CONSULTATION

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

GUIDANCE FOR THE PREPARATION OF A BUSINESS REVIEW UNDER THE HONG KONG COMPANIES ORDINANCE CAP. 622

INTRODUCTION

These comments are submitted by the Association of International Accountants (AIA), with input from a Technical Committee and members of the Association.

ABOUT AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and from conception has promoted the concept of 'international accounting' to create a global network of accountants in over 85 countries worldwide.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the companies act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the companies (auditing and accounting) act 2003 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the money laundering regulations 2007.

AIA promotes and supports the advancement of the accountancy profession both in the UK and internationally. The AIA exams are based on international financial reporting and international auditing standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic accounting.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

AIA RESPONSE

SUMMARY

The AIA support the issuance of this guidance by the HKICPA.

Publication of a business review including KPIs improves the disclosures about aspects of a company's business by providing significant insight into the sources of its value. The Enhanced Business Reporting Consortium has stated that the value drivers for a business "can be measured numerically through KPIs or may be qualitative factors such as business opportunities, risks, strategies and plans – all of which permit assessment of the quality, sustainability and variability of its cash flows and earnings."

We have reviewed the Exposure Draft and do not have any significant comments on it. However, we have suggested certain editorial improvements to the proposed guidance, which are marked-up in the attached file for your consideration.

FURTHER INFORMATION

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

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AB 5
Exposure Draft

Accounting Bulletin 5

Guidance for the Preparation of a Business Review under the Hong Kong Companies Ordinance Cap. 622

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ACCOUNTING BULLETIN 5

GUIDANCE FOR THE PREPARATION OF A BUSINESS REVIEW UNDER THE HONG KONG COMPANIES ORDINANCE CAP. 622

(Issued [ ] 2014)

Accounting Bulletins reflect the views of the Financial Reporting Standards Committee on subjects of topical interest. They are intended to assist members or stimulate debate on accounting issues. They do not have the authority as either Hong Kong Financial Reporting Standards or Accounting Guidelines.

This Accounting Bulletin provides general guidance for the preparation of a business review under the Hong Kong Companies Ordinance Cap. 622, the application of which may vary considerably depending on the size and complexity of the reporting entity. It does not introduce additional accounting, disclosure or legal requirements. Users of this Accounting Bulletin should consider taking their own legal advice if in doubt as to their obligations under the Hong Kong Companies Ordinance as the HKICPA and the authors do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this Accounting Bulletin, whether such loss is caused by negligence or otherwise.

CONTENTS

Paragraphs

INTRODUCTION

1. This Accounting Bulletin is prepared and issued by the Institute at the invitation of the Companies Registry to provide guidance on the preparation of a business review under section 388 of, and Schedule 5 to, the new Hong Kong Companies Ordinance (CO), Cap. 622. Given the requirements on the preparation of a business review under the CO are partly modelled on the requirements in the United Kingdom, in the preparation of this Accounting Bulletin reference has been made to the Reporting Statement: Operating and Financial Review, modified and adapted for use in Hong Kong, by kind permission of the UK Financial Reporting Council.

2. In accordance with section 358(1) of the CO, section 388 (and consequently Schedule 5) applies in relation to financial years beginning on or after the commencement date of that section i.e. it applies to financial years beginning on or after 3 March 2014.

3. In general, companies are required by section 388 to prepare a business review which complies with Schedule 5 unless explicitly exempt. The requirements of section 388 are summarised in paragraph 13 of this Accounting Bulletin. The exemptions from preparation of a business review are set out in section 388(3) of the CO. These are summarised in paragraph 14 of this Accounting Bulletin.

4. In order to satisfy the minimum requirements of Schedule 5 to the CO, a business review should consist of a fair review of the company's business; a description of the principal risks and uncertainties facing the company; particulars of important events affecting the company that have occurred since the end of the financial year; and an indication of likely future development in the company's business. Where the company is required to prepare consolidated financial statements, the review should be prepared on a consolidated basis. ~~The term "reporting entity" used in this Accounting Bulletin should be understood to refer to the company and its subsidiary undertakings included in the annual consolidated financial statements in such cases.~~ This Accounting Bulletin reproduces the full requirements of Schedule 5 in paragraph 16.

5. In addition to providing additional information for members of a company and helping them assess how the directors have performed their duties, the information disclosed in the business review will also be of relevance to other stakeholders of the company. The business review should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.

6. This Accounting Bulletin sets out the guiding principles for the preparation of a business review. These principles are that the review should:

   - analyse the business through the eyes of the board of directors;
   - have a scope consistent with the scope of the financial statements for the period under review;
   - both complement and supplement the financial statements;
   - be understandable; and
   - be balanced and neutral.

7. This Accounting Bulletin sets out the key elements for the contents of a business review, including details on particular matters that should be disclosed to the extent necessary to meet the minimum requirements for the business review. These include financial key performance indicators (KPIs) judged by the directors to be effective in measuring the development, performance or position of the business of the reporting entity, which should be disclosed together with information that should enable members to understand and evaluate each KPI.

8. This Accounting Bulletin is accompanied by Implementation Guidance that provides illustrative examples of financial KPIs that might be disclosed in a business review if appropriate to the reporting entity's circumstances. The Implementation Guidance also includes further guidance on and examples of non-financial KPIs and other quantified data which directors may wish to include in the business review in order to enhance the usefulness for members and other users.

9. The application of the guidance in this Accounting Bulletin may vary considerably depending on whether the reporting entity is large or small and whether its business is complex or relatively simple. However, in all cases, the directors should ensure that they comply with the minimum requirements of the CO with respect to the preparation and presentation of a business review. Users of this Accounting Bulletin should consider taking their own legal advice if in doubt as to their obligations in this regard.

OBJECTIVE

10. The objective of this Accounting Bulletin is to provide guidance for the preparation of a business review under section 388 of the CO, which complies with the requirements of Schedule 5 ~~to the CO~~ and provides information that is useful for members of the company. This Accounting Bulletin is for guidance only and does not introduce additional accounting, disclosure or legal requirements.

11. The guidance in this Accounting Bulletin is intended to assist Hong Kong incorporated companies to satisfy their reporting obligations under the CO. It may therefore be insufficient for reporting entities, in particular companies listed on the Stock Exchange of Hong Kong, which are subject to additional requirements in respect of the presentation of a more detailed management discussion and analysis (MD&A) than is required by Schedule 5, and/or whose MD&A is prepared for a broader group of stakeholders. Although this Accounting Bulletin provides guidance which may be useful for such companies, the examples are directed towards non-public companies, in particular those companies which previously have not been required to prepare a business review.

DEFINITIONS

12. The following terms are used in this Accounting Bulletin with the meanings specified:

Companies (Directors' Report) Regulation refers to the Companies (Directors' Report) Regulation Cap 622D.

Companies Ordinance (or ***CO***) refers to Chapter (Cap.) 622 of the Laws of Hong Kong which comes into operation on 3 March 2014.

Key performance indicators (or ***KPIs***) are defined in paragraph 5 of Schedule 5 to the CO as factors by reference to which the development, performance or position of the company's business can be measured effectively.

Member in relation to a company is as defined in section 2 of the CO.

Reporting entity refers to a company which is required under section 388 of the CO to prepare a business review. Where the business review is required to be prepared on a consolidated basis in accordance with section 388(2) of the CO, the term "reporting entity" should be understood to refer to the company and its subsidiary undertakings included in the annual consolidated financial statements for the financial year pursuant to paragraph 4 of Schedule 5 and section 381 of the CO.

Schedule 5 refers to Schedule 5, "Contents of Directors' Report: Business Review", to the CO.

OBLIGATION UNDER THE COMPANIES ORDINANCE TO PREPARE A BUSINESS REVIEW

13. Section 388 of the CO provides for the directors' duty to prepare a directors' report that:

(a) complies with sections 390 and 543(2) and Schedule 5;

(b) contains the information prescribed by the Companies (Directors' Report) Regulation; and

(c) complies with other requirements prescribed by the Companies (Directors' Report) Regulation.

In accordance with section 388(2) of the CO, if the company is a holding company in a financial year and the directors prepare annual consolidated financial statements for the financial year, the directors' report which complies with the above requirements should be a consolidated report.

14. Under section 388(3), the following companies are exempted from preparation of a business review which complies with Schedule 5:

(a) the company falls within the reporting exemption for the financial year[1]; or

(b) the company is a wholly owned subsidiary of another body corporate in the financial year; or

(c) the company is a private company[2] that does not fall within the reporting exemption for the financial year, and a special resolution (as defined in section 564 of the CO) is passed by the members to the effect that the company is not to prepare a business review required by Schedule 5 for the financial year.

15. In accordance with section 358(1) of the CO, section 388 of the CO applies in relation to a financial year beginning on or after the commencement date of that section i.e. it applies to financial years beginning on or after 3 March 2014.

[1] Further details on which companies are eligible for the reporting exemption can be found in the Small and Medium-Sized Enterprise Financial Reporting Framework (revised 2014) issued by the HKICPA.

[2] As stated in section 11 of the CO, a private company is a company not limited by guarantee whose articles restrict a member's right to transfer shares, limit the number of members to 50 and prohibit any invitation to the public to subscribe for any shares or debentures of the company.

REQUIREMENTS OF SCHEDULE 5 "CONTENTS OF DIRECTORS' REPORT: BUSINESS REVIEW"

16. The following sets out the requirements of Schedule 5:

Paragraph 1 of Schedule 5 states that 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.

Paragraph 2 of Schedule 5 states that 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.

Paragraph 3 of Schedule 5 states that 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.

Paragraph 4 of Schedule 5 states that 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.

Paragraph 5 of Schedule 5 states that in this Schedule "key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively.

GUIDING PRINCIPLES FOR THE PREPARATION OF A BUSINESS REVIEW

17. Business reviews prepared for the purposes of compliance with Schedule 5 should be consistent with the following guiding principles:

    (a) The review should set out an analysis of the business through the eyes of the board of directors

    (b) The scope of the review should be consistent with the scope of the financial statements

    (c) The review should complement as well as supplement the financial statements, in order to enhance the overall corporate disclosure

    (d) The review should be understandable

    (e) The review should be balanced and neutral, dealing even-handedly with both good and bad aspects

Reviewing the business through the eyes of the board of directors

18. A business review which has been prepared in accordance with Schedule 5 forms part of the directors' report to be approved by the directors in accordance with section 391 of the CO. Accordingly, the review should reflect the directors' view of the business and be consistent with information which the directors use in managing the reporting entity, including the identification and management of operating segments, the strategic priorities of or within the reporting entity, the management of capital, the financial risk management strategies of the reporting entity and any KPIs monitored by the directors.

Ensuring consistency of scope

19. The scope of the business review should be consistent with the scope of the financial statements that are presented for the same accounting period. This means that where those financial statements are consolidated financial statements prepared in accordance with section 379(2) of the CO, the review should consider the company and all the subsidiaries as a whole, in order to satisfy the requirement of paragraph 4 of Schedule 5. In this Accounting Bulletin, as defined in paragraph 12, the term "reporting entity" should be understood to refer to the company and its subsidiary undertakings included in the annual consolidated financial statements in such circumstances.

Complementing and supplementing the financial statements, in order to enhance the overall corporate disclosure

20. 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 financial statements but which, in the directors' judgement, may be relevant to the members' evaluation of past results and assessment of future prospects.

21. In supplementing the financial statements, where relevant 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.

22. In accordance with section 406(2) of the CO, if the company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the company's auditor has a duty to state that opinion in the auditor's report and may bring that opinion to the members' attention at a general meeting. To avoid the business review being viewed as inconsistent with the financial statements in circumstances where amounts from the financial statements have been adjusted for inclusion in the business review, it may be necessary for the directors to highlight the adjustments or differences and/or provide a reconciliation[3].

Ensuring the business review is understandable

23. Directors should consider which matters should be included in the business review in order to provide members with focused and relevant information. The inclusion of too much information may obscure judgements 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 members.

24. Directors should consider the evidence underpinning the information to be included in the business review. Where relevant, directors should explain the source of the information and the degree to which the information is objectively supportable, to allow members to assess the reliability of the information presented for themselves.

25. The business review should be written in a clear and readily understandable style. Where KPIs are disclosed in the review it should be clear to the user how the KPI has been computed and the source of data used in that calculation.

26. Directors may also wish to consider the extent to which the review is comparable with reviews prepared by other entities in the same industry or sector.

Ensuring the business review is balanced and neutral, dealing even-handedly with both good and bad aspects

27. The directors should ensure that the business review retains balance and that members are not misled as a result of the excessive focus on favourable information or the omission of any significant information on unfavourable aspects.

28. KPIs should be selected with due regard to their relevance to the development, performance or position of the reporting entity's business without undue focus on whether they show the business in a favourable or unfavourable light.

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[3] Further details on the auditor's responsibilities in this regard can be found in Hong Kong Standard on Auditing (HKSA) 720 "The auditor's responsibilities relating to other information in documents containing audited financial statements".

29. The balanced and neutral presentation of a business review is increased when KPIs and other information in the review are prepared and presented consistently from one year to the next, unless a significant change in the development, performance or position of the reporting entity's business indicates that a change in the information presented would result in a more balanced or neutral view.

~~THE~~ CONTENT OF A BUSINESS REVIEW

30. Paragraphs 33 to 55 below set out a framework for the disclosures to be provided by directors in a business review in order to satisfy the minimum requirements of Schedule 5. It is for directors to consider how best to use the framework to structure the business review and the precise content, including the level of detail to be disclosed relating to the key elements, given the particular circumstances of the reporting entity. These circumstances may include:

(a) the industry or industries in which it operates;

(b) the range of products, services or processes it offers;

(c) the number of markets it serves.

31. Members' needs are paramount when directors consider what information should be contained in the business review prepared in accordance with Schedule 5. Information in the business review may also be of interest to users other than members, for example other investors, potential investors, creditors, customers, suppliers, employees and society more widely. The business review should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.

32. As stated in paragraph 3 of Schedule 5, no disclosure of information is required to be made about impending developments or about matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the company's interests. This exemption from disclosure overrides anything to the contrary set out in paragraphs 33 to 55.

A fair review of the reporting entity's business (paragraph 1(a) of Schedule 5)

33. In order to satisfy the minimum requirements for a fair review of the reporting entity's business, the review should include as a minimum:

(a) a description of the business and the external environment in which the reporting entity operates, as context for the directors' discussion and analysis;

(b) 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;

(c) a discussion of 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; and

(d) 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.

Description of the business and the external environment in which the reporting entity operates

34. A description of the business provides members with an understanding of the industry or industries in which the reporting entity operates, its main products, services, customers, business processes and distribution methods, the structure of the business, and its economic model, including an overview of the main operating facilities and their location. The description of the business includes a description of resources which are significant to the reporting entity's operations irrespective of whether these resources are recognised in the reporting entity's statement of financial position. For example, the description of the business may refer to corporate reputation and brand strength, natural resources, research and development projects, intellectual capital, licences, patents, copyrights and trademarks where relevant. The description may also refer to the objectives of the business to generate or preserve value over the longer-term. Objectives will often be defined in terms of financial performance; however, objectives in non-financial areas should also be discussed where appropriate.

35. Every company is affected by its external environment. Depending on the nature of the business, the business review should include discussion of matters such as the reporting 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 number of different countries, which could have an impact on the future development and performance of the business.

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

36. The business review should discuss:

(a) the significant features of the development and performance of the business in the financial year covered by the financial statements; and

(b) the financial position of the business, at the end of the year under review.

37. When discussing the significant features of the development and performance of the business, the business review should focus 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.

38. The analysis, whilst based upon the financial statements, should supplement the information provided in the financial statements by, for example, commenting on the events that have impacted the reporting entity during the financial year and any special factors that have influenced cash flows in the financial year. For example, the 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. In addition, the business review should draw attention to the accounting policies which have changed during the financial year under review to a material extent.

39. When discussing the financial position of the business the business review should include a description of the capital structure and liquidity of the reporting entity. This could include the balance between equity and debt, the maturity profile of debt, type of financial instruments used, currency, regulatory capital and interest rate structure.

40. Where necessary for an understanding of the business, the business review should also describe receipts from, and returns to, members in relation to shares held by them. This should include a description of any distributions, contributions, capital raising and share repurchases.

41. The KPIs disclosed should be those that the directors judge are effective in measuring the delivery of their strategies and managing their business. Regular measurement using KPIs enables a reporting entity to set and communicate its performance targets and to measure whether it is achieving them.

42. KPIs should be presented in a way which is understandable to the users. To achieve this objective it may be necessary for the business review to include information which:

- explains the calculation methods;
- discloses the source of underlying data and, where relevant, explains the assumptions;
- highlights where information from the financial statements has been adjusted for the purposes of computing a KPI, and provides a reconciliation;
- discloses corresponding amounts for the financial year immediately preceding the current year where available; and/or
- identifies and explains any significant changes to the calculation method used to compute the KPIs compared to previous financial years, including significant changes in the underlying accounting policies adopted in the financial statements.

43. Comparability will be enhanced if the KPIs disclosed are accepted and widely used, either within the reporting entity's industry sector(s) or more generally.

Discussion of 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 reporting entity

44. To the extent necessary for an understanding of the development, performance or position of the reporting entity's business, the business review should include information about 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 reporting entity. Information to be disclosed in the review in this regard should be selected with due regard to their relevance to the development, performance or position of the reporting entity's business without undue focus on whether they show the business in a favourable or unfavourable light.

Account of the reporting entity's key relationships with its employees, customers and suppliers and others that have a significant impact on the reporting entity and on which the reporting entity's success depends

45. To the extent necessary for an understanding of the development, performance or position of the reporting entity's business, the business review should include information about significant relationships with stakeholders other than members, which are likely, directly or indirectly, to influence the performance of the business and its value.

46. Directors, in deciding what should be included in the business review, should take a broad view in considering the extent to which the actions of stakeholders other than members can affect a company's performance and thus its value. For example, for many companies, relationships with customers, suppliers, employees, contractors, lenders, creditors and regulators will be important, as will the company'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.

A description of principal risks and uncertainties facing the reporting entity (paragraph 1(b) of Schedule 5)

47. The description of the principal risks and uncertainties facing the reporting entity can be presented together with the fair review of the reporting entity's business or as a separate section of the business review. Irrespective of whether it is presented separately or not, the description of the principal risks and uncertainties facing the reporting entity should supplement and complement the information contained in the fair review of the business. 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.

48. The principal risks and uncertainties facing companies will vary according to the nature of the business, although it is expected that some risks, such as reputational risk, will be common to all. The principal risks and uncertainties facing the business may be strategic, commercial, operational or financial risks. Examples include the following (this list is not intended to be exhaustive):

(a) risk of loss of income, for example arising from increased competition affecting market shares 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

(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)

49. The discussion of principal risks and uncertainties facing the reporting entity should include discussion of the ability of the reporting entity to fund its current and future operations and stated strategies[4]. Where relevant, this should include commentary on:

(a) the reporting entity's level of borrowings, the seasonality of borrowing requirements (indicated by the peak level of borrowings during that period) and the maturity profile of both borrowings and undrawn committed borrowing facilities; and

(b) internal sources of liquidity, referring to any restrictions on the ability to transfer funds from one part of the reporting entity to meet the obligations of another part of the reporting entity, where these represent, or might foreseeably come to represent, a significant restraint on the reporting entity. Such constraints would include exchange controls and taxation consequences of transfers.

50. Where the reporting entity has entered into covenants in financing contracts which could have the effect of restricting the use of financing arrangements or credit facilities, and negotiations with the lenders on the operation of these covenants are taking place or are expected to take place, this fact should be indicated in the business review. Where a breach of a covenant has occurred or is expected to occur, the business review should give details of the measures taken or proposed to remedy the situation.

Particulars of important events affecting the reporting entity that have occurred since the end of the financial year (paragraph 1(c) of Schedule 5)

51. The review should include particulars of important events that have occurred since the end of the financial year or make reference to where such information may be found elsewhere in the annual report. These events may relate to strategic, commercial, operational or financial matters. Directors, in deciding what should be included in the review, should take a broad view in identifying those events important enough to affect the reporting entity's performance and thus its value.

52. The review should comment on the impact of these events on the reporting entity's future performance and financial position. This commentary should include an indication of the likely impact on financial KPIs reported in the business review, where relevant and the impact can be estimated. The commentary should also cover the purpose and effect of major financing transactions undertaken up to the date of approval of the financial statements, including the effect of interest costs on profits and the potential impact of interest rate changes.

An indication of likely future development in the reporting entity's business (paragraph 1(d) of Schedule 5)

53. The business review should analyse the main trends and factors that directors consider likely to impact future prospects, including an indication of the directors' plans for the reporting entity. The trends and factors will vary according to the nature of the business, but could include the development of known new products and services or the benefits expected from capital investment or changes in the industry or the external environment in which the business operates. Any assumptions underlying the main trends and factors should be disclosed.

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4 Hong Kong Financial Reporting Standard (HKFRS) 7 requires an entity to disclose qualitative and quantitative information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period, and the entity's objectives, policies and processes for managing and measuring these risks. Care should therefore be taken to ensure consistency between the business review and the financial statements in respect of any discussion of the financial risks faced by the reporting entity. Users of the business review may also find it useful for a cross reference to be made to the financial statements to where more detailed information on the risk exposures may be found.

54. The discussion should include comments on [illegible]t and longer-term funding plans to support the directors' strategies to achieve the ~~company'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. 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 cash.

55. Given the nature of some forward-looking information, in particular elements that cannot be objectively verified but have been made in good faith, directors may want to include a statement in the review to treat such elements with caution, explaining the uncertainties underpinning such information.

IMPLEMENTATION GUIDANCE

~~*This guidance accompanies, but is not part of, Accounting Bulletin 5.*~~

INTRODUCTION

IG1. This Implementation Guidance outlines some suggestions and illustrations of financial KPIs which may assist directors in satisfying the requirements of Schedule 5. This Implementation Guidance also includes additional examples of non-financial KPIs and other quantified data measures which directors may wish to include in the business review in order to enhance the usefulness for members and other users. These suggestions are non-exhaustive. Many further KPIs exist within different industries.

IG2. The format used for the illustrative examples of measures featured in IG Examples 1-21 should not be taken as a template. Its purpose is simply to demonstrate the information that could be provided for a particular measure. It is not envisaged that the layout presented in the Implementation Guidance will be replicated by directors preparing a business review. It is for the directors to consider how best to present the information, perhaps by providing some of the details within the footnotes, or in a separate section of the business review, giving due consideration to the guiding principle of understandability discussed in paragraph 25 of the Accounting Bulletin and the guidance on disclosure of KPIs set out in paragraph 42.

IG3. Definitions and other criteria set out in IG Examples 1-21 are illustrative and should not be taken to imply generally accepted definitions or calculations. They are simply provided to demonstrate the information that could be provided for a particular measure. It is important that the information provided in the business review with regard to any KPIs or quantified other measures is selected for disclosure giving due consideration to the guiding principle of reviewing the business through the eyes of the board of directors discussed in paragraph 18 of this Accounting Bulletin and that the disclosure makes explicit the definition and precise calculation method used by the reporting entity if the data is not clearly extracted from the financial statements.

~~MINIMUM CONTENT OF THE BUSINESS REVIEW~~: FINANCIAL KPIs

IG4. Paragraph 2 of Schedule 5 states that, to the extent necessary for an understanding of the development, performance or position of the company's business, a business review must include an analysis using financial key performance indicators (KPIs).

IG5. Paragraph 33(b) of this Accounting Bulletin reflects that in order to satisfy the minimum requirements of Schedule 5 for a fair review of the reporting entity's business, the review should include, amongst other things, 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.

IG6. Paragraph 41 of this Accounting Bulletin states that the KPIs disclosed should be those that the directors judge are effective in measuring the delivery of their strategies and managing their business. Paragraph 43 of this Accounting Bulletin advises that comparability will be enhanced if the KPIs disclosed are accepted and widely used, either within the industry sector or more generally.

IG7. A number of economic measures exist that are commonly used by companies in order to assess a company's ability to create value over time, and which are likely to be considered a KPI. These include the following example:

IG Example 1: Return on capital employed (ROCE)

As an example of a measure of the creation of value, the recommended disclosure would incorporate the following:

- Definition and calculation: ROCE measures the operating result as a percentage of the average total capital employed (invested) in the business over the period. The company uses "Earnings before interest, tax, depreciation and amortisation" (EBITDA) as a measure of operating result for this purpose. As disclosed in note 3 to the financial statements, the company considers its "capital" to comprise equity plus non-current debt financing.[5]

- Purpose: The company's aim is to increase shareholder value. The extent to which this goal has been achieved is assessed by computing ROCE over the period and comparing this measure from one period to the next, as it is a measure of how well the money invested in the business is providing a return to investors.

- Source of underlying data: Figures from financial statements prepared in accordance with financial reporting standards promulgated by the Hong Kong Institute of Certified Public Accountants as adjusted below.

- Reconciliation of financial statement information:

  Operating result for calculation of ROCE (EBITDA) =

  Profit before tax

  Plus add back interest expense, depreciation and amortisation charges

  Capital employed =

  Equity
  Plus non-current debt financing

  Average capital employed =

  (Opening capital employed plus closing capital employed) / 2

- Quantified KPI data: 20X5 – Consolidated ROCE – 10.4%, 20X4 – 10.2%

- No changes have been made to the source of data or calculation methods used compared to 20X4.

[5] Paragraph 134 of Hong Kong Accounting Standard (HKAS) 1 requires an entity to disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. In accordance with paragraph 135 of HKAS 1, this disclosure should include summary quantitative data about what it manages as capital. Care should therefore be taken to ensure consistency between the business review and the financial statements in respect of any discussion of what the reporting entity manages as capital.

IG8. In addition, directors often supplement these with other measures common to their industry to monitor their long term objectives around market positioning and progress towards stated objectives. The following examples are illustrated in this Implementation Guidance:

- **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

IG Example 2: Market Share

For a company reporting market share as a KPI, the recommended disclosure would incorporate the following:

- Definition and calculation: Market share, being company revenue over estimated market revenue.
- Purpose: To assess how the company is performing in its particular market.
- Source of underlying data: No external verifiable source for market share exists; accordingly data are internal estimates.
- Quantified KPI data: Graph showing five year trend data, 20X1 – 17%, 20X2 – 18%, 20X3 – 17%, 20X4 – 19%, 20X5 – 20%.
- No changes have been made to the source of data or calculation methods used over the periods shown.

IG Example 3: Average revenue per user (customer)

A telecoms company may measure average revenue per user (ARPU) by types of product offerings as a KPI. By doing this, the directors are able to monitor customer buying patterns as this is a key factor that is likely to affect the development of future revenues. Recommended disclosure would incorporate the following information:

- Definition and calculation: Average revenue per user (ARPU) by major product segments, e.g. pre-pay and post-pay customers.
- Purpose: In the mobile network industry, ARPU is one of the key drivers for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified KPI data: ARPU graph showing comparatives and percentage change year on year e.g. Pre-pay 20X4 – $121, 20X5 – $141, growth of 16.5%, Post-pay 20X4 – $503, 20X5 – $525, growth of 4.4%.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 4: Sales per square foot

A retail company with an objective of increasing revenues may monitor and measure revenue per square foot as a KPI. Recommended disclosure would incorporate the following information:

- Definition and calculation: Average revenue per square foot ($ per week), with square footage measured as store space excluding storage/delivery space, checkout and administrative space.
- Purpose: In the retail industry, sales per square foot is one of the key drivers for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified KPI data: Graph showing weekly sales per square foot over the past five years, 20X5 – $18.53, 20X4 – $17.56, 20X3 – $16.99, 20X2 – $16.04, 20X1 – $15.67
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 5: Percentage of revenue from new products

A consumer products company that has a strategy of providing innovation products to its customers may measure and monitor the percentage of revenue from new products as a KPI. Recommended disclosure would incorporate the following information:

- Definition and calculation: Percentage of revenue from new products = revenue from those products launched over the past two years over total revenue for the year.
- Purpose: In order to continue to grow in the fast paced market of consumer products, the company needs to ensure that it is continually renewing its product portfolio. One way of measuring success is to look at the percentage of revenue generated by new products.
- Source of underlying data: Internal company data.
- Quantified KPI data: Percentage of revenue from new products, 20X5 – 37%, 20X4 – 33%, 20X3 – 36%.
- No changes have been made to the source of data or calculation methods used over the periods shown.

IG Example 6: Cost per unit produced

The directors in a utility company may measure costs per unit produced as a KPI in order to monitor progress towards becoming a low cost producer. Recommended disclosure would incorporate the following information:

- Definition and calculation: Exploration and production finding and development unit costs, being costs per $ per boe (E&P F&D costs ($/boe)). Boe means barrel of oil equivalent, which is a standard method of equating oil, gas and natural gas liquids by converting gas and natural gas liquids to oil based on their relative energy contents.
- Purpose: One of the key drivers to strong economic returns is to reduce E&P F&D costs.
- Source of underlying data: Internal company data.
- Quantified KPI data: E&P F&D unit costs ($ per boe) graph showing comparatives for three years e.g. 20X5 – 32.2, 20X4 – 32.0, 20X3 – 30.8.
- No changes have been made to the source of data or calculation methods used over the periods shown.

IG Example 7: "Economic capital"

The directors of a financial institution may measure economic capital, in addition to regulatory capital, as a risk management tool and to monitor risk positions in individual business units. Recommended disclosure would incorporate the following information:

- Definition and calculation: Economic capital is the amount of capital that a transaction or business unit requires in order to support the economic risks it creates. A 99.95% confidence interval and a one-year time horizon are used to calculate economic capital. The economic capital calculation is subdivided into five distinct risk types: credit risk, market risk, transfer risk, business risk and operational risk.
- Purpose: The directors measure economic capital in order to monitor the efficient use of group's capital base.
- Source of underlying data: Internal company data.
- Quantified KPI data: Economic capital for each business unit, reconciling to total economic capital for 20X4 and 20X5.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 8: Cash conversion rate

To supplement the cash flow information provided in the financial statements, directors may measure operating profit cash conversion rates as a KPI. Recommended disclosure would incorporate the following information:

- Definition and calculation: Cash conversion rate being cash flow from operations as a percentage of operating profit.
- Purpose: One of the key drivers to strong economic returns is the ability to convert operating profits into cash.
- Source of underlying data: Internal company data.
- Quantified KPI data: Cash conversion 20X1 – 74%, 20X2 – 101%, 20X3 – 92%, 20X4 – 85%, 20X5 – 92%.
- No changes have been made to the source of data or calculation methods used over the periods shown.

~~ADDITIONAL CONTENT IN THE BUSINESS REVIEW~~: NON-FINANCIAL KPIs AND OTHER QUANTIFIED DATA

IG9. This Implementation Guidance also includes the following additional examples of non-financial KPIs and other quantified data which directors may wish to include in the business review in order to enhance the usefulness of the business review for members and other users:

- Measures relating to the reporting entity's environmental policies and performance and compliance with laws and regulations (paragraph 44):
  - **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 45-46):
  - **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

Measures relating to the reporting entity's environmental policies and performance and compliance with laws and regulations *(Ref: paragraph 44)*

IG10. Paragraph 44 of the Accounting Bulletin reflects the requirements of Schedule 5 that to the extent necessary for an understanding of the development, performance or position of the reporting entity's business, the business review should include information about 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 reporting entity.

Environmental matters

IG11. Environmental matters, particularly environmental risks and uncertainties, impact to some extent on all businesses, as they can affect investment decisions, consumer behaviour and Government policy. Poor management of energy, natural resources or waste can affect current performance; failure to plan for a future in which environmental factors are likely to be increasingly significant may risk the long-term future of the business. Proper attention to the environmental impacts of supply chains and products and to regulatory compliance of the reporting entity's own operations are both important for a business' public reputation and for its licence to operate.

IG12. Environmental matters cover a very wide range of areas. The matters that will be of concern to a particular company will vary depending on both the industry in which it operates and the strategies it has adopted. However, some consensus as to the generic environmental concerns facing all companies has been reached[6], which might serve as a useful reference point for directors:

- Water use;
- Energy use;
- Waste;
- Climate change, including global warming contribution or emissions management;
- Ozone depleting substances.

IG13. Companies in industries that have a significant environmental footprint may set objectives and adopt strategies to specifically address key environmental risks, as illustrated in IG Examples 9 to 11. For others, whilst the management of environmental risks will impact the company's reputation, monitoring of performance in this area may not be considered a KPI. As set out in paragraph 24 of the Accounting Bulletin, where relevant the directors should explain the source of the information provided in the business review and the degree to which the information is objectively supportable, for example the review may refer to consumption rates of scarce resources (energy and/or water) if this significantly impacts the company's reputation.

[6] *UN Conference on Trade and Development (2000) Integrating Environmental and Financial Performance at the Enterprise Level*

IG Example 9: Environmental spillage

A company involved in the transportation of hazardous materials may monitor "significant spills" as a KPI due to the potential impact of a spill on the reputation of the company. The following information might be disclosed in such cases:

- Definition and calculation: Significant spills, being spills exceeding 100,000 litres.
- Purpose: To assess the effectiveness of the management of hazardous waste.
- Source of underlying data: All data from 100% controlled companies, representing 85% of the total group on a revenue basis.
- Quantified data: In 20X5 there were 25 significant spills, in 20X4 there were 30 spills, all due to leaking tanks.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 10: CO2 emissions

A company involved in energy production may monitor CO2 equivalent emissions due to both potential fines and the impact of growing emissions on the reputation of the company. The following information might be disclosed in such cases:

- Definition and calculation: CO2 emissions, being on-site greenhouse gas emissions measured in millions of tonnes of CO2 equivalents (CO2-e)
- Purpose: To assess the effectiveness of the management of the company's impact on greenhouse gas emissions.
- Source of underlying data: Data from 100% controlled companies within Asia, representing 95% of the company on a revenue basis.
- Quantified data: 20X5 CO2-e 5.7, 20X4 6.0, 20X3 6.2
- No changes have been made to the source of data or calculation methods used over the periods shown.

IG Example 11: Waste

A retail group that promotes its 'green credentials' might monitor waste due to packaging, as this may impact on the reputation of the company. The following information might be disclosed in such cases:

- Definition and calculation: Amount of waste (measured in kg) arising from packaging on each $1,000 of products we sell.
- Purpose: As the retail businesses in the group handle large amounts of packaging for transporting and presenting the goods sold, the group has established processes to minimise packaging waste.
- Source of underlying data: Data from all retail businesses in the group, representing 80% of the company on a revenue basis.
- Quantified data: 20X5 1.34, 20X4 1.40, 20X3 1.38, 20X2 1.29, 20X1, 1.21
- No changes have been made to the source of data or calculation methods used over the periods shown.

Other laws and regulations

IG14. As stated in paragraph 44 of the Accounting Bulletin, information to be disclosed in the review in respect of compliance with laws and regulations should be selected with due regard to its relevance to the development, performance or position of the reporting entity's business without undue focus on whether it shows the business in a favourable or unfavourable light. Proper attention to regulatory compliance of the reporting entity's own operations is also important for a business' public reputation and for its licence to operate. Directors may wish to include quantified data which illustrates the extent of the reporting entity's compliance.

IG Example 12: Employee health and safety

In an industry such as mining, where the "licence to operate" is based on effectively managing a myriad of issues, including health and safety, the directors may monitor "lost time injury frequency rate" as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Lost time injury frequency rate (LTIFR) – the number of lost-time injuries per million hours worked.
- Purpose: As the industry involves large equipment and working with hazardous materials, safety is a core value and a major priority.
- Source of underlying data: Injury data returns from 100% owned facilities only.
- Quantified data: LTIFR table showing comparatives e.g. 20X4 – 10 injuries/million hours worked, 20X5 – 8.4 injuries/million hours worked.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

Measures relating to the reporting entity's key relationships *(Ref: paragraphs 45-46)*

IG15. The decisions of those with whom the reporting entity has relations – regulators, customers, suppliers, employees, community and society at large – can affect the entity's prospective performance and accordingly its value. For example, in regulated sectors, the risk of non-compliance with regulatory requirements could lead to the loss of a licence to operate. Accordingly the effective management of these relationships could significantly impact on the success of the reporting entity's strategies and affect its long-term value.

IG16. The directors should consider whether such relationships could have a significant impact. The directors could do this by seeking the answers to a number of key questions, such as:

a. How do our customers view the service we provide?

b. How do our employees feel about the company?

c. How do our suppliers view the company?

d. How do our regulators view the company?

IG17. For example, in considering the first question above, the measures illustrated in IG Examples 13 to 15 provide an indication of the extent of the reporting entity's relationship with customers, the strength of that relationship and whether that relationship is improving or deteriorating, particularly when comparative data is included. Ultimately, the selection of appropriate customer measures will depend on the nature of the business and the strategies adopted by the board.

IG Example 13: Number of subscribers

A pay TV company with an objective of achieving revenue growth may monitor the effectiveness of their actions and progress towards their goal through measuring of the number of subscribers as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Number of subscribers by type of connection, i.e. direct to home (DTH) and cable.
- Purpose: In the pay TV industry, the level of subscribers is the key driver for future revenue growth.
- Source of underlying data: Internal company data.
- Quantified KPI data: Table showing number of subscribers and percentage increase from year to year e.g. 20X5 – DTH 4,532 million, cable 3,241 million, 20X4 – DTH 4,013, cable 3,004, growth of 12.9% and 7.9%.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 14: Number of products sold per customer

In the financial services industry, a company may have an objective to increase margins by increasing the number of products sold to existing customers. Directors may monitor the number of products sold per customer, or "customer penetration" rates as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Customer penetration rates by geographic segment. Penetration rates are measured by taking the number of products sold to each customer on an annual basis.
- Purpose: Increasing customer penetration rates, leads to increased revenues without incurring significant customer handling costs.
- Source of underlying data: Company data from Hong Kong and Jurisdiction A.
- Quantified target: To increase customer penetration rates to 5.0 products per customer territory.
- Quantified KPI data: Table showing penetration by territory over time e.g. 20X5 – Hong Kong 4.3, Jurisdiction A 4.9, 20X4 – Hong Kong 4.5, Jurisdiction A 4.5, 20X3 – Hong Kong 4.0, Jurisdiction A 4.1.
- No changes have been made to the source of data or calculation methods used over the periods shown.

IG Example 15: Customer churn

In the telecoms industry, future prospects are greatly affected by the number of customers they can retain. Directors may monitor "customer churn" rates by the types of products offered as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Churn rates by geographical market. Churn measured as the percentage of customers who do not renew their contract with the company at the end of the contract, over the total number of customers under that contract type.

- Purpose: Reducing churn rates means there is less pressure to increase customer acquisitions in order to improve revenues. Lower churn rates lead to direct savings in the form of savings in marketing, sales, installation and disconnection costs.

- Source of underlying data: Company data from Hong Kong, Jurisdiction A and Jurisdiction B.

- Quantified KPI data: Table showing churn rate by geographical market over time e.g., 20X5 – Hong Kong 15%, Jurisdiction A 18%, Jurisdiction B 22%, 20X4 – Hong Kong 14%, Jurisdiction A 21%, Jurisdiction B 25%, 20X3 – Hong Kong 15%, Jurisdiction A 24%, Jurisdiction B 26%.

- No changes have been made to the source of data or calculation methods used over the periods shown.

IG18. Areas of importance relating to employees are addressed in paragraphs IG19-22. For other stakeholders with which the company has relations, such as customers, suppliers, regulators, contractors and pensioners, some areas of interest might be:

- Profile of the stakeholder and nature of the relationship (length of relationship, is it subject to contract, if so when does the contract expire).

- Level of dependency.

- Satisfaction with relationship – feedback results, levels of complaints, fines etc.

Employees

IG19. Employees may be a particularly key resource – and accordingly a key risk – for many entities. The strengths of a company's workforce and the ways it is managed can play a major role in both current and future company performance. Companies will need to be able to recruit and retain the staff they need to achieve their business strategies. Accordingly, the risks and uncertainties associated with the management of recruitment and retention of staff with the particular skills required for the company's strategies could have a significant impact on the company's future development and performance. For example, poor employment relationships can carry the risk of costly litigation, low workforce morale and ultimately affect company reputation. In addition, directors should consider their employment policies and practices and to assess which aspects are relevant to an understanding of the reporting entity. For example, the degree to which the human resources of the reporting entity represent a significant competitive advantage or are critical to a key product, service or process.

IG20. The employee matters that will be of concern to directors will vary from company to company, depending on the industry in which the company operates and the strategies it has adopted.

IG21. In order to assess employee performance and development, the following areas, along with related performance measures, may be helpful:

- Employee health and safety (which could also be considered a "compliance with laws and regulations" matter see paragraph IG13), lost days to injury, levels of occupational related diseases in the workforce, compliance levels with working hours directives;
- Recruitment and retention – employee turnover, retention rates, remuneration policies, number of applicants per post, offer/acceptance statistics, levels of skills shortages;
- Training and development – hours spent on training, number of courses taken, leadership/career development;
- Morale/motivation – employee feedback results, absence rates, levels of employee engagement;
- Workforce performance and profile – employee productivity, revenue/profit per employee, diversity, number of professionally qualified employees.

IG22. IG Examples 12 and 16 provide some illustrations of where entities might set objectives relative to employees and monitor their progress as KPIs. Alternatively, the board may monitor employee measures to assess how effectively the company is managing its employee resources, development and performance to ensure that adequate resources are available to the company, even though these performance measures are not considered KPIs. In such circumstances, the business review may include these performance measures.

IG Example 16: Employee morale

A professional services company may measure "employee satisfaction" in order to monitor employee morale, as decreasing levels of morale indicate higher levels of leavers in the future. The following information might be disclosed in such cases:

- Definition and calculation: Employee satisfaction on a scale of 1 to 5 where 1 is low and 5 is high.
- Purpose: A professional services company needs to ensure it retains its best and brightest employees in order to properly service clients.
- Source of underlying data: Annual employee surveys in Hong Kong and Jurisdiction A, representing 85% of the total client facing employees.
- Quantified data: Employee satisfaction graph showing comparatives e.g. 20X4 – 4.1 rating, 20X5 – 4.4 rating.
- Comparability: The 20X4 survey results were based on surveys in Hong Kong, representing 65% of total client facing employees.

Other measures that may reflect on the current or future development in the business or the principal risks and uncertainties facing the reporting entity

IG23. Set out below are further examples of measures which directors may wish to include in the business review in order to enhance the usefulness of the review for members and other users. The measures may be relevant to discussing the current position of the reporting entity or its future development, or when discussing how management identifies and manages the principal risks and uncertainties facing the reporting entity. As stated in paragraph IG1 of this Implementation Guidance, these suggestions are non-exhaustive and many further measures exist within different industries.

IG Example 17: Products in the development pipeline

In the pharmaceutical industry, for example, future revenues may be greatly affected by the launch of new products from the company's product development pipeline. Directors may monitor number of products at each stage of development and the markets/timing for future launches as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Product development pipeline being the key products currently under development, and the stage of development (Phase I, II or III). Phase I initial evaluation, Phase II determination of dose and initial evaluation of efficacy, Phase III large comparative study in patients to establish clinical benefit and safety.

- Purpose: In order to achieve a strategy of continuing growth, the company must have a productive product development pipeline.

- Source of underlying data: Company data.

- Quantified KPI data : Table showing breakdown of product development activity in 20X5 and 20X4 e.g. Phase I – 25 projects (20X4: 20), Phase II – 18 projects (20X4: 15), Phase III – 12 projects (20X4: 10), number of new products launched this year 4 (20X4: 3). Detailed information for those projects in Phase III and those launched during the year, e.g. name of product, description, projected market launch dates by territory.

- No changes have been made to the source of data or calculations methods used compared to 20X4.

IG Example 18: Reserves

In an extractive industry, future revenues are greatly affected by the reserves controlled by the company. Accordingly, proven and probable reserves may be monitored by the directors as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Reserves are defined as those quantities of petroleum which are anticipated to be commercially recoverable from known accumulations from a given date forward. Reserves are reported net of the gas required for processing and transportation to the customer. The reporting process is in line with reserves definitions and resource classification systems published by the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC).

- Purpose: The most critical driver of growth of any oil and gas company is reserve replacement.

- Source of underlying data: Internal company data reviewed by an independent expert (who should be named, along with professional qualifications).

- Quantified data: Reconciliation of movement in proven reserves over the period e.g. Proven at end of 20X4 = 316, less production 57, add revisions 27, add exploration additions 41, Proven at end of 20X5 = 327. Reconciliation of movement in proven and probable reserves over the period e.g. Proven and probable at end of 20X4 = 724, less production 57, add revisions -4, add exploration additions 69, Proven and probable at end of 20X5 = 732.

- No changes have been made to the source of data or calculations methods used compared to 20X4.

IG Example 19: Market risk

A bank might measure market risks arising from uncertainty about changes in market prices and rates, such as interest rates, equity prices, exchange rates, commodity prices) by using "value-at-risk" approaches as a KPI. The following information might be disclosed in such cases:

- Definition and calculation: Value-at-risk (VaR) uses a Monte Carlo simulation process. Volatilities and correlations of market parameters are observed over the most recent twelve-month period and used on an unweighted basis. The VaR estimates are made at a 99% confidence level for a one-day time horizon.

- Purpose: Tracking the daily VaR allows the bank to derive a quantitative measure of market risk in order to monitor the risk profile it has taken on related to all market risk areas.

- Source of underlying data: VaR of trading units in Hong Kong and of the units responsible for management of interest rate and foreign exchange risks of non-trading units.

- Target: The goal is not to exceed the limit set by the VaR calculation on any day of trading during any year.

- Quantified data: VaR histogram, showing the number of days VaR was at certain levels for 20X5 and 20X4.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 20: Monitoring of social risks in the supply chain

A company that sources its branded products from overseas could face additional risks relating to stakeholder, in particular customer, concerns around local labour practices. In this situation, a company might have put in place a system to validate and monitor supply chain performance, specifically related to adherence to stated policies. The directors may monitor the extent of the programme and compliance rates as KPIs. The following information might be disclosed in such cases:

- Definition and calculation: Number of factories subject to ratings by independent accredited monitors, number of factories in each rating category, where one star signifies numerous severe non-compliance issues and four stars reflects those factories with no non-compliance issues.
- Purpose: Whilst the company has outsourced its supply chain, it wants to reassure customers that it has not outsourced its moral responsibility for the way its products are made. The objective is for all parts of the business – including suppliers – to share a common set of values and live up to them.
- Source of underlying data: Results of assessments made by accredited monitors in the current year.
- Target: To increase the number of suppliers monitored by 20% per annum and reduce non-compliance to below 3%.
- Quantified data: Table showing geographical split (for 20X5 and 20X4) of results for overseas suppliers, by Asia, Americas and Europe. Total factories in each of the four rating categories.
- No changes have been made to the source of data or calculation methods used compared to 20X4.

IG Example 21: Business Continuity Management

A company providing computer services may monitor its compliance with business continuity plans. The following information might be disclosed in such cases:

- Definition and calculation: Number of business units in each rating category, where an 'Pass' rating signifies full compliance with stated business continuity plans, whilst 'Fail' rating signifies numerous non-compliance issues.
- Purpose: As the provider of computer services, the company wishes to provide assurance of their ability to withstand events that would interrupt the provisions of such services.
- Source of underlying data: Data from all business units within the company.
- Quantified data: Bar chart showing pass/fail rates over time e.g. 20X5 98% Pass, 2% Fail, 20X4 95% Pass, 5% Fail, 20X3 93% Pass, 7% Fail.
- No changes have been made to the source of data or calculation methods used over the periods shown.