the aggregate total assets, profits or revenue represents 5% or more under any of the percentage ratios as defined under Main Board Rule 14.04(9) (GEM Rule 19.04(9)), these acquisitions will be deemed to be an acquisition of a major subsidiary and subject to Rule 4.28. 100% of the major subsidiary's total assets, profits and revenue (irrespective of the interest held by the applicant) of the major subsidiaries for the most recent financial year should be compared to the applicant's latest financial year during the trading record period (*Added in October 2014*).
- 4.7 *Merged with paragraph 4.2 in October 2014.*
- 4.8 *Moved to paragraph 4.10A in October 2014.*

### *Accounting and disclosure requirements*

- 4.9 The Relevant Rules: The financial information on the relevant subsidiary or business must normally be drawn up in conformity with accounting policies adopted by the applicant. The financial information required under Rules 4.04(2) and (4) and Rule 4.05A may be disclosed in a note to the accountants' report or in a separate accountants' report. The pro forma financial information required under Rule 4.28 is disclosed as an appendix to the listing document and must be covered by a report issued by the reporting accountants as required under Main Board Rule 4.29 (GEM Rule 7.31) (*Updated in October 2014*).

- 4.10 Rules 4.04(2) and (4): The financial information to be disclosed should include the income statement and balance sheet (including information required by Main Board Rule 4.05 (GEM Rule 7.04)) in respect of (a) each of the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document or since the incorporation of such subsidiary/ the commencement of such business if this occurred less than three years (two years for GEM applicants) prior to such issue (the “**Financial Information**”); and (b) any stub period disclosed in conformity with Main Board Rule 8.06 (GEM Rule 11.11).
- 4.10A An acquisition subject to Rules 4.04(2) and (4) will also be subject to the requirements under paragraphs 32 and 33 of the Third Schedule to the Companies Ordinance<sup>6</sup> (“**Third Schedule Requirements**”) if part of the listing proceeds is to be applied directly or indirectly to purchase of any business or subsidiary. In such case, the Financial Information of the acquisition has to be disclosed in a separate accountants’ report (*Updated in March and October 2014*).
- 4.11 Rule 4.05A: The pre-acquisition financial information to be disclosed should include full financial statements (including information required by Main Board Rules 4.04 and 4.05 (GEM Rules 7.03 and 7.04)) of the relevant subsidiary or business for the period from the commencement of the trading record period (or since the incorporation of such subsidiary or the commencement of such business) to the date of acquisition.
- 4.11A Rule 4.28: Where any of the percentage ratios calculated in accordance with Rule 4.28 is 5% or more but is 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, an 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<sup>7</sup> (*Added in January 2014 and updated in October 2014*).

### **Waivers**

- 4.12 Rules 4.04(2) and (4): We may consider granting waivers of Rules 4.04(2) and (4) on a case-by-case basis. Having regard to all relevant facts and circumstances, the Exchange will ordinarily grant a waiver of Rules 4.04(2) and (4) subject to the following conditions, which may be modified if required:-
- (i) in relation to acquisitions of equity securities<sup>8</sup> in the ordinary and usual course of business<sup>9</sup> of a listing applicant:-
    - (a) the percentage ratios (as defined under Main Board Rule 14.04(9)/ GEM Rule 19.04(9)) of each acquisition are all less than 5% by reference to the most recent financial year of the applicant’s trading record period;
    - (b) the applicant is neither able to exercise any control, nor has any significant

<sup>6</sup> Retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) with effect from March 2014.

<sup>7</sup> Extracted from HKEx News Release regarding “Clarification of certain Listing Rules provisions relating to financial disclosure in listing documents and circulars” first published on 11 November 2004.

<sup>8</sup> The Exchange may require further information where securities acquired are not listed securities.

<sup>9</sup> “Ordinary and usual course of business” of an entity means the entity’s existing principal activities.

influence, over the underlying company or business; and

- (c) the listing document should include the reasons for the acquisitions and a confirmation that the counterparties and the ultimate beneficial owners of the counterparties are independent third parties of the applicant and its connected persons;

(ii) in relation to acquisitions of a business or subsidiary:-

- (a) the percentage ratios (as defined under Main Board Rule 14.04(9)/ GEM Rule 19.04(9)) of the acquired or to be acquired business or subsidiary are all less than 5% by reference to the most recent financial year of the applicant's trading record period;
- (b) the historical financial information of the acquired or to be acquired business or subsidiary is not available or would be unduly burdensome to obtain or prepare; and
- (c) the listing document should include at least the information that would be required for a discloseable transaction under Chapter 14 of the Main Board Rules (Chapter 19 of the GEM Rules) on each acquisition; and

(iii) in cases where the Third Schedule Requirements apply, an exemption of the relevant requirements is granted by the Securities and Futures Commission<sup>10</sup> (*Updated in October 2014*).

4.13 *Repealed.*

4.14 *Moved to paragraph 4.11A in October 2014.*

#### **(B) Guidance Relating to Stub Period Comparatives**

4.15 The Main Board Listing Rules and GEM Listing Rules require certain financial information, including stub period comparatives for income statements and cash flow statements to be included in accountants' reports. A listing document or circular should contain a discussion and analysis of a group's performance during the years or periods covered by an accountants' report. The Exchange holds the view 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. To make such analysis possible and meaningful, inclusion of stub period comparatives is necessary (*Added in January 2014*).

4.16 For the avoidance of doubt, the financial information for all financial years or periods included in an accountants' report, except for the stub period comparatives, are required to be audited. Where the stub period comparatives are unaudited, at a minimum, a review opinion for such financial information is required to be included in accountants' reports and the unaudited financial information must be clearly identified as unaudited. A review of stub period comparatives by reporting accountants must be in accordance with the International Standards on Review

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<sup>10</sup> Refer to HKEx-GL14-09 "Guidance on application for exemptions from the Companies Ordinance".

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<sup>11</sup> (*Added in January 2014*).

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<sup>11</sup> International Standards on Review Engagements 2400 (Revised) “Engagements to Review Historical Financial Statements” or Hong Kong Standard on Review Engagements 2400 (Revised) “Engagements to Review Historical Financial Statements” should be used if the review of the stub period comparatives in the accountants’ report for a proposed acquisition where the reporting accountant is not the listing applicant’s auditor.

## Attachment 1

Set out below is a summary of the relevant requirements under Main Board Rules 4.04(2), 4.04(4) and 4.05A (GEM Rules 7.03(2), 7.03(4) and 7.04A):-

	<b>Main Board Rules 4.04(2) and 4.04(4) and GEM Rule 7.03(2) and 7.03(4)</b>	<b>Main Board Rule 4.05A and GEM Rule 7.04A</b>
Scope	➤ Acquisitions (including where an issuer has entered into any acquisition agreements or has an intention to acquire) of <u>any</u> subsidiary or business (including any equity interest in another company) <u>after</u> the trading record period ( <u>including</u> the stub period)	➤ Acquisitions of <u>material</u> subsidiary or business (including any equity interest in another company) <u>during</u> the trading record period ( <u>including</u> the stub period)
Size test	➤ No size test	➤ 25% or more (major transaction or very substantial acquisition) ➤ By comparing the assets, profits and revenue of the subsidiary or business for the most recent financial year of the trading record period with the total assets, profits or revenue of the applicant for the same financial year
Accounting requirements	➤ In conformity with the accounting policies adopted by the applicant	
Disclosure requirements	<ul style="list-style-type: none"> <li>➤ Financial information during the trading record period (including the stub period)</li> <li>➤ In a note to accounts or separate accountants' report</li> <li>➤ Full financial statements preferred but at least include income statement and balance sheet (including information required by Main Board Rule 4.05 (GEM Rule 7.04))<sup>12</sup></li> </ul>	<ul style="list-style-type: none"> <li>➤ Pre-acquisition financial information (from commencement of the trading record period to the date of acquisition)</li> <li>➤ In a note to accounts or separate accountants' report</li> <li>➤ Full financial statements (including information required by Main Board Rules 4.04 and 4.05 (GEM Rules 7.03 and 7.04))</li> </ul>
Waivers considered	➤ We may consider granting waivers on a case-by-case basis (see paragraph 4.12 of this guidance letter for further guidance)	➤ We may consider granting waivers on a case-by-case basis. Note that we have only granted waivers in exceptional cases based on the special circumstances of each case to date.

<sup>12</sup> Paragraphs 32 and 33 of the Third Schedule of the Companies Ordinance<sup>6</sup> require the preparation of a separate accountants' report in certain circumstances where offering proceeds are used for the acquisition of a business or shares of a body corporate (*Updated in March 2014*).