



To: **HKSA members**

**All other interested parties**

## EXPOSURE DRAFT

### Proposed Standards And Guidance For HKSA Members In Performing Listing Engagements

*Comments to be received by 14 August 2004*

*Issued by the Council,  
Hong Kong Society of Accountants*

The Hong Kong Society of Accountants' (HKSA) Council (Council) has issued an Exposure Draft (ED) of a comprehensive and robust set of standards and guidance for HKSA members in performing listing engagements, in response to changes in market practice over the past two decades and new and emerging market needs. The ED is a milestone of the HKSA Accountants' Report Project which commenced in 2001.

The ED includes an Explanatory Memorandum and seven proposed professional pronouncements which govern the work of reporting accountants, and provide guidance on the preparation of financial information by the directors of listing applicants/listed companies, in connection with the issuance of investment circulars.

A copy of the ED is attached. The ED can also be found on-line at:  
< [http://www.hksa.org.hk/professionaltechnical/assurance/artf/exposure\\_draft.pdf](http://www.hksa.org.hk/professionaltechnical/assurance/artf/exposure_draft.pdf) >.

The Council welcomes comments on all aspects of the ED, and specifically on the proposed new reporting framework and the proposed significant changes from current practice as detailed in paragraphs 4 and 5 of the Explanatory Memorandum to the ED. Comments would be most helpful if they indicate the specific paragraph(s) of the proposed professional pronouncements to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments are requested to be received by **14 August 2004** and may be sent by mail, fax or e-mail to:

Stephen Chan  
Technical Director (Ethics & Assurance)  
Hong Kong Society of Accountants  
4th Floor, Tower Two, Lippo Centre  
89 Queensway  
Hong Kong

Fax number: 2865 6776  
E-mail: [commentletters@hksa.org.hk](mailto:commentletters@hksa.org.hk)

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

*(May 2004)*

# **Exposure Draft of Proposed Standards And Guidance For HKSA Members In Performing Listing Engagements**

## **TABLE OF CONTENTS**

	<i>Page</i>
<b>Explanatory Memorandum</b>	3
<b>Exposure Draft</b>	
HKSIR 100 Investment circulars and reporting accountants	9
HKSIR 200 Accountants' reports on historical financial information in investment circulars	34
HKSIR 300 Accountants' reports on pro forma financial information in investment circulars	45
HKSIR 400 Comfort letters and other assistance to sponsors	55
PN 2000 Other letters issued in relation to investment circulars	85
AG 2.211 Preparation of historical financial information for inclusion in investment circulars	90
AG 2.212 Preparation of pro forma financial information for inclusion in investment circulars	96

# EXPLANATORY MEMORANDUM

## 1. **Introduction**

- 1.1 In view of the changes in market practices over the past two decades, the Hong Kong Society of Accountants' (HKSA) Council appointed the Accountants' Report Task Force (ARTF) to develop new standards and guidance to HKSA members on the reports and letters that are issued by reporting accountants, and on the preparation by the directors of listing applicants of financial information, in connection with the issuance of investment circulars including prospectuses.
- 1.2 This Explanatory Memorandum explains the proposed new reporting framework to be introduced by the Exposure Draft (ED) of a suite of seven professional pronouncements under the Accountants' Report Project and the related key proposals. It also highlights the significant proposed changes from current practice.
- 1.3 The proposed new reporting framework may require changes to the Listing Rules and current market practices, and the ARTF will consult the Securities and Futures Commission (SFC) and Hong Kong Exchanges and Clearing Limited (HKEx) in this respect. If changes are necessary, the effective date of the proposed new reporting framework is subject to such changes being made.
- 1.4 The seven proposed professional pronouncements developed by the ARTF, with the exception of the proposed HKSIR 400, are largely based on the equivalent UK standards and guidance which include Statements of Investment Circular Reporting Standards issued by the UK Auditing Practices Board (APB) and other relevant guidance issued by the APB or the Institute of Chartered Accountants in England and Wales, with necessary local amendments. The proposed HKSIR 400 is largely based on the equivalent standards and guidance issued by the Canadian Institute of Chartered Accountants, with necessary local amendments.

## 2. **Consultation with the SFC and HKEx**

- 2.1 In developing the ED, the ARTF has started a dialogue with the SFC and HKEx. A number of meetings and presentations were held to exchange views on the HKSA's proposals. The SFC and HKEx have indicated to the HKSA that they support the Accountants' Report Project to update the HKSA's existing guidance, and will review and comment on the ED once it is issued.
- 2.2 The ARTF will continue to work closely with the SFC and HKEx on the proposed professional pronouncements before finalizing them.

## 3. **Scope of the ED**

- 3.1 The seven proposed professional pronouncements included in the ED for consultation are:
  - HKSIR 100 "Investment circulars and reporting accountants"
  - HKSIR 200 "Accountants' reports on historical financial information in investment circulars"

- HKSIR 300 “Accountants’ reports on pro forma financial information in investment circulars”
- HKSIR 400 “Comfort letters and other assistance to sponsors”
- PN 2000 “Other letters issued in relation to investment circulars”
- AG 2.211 “Preparation of historical financial information for inclusion in investment circulars”
- AG 2.212 “Preparation of pro forma financial information for inclusion in investment circulars”.

3.2 The proposed HKSIRs (Hong Kong Standards on Investment Circular Reporting Engagements) is a new series of standards governing the work of reporting accountants. The proposed PN (Practice Note) 2000 is to assist reporting accountants where they are requested by the directors of listing applicants to issue letter on cash flow forecasts or projections and letter on schedule of indebtedness. The two proposed AGs (Accounting Guidelines) are issued to assist the directors of listing applicants in preparing financial information for inclusion in investment circulars.

#### **4. Proposed new reporting framework introduced by the ED**

##### ***4.1 Historical financial information***

###### **4.1.1 Respective roles of reporting accountants and directors of listing applicants**

Under the proposed new reporting framework, the directors of listing applicants will be responsible for the preparation of the historical financial information for inclusion in investment circulars, and the reporting accountants will be responsible for reporting on the historical financial information as prepared by the directors.

Currently, reporting accountants are responsible for the preparation of an accountants’ report, which includes the historical financial information as well as an opinion by the reporting accountants on the truth and fairness of the historical financial information.

###### **4.1.2 Format and contents of the accountants’ reports**

Reporting accountants will issue an accountants’ report expressing a true and fair opinion on the historical financial information.

The proposed new accountants’ report will adopt the style of a “short-form SAS 600 auditors’ report” issued by the auditors on the annual financial statements.

The historical financial information will not form part of the accountants’ report.

###### **4.1.3 Statement of adjustments**

Since the directors of listing applicants will be responsible for the preparation of the historical financial information for inclusion in investment circulars under the proposed new reporting framework, the preparation of the statement of adjustments will also rest with the directors.

Paragraph 42 of the Third Schedule to the Companies Ordinance provides that an accountants' report shall either:

- (a) indicate by way of note any adjustments as respects the figures of any profits or losses or assets and liabilities dealt with by the report which appear to the persons making the report necessary; or
- (b) make those adjustments and indicate that adjustments have been made.

Based on legal advice obtained by the HKSA, reporting accountants will comply with alternative requirement (a) of paragraph 42 of the Third Schedule to the Companies Ordinance if they refer in the accountants' report to a note in the historical financial information which contains the adjustments that have been made by the directors.

#### **4.2 *Pro forma financial information***

With effect from 31 March 2004, the Listing Rules require the preparation of pro forma financial information for inclusion in investment circulars in certain cases and the reporting thereon by the reporting accountants. As a result, the HKSA has developed the proposed AG 2.212 and HKSIR 300 to provide guidance to the directors of listing applicants and reporting accountants in the preparation of and reporting on pro forma financial information respectively.

Where the pro forma financial information is included in an investment circular, reporting accountants will issue an accountants' report expressing a "proper compilation" opinion.

#### **4.3 *Other financial information***

Main Board Listing Rule 9.12(10) requires that where the listing document is required to contain a statement by the directors as to the sufficiency of working capital, a letter from the sponsor or, in the case of a listed issuer, the issuer's financial advisers or auditors is required to be lodged with the Stock Exchange, confirming that they are satisfied that the statement in the listing document as to the sufficiency of working capital has been made by the directors after due and careful enquiry and that persons or institutions providing finance have stated in writing that such facilities exist.

The reporting accountants' work will be aligned with HKSA ED/SAS 730 "The examination of prospective financial information". Instead of reporting on the directors' statement of working capital sufficiency, under the proposed PN 2000, the reporting accountants will report on the appropriateness of the best-estimate assumptions used in the preparation of the cash flow forecast which is the basis for the preparation of the statement of working capital sufficiency, and whether the forecast is properly prepared on the basis of the best-estimate assumptions.

#### **4.4 *Comfort letters***

At the request of the directors of listing applicants, the reporting accountants may accept an engagement to issue a comfort letter to assist the sponsors in discharging their responsibilities. Such a comfort letter will be a private letter addressed to the directors of listing applicants as well as the sponsors provided that the sponsors are also party to the engagement letter.

Reporting accountants will perform an agreed-upon procedures engagement in connection with the issuance of the comfort letter in accordance with the proposed HKSIR 400.

**4.5 Respective roles and responsibilities of reporting accountants and directors of listing applicants**

The table below summarizes the respective roles and responsibilities of reporting accountants and directors of listing applicants under the proposed new reporting framework.

Proposed new reporting framework	
Role and responsibilities of directors of listing applicants	Role and responsibilities of reporting accountants
<p>4.1 <u>Historical financial information</u></p> <p>Preparation of GAAP compliance historical financial information for inclusion in investment circulars in accordance with the proposed AG 2.211.</p>	<p>Under the proposed HKSIR 200, reporting on the historical financial information as prepared by the directors.</p>
<p>4.2 <u>Pro forma financial information</u></p> <p>Preparation of pro forma financial information for inclusion in investment circulars to provide investors with relevant information about the impact of the transaction that is the subject of the investment circular by illustrating how that transaction might have affected the financial information presented in the investment circular, had the transaction been undertaken at an earlier date in accordance with the proposed AG 2.212.</p>	<p>Under the proposed HKSIR 300, reporting on the pro forma financial information as prepared by the directors.</p>
<p>4.3 <u>Other financial information</u></p> <p>Preparation of other financial information relating to an investment circular as required by the Listing Rules, such as statement of working capital sufficiency and letter of indebtedness.</p>	<p>Under the proposed PN 2000, reporting on certain financial information relating to an investment circular to assist the directors in discharging their responsibilities under the Listing Rules.</p>
<p>4.4 <u>Comfort letters</u></p> <p>Engaging the reporting accountants to issue a comfort letter to assist the sponsors in discharging their responsibilities.</p>	<p>Performing an agreed-upon procedures engagement in connection with the issuance of the comfort letter in accordance with the proposed HKSIR 400.</p>

## **5. Significant changes from current practice introduced by the ED**

### **5.1 *Requiring sponsors to be party to the engagement letter in relation to the accountants' reports***

Under the extant HKSA Auditing Guideline 3.340 "Prospectuses and the reporting accountant", reporting accountants address their reports jointly to the directors of listing applicants and to the adviser (who is normally the sponsors).

Under the proposed new reporting framework, reporting accountants will address the accountants' reports only to those parties who are party to the engagement letter. Consequently, sponsors will continue to be one of the addressees of the accountants' reports only if they are party to the engagement letter.

### **5.2 *Discontinuing the practice of making reference to previous auditors***

Under the proposed new reporting framework, the reporting accountants will carry out appropriate procedures in order to express an opinion on the truth and fairness of the historical financial information for inclusion in investment circulars regardless of whether the historical financial information has previously been audited. As the reporting accountants will take on the responsibility for expressing an opinion on the historical financial information for the whole track period, the reference to the previous auditors does not add value to the opinion of the reporting accountants and may cause confusion regarding responsibilities. It is therefore recommended that this practice be discontinued to make clear the reporting accountants' responsibility.

### **5.3 *Discontinuing the practice of making reference to previous audit qualifications***

Under the current practice, where the reporting accountants conclude that they need not, for the purpose of their report, repeat a previously qualified audit opinion, they should indicate in their accountants' report how the matter was resolved.

For the same reason mentioned above regarding reference to previous auditors, under the proposed new reporting framework, it will no longer be necessary for the reporting accountants to indicate in their report how a matter which led to a previously qualified audit opinion was resolved. Furthermore, the reporting accountants will report on the truth and fairness of the historical financial information as a whole and it is not appropriate for reporting accountants to deal with specific matters covered by a previously qualified audit opinion.

### **5.4 *No involvement in signing verification notes***

Under the proposed new reporting framework, the reporting accountants will not be involved in signing any separate verification notes.

## **6. Completeness**

6.1 Profit forecasts are not mandatory. However in limited circumstances, it may be appropriate to include a profit forecast in which case the reporting accountants will report in accordance with HKSA ED/SAS 730 "The examination of prospective financial information" (<http://www.hksa.org.hk/professionalttechnical/assurance/exposedraft/ed-sas730.pdf>).

ED/SAS 730 was issued by the HKSA in May 2002 for consultation adopting International Standard on Auditing 810 of the same title in Hong Kong under the HKSA International Convergence Programme.

6.2 The suite of seven proposed professional pronouncements identified in paragraph 3.1 above together with HKSA ED/SAS 730 represent the new standards and guidance that will be required in respect of all matters relating to an investment circular issued in Hong Kong.

**7. HKSA professional pronouncements to be withdrawn**

7.1 Upon the finalization of the seven proposed professional pronouncements in the ED, the following HKSA Auditing Guidelines will be withdrawn:

- Auditing Guideline 3.340 “Prospectuses and the reporting accountant”
- Auditing Guideline 3.341 “Accountants’ report on profit forecasts”.

**8. Commentators guide and consideration of specific issues**

8.1 The HKSA invites comments from any interested party on all aspects of the ED, and specifically on the proposed new reporting framework and the proposed significant changes from the current practice as detailed in paragraphs 4 and 5 respectively above. Comments would be most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.



ISSUED FOR COMMENTS BY 14 AUGUST 2004

## HONG KONG STANDARD ON INVESTMENT CIRCULAR REPORTING ENGAGEMENTS

100

### INVESTMENT CIRCULARS AND REPORTING ACCOUNTANTS

(Issued [ ])

*Hong Kong Standards on Investment Circular Reporting Engagements (“HKSIRs”) are to be applied in the conduct of an engagement involving an investment circular intended to be issued in connection with a securities transaction governed wholly or in part by the laws and regulations of Hong Kong.*

*HKSIRs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.*

*To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the HKSIR including explanatory and other material contained in the HKSIR not just that text which is black lettered.*

*In exceptional circumstances, reporting accountants may judge it necessary to depart from a HKSIR in order to more effectively achieve the object of an engagement involving an investment circular. When such a situation arises, the reporting accountants should be prepared to justify the departure.*

*HKSIRs need only be applied to material matters.*

*The definitions set out in paragraph 13 of HKSIR 100 are to be applied in the interpretation of HKSIRs.*

*This HKSIR is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

### **Introduction**

1. The purpose of this HKSIR is to establish standards and provide guidance on the general principles governing reporting accountants’ engagements in the context of investment circulars. There is a wide range of roles and activities which may be undertaken by reporting accountants in the context of such engagements, many of which involve the issuance of reports or letters.
2. Although the reports and letters to be issued by reporting accountants are separately described in this HKSIR, they are seldom prepared in isolation. It is normal for the reporting accountants to be engaged to prepare several reports and letters below in connection with a securities transaction.
  - a. Public reports and letters:
    - an accountants’ report on historical financial information;

- an accountants' report on pro forma financial information;
- a letter of consent to the inclusion of the above accountants' reports in the investment circular.

These public reports are published either by inclusion in the investment circular or by being made available for inspection by the public.

- b. Private letters:
- a letter on cash flow forecast or projection;
  - a letter on schedule of indebtedness.

These private letters are not published and are usually prepared at the request of the directors and addressed to them.

3. Although the focus of each of these reports and letters is different and may provide the user with different levels of assurance, they will not normally be carried out as independent engagements. For instance, the work on the cash flow forecast or projection underlying the working capital statement prepared by the directors of an issuer may be relevant to the review of the going concern assumption in connection with the accountants' report on the historical financial information.
4. There are a number of principles and procedures which are common to all engagements to prepare such reports and letters and these are considered in this HKSIR. HKSIR 200 "Accountants' reports on historical financial information in investment circulars" and HKSIR 300 "Accountants' reports on pro forma financial information in investment circulars" address particular issues and requirements relating to specific engagements to prepare the accountants' reports on historical financial information and pro forma financial information respectively. PN 2000 "Other letters issued in relation to investment circulars" provides guidance on specific engagements to prepare the private letters as set out in paragraph 2(b) above.
5. ***The reporting accountants should familiarize themselves with the applicable laws and regulations governing the report or letter which is to be provided by them. (HKSIR 100.1)***
6. For companies listed or to be listed on the Stock Exchange, the relevant requirements determining how and what financial information is presented are contained in the Listing Rules/GEM Rules and the Companies Ordinance.
7. When an investment circular is made for a takeover or merger, it falls under the governance of the Takeover Code.
8. This HKSIR refers to various legal and regulatory requirements relating to the work of reporting accountants. However, this HKSIR does not attempt to reproduce or summarize these rules and regulations, and it would need to be read in conjunction with these rules and regulations. Appendix 1 to this HKSIR sets out the reports and letters that reporting accountants are normally engaged to produce, indicating the circumstances in which they may be required and the applicable regulations.
9. The roles and responsibilities of the reporting accountants depend upon the particular circumstances of the securities transaction and to some extent upon the requirements of the issuer, the sponsor or financial adviser. A summary of the roles and responsibilities of other professional advisers are set out in Appendix 2 to this HKSIR.

10. The adviser may require the reporting accountants to prepare a detailed report covering various aspects of the issuer's business, including its management, profit record, assets and liabilities, and prospects. This work is a separate engagement to that of reporting accountants and gives rise to a "long-form" report to the adviser. This type of engagement is outside the scope of this series of HKSIRs. However, the work performed in producing such "long-form" report often forms the basis of the reporting accountants' assurance in preparing the accountants' report to be included in the investment circular.
11. ***In the conduct of an engagement involving an investment circular, the reporting accountants should comply with HKSIRs and Statements of Auditing Standards (SASs) issued by the Hong Kong Society of Accountants. (HKSIR 100.2)***
12. The investment circular in which the accountants' reports are included may be available in other countries, such as the United States of America, which have their own standards for reporting accountants when preparing the accountants' reports. In such circumstances, reporting accountants consider whether they need to include a reference to the fact that the accountants' reports issued in accordance with this series of HKSIRs should not be relied upon as if they had been issued in accordance with the standards of that country.

## Definitions

13. The definitions used in the series of HKSIRs are:
  - a. *Accountants' report on historical financial information:* A report by reporting accountants included in an investment circular, in which the reporting accountants are required to express an opinion on the historical financial information in accordance with HKSIR 200 "Accountants' reports on historical financial information in investment circulars".
  - b. *Accountants' report on pro forma financial information:* A report by reporting accountants included in an investment circular, in which the reporting accountants are required to express an opinion on the pro forma financial information in accordance with HKSIR 300 "Accountants' reports on pro forma financial information in investment circulars".
  - c. *Circular:* A press release or document issued by an issuer relating to certain transactions significant to the company (e.g. major transactions), which does not constitute a prospectus as required by the Listing Rules/GEM Rules.
  - d. *Consent letter:* A letter whereby the reporting accountants consent to the inclusion in an investment circular of references to their name or the inclusion of any of their reports which are to be published therein.
  - e. *GEM Rules:* "Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited" for GEM issuers.

- f. *GEM:* The Growth Enterprise Market operated by the Stock Exchange.
- g. *Investment circular:* A document issued by an issuer pursuant to the Listing Rules/GEM Rules, the Takeover Code or the Companies Ordinance relating to listed or unlisted securities on which it is intended that a third party would make an investment decision, including prospectus, circular to shareholders or similar document.
- h. *Issuer:* As defined by the Listing Rules/GEM Rules, an issuer is any company or other legal person any of whose equity or debt securities are the subject of an application for listing or some of whose equity or debt securities are already listed.
- i. *Listing Rules:* “Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited” for Main Board issuers.
- j. *Prospectus:* Any prospectus, notice, circular, brochure, advertisement, or other document offering any shares or debentures of a company to the public for subscription or purchase for cash or other consideration; or circular to invite offers by the public to subscribe for or purchase for cash or other consideration any shares or debentures of a company.
- k. *Reporting accountants:* A professional accountant engaged to prepare public reports and letters for inclusion in, or private letters in connection with, an investment circular. Where the context requires, this term includes auditors where they are carrying out a role in connection with an investment circular, other than that of reporting as auditors on financial statements.
- l. *Sponsor:* An entity appointed under the Listing Rules/GEM Rules by an issuer to provide advice to and assist the issuer in listing, lodging the formal application for listing and supporting documents and dealing with the Stock Exchange.
- m. *Stock Exchange:* The Stock Exchange of Hong Kong Limited.
- n. *Takeover Code:* The Codes on Takeovers and Mergers and Share Repurchases.
- o. *Third Schedule:* The Third Schedule to the Companies Ordinance.

## Independence and ethical standards

14. ***In the conduct of an engagement involving an investment circular, the reporting accountants should comply with the requirements of the Statements of Professional Ethics/ [HKSA Code of Ethics] issued by the Hong Kong Society of Accountants. (HKSIR 100.3)***
15. In addition to the ethical principles governing auditors (such as independence, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards), other relevant guidance includes that dealing with ethical considerations which arise from the provision of corporate finance advice.
16. While the decision whether a securities transaction should proceed is not that of the reporting accountants, there may be rare circumstances when the reporting accountants consider the proposed securities transaction to be so inappropriate that they cannot properly continue to act.
17. ***In engagements involving an investment circular, a partner with appropriate experience should be involved in the conduct of the work. (HKSIR 100.4)***
18. Frequently reporting accountants are from a firm that is also the auditors of the issuer. The audit partner although having knowledge of the issuer may not, however, have the necessary experience to take responsibility for all aspects of an engagement involving an investment circular. The extent of involvement of a partner with the requisite experience of dealing with investment circulars varies and is determined, among other things, by the expertise required to prepare the reports and letters that the reporting accountants have agreed to provide and the experience of the audit partner.
19. In some cases it may be appropriate for the partner with the requisite experience of dealing with investment circulars to act as a second or concurring partner. In other cases it may be appropriate for such a partner to be the lead engagement partner.

## Agreeing the terms of the engagement

20. ***The reporting accountants should agree the terms of the engagement with those from whom they accept instructions. The whole of the terms of the engagement should be recorded in writing. (HKSIR 100.5)***
21. Specific terms of engagement are agreed in writing for each engagement and recorded in an instruction letter from the directors of the issuer. Alternatively, a letter is prepared by the reporting accountants, in lieu of an instruction letter, and accepted in writing by the directors.
22. Where an instruction letter is addressed to the reporting accountants, its terms are formally acknowledged by the reporting accountants in writing, clarifying particular aspects of the instructions and covering any matters which might have been overlooked.
23. This letter, or exchange of letters (together referred to as “the engagement letter”), provides evidence of the contractual relationship between the reporting accountants and the issuer. It sets out clearly the scope and limitations of the work to be performed by the reporting accountants. It also confirms the reporting accountants’ acceptance of the engagement and includes a summary of their responsibilities and those of the directors as they relate to the reporting accountants’ role.
24. The engagement letter will normally include separate paragraphs to describe each specified report or other work product the reporting accountants have agreed to produce.

25. The engagement letter will usually set out the form of any reports or letters required (including, in each case, the nature of any opinion to be expressed by the reporting accountants). These reports and letters can be critical to the directors' assessment of the securities transaction. Accordingly, it is important to clarify their requirements and the scope and content of the reports and letters at the earliest possible stage.

### **Obligations and responsibilities**

26. The engagement letter establishes a direct responsibility to those to whom it is addressed (or in the case of an instruction letter those to whom the reporting accountants have formally acknowledged acceptance of the instructions). It is also the mechanism by which the scope of the reporting accountants' contribution to the overall due diligence process is defined and agreed. The reporting accountants' work is tailored to the specific circumstances of the securities transaction through the process of agreeing the terms of the engagement letter.
27. ***The engagement letter should specify those reports and letters which are intended for publication in the investment circular and any other private letters that are required. The engagement letter should specify to whom all reports or letters are to be addressed. (HKSIR 100.6)***
28. The engagement letter identifies those reports which are intended for publication in the investment circular, or otherwise made publicly available, and those letters which are intended to provide private comfort to the directors who have specific responsibilities to discharge in respect of the preparation of the investment circular, to whom the relevant reports and letters will be addressed and, therefore, to whose use the relevant reports and letters will be restricted.
29. The engagement letter sets out the express terms governing the reporting accountants' contractual responsibilities, in connection with the securities transaction, to those instructing them. It is important that the scope of the reporting accountants' work is defined realistically. Where there is already a body of knowledge by way of background, the scope of the reporting accountants' involvement may be set to take account of the users' prior knowledge. Reporting accountants do not accept responsibility beyond the matters or entities in respect of which they are specifically instructed. Nor would they be expected to comment or report on matters which more properly fall within the skill and experience of other experts or advisers. They understand, however, the need to apply their own professional skill and experience in interpreting and carrying out their instructions. Further, if the reporting accountants happen to find information outside the defined scope of their engagement that they believe should be disclosed, as being in their view material to the securities transaction, the reporting accountants discuss these matter with the directors and agree a course of action.
30. In preparing any report or letter the reporting accountants rely on information supplied to them by the directors, employees or agents of the issuer that is the subject of the reporting accountants' enquiries. Because of the importance of such information and any associated representations for their work, the engagement letter usually limits the extent of the reporting accountants' responsibility where information which is material to their report or letter has been withheld from, concealed from or misrepresented to them. While such a limitation is reasonable in the circumstances, the reporting accountants do not accept such information without further enquiry where the information provided prima-facie gives rise to doubts about its validity. If the reporting accountants become aware of any such withholding, concealment or misrepresentation, they would normally inform the directors as soon as practicable.
31. Matters normally dealt with in the engagement for the principal forms of reporting covered by

this HKSIR together with routine engagement administration and contractual matters are set out in the example engagement letter in Appendix 3 to this HKSIR.

### **Subsequent amendments to the terms of the engagement**

32. *If in the course of the engagement it becomes clear that the terms of the engagement need to be changed, such changes should be agreed and recorded in writing. (HKSIR 100.7)*
33. The agreement of the scope of the reporting accountants' involvement is usually an iterative process and accordingly the scope can evolve as the securities transaction progresses. It is important that any material changes in the terms of the engagement subsequent to the issue of the engagement letter are recorded in supplementary engagement letters as they are agreed in order that the resulting letters together evidence the scope of work finally determined by the parties.

### **Planning**

34. *The reporting accountants should develop and document a plan for their work so as to perform the engagement in an effective manner. (HKSIR 100.8)*
35. Planning is necessary for all reporting accountants' engagements. The objectives of planning include:
- a. assessing whether the timetable is realistic;
  - b. ensuring that appropriate attention is devoted to different aspects of the engagement;
  - c. ensuring that potential problems are identified and appropriate steps planned to deal with them;
  - d. considering the need for the involvement of specialists; and
  - e. facilitating review.
36. An initial plan is prepared documenting the approach to be adopted. A preliminary review of the available financial information, and of any audit opinions previously given, may provide an indication of potential issues that might need to be addressed in carrying out the engagement. If the preliminary review indicates that there are factors which may give rise to a qualification or other modification of any report or letter then such factors are reported immediately to the issuer.
37. Reporting accountants plan their work in a particular area taking account of information or knowledge gained in other areas. This extends beyond the obvious elimination of duplication of work between reports, for example, between the consideration of appropriateness of the going concern basis in the context of the accountants' report and the work carried out in connection with the letter on cash flow forecast or projection. It could also result in the reporting accountants adopting a different approach to a particular area in the light of experience gained in other facets of their work.
38. Changes in circumstances, or unexpected results of work carried out, may require the plan to be amended as work progresses. Any such amendments are documented. Where the changes affect the scope of work as set out in the engagement letter, the engagement letter is also amended as necessary in accordance with HKSIR100.7 following agreement with the directors.

## Knowledge of the business and the securities transaction

39. *The reporting accountants should obtain such knowledge of the entity's business and the proposed securities transaction as is reasonably required to enable them to identify the key factors affecting the financial information in respect of which their report or letter is to be given. (HKSIR 100.9)*
40. Where the reporting accountants also act as auditors to the entity, they will already have a knowledge of the business of the issuer sufficient to enable them to understand the events, transactions and practices that may have a significant effect on the financial information. However, such knowledge may not of itself be sufficient in the circumstances of an engagement as reporting accountants. Accordingly, the knowledge gained as auditors, although providing a platform on which the necessary knowledge will be based, will often need to be expanded to ensure the proper discharge of the responsibilities of the reporting accountants in the circumstances of the particular engagement.
41. The nature and terms of the proposed securities transaction, that is the objective of the investment circular, are also factors affecting the report or letter to be issued by the reporting accountants. The reporting accountants, therefore, seek to gain an understanding of the principal terms of the securities transaction, the key sensitivities upon which the success of the proposal is dependent and the issuer's reason for proposing it.

## Evidence

42. *The reporting accountants should obtain sufficient appropriate evidence on which to base their opinions, letters or reports. (HKSIR 100.10)*
43. The reporting accountants, either directly or indirectly, will seek to obtain evidence derived from one or more of the following procedures: inspection, observation, enquiry and confirmation, computation and analytical procedures. The choice of which of these, or which mix of them, is appropriate will depend on the circumstances of each engagement and on the form of opinion, if any, to be given. Guidance on considerations applicable in particular circumstances is given in other HKSIRs which address the particular issues and requirements arising on specific engagements.
44. Reporting accountants approach their work with diligence and professional skepticism. Their work will be based initially on information and explanations provided by the directors and management of the issuer. While they may proceed on the basis that such information and explanations are reliable, they assess them critically and consider them in the context of their knowledge and findings derived from other areas of their work. They are alert for, and where appropriate report, any inconsistencies they consider to be significant. The extent to which they are required to go further and test the information and explanations received will depend upon their specific instructions, the degree of assurance, if any, they are to provide and the requirements of relevant professional standards.
45. The reporting accountants obtain, where practicable, written confirmation of certain matters from the directors of the issuer. Such confirmations usually encompass representations made by the directors and officials to the reporting accountants in the course of their work.
46. An example management representation letter is set out in Appendix 4 to this HKSIR.
47. The evidence gathered in support of an individual report takes account of the information gathered and conclusions drawn in support of other reports comprised in the reporting accountants' instructions in connection with the securities transaction.



## Documentation

48. *Working papers should record the reporting accountants' planning; the nature, timing and extent of the procedures performed; and the conclusions drawn. (HKSIR 100.11)*
49. *The reporting accountants should record in their working papers their reasoning on all significant matters that require the exercise of judgement and their conclusions thereon. (HKSIR 100.12)*
50. The extent of working papers is a matter of professional judgement since it is neither necessary nor practical to document every matter reporting accountants consider.
51. The form and content of working papers are affected by matters such as:
- a. the nature and scope of the engagement;
  - b. the form of the report and the opinion, if any, to be given;
  - c. the nature and complexity of the issuer's business;
  - d. the nature and condition of the issuer's accounting and internal control systems;
  - e. the needs in the particular circumstances for direction, supervision and review of the work of members of the reporting accountants' team; and
  - f. the specific methodology and technology that the reporting accountants use.
52. Working papers are designed and organized to meet the circumstances and the reporting accountants' needs for each part of the engagement.

## Materiality

53. *Reporting accountants should consider materiality in planning their work in accordance with their instructions and in determining the effect of their findings on any report or letter to be issued. (HKSIR 100.13)*
54. "Materiality" is an expression of the relative significance or importance of a particular matter in the context of the financial information or other subject matter of the accountants' report or letter. A matter is material if its omission is likely to influence the decisions of an addressee of the reporting accountants' report or letter; likewise a misstatement is material if it is likely to have a similar influence. Materiality is not capable of general mathematical definition as it has both qualitative and quantitative aspects. SAS 220 "Audit materiality" provides useful guidance for reporting accountants concerning materiality in the context of expressing an opinion in "true and fair" terms on historical financial information included in an investment circular.

## Quality control

55. *Reporting accountants should apply quality control policies and procedures, appropriate to the particular opinions, letters or reports that they will be issuing, which ensure compliance with HKSIRs and SASs issued by the Hong Kong Society of Accountants (HKSIR 100.14).*
56. *Any delegated work should be directed, supervised and reviewed in a manner which*

*provides reasonable assurance that such work is performed competently. (HKSIR 100.15)*

57. The explanatory material, concerning the quality control of audits, provided by SAS 240 “Quality control for audit work” may provide useful guidance for reporting accountants to the extent that it is appropriate to the particular assignment on which they are engaged.

## Reporting

58. *In all reports or letters for inclusion in, or in connection with, an investment circular, reporting accountants should:*
- a. address their reports or letters only to those parties who are party to the engagement letter;*
  - b. identify the financial information to which their report relates;*
  - c. address all matters that are required by the engagement letter;*
  - d. explain the basis of their report or opinion;*
  - e. give, where applicable, a clear expression of opinion;*
  - f. where there has been a limitation on the scope of their work such that they have been unable to complete their report or letter in accordance with their instructions, describe the factors giving rise to the scope limitation and its consequences for their report or letter;*
  - g. include their manuscript or printed signature; and*
  - h. state the date of their report or letter. (HKSIR 100.16)*
59. Certain of the reports prepared in connection with investment circulars are intended for publication in an investment circular (for example, accountants’ reports) and these are discussed in paragraph 64 below. More detailed guidance on the expression of particular types of opinion is given in the appropriate HKSIR.
60. There will be letters not prepared for publication in an investment circular but for the directors. These private letters are discussed in paragraphs 65 to 68 below.
61. The report or letter is dated on the same date as the investment circular in which it is included or to which it relates. To assist in the identification of the reporting accountants, the report normally includes their address.
62. As noted in paragraph 25 above, the engagement letter usually sets out the form of the report or letter to be issued, including the form of opinion to be expressed where applicable. The reporting accountants ensure that the form of their report/letter or opinion is consistent with the terms of their engagement.
63. Because of the wide range of characteristics of the subject matter of reporting accountants’ engagements, the level of assurance provided by the reporting accountants also varies considerably. To avoid any misunderstanding by the user of the report or letter as to the scope of the opinion or the level of assurance provided, it is important that the subject matter is clearly identified and that the reporting accountants’ opinion or other assurance is expressed in terms that are appropriate to the particular engagement. Guidance on the form and scope

of reports appropriate in particular circumstances is given in other HKSIRs and PN 2000 which address particular issues and requirements relevant to individual reports and letters.

### **Public reports**

64. *Where reporting accountants are engaged to produce public report(s) they should in their published report(s) include a statement of their compliance or otherwise with the applicable HKSIRs. (HKSIR 100.17)*

### **Private letters**

65. *Private letters prepared in connection with an investment circular should:*
- a. refer specifically to the terms of the engagement as set out in the engagement letter; and*
  - b. provide any assurance that has been agreed regarding the subject matter of the letter. (HKSIR 100.18)*
66. The Stock Exchange requires the directors of the issuer to state in their opinion the entity's working capital is sufficient for the requirements of the business or, if not, how it is proposed to provide the additional working capital. The directors are solely responsible for this statement. The Listing Rules/GEM Rules also require that a letter from the sponsor or, in the case of a listed issuer, the issuer's financial adviser or auditors, confirming that they are satisfied that the statement in the investment circular as to the sufficiency of working capital has been made by the directors after due and careful enquiry. Typically the directors of the issuer and/or the sponsor or financial adviser will instruct the reporting accountants to examine a cash flow forecast or projection as prepared by the directors for the purpose of making the working capital sufficiency statement. The reporting accountants will issue a letter on the cash flow forecasts or projections.
67. The Stock Exchange requires disclosure of detail on indebtedness as at the most recent practical date. The directors are solely responsible for this statement of indebtedness. The directors will instruct the reporting accountants to provide a letter on a schedule of indebtedness for the purpose of preparing the statement of indebtedness.
68. Guidance on particular considerations to which the reporting accountants have regard are set out in PN 2000 which address particular issues and requirements relevant to the private letters issued by the reporting accountants.

### **Consent**

69. *Where the reporting accountants are to give consent to the inclusion of their statement, report or letter (their report), or references to their name, in an investment circular they should, before doing so, consider their report in the form and context in which it appears, or is referred to, in the investment circular as a whole by:*
- a. comparing their report with the information in the rest of the investment circular and assessing whether they have any cause to believe that they are inconsistent; and*
  - b. assessing whether they have any cause to believe any information in the investment circular to be misleading.*

*When the reporting accountants believe information in the investment circular is either inconsistent with their report or misleading they should withhold their consent until they are satisfied that their concerns are unwarranted or until the investment circular has been appropriately amended. (HKSIR 100.19)*

70. A requirement for reporting accountants to consent to the inclusion of their report in an investment circular arises from the Listing Rules/GEM Rules - where a statement or report attributed to an expert (including the reporting accountants) is included in a prospectus or circular issued by a listed company (or by a new applicant for listing). In all such cases there must be a statement that the report is included in the investment circular, in the form and context in which it is included, with the consent of the expert. Where the investment circular comprises a prospectus, there must be a further statement that the expert has authorized the contents of that part of the prospectus. An example consent letter is set out in Appendix 5 to this HKSIR.

### **Procedures**

71. Whilst the reporting accountants' reporting responsibilities do not extend beyond their report, the process of giving consent involves an awareness of the overall process whereby the investment circular is prepared, and may entail discussions with those responsible for the investment circular as a whole in relation to its contents.
72. In deciding whether to give their consent, reporting accountants read the final version of the investment circular with a view to assessing the overall impression given by the document, having regard to the purposes for which it has been prepared, as well as considering whether there are any inconsistencies between their report and the information in the rest of the document. As part of this process the reporting accountants consider whether they have any cause to believe that any information in the investment circular may be misleading and that therefore they would not wish to be associated with it.
73. For this purpose the engagement partner uses the knowledge of the partners and professional staff working on the engagement. If particular issues are identified the engagement partner may consult with partners and professional staff working on the engagement, and any other partners and professional staff who may have been previously consulted regarding such issues. It would be unrealistic to consult more widely within the firm and the engagement partner is not expected to do so.
74. Because of the degree of knowledge required and the increased responsibility that may be assumed, it is inappropriate for reporting accountants to provide consent unless they have been commissioned to undertake work specifically in connection with the investment circular in relation to the matter for which consent is sought. Hence, if an investment circular includes a reference to a report or opinion previously provided by the reporting accountants which is already in the public domain, the reporting accountants do not expect to be required to provide consent and do not generally do so.
75. An exception to this general rule would be where they have previously consented to the inclusion in an investment circular of that earlier report or opinion and it is being repeated or referred to in connection with the same securities transaction in respect of which it was originally issued. For example, an accountants' report included in one investment circular is required to be repeated in a subsequent investment circular in connection with the same offer, and for reporting accountants to indicate that they have no objection to their report continuing to apply. In such a case, before issuing their consent the reporting accountants make enquiries as to whether there have been any material events subsequent to the date of their original report which might require modification of or disclosure in that report.

**Date of letter**

76. Consent letters are dated the same date as the relevant investment circular.

**Display of letter**

77. The Stock Exchange requires the consent letter to be made available for public inspection. The consent letter may be made available for public inspection in other cases.

**Subsequent events**

78. *After the date of their report, reporting accountants have no obligation to perform procedures or make enquiries regarding the investment circular. If the reporting accountants become aware of any subsequent events after the date of their report, they should follow the requirements in SAS 150 "Subsequent events" for proper action to be taken. (HKSIR 100.20)*
79. Under the Listing Rules/GEM Rules, unless the Stock Exchange agrees otherwise, supplementary listing particulars or a supplementary prospectus must be prepared if, after the date the listing particulars or prospectus have been formally approved by a Stock Exchange and before dealings in the relevant securities commence, the issuer becomes aware that there has been a significant change affecting any matter contained in the investment circular or a significant new matter has arisen, the inclusion of information in respect of which would have been required if it had arisen at the time of their preparation.

## Appendix 1

## Table of reporting accountants' engagements

OUTPUT	CIRCUMSTANCES/DOCUMENTS	APPLICABLE REGULATIONS (IF ANY)
<b><i>PUBLISHED REPORTS/LETTERS</i></b>		
Accountants' report on historical financial information <sup>1</sup> <b>[HKSIR 200]</b>	A listing document issued by a new applicant.	Companies Ordinance: para. 32 and 33 of Part II of Schedule 3 Listing Rules: Rule 4.01 and App. 1A para. 37 GEM Rules: Ch. 7, Ch. 12 and App. 1A para. 37
	A listing document issued by a listed issuer in connection with an offer of securities to the public for subscription or purchase.	Companies Ordinance: s38(1) and s342(1) Listing Rule: Rule 4.01 and App. 1B para. 31(1) GEM Rules: Ch. 7 and App. 1B para. 31(1)
	A circular on a very substantial acquisition or a major transaction (or reverse takeover for GEM listed issuer) unless the company being acquired is itself a listed company. Accountants' report should contain financial information on the target company.	Listing Rule: Rules 4.01, 14.06 and 14.09 GEM Rules: Rules 19.55 and 19.56
Accountants' report on pro forma financial information <b>[HKSIR 300]</b>	A circular in connection with a major transaction, a reverse takeover or a very substantial acquisition, a very substantial disposal, or a listing document issued by a new applicant which has acquired or proposed to acquire any businesses or companies, which would at the date of application or such later date of acquisition before listing of the applicant be classified as a major subsidiary.	Listing Rules: Rules 4.25 to 4.29, App. 1B para. 31(3)(b) GEM Rules: Rules 7.27 to 7.31, App. 1B, para. 31(3)(b)
Consent letter <b>[HKSIR 100]</b>	When a report or letter by reporting accountants is included in a prospectus, listing document or circular, the reporting accountants must consent in writing to the inclusion of their report or letter in such document.	Companies Ordinance: s38C and s342C

OUTPUT	CIRCUMSTANCES/DOCUMENTS	APPLICABLE REGULATIONS (IF ANY)
<b>PRIVATE LETTERS</b>		
Report on cash flow forecast or projection <b>[PN 2000]</b>	Most prospectuses, listing documents and other circulars are required to contain a statement by the directors as to the sufficiency of working capital, a letter from the sponsor (in the case of new listing) or a letter from the issuer's financial adviser or auditor (in the case of a listed issuer), confirming that they are satisfied that the statement in the listing document as to the sufficiency of working capital has been made by the directors after due and careful enquiry and that persons or institutions providing finance have stated in writing that such facilities exist. In such cases the directors and the sponsor/financial adviser are required to report to the Stock Exchange in connection with this statement and accordingly it will usually commission reporting accountants to report on cash flow forecasts or projections which form the basis of the statement of working capital sufficiency.	Listing Rules: Rules 9.12(10), 14.08(4) and 14.19, App. 1A para. 36 and App. 1B para. 30 GEM Rules: Rules 12.22(13) and 19.54(2), App. 1A para. 36 and App. 1B para. 30
Report on schedule of indebtedness <b>[PN 2000]</b>	Listed companies - most prospectuses, listing documents and other circulars must contain a statement of indebtedness at the latest practical date. In such cases the sponsor or director has to report to the Stock Exchange in connection with this statement and accordingly it will usually commission reporting accountants to report on a schedule of indebtedness.	Listing Rules: App. 1A para 32(2) and App. 1B para. 28(2) GEM Rules: App. 1A para 32(2) and App. 1B para. 28(2)

*Note 1: If the transaction falls within the scope of the Takeover Code, the accountants' report is also subject to the provisions set out in the Takeover Code.*

## Appendix 2

### Roles and responsibilities of other professional advisers

*The description of roles and responsibilities provided in this appendix is intended to be a guide and not intended to be a definitive interpretation of legal and regulatory obligations. Different roles are sometimes undertaken by the same organization.*

**The issuer or the company** - In practice, the company is represented by its board of directors which takes primary responsibility for the reliability and completeness of the information contained within the documents issued in connection with a securities transaction. This is reflected in the directors' responsibility statement, where one is made. The manner of discharge of these responsibilities differs from transaction to transaction, depending among other things on the size and nature of the transaction and the skills and experience of the particular individuals who comprise the board. Typically the directors will take advice and will normally appoint a sponsor/financial adviser with experience of the type of transaction contemplated.

**The sponsor under the Listing Rules** - The Stock Exchange require an applicant for listing to appoint a person who is acceptable to the Exchange for the purpose to act as "sponsor" to the application for listing of its shares on the Exchange or where a listed company undertakes certain transactions subsequently. The responsibilities of a sponsor of a listed company are set out in Chapter 3 and Appendix 9 of the Listing Rules, and Chapter 6 of GEM Rules, respectively. These responsibilities are aimed broadly at ensuring that the directors of the company understand their obligations, both on initial listing and subsequently, and that the documents and the company comply with the relevant conditions for listing and other requirements of the Listing Rules/GEM Rules.

**The financial adviser** - The financial adviser actively manages the transaction on behalf of the board of the company and is closely involved in the decision-making process. Typically this will involve co-ordinating the planning, drafting and production of the investment circular and other transaction documents, including liaising with the other professional advisers to ensure that all the necessary reports and letters are obtained. In the case of a flotation or subsequent share issue, the financial adviser's role may include participation in the timing and pricing of the issue.

In the case of other acquisitions or disposals, the financial adviser's role often extends to commenting on the terms of the transaction, privately to the board or, by virtue of a reference in the directors' recommendation, publicly in the document.

The financial adviser will therefore wish to carry out its own "due diligence" process to ensure that it has an appropriate basis for the advice it gives and any recommendations it makes relating to the proposed transaction. As part of this process, the financial adviser will seek to obtain comfort on a number of financial and legal matters from the reporting accountants and the solicitors, as well as the directors. The scope of the reporting accountants' work in connection with any comfort they are engaged to provide in connection with the overall due diligence process will be determined by negotiation between the parties.

**The solicitors** - The primary role of the solicitors to the company is to advise the board with a view to ensuring that all legal and regulatory requirements are complied with and that full disclosure is made in the documents of all necessary information as required by law or applicable regulations. In addition they usually take responsibility for drafting the legal documents connected with the proposed transaction, including agreements entered into between the company or companies involved in the transaction, their shareholders, the sponsor and any third parties.

While the sponsor may rely on the company's solicitor it is usual in significant or complex



transactions, or where there may be conflicts of interest, for two firms of solicitors to be involved, one representing the company's interests and the other representing those of the sponsor.

Invariably the solicitors are closely involved in drafting the investment circular and they generally assume responsibility for managing the process of verification of the information contained in it.

**The brokers** - The role of the brokers is to advise on market conditions and the potential demand from the investment community for the company's shares, and to give guidance on the method, marketing, size and terms of the issue, as well as the timing and pricing of the issue and, where required, to organize sub-underwriting and placing arrangements with institutions.

**The underwriters** - Their role is to agree, in consideration for a commission, to apply for or find someone else to apply for a certain number or all of the securities which are the subject of an investment circular, that are not applied for by the public.

**The public relations advisers** - Their role is to manage and control communications with the media and other outside parties (including analysts and potential investors).

### Appendix 3

#### Example reporting accountants' engagement letter

*This example is only illustrative and is not intended to be prescriptive as to the form or content of an engagement letter.*

*Reporting accountants would seek their own advice as to the form of contract they wish to adopt. In particular, if reporting accountants wish to include statements in the engagement letter:*

- a. limiting their liability in respect of the engagement; or*
- b. dealing with their responsibility in the event that material is withheld, concealed, or misrepresented,*

*then they would take legal advice concerning the wording of such statements and how they are communicated.*

*This engagement letter assumes that the sponsor firm will be a signatory to the engagement letter thereby enabling it to be an addressee of the accountants' report. If the sponsor firm is not a signatory to the engagement letter, the accountant's report should not be addressed to the sponsor firm.*

---

(Letterhead of the reporting accountants)

The Directors  
XYZ Limited

The Directors  
Sponsors Limited

Dear Sirs

**Proposed flotation of XYZ Limited on the [Main Board/Growth Enterprise Market]  
of the Stock Exchange of Hong Kong Limited**

1. Further to our recent meeting, we are writing to set out our understanding of the services required and the respective areas of responsibilities of the directors of the Company, directors of Sponsors Limited and ourselves in connection with the proposed flotation of XYZ Limited ("the Company") on the [Main Board/Growth Enterprise Market] of the Stock Exchange of Hong Kong Limited ([ "MB"/ "GEM"]).
2. [Partner name] will be the partner in charge of this assignment. [Name of manager] will be responsible for controlling the assignment on a day-to-day basis.

**Documents to be delivered**

3. We will deliver the following documents as agreed:

**(a) Accountants' report on historical financial information**

An accountants' report on historical financial information of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") for inclusion in the prospectus of the Company (the "Prospectus") in accordance with the relevant requirements set out in the Rules Governing the Listing of Securities on the [MB/GEM] ([“MB/GEM Listing Rules”]) and the Hong Kong Companies Ordinance (“Companies Ordinance”).

**(b) Accountants' report on pro forma financial information**

An accountants' report on pro forma financial information of the Group for inclusion in the Prospectus. The Prospectus will include the following pro forma financial information: [List here statements to be produced. For example: pro forma balance sheet, pro forma net asset statement or pro forma profit statement and, in each case, basis of preparation and supporting notes] to illustrate how the [transaction] might have affected the financial information of the Group had the transaction been undertaken at the beginning of the period concerned or at the date stated.

**(c) Other letters**

A letter on cash flow forecast [or projection] of the Group for the period to [date] and a letter on the schedule of indebtedness of the Group at a date to be agreed. These letters are not to be published in the Prospectus.

4. The documents set out in paragraph 3 above will be addressed to the directors of the Company, and also the directors of Sponsors Limited on the basis that Sponsors Limited is a signatory to this engagement letter.

**Scope of our work**

5. Our work will be carried out in accordance with Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs) 100 “Investment circulars and reporting accountants”, 200 “Accountants' report on historical financial information in investment circulars” and 300 “Accountants' report on pro forma financial information in investment circulars”, and PN 2000 “Other letters issued in relation to investment circulars” issued by the Hong Kong Society of Accountants.

**Responsibilities of directors of the Company and ourselves**

6. The [MB/GEM Listing Rules] require the directors of the Company to prepare historical financial information of the Group which gives a true and fair view for inclusion in the Prospectus.
7. It is our responsibility to form an independent opinion on the historical financial information and to report our opinion to you.
8. The pro forma financial information to be included in the Prospectus will be the responsibility solely of the directors of the Company, and such pro forma financial information will be prepared for illustrative purposes only.
9. It is our responsibility to form an independent opinion on the pro forma financial information which will state whether, in our opinion, (a) the pro forma financial information has been properly compiled by the directors on the basis stated, (b) such basis

is consistent with the accounting policies of the Group and (c) the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to Accounting Guideline 2.212 “Preparation of pro forma financial information for inclusion in investment circulars” issued by the Hong Kong Society of Accountants.

10. The directors of the Company are solely responsible for their statement regarding the adequacy of working capital of the Group which they are required to make under [Appendix 1A paragraph 36 / Appendix 1B paragraph 30 of the MB/GEM Listing Rules] to be included in the Prospectus. The statement will be made based on a cash flow forecast [or projection] which the directors are also responsible. The cash flow forecast [or projection] will be compiled on the basis of certain principal assumptions to be set out by the directors. We will agree with you on the period to be covered. [*Note : usually a period of approximately 12 months from the date of the Prospectus.*] Our responsibility is limited to report on whether in our opinion, (a) in the case of [best-estimate assumptions/hypothetical assumptions], the underlying assumptions provide a reasonable basis for the cash flow forecast [or projection] [assuming that the hypothetical assumptions occurred]; and (b) the cash flow forecast [or projection] is properly prepared on the basis of the underlying assumptions and is presented on a basis consistent with the accounting policies normally adopted and disclosed by the Group. Our report will also include the responsibility statements required. We cannot in any way accept responsibility for the ultimate accuracy and realization of the cash flow forecast [or projection].
11. The directors of the Company are solely responsible for the statement of indebtedness of the Group to be included in the Prospectus. We shall perform work on a schedule of indebtedness prepared by the directors of the Company. We will rely on the representations of officials of the Group on the completeness of the amounts shown in the schedule of indebtedness, including contingencies and commitments. Our responsibility is limited to report whether the schedule of indebtedness has been properly prepared by the directors from the records of the Group.

*[Insert other responsibilities paragraphs in case reporting accountants are engaged to perform work other than those stated above]*

#### **Attendance at meeting/Access to information**

12. We will need to have the opportunity to attend any meetings at which the listing particulars will be drafted, to receive draft copies of the Prospectus and to be able to communicate with the previous auditors of the companies comprising the Group and other professional advisers.

#### **Consent Letter**

13. We will need to be satisfied with the form and context in which our accountants’ reports are included in the final version of the Prospectus before giving our written consent to the issue of the Prospectus.
14. Our consent letter will be prepared solely for the use of the directors of the Company. It should not be referred to in the Prospectus or in any literature or publicity in respect of the Prospectus. [Name of reporting accountants] will not accept any liability to any other party to whom our consent letter may be shown or into whose hands they may come.

#### **Applicable law**

15. This engagement letter shall be governed by, and construed in accordance with, Hong Kong law. The Courts of Hong Kong shall have exclusive jurisdiction in relation to any claim,

dispute or difference concerning the engagement letter and any matter arising from it. Each party irrevocably waives any right it may have to object to an action being brought in those Courts, to claim that the action has been brought in an inconvenient forum, or to claim that those courts do not have jurisdiction.

**Timing of reports**

16. The above work will be carried out in accordance with a timetable to be agreed in order to satisfy the requirements for the Prospectus. We will keep you informed of progress regularly during the course of our work. We will also inform you immediately of any potential changes in the scope or timing of our work should they be considered necessary.

**Draft reports and oral comments**

17. In the course of performing our work we may provide oral comments, or drafts of reports, letters or schedules. As these represent work in progress and may not be our final findings, we do not assume a duty of care to you in respect of them and they should not be relied upon. The final results of our work will be contained in our final reports and letters.

**Fee**

18. Our fees are computed on the basis of the time spent on this assignment by the partners and our staff, and on the levels of skill and responsibility involved plus out-of-pocket expenses. [As discussed, our fees for this assignment are HK\$[Amount]/ [As indicated to you, you should contemplate a fee in the range of HK\$[Amount] to HK\$[Amount]]. In the event that the listing does not go ahead our fees for work completed up to that date will still be payable.

**Distribution and future use of the documents set out in paragraph 3 above**

19. Our accountants' reports described in paragraph 3(a) and (b) above are prepared solely for the use and benefit of the directors of the Company and only in connection with the proposed flotation of the Company. These documents are to be addressed to Sponsors Limited solely in its capacity as an entity that may be responsible for the contents of the Company's Prospectus. Our work will be planned and conducted in accordance with the scope and terms of this letter. Our work will not be planned in contemplation of reliance by any third party including Sponsors Limited, excluding any liabilities which cannot lawfully be limited or excluded, or with respect to any other specific transaction. Therefore, items of possible interest to any third party, or in connection with another specific transaction, will not be specifically addressed and matters may exist that would be assessed differently by a third party in connection with this or another specific transaction. Copies of our documents set out in paragraph 3(c) above may be made available to Sponsors Limited provided that it is clearly understood by Sponsors Limited that they enjoy such receipt for information only and that we accept no duty of care to them in respect of these letters.
20. Other than our accountants' reports for inclusion in the Prospectus and in the situation described in the preceding paragraph or unless required by law, you will not provide any of our report or letter, or a copy thereof, to any third party or refer to us without our prior written consent which we may at our discretion grant, withhold or grant subject to conditions. In no event, regardless of whether consent has been provided, will we assume any liability or responsibility to any third party to which any report or letter (or part thereof) is disclosed or otherwise made available.

**Acknowledgement and acceptance**

- 21. We shall be grateful if you could confirm in writing your agreement to these terms by signing and returning the enclosed copy of this letter, or let us know if they are not in accordance with your understanding of our terms of engagement.

**Changes in scope and termination**

- 22. We or the Company may request changes to the scope or work performed. Changes must be agreed between us and the Company and will be subject to reasonable adjustments to fees and timetable. Changes which amount to the provision of additional services, rather than adjustments to the scope of work already agreed, must be agreed in writing. Unless otherwise agreed in writing, any further work we may agree to carry out in connection with this agreement will be subject to the terms included in this letter.
- 23. This agreement may be terminated by either the Company or us giving written notice to the other, which will have immediate effect. In such circumstances, the Company will pay us reasonable fees and expenses, taking into account the circumstances of termination, for time spent by us up to the date of termination. Where the Company terminates the agreement before its completion, other than for material breach, the Company will pay any additional costs that we reasonably incur in connection with early termination.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

---

We agree to the terms of this letter.

(Signed)

.....  
Director, for and on behalf of the board of XYZ Limited  
Date

(Signed)

.....  
Director, for and on behalf of Sponsors Limited  
Date

## Appendix 4

### Example management representation letter

Note: this example is only illustrative and is not intended to be prescriptive as to the form or content of a management representation letter.

(Company letterhead)

(To the reporting accountants)

(Date)

Dear Sirs

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other directors and officials of XYZ Limited (“the Company”) and its subsidiaries (“the Group”), the following representations relating to the following reports/letters issued by you, in connection with the prospectus of the Company (the “Prospectus”) dated [date]:

#### **Accountants’ report on historical financial information for the [years/period] ended [date]**

1. we acknowledge that we are responsible for the historical financial information which gives a true and fair view for inclusion in the Prospectus;
2. we confirm that there have been no events since the most recent balance sheet date which necessitate any revisions to the historical financial information;
3. we attach a copy of the adjustments which we have been made to the underlying financial statements for the purposes of preparing the historical financial information and the reasons thereof. We confirm that in our opinion the adjustments are necessary, have been correctly stated, and that there are no other adjustments which are necessary;
4. [any other specific representations relating to the historical financial information];

#### **Accountants’ report on unaudited pro forma [insert name of the statement] (“pro forma financial information”) for the [year/period] ended [date]**

5. we acknowledge that we are responsible for the pro forma financial information which has been prepared in accordance with Accounting Guideline 2.212 “Preparation of pro forma financial information for inclusion in investment circulars” issued by the Hong Kong Society of Accountants;
6. we have considered the pro forma financial information and we confirm that, in our opinion, the pro forma financial information provides investors with information about the impact of the transaction by illustrating how that transaction might have affected the financial information presented in the Prospectus had the transaction been undertaken [at the commencement of the period being reported on/at the date reported on]. Furthermore, we confirm that, in our opinion, the pro forma financial information is not misleading;
7. we have considered the adjustments included in the pro forma financial information. We confirm that, in our opinion, the pro forma financial information includes all appropriate adjustments of which we are aware, necessary to give effect to the transaction as if the transaction had been undertaken at the commencement of the period being reported on or, in the case of a pro forma balance sheet or net asset statement, at the date reported on;

8. [any other specific representations relating to the pro forma financial information];

**Schedule of indebtedness dated [date] in connection with the statement of indebtedness for inclusion in the section headed “Financial Information” of the Prospectus**

9. we acknowledge that we are responsible for the schedule of indebtedness as at [date];
10. we have prepared the schedule of indebtedness from the records of the Group to include all liabilities, both actual and contingent, pledge of assets and guarantees;
11. we confirm that the items included in the schedule of indebtedness are presented on a basis consistent with the accounting policies normally adopted by the Group;
12. we confirm that there has not been any material change in indebtedness, commitments and contingent liabilities of the Group since [the date of the presentation] to the date of this letter;

**Cash flow forecast for the [year/period] ending [date] in connection with the statement made by us regarding the sufficiency of working capital in the Prospectus**

13. we acknowledge that we are responsible for the cash flow forecast;
14. we have made available to you all significant information relevant to the cash flow forecast of which we have knowledge;
15. we confirm that in the preparation of the projection of cash requirements, due regard has been made to likely capital expenditure, loan repayments, interest, taxation, dividend payments, issue proceeds and use of issue proceeds and movements in the levels of stock, debtors and creditors;
16. we consider that the assumptions upon which the cash flow forecast have been based are reasonable and realistic, that no material assumption has been omitted [not applicable for profit estimate] and that adequate allowance has been made for contingencies;
17. we believe the forecast results are achievable although achievement of the forecast may be favourably or unfavourably affected by unforeseeable and uncontrollable events;

**General**

18. we confirm that the terms of this letter were considered at a board meeting of the Company held on [date] and it is recorded in the minutes that the directors approved the signature of this letter of representation.

Yours faithfully,

For and on behalf of XYZ Limited

---

[Name]  
Managing Director

---

[Name]  
Finance Director



## **Appendix 5**

### **Example consent letter**

(Letterhead of the reporting accountants)

The Directors  
XYZ Limited

Dear Sirs,

We hereby give our consent to the inclusion in the [Prospectus/Listing Particulars/Circular] dated *[insert date here]* issued by XYZ Limited of [our accountants' report dated *[insert date here]* on the historical financial information for the years ended *[insert dates here]*] / [our accountants' report dated *[insert date here]* on the pro forma financial information for the year ended *[insert date here]*] [and the references to our name] in the form and context in which [it ]/[they] are included, as shown in the enclosed proof of the [Prospectus/Listing Particulars/Circular] which we have signed for identification.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

ISSUED FOR COMMENTS BY 14 AUGUST 2004

**HONG KONG STANDARD ON  
INVESTMENT CIRCULAR REPORTING ENGAGEMENTS**

**200**

**ACCOUNTANTS' REPORTS ON  
HISTORICAL FINANCIAL INFORMATION IN INVESTMENT CIRCULARS**

*(Issued [ ])*

*Hong Kong Standards on Investment Circular Reporting Engagements ("HKSIRs") are to be applied in the conduct of an engagement involving an investment circular intended to be issued in connection with a securities transaction governed wholly or in part by the laws and regulations of Hong Kong.*

*HKSIRs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.*

*To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the HKSIR including explanatory and other material contained in the HKSIR not just that text which is black lettered.*

*In exceptional circumstances, reporting accountants may judge it necessary to depart from a HKSIR in order to more effectively achieve the object of an engagement involving an investment circular. When such a situation arises, the reporting accountants should be prepared to justify the departure.*

*HKSIRs need only be applied to material matters.*

*The definitions set out in paragraph 13 of HKSIR 100 are to be applied in the interpretation of HKSIRs.*

*This HKSIR is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

## **Introduction**

1. HKSIR 100 "Investment circulars and reporting accountants" establishes the generic standards and provides guidance applicable to all engagements involving investment circulars. The purpose of this HKSIR is to establish specific standards and provide guidance for reporting accountants engaged to issue an accountants' report on historical financial information for inclusion in an investment circular.
2. When issuing an accountants' report on historical financial information, reporting accountants comply with the general principles set out in HKSIR 100. Where applicable this HKSIR elaborates on the general principles set out in HKSIR 100 in order to place those principles and guidance in context.
3. In principle, the role of reporting accountants is similar to that of auditors in that assurance is

being provided by them in the form of an opinion, usually as to whether the historical financial information gives a true and fair view. There are, however, differences in role that make it inappropriate for reporting accountants solely to apply Statements of Auditing Standards (SASs) issued by the Hong Kong Society of Accountants (HKSA):

- a. the reporting accountants are often examining historical financial information that has been prepared by the directors from the underlying audited financial statements; and
  - b. the reporting accountants do not have the statutory reporting responsibilities of auditors (for example there is no requirement to report whether proper accounting records have been kept by the issuer).
4. ***In an engagement to report on historical financial information in investment circulars, the reporting accountants should comply with the requirements of this HKSIR, as well as SASs, HKSIR 100 “Investment circulars and reporting accountants” and the requirements of Professional Ethics Statements/[HKSA Code of Ethics] issued by the HKSA. (HKSIR 200.1)***
5. The extent to which and manner in which SASs and Professional Ethics Statements/[HKSA Code of Ethics] are applicable to a particular engagement will vary and reporting accountants will, based on their knowledge of SASs and Professional Ethics Statements/[HKSA Code of Ethics], apply their own judgement in each circumstance.

## **Historical financial information upon which an accountants’ report is to be given**

### **Legal and regulatory requirements for historical financial information**

6. ***Reporting accountants should ensure the historical financial information upon which they are reporting is presented in compliance with all relevant requirements. (HKSIR 200.2)***
7. The relevant requirements determining how and what historical financial information is presented are contained in the Listing Rules/GEM Rules and the Companies Ordinance.
8. This HKSIR does not attempt to reproduce or summarize the Third Schedule or the Listing Rules/GEM Rules, and it should therefore be read in conjunction with them. The reporting accountants will need to be familiar with these regulations which govern the minimum contents of the particular type of investment circular in which their report will be included. A summary of the applicable governing regulations is set out in Appendix 1 to HKSIR 100.

### **Respective responsibilities of the directors and reporting accountants**

9. ***Reporting accountants should obtain evidence that management acknowledges its responsibility for the historical financial information which is the subject of the accountants’ report. (HKSIR 200.3)***

10. The Listing Rules/GEM Rules are required to be amended to prescribe the following:  
The directors are responsible for preparing historical financial information which gives a true and fair view for inclusion in investment circulars.
11. Historical financial information is based on the records of the issuer for the periods reported on. These records reflect the representations and intentions of the management. Matters such as the selection of accounting policies, accounting estimates and valuation judgements form part of the responsibilities of management in compiling a record of its stewardship.
12. It is the reporting accountants' responsibility to form an opinion on the historical financial information by issuing an accountants' report.
13. The reporting accountants obtain written acknowledgement from management of its responsibility for the historical financial information (see paragraph 39).

### **Agreeing the terms of the engagement**

14. HKSIR 100.5 and HKSIR 100.6 deal with agreeing the terms of engagement and HKSIR 100.7 deals with subsequent amendments to the terms of engagement. An engagement letter is the usual method by which such agreement is recorded. Matters normally dealt with in engagement letters for the accountants' report covered by this HKSIR are set out in Appendix 3 to HKSIR 100.

### **Planning**

15. HKSIR 100.8 deals with planning the engagement. An initial plan is prepared documenting the approach to be adopted. The plan may be amended as work progresses. Matters for consideration include:
  - a. liaison with the auditors of the issuer and terms of access to their working papers, or equivalent evidence if maintained in a machine readable form;
  - b. other partner involvement (In some cases it may be appropriate for the partner with the requisite experience of dealing with investment circulars to act as a second or concurring partner. The extent of involvement of the second or concurring partner will depend upon the particular circumstances of the engagement. In any event, that partner is consulted on all significant decisions and conclusions.);
  - c. considering at an early stage whether there are any matters likely to give rise to adjustments (for example changes in accounting policies);
  - d. interaction with other roles undertaken by the reporting accountants in connection with the securities transaction;
  - e. the risks that the historical financial information that they are to report upon may be misstated;

- f. staffing, including relevant skills;
- g. consultation needs;
- h. timetable.

## **Evidence**

16. HKSIR 100.10 deals with the requirement for the reporting accountants to obtain sufficient appropriate evidence to be able to draw reasonable conclusions on which to base their opinions. The evidence which may be available to support the range of historical financial information which may be the subject of an accountants' report varies widely.
17. When audited financial statements have been used by the directors to derive the historical financial information upon which they are reporting, the reporting accountants consider whether applicable SASs were complied with by the auditors of the issuer. The reporting accountants assess the extent to which they are able to rely on the auditors' work and the further evidence they need to support their own opinion. When the historical financial information is not derived from previously audited financial statements the reporting accountants comply with SASs in performing their own work to the extent that the reporting accountants judge applicable. In these circumstances much of this work is being done with the benefit of hindsight.
18. In the case where audited financial statements have been used by the directors to derive the historical financial information, the reporting accountants will be able to obtain much of the evidence they require to support their opinion from the working papers of the auditors of the issuer. The reporting accountants determine the extent to which they intend to rely on the work evidenced by the auditors' working papers and the extent to which they will themselves examine the accounting records of the issuer concerned to supplement the evidence obtained from the auditors' working papers. Notwithstanding the extent of evidence obtained from the auditors' working papers, the reporting accountants will usually become familiar with the business and its finances through visiting the issuer's principal locations, discussions with management, examination of the accounting records, applying analytical procedures and reviewing the reporting arrangements of the business.
19. In certain cases, use of the work of the auditors may be the only practicable means of obtaining evidence necessary to support the reporting accountants' opinion. For example, the work of reporting accountants will typically be undertaken some time after the end of the periods to which the report relates. New evidence obtained from physical inspection will not be possible.
20. The reporting accountants may be undertaking a number of exercises related to the securities transaction giving rise to the accountants' report. Evidence obtained as a result of such exercises may form part of the basis for the reporting accountants' opinion included in the accountants' report.

### **Preliminary procedures**

21. *The reporting accountants should obtain such knowledge of the issuer's business (including its accounting systems) as is required to enable them to prepare their report. (HKSIR 200.4)*
22. HKSIR 100.9 deals with knowledge of the business. With respect to historical financial information relevant knowledge of the business would include information about the accounting systems and accounting policies, including those followed generally in the industry, as well as other appropriate industry knowledge.
23. A preliminary review of the historical financial information that will form the basis of the report, a consideration of the accounting policies applied and of the audit opinions previously given (if any) will provide an initial assessment of potential issues to be faced and assist in an identification of the key factors affecting the historical financial information. If the preliminary review indicates there are factors which may give rise to a modification of the accountants' report or a reference to a fundamental uncertainty, then such factors are reported immediately to the directors.
24. These preliminary procedures provide a risk assessment that enables the reporting accountants to plan their work to obtain the evidence they need.

### **Joint reporting accountants**

25. When joint reporting accountants are appointed the division of work as between them is a matter for agreement. The arrangements between the joint reporting accountants may form part of the engagement letter. Irrespective of any such arrangement, the joint reporting accountants are jointly and severally responsible for the entire accountants' report. Each of the joint reporting accountants participates in the planning of the engagement and they agree upon the scope of work and any changes subsequently found to be necessary thereto. Each of the joint reporting accountants has regard to the considerations set out below in respect of using the work of other auditors in determining the extent to which they are satisfied to rely on the evidence obtained by the other reporting accountants or the extent to which they consider it necessary to carry out their own work, including especially the matters set out in paragraph 34 below. Each of the joint reporting accountants reviews the work of the other to the extent considered necessary and records the results of that review. A common set of working papers is normally maintained.

### **Risk**

27. *In determining their approach and the supplementary procedures which they perform themselves, the reporting accountants should assess inherent risk in relation to the historical financial information taking account of factors relevant both to the issuer as a whole and to specific assertions relating to material account balances and classes of transactions. (HKSIR 200.5)*

## Accounting systems

27. *The reporting accountants should undertake a general assessment of the issuer's accounting systems and records and control environment in order to determine their influence on the approach to obtaining and assessing evidence. Where reliance is placed on tests of controls the reporting accountants should also assess control risk in determining the extent of supplementary procedures required to reduce risk to an acceptable level. (HKSIR 200.6)*
28. When the reporting accountants intend to rely on tests of control performed in advance of the last period end, the reporting accountants obtain sufficient evidence as to the nature and extent of any changes in design or operation of the issuer's accounting and internal control systems within the period reported upon since such tests were performed.

## Types of evidence

29. The reporting accountants, either directly or indirectly, will seek to obtain evidence derived from one or more of the following procedures: inspection, observation, enquiry and confirmation, computation and analytical procedures.

## Evidence from the work of auditors

30. Where the historical financial information is derived from audited financial statements, the audit files will frequently be a useful source for the evidence which the reporting accountants may need to provide an opinion on the historical financial information.
31. The reporting accountants accept evidence on an audit file as being prima facie truthful and genuine, but in considering that evidence adopt an attitude of professional scepticism, whether the audit file was produced by auditors from the reporting accountants' firm or by other auditors. However, with respect to audit files obtained from their own firm reporting accountants are more familiar with the detailed quality control procedures that will have been applied in the conduct of the audit. The extent to which independent testing of the evidence provided will be necessary is a matter for the reporting accountants' judgement on the basis of the information available at the time, including their assessment of the risks of misstatement.
32. When the issuer's auditors, or former auditors, are not appointed as the reporting accountants, they will be aware that the reporting accountants may need access to information contained in the audit files. The auditors or former auditors are normally prepared to make their audit files available in accordance with relevant professional guidance to reporting accountants for the purpose of work under this HKSIR.
33. Access may be granted only on the basis that the auditors accept no responsibility or liability to the reporting accountants in connection with the use of the audit files by the reporting accountants. Such a basis of access has no effect on the validity or otherwise of auditors' working papers as a source of evidence for the reporting accountants. The reporting accountants use their own judgement in determining whether they can rely on the working papers as appropriate evidence. The reporting accountants, however, do not use the conclusions recorded in the auditors' working papers as a substitute for their own judgement.

34. The matters that are considered in the course of planning what reliance might be placed upon the work of auditors and the degree of independent testing which may be necessary, particularly where the auditors are subject to different regulatory requirements, will normally include:
- a. What is known about the professional qualification and integrity of the auditors?
  - b. What auditing standards and requirements apply to the work of the auditors?
  - c. Are there any special circumstances concerning the appointment of the auditors and to whom do they report?
  - d. Are the reporting accountants able to satisfy themselves that the auditors are independent in all respects?
  - e. Has any limitation been placed on the work of the auditors (either in terms of access, time etc, or because of level of remuneration) or have they been free to decide on the scope and level of their audit tests?
  - f. Has the work of the auditors been conducted to an appropriate materiality level?
  - g. Have the auditors in fact complied with the basic principles and essential procedures, indicated by paragraphs in bold type in SASs, with which auditors are required to comply in the conduct of any audit (or with equivalent overseas standards)?
  - h. Do corrections or adjustments to subsequent financial statements indicate possible inadequacies in the audits of earlier periods?
  - i. Were the auditors' reports modified?
35. Whether or not the reporting accountants have access to the auditors' working paper files, they seek to obtain, either from the directors or from the auditors, copies of all relevant management letters sent by the auditors to the entity and copies of any responses to such letters made by management. A relevant management letter would, for example, be one that discussed control and other weaknesses.

**Evidence from other sources**

36. Notwithstanding that evidence is to be or has been obtained from an assessment of the auditors' working papers, the reporting accountants will usually seek direct evidence from the issuer to be reported on. Such direct evidence is usually obtained:
- a. by meeting the directors and management of the issuer;
  - b. by visiting the issuer's premises;
  - c. from discussing the historical financial information and recent results with management;



- d. from applying analytical procedures to the historical financial information;
  - e. from obtaining an understanding of the principal transaction flows, internal controls and reporting arrangements of the business.
37. The audit working papers are unlikely to contain information concerning post balance sheet events up to the date of signing the accountants' report. In such circumstances reporting accountants apply SAS 150 "Subsequent events".

### **Analytical procedures**

38. Reporting accountants apply analytical procedures at the planning and at the evidence gathering stages of the assignment as well as part of the overall review when completing the assignment. When significant fluctuations or unexpected relationships are identified that are inconsistent with other relevant information, reporting accountants investigate and obtain explanations. Where practicable, they discuss with management the features and trends of the results during the relevant period.

### **Management representations**

39. Matters which reporting accountants may consider for incorporation in a letter of representation approved by the Board include:
- a. confirmation from management that they are responsible for the historical financial information;
  - b. specific representations relating to the historical financial information (directors may, however, only be able to make representations for the periods during which they were directors of the entity);
  - c. confirmation that there have been no events since the most recent balance sheet date which necessitate adjustment of the historical financial information or inclusion of a note relating to the events;
  - d. acknowledgement that management is not aware of any reason why the historical financial information is not suitable for inclusion in the investment circular; and
  - e. confirmation that management has considered the adjustments made in arriving at the historical financial information together with confirmation that in their opinion the adjustments are necessary, have been correctly stated, and that there are no other adjustments which are necessary.

An example management representation letter is set out in Appendix 4 to HKSIR 100.

### **Working papers**

40. HKSIR 100.11 deals with the need for working papers and HKSIR 100.12 with the need for reporting accountants to record their reasoning on all significant matters that require the

exercise of judgement.

41. A large part of the work performed will often take the form of reading files and documents and discussions with the issuer's management, staff and professional advisers. The working papers are designed so as to reflect adequately the nature of these procedures carried out, the evidence examined and the conclusions reached. Therefore, it is not usually necessary for the working papers to replicate all of the detailed findings contained in the auditors' working papers.

## Reporting

42. HKSIRs 100.16, 100.17 and 100.18 deal with the generic aspects of reporting in relation to investment circulars. The following standards and guidance are applicable to accountants' reports on historical financial information.

### Statement of responsibility

43. *The reporting accountants should distinguish between their responsibilities and those of the directors by including in their report:*
- a. *a statement that the historical financial information is the responsibility of the directors; and*
  - b. *a statement that the reporting accountants' responsibility is to express an opinion on the historical financial information. (HKSIR 200.7)*

44. Where an acknowledgement of responsibility from the directors responsible for the historical financial information cannot be obtained or is refused, the reporting accountants consider the circumstances in determining what consequence, if any, this might have for their report. The reporting accountants may consider such a refusal to provide acknowledgement to be a scope limitation. In such circumstances the reporting accountants draw attention to the refusal in their accountants' report and qualify their opinion on the historical financial information.

45. The accountants' report would refer to the basis of preparation of the historical financial information.

### Basis of opinion

46. *Reporting accountants should explain the basis of their opinion by including in their report:*
- a. *a statement as to their compliance or otherwise with HKSIRs 100 and 200 issued by the Hong Kong Society of Accountants or the reasons for any departure therefrom; and*
  - b. *a statement that they planned and performed their work so as to obtain reasonable assurance that the historical financial information upon which their opinion is given is free from material misstatement. (HKSIR 200.8)*

### **Expression of opinion**

47. *The accountants' report should contain a clear expression of opinion on the historical financial information. (HKSIR 200.9)*
48. The reporting accountants' opinion is usually expressed in terms of whether the historical financial information gives a true and fair view of the state of affairs, profits and cash flows.
49. *The reporting accountants should apply the Standards set out in SAS 600 "Auditors' reports on financial statements" relating to modified reports. With respect to fundamental uncertainties arising from the adoption of the going concern basis the reporting accountants should apply the Standards set out in SAS 130 "Going concern". (HKSIR 200.10)*

### **References to dividends and adjustments made by the directors**

50. Paragraph 31(1)(b) of the Third Schedule requires information about dividends to be stated in the accountants' report or, if this be the case, that dividends have not been paid.
51. Paragraph 42 of the Third Schedule provides that an accountants' report shall either:
- a. indicate by way of note any adjustments as respects the figures of any profits or losses or assets and liabilities dealt with by the report which appear to the persons making the report necessary; or
  - b. make those adjustments and indicate that adjustments have been made.

Based on legal advice obtained by the HKSA, reporting accountants will comply with alternative requirement (a) of paragraph 42 of the Third Schedule if they refer in the accountants' report to a note in the historical financial information which contains the adjustments that have been made by the directors.

### **No historical financial statements**

52. Paragraph 31(1) of the Third Schedule requires that where no financial statements have been made up in respect of any part of the period of three years ending on a date three months before the issue of the investment circular, the accountants' report contains a statement of that fact.
53. Such statement is usually required where the company, which is the subject of the investment circular, is incorporated shortly before the date of the investment circular.

### **Date of accountants' report**

54. The accountants' report is dated on the same date as the investment circular in which it is included or to which it relates.

### **Example accountants' report**

55. An example accountants' report on historical financial information in investment circular is set out in the Appendix to this HKSIR.

**Appendix - Example accountants' report on  
historical financial information in investment circulars**

**ACCOUNTANTS' REPORT ON HISTORICAL FINANCIAL INFORMATION  
TO THE DIRECTORS OF XYZ LIMITED**

We have examined the historical financial information of XYZ Limited and its subsidiaries (Group), which has been prepared by the directors of XYZ Limited in accordance with accounting principles generally accepted in Hong Kong, for inclusion as Appendix [ ] to the Investment Circular of XYZ Limited dated [ ].

**Respective responsibilities of directors and reporting accountants**

The [Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited/ Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited] require the directors to prepare historical financial information which gives a true and fair view for inclusion in an investment circular.

It is our responsibility to form an independent opinion on the historical financial information and to report our opinion to you.

**Basis of opinion**

We conducted our engagement in accordance with HKSIR 100 "Investment circulars and reporting accountants" and HKSIR 200 "Accountants' reports on historical financial information in investment circulars" issued by the Hong Kong Society of Accountants. Our work included an assessment, on a test basis, of evidence relevant to the amounts and disclosures in the historical financial information. It also included an assessment of significant estimates and judgements made by the directors in the preparation of the historical financial information and whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the historical financial information is free from material misstatement.

**Opinion**

In our opinion the historical financial information gives a true and fair view of the Group's state of affairs as at [ ], [ ] and [ ] and of its profits and cash flows for the years then ended.

We refer to note [ ] to the historical financial information which [contains information about the dividends paid by XYZ Limited/ states that no dividends have been paid by XYZ Limited][, and note [ ] to the historical financial information which indicates and gives reasons for the adjustments made by the directors which appear to us to be necessary]<sup>1</sup>.

ABC & Co.  
Certified Public Accountants  
Hong Kong  
Date

---

*Note*

1. *Not applicable if there are no adjustments.*

ISSUED FOR COMMENTS BY 14 AUGUST 2004

**HONG KONG STANDARD ON  
INVESTMENT CIRCULAR REPORTING ENGAGEMENTS**

**300**

**ACCOUNTANTS' REPORTS ON  
PRO FORMA FINANCIAL INFORMATION IN INVESTMENT CIRCULARS**

*(Issued [ ])*

*Hong Kong Standards on Investment Circular Reporting Engagements (“HKSIRs”) are to be applied in the conduct of an engagement involving an investment circular intended to be issued in connection with a securities transaction governed wholly or in part by the laws and regulations of Hong Kong.*

*HKSIRs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.*

*To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the HKSIR including explanatory and other material contained in the HKSIR not just that text which is black lettered.*

*In exceptional circumstances, reporting accountants may judge it necessary to depart from a HKSIR in order to more effectively achieve the object of an engagement involving an investment circular. When such a situation arises, the reporting accountants should be prepared to justify the departure.*

*HKSIRs need only be applied to material matters.*

*The definitions set out in paragraph 13 of HKSIR 100 are to be applied in the interpretation of HKSIRs.*

*This HKSIR is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

## **Introduction**

1. Accounting Guideline 2.212 (“AG 2.212”) “Preparation of pro forma financial information for inclusion in investment circulars” issued by the Hong Kong Society of Accountants is to provide guidance to the directors on the preparation and presentation of pro forma financial information for inclusion in investment circulars.
2. HKSIR 100 “Investment circulars and reporting accountants” establishes the generic standards and provides guidance applicable to all engagements involving investment circulars. The purpose of this HKSIR is to establish specific standards and provide guidance for reporting accountants engaged to issue an accountants’ report on pro forma financial

information in an investment circular.

3. The work outlined in this HKSIR, having regard to the nature of pro forma financial information and the opinion required by paragraph 42 below, is substantially less in scope than that of an audit and consists primarily of comparing the historical financial information with the source documents, considering the evidence supporting the adjustments made by the directors and making enquiries of the directors regarding the process by which they have prepared the pro forma financial information under AG 2.212.
4. ***In an engagement to report on pro forma financial information in investment circulars, the reporting accountants should comply with this HKSIR as well as Statements of Auditing Standards (SASs), HKSIR 100 “Investment circulars and reporting accountants” and the requirements of Professional Ethics Statements/[HKSA Code of Ethics] issued by the Hong Kong Society of Accountants. (HKSIR 300.1)***
5. Whilst reporting accountants are not required to report explicitly as to whether the pro forma financial information is misleading, AG 2.212 states that the information as presented by the directors must not be misleading and reporting accountants are required to express an opinion on whether the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to AG 2.212. Guidance for directors to enable them to judge whether pro forma financial information is misleading is provided by AG 2.212. Matters which might be relevant to the question of whether the pro forma financial information is misleading include:
  - a. whether appropriate disclosure is made as to any inherent deficiencies or limitations in the historical financial information;
  - b. whether adjustments of which the issuer is aware and which are material to the purpose of the pro forma financial information have been omitted; and
  - c. whether inappropriate adjustments have been made by the issuer.
6. In the event that the reporting accountants have reason to believe that the pro forma financial information is misleading in the context of the purpose for which the pro forma financial information has been presented, they are unable to give the opinion as required in paragraph 42 below until they have resolved the matter.

#### **Nature of pro forma financial information**

7. Pro forma financial information is included in an investment circular to provide users of the investment circular with information about the transaction that is the subject of the investment circular by showing how it might have affected financial information of the issuer if the transaction had been undertaken at the commencement of the financial period used for the illustration or, in the case of a pro forma balance sheet or net asset statement, at the date reported on.
8. For the purpose of this HKSIR “pro forma financial information” is defined to include the financial information such as net assets or profit or cash flow statements which demonstrate the impact of a transaction on previously published financial information and the explanatory

notes thereto. Under AG 2.212 pro forma financial information is accompanied by introductory text describing its purpose and limitations.

## **Agreeing the terms of engagement**

9. HKSIR 100.5 and HKSIR 100.6 deal with agreeing the terms of engagement and HKSIR 100.7 deals with subsequent amendments to the terms of engagement. An engagement letter is the usual method by which such agreement is recorded. Matters normally dealt with in engagement letters for the accountants' report covered by this HKSIR are set out in the example reporting accountants' engagement letter in Appendix 3 to HKSIR 100.

## **Presentation of pro forma financial information under AG 2.212**

10. ***Reporting accountants should assess whether the presentation adopted in the pro forma financial information is consistent with the recommended practice in AG 2.212. (HKSIR 300.2)***
11. In particular, reporting accountants assess whether:
  - a. as recommended by AG 2.212, the pro forma financial information clearly states the purpose for which it has been prepared, that it has been prepared for illustrative purposes only and that because of its nature, it may not give a true picture of the issuer's financial position or results; and
  - b. as recommended by AG 2.212, the pro forma financial information is presented in columnar form showing separately the historical financial information, the pro forma adjustments and the pro forma financial information.
12. AG 2.212 recommends pro forma financial information to be published in respect of:
  - a. the current financial period;
  - b. the most recently completed period; and/or
  - c. the most recent interim period for which relevant unadjusted information has been or will be published or is being published in the same investment circular,

and, in the case of a pro forma balance sheet or net asset statement, as at the date on which such periods end or ended.

### **Evidence**

13. ***Reporting accountants should obtain sufficient appropriate evidence on which to base their opinion on the pro forma financial information. (HKSIR 300.3)***
14. Reporting accountants gain an understanding of the transaction, in respect of which the pro forma financial information is being prepared, by discussions with the directors or

management of the issuer and by reading relevant supporting documentation.

#### **Historical financial information for the issuer**

15. ***Reporting accountants should determine whether the source of the historical financial information for the issuer is one of those recommended by AG 2.212 and assess whether the source of the historical financial information is clearly stated. (HKSIR 300.4)***
16. Since AG 2.212 recommends the acceptable sources of historical financial information, the reporting accountants are not required to have audited or carried out an interim review on that information nor do the reporting accountants have a responsibility to verify it.
17. ***If reporting accountants have reason to believe that the historical financial information is, or may be, unreliable, such as if it is unaudited or if an accountants' or auditors' report thereon has identified any uncertainties or disagreements, reporting accountants should seek to ensure that appropriate disclosure is made. Where such disclosure is not made the reporting accountants should consider the effect of this on their opinion. (HKSIR 300.5)***
18. ***Reporting accountants should check the extraction and, where relevant, summarization of the historical financial information from the source concerned. (HKSIR 300.6)***

#### **Adjustments**

19. ***Reporting accountants should report, among other things, that adjustments are appropriate for the purposes of the pro forma financial information. Such adjustments will include any information concerning an acquisition target. (HKSIR 300.7)***
20. AG 2.212 recommends all appropriate adjustments to be made “of which the issuer is aware” and provides guidance for directors concerning such adjustments.
21. Reporting accountants consider the way in which the directors have fulfilled their responsibilities. With their understanding of the transaction as background reporting accountants discuss with the issuer the steps the directors have taken to identify relevant adjustments.
22. ***If, as a result of these enquiries, reporting accountants are aware of a significant adjustment which, in their opinion, should be made for the purposes of the pro forma financial information, they should discuss the position with the directors of the issuer. If reporting accountants are not able to agree with the directors as to how the matter should be resolved they should consider the consequences for their opinion. (HKSIR 300.8)***
23. The requirement for adjustments to be made is qualified by reference to the tests set out in AG 2.212, which are that any adjustments must be:
  - a. clearly shown and explained;
  - b. directly attributable to the transaction concerned and not relating to future events or decisions;



- c. factually supportable; and
  - d. in respect of a pro forma profit or cash flow statement, clearly identified as to those adjustments which are expected to have a continuing effect on the issuer and those which are not.
24. Reporting accountants consider the adjustments to assess whether they are “directly attributable” to the transaction whose impact is being illustrated by the pro forma financial information, that is, that they are an integral part of the transaction concerned.
25. Reporting accountants assess whether adjustments “relate to future events and/or decisions”. This condition would lead to the exclusion of adjustments that are related to the transaction being illustrated but which are dependent on actions to be taken once the transaction has been completed.
26. Reporting accountants consider whether the adjustments have been clearly shown and explained and, in respect of a pro forma profit or cash flow statement, whether they have been clearly identified as to those which are expected to have a continuing/effect on the issuer (that is, relate to events or circumstances that are expected to recur) and to those which are not.
27. Reporting accountants obtain appropriate evidence that the directors of the issuer have factual support for each adjustment. Sources of such evidence would include audited financial statements, other financial information or valuations disclosed elsewhere in the investment circular, purchase and sale agreements and other agreements relating to the transaction.

#### **Consistent accounting policies**

28. Directors of the issuer are responsible for ensuring that the pro forma financial information is prepared on a basis consistent with the accounting policies of the issuer.
29. ***Reporting accountants should assess and report whether the pro forma financial information has been compiled on a basis consistent with the accounting policies of the issuer. (HKSIR 300.9)***
30. Where reporting accountants are not the auditors of the issuer or have not prepared an accountants’ report on the historical financial information relating to the subject of the securities transaction, they make enquiries of the issuer as to the steps taken to ensure that the pro forma financial information has been prepared on a basis consistent with the accounting policies of the issuer. Guidance for directors with respect to the consistency of accounting policies is provided in AG 2.212.

#### **Omitted adjustments**

31. In view of the specific restrictions on the nature of the adjustments that can be made under AG 2.212, the directors may not be permitted to make all the adjustments which they would otherwise wish to.
32. ***If any adjustments are excluded because of AG 2.212, reporting accountants should consider the effect on the pro forma financial information and in particular whether the***

*exclusion renders the pro forma misleading. (HKSIR 300.10)*

33. In such circumstances, reporting accountants may consider that disclosure in the notes to the pro forma financial information of the fact that such an adjustment has not been made is sufficient in the context of the overall purpose of the pro forma financial information.
34. *However, if reporting accountants conclude that an omitted adjustment is so fundamental as to render the pro forma statement misleading in the context of the purpose for which the pro forma financial information has been presented, they should consider the impact of this on their opinion. (HKSIR 300.11)*

### **Compilation**

35. *Reporting accountants should check whether the adjustments made in the pro forma financial information are correctly compiled from the source documentation and included under the appropriate financial statement caption as well as the arithmetical accuracy of the pro forma financial information itself. (HKSIR 300.12)*

### **Representation letter**

36. Reporting accountants obtain from the directors of the issuer such representations as they consider appropriate. Examples of such representations might include an acknowledgement of the directors' responsibility for the pro forma financial information and the completeness of the adjustments. An example of a representation letter covering matters dealt with in this HKSIR is set out in Appendix 4 to HKSIR 100.

### **Reporting**

37. HKSIRs 100.16, 100.17 and 100.18 deal with the generic aspects of reporting in relation to investment circulars. The following standards and guidance are applicable to reports dealing with pro forma financial information.

### **Statement of responsibility**

38. *The reporting accountants should distinguish between their responsibilities and those of the directors by including in their report:*
- a. a statement that the pro forma financial information is the responsibility of the directors; and*
  - b. a statement that the reporting accountants' responsibility is to express an opinion on the pro forma financial information. (HKSIR 300.13)*
39. Reporting accountants' responsibility in relation to the opinion is limited to the provision of the accountants' report and the opinion expressed. Reporting accountants do not assume responsibility for the pro forma financial information nor, in so far as the accountants' report is concerned, any responsibility for the components of the pro forma financial information.

### **Basis of opinion**

40. *Reporting accountants should include in the basis of opinion section of the accountants' report a statement that their work was conducted in accordance with this HKSIR and HKSIR 100. (HKSIR 300.14)*

### **Expression of opinion**

41. *The reporting accountants' report should contain a clear expression of opinion on the pro forma financial information. (HKSIR 300.15).*
42. Reporting accountants express an opinion as to whether:
- a. the pro forma financial information has been properly compiled by the directors on the basis stated;
  - b. such basis is consistent with the accounting policies of the issuer; and
  - c. the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to AG 2.212.
43. The first element of the opinion relates to the compilation of the pro forma information from the stated sources, and entails consideration of the accuracy of extraction of information from the sources and the arithmetical accuracy of the calculations in arriving at the pro forma financial information.
44. The second element relates to whether the adjustments have been measured and presented in the pro forma financial information in accordance with the accounting policies of the issuer.
45. The third element entails consideration of whether the adjustments made by the directors of the issuer in preparing the pro forma financial information satisfy the requirements of AG 2.212.
46. In providing the opinion reporting accountants are not providing any assurance in relation to any source financial information on which the pro forma financial information is based beyond that opinion. In particular, reporting accountants are not re-addressing or updating any opinion that they may have given in any other capacity on that source financial information.

### **Date of accountants' report**

47. The accountants' report is dated on the same date as the investment circular in which it is included or to which it relates.

### **Modified report**

48. *If reporting accountants conclude that they are unable to report in the manner prescribed in the paragraph 42 above they should consider modifying their opinion accordingly. (HKSIR 300.16)*

### **Example accountants' report**

49. An example accountants' report on pro forma financial information in investment circulars is set out in the Appendix to this HKSIR.

### **Comfort letters**

50. As a consequence of providing the accountants' report on pro forma financial information for inclusion in the investment circulars, reporting accountants do not normally provide any separate private comfort letter on pro forma financial information to those responsible for the contents of the investment circular.

**Appendix - Example accountants' report on  
pro forma financial information in investment circulars**

**ACCOUNTANTS' REPORT ON PRO FORMA FINANCIAL INFORMATION  
TO THE DIRECTORS OF XYZ LIMITED**

We have examined the pro forma financial information of XYZ Limited and its subsidiaries (Group), which has been prepared by the directors for illustrative purposes only, to provide information about how the [*insert brief description of the transaction, e.g. "proposed placing and public offer" or "proposed acquisition of XY Company Limited"*] might have affected the financial information presented, for inclusion as Appendix [ ] to the Investment Circular of XYZ Limited dated [ ].

**Respective responsibilities of directors and reporting accountants**

It is the responsibility solely of the directors to prepare the pro forma financial information in accordance with AG 2.212 "Preparation of pro forma financial information for inclusion in investment circulars" issued by the Hong Kong Society of Accountants.

It is our responsibility to form an opinion on the pro forma financial information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the pro forma financial information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

**Basis of opinion**

We conducted our engagement in accordance with HKSIR 100 "Investment circulars and reporting accountants" and HKSIR 300 "Accountants' reports on pro forma financial information in investment circulars" issued by the Hong Kong Society of Accountants. Our work consisted primarily of comparing the historical financial information with the information set out on pages [ ] to [ ] of the Investment Circular of XYZ Limited dated [ ]<sup>1</sup>, considering the evidence supporting the adjustments and discussing the pro forma financial information with the directors. This engagement did not involve independent examination of any of the underlying financial information.

**Opinion**

In our opinion:

- a. the pro forma financial information has been properly compiled by the directors on the basis stated;
- b. such basis is consistent with the accounting policies of the Group; and
- c. the adjustments are appropriate for the purposes of the pro forma financial information as disclosed pursuant to Accounting Guideline 2.212 "Pro forma financial information for inclusion in investment circulars" issued by the Hong Kong Society of Accountants.

ABC & Co.  
Certified Public Accountants  
Hong Kong  
Date

---

*Note*

- 1. In the event that the source document is not included in the investment circular, the source of the information has to be specified.*

ISSUED FOR COMMENTS BY 14 AUGUST 2004

## HONG KONG STANDARD ON INVESTMENT CIRCULAR REPORTING ENGAGEMENTS

400

### COMFORT LETTERS AND OTHER ASSISTANCE TO SPONSORS

(Issued [ ]) )

*Hong Kong Standards on Investment Circular Reporting Engagements (“HKSIRs”) are to be applied in the conduct of an engagement involving an investment circular intended to be issued in connection with a securities transaction governed wholly or in part by the laws and regulations of Hong Kong.*

*HKSIRs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.*

*To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the HKSIR including explanatory and other material contained in the HKSIR not just that text which is black lettered.*

*In exceptional circumstances, reporting accountants may judge it necessary to depart from a HKSIR in order to more effectively achieve the object of an engagement involving an investment circular. When such a situation arises, the reporting accountants should be prepared to justify the departure.*

*HKSIRs need only be applied to material matters.*

*The definitions set out in paragraph 13 of HKSIR 100 are to be applied in the interpretation of HKSIRs.*

*This HKSIR is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

*This HKSIR applies to comfort letters and other assistance given to sponsors as part of their investigations and obligations (commonly referred to as due diligence) under the Listing Rules/GEM Rules, relating to information included in an investment circular. Where this role is performed by other parties, such as underwriters, merchant banks or other persons acceptable to the Stock Exchange, this HKSIR also applies.*

### Introduction and scope

- 1. Reporting accountants who issue a comfort letter to sponsors or take part in a due diligence meeting with sponsors, should comment only in accordance with the requirements in this HKSIR, and the terms of the engagement. Reporting accountants should also comply with HKSIR 100 “Investment circulars and reporting accountants” and the requirements of the Professional Ethics Statements/[HKSA Code of Ethics] issued by the Hong Kong Society of Accountants. (HKSIR 400.1)***
- 2. The Stock Exchange requires an applicant for listing to appoint a person approved by the Stock Exchange for the purpose to act as a “sponsor” to the issuer. The responsibilities of***

sponsors are set out in the Listing Rules/GEM Rules. These responsibilities are aimed broadly at ensuring that the directors of the issuer understand their obligations, both on initial listing and subsequently and that the listing document is to the best of the sponsor's knowledge and belief in compliance with the Listing Rules/GEM Rules, is accurate and complete in all material respects and is not misleading. In certain cases the responsibilities of sponsors continue after the issuer has been listed.

3. In connection with the issuance of a prospectus by an issuer, reporting accountants may be requested by sponsors, to perform procedures to provide comfort in respect of the integrity of certain information disclosed in the listing document, or to comment on changes in selected financial statement items subsequent to the latest period reported on in the accountants' report. The narrative that follows in this HKSIR focuses on the issuance of a comfort letter and the participation in a due diligence meeting in these circumstances. Less frequently, these procedures may also be requested by sponsors in relation to other investment circulars prepared by issuers that are already listed. This HKSIR also applies to such letters and due diligence meetings.
4. A due diligence investigation will normally be undertaken by sponsors to demonstrate that they have fulfilled their obligations under the Listing Rules/GEM Rules. It is not usually practical for sponsors to carry out such an investigation entirely by themselves, and so they will often ask for assistance to provide them with comfort in certain areas outside of the historical financial information. Such assistance may be provided by reporting accountants in the form of a comfort letter and/or agreeing to answer questions at a due diligence meeting. Although the reporting accountants may provide such assistance, the responsibility for the completeness and accuracy of the listing document, and its compliance with regulatory requirements remains that of the directors of the issuer. There is no statutory or Listing Rules/GEM Rules requirement for reporting accountants to provide a comfort letter covered by this HKSIR to sponsors.
5. Ordinarily, reporting accountants engaged by the issuer to prepare an accountants' report to be included in the listing document will also be engaged to assist the sponsors in conducting their investigation of the issuer's affairs.
6. In providing a comfort letter and/or formulating a response to questions asked by sponsors, reporting accountants would bear in mind four principles underlying this HKSIR:
  - a. Only the sponsors can determine what is sufficient for a reasonable investigation in connection with their obligations under the Listing Rules/GEM Rules.
  - b. The sponsors may rely on any statement made by reporting accountants to add credibility to the subject matter of the statement; accordingly, any statement needs to be appropriately supported.
  - c. In order to make a statement that would be appropriately supported, reporting accountants need to possess adequate knowledge of the subject matter, and to act with due care and an objective state of mind.
  - d. Reporting accountants can properly make a statement only if there is suitable evidence as a basis for reporting factual findings on the subject matter.
7. By providing a comfort letter or participating in a due diligence meeting, reporting accountants lend credibility to the information on which comments are made. Hence it is important that the procedures to be undertaken relate only to matters to which their professional competence is relevant, and are performed in accordance with this HKSIR.
8. In carrying out an engagement under this HKSIR, reporting accountants apply the principles



in SAS 710 “Engagements to perform agreed-upon procedures regarding financial information”. Accordingly, reporting accountants report the procedures carried out and the findings obtained, but do not provide either positive or negative assurance.

9. Only sponsors can determine the information on which comfort is required and the procedures that will provide the required degree of comfort on that information. Consequently, it is important for the reporting accountants, the issuer’s management and the sponsors to reach an early understanding and agreement as to the sponsors’ requirements and the procedures the reporting accountants can properly perform.

## Comfort letters

### Agreeing the terms of the engagement

10. ***In accordance with the principles in SAS 140 “Engagement letters”, reporting accountants when engaged to issue a comfort letter should agree the terms of the engagement with the issuer and the sponsors. The terms of the engagement should be recorded in writing. (HKSIR 400.2)***
11. The terms of the engagement to issue a comfort letter are recorded in an engagement letter. The engagement letter documents and confirms the reporting accountants’ acceptance of the engagement, and the nature of the work to be performed. It also documents the responsibilities of the issuer and the sponsors, and the extent of the reporting accountants’ responsibilities to them. The issuer and the sponsors being signatories to the letter, also confirm their acceptance of the terms and procedures described therein.
12. Because the engagement letter is issued before the commencement of the engagement, it may not be practical to include a detailed list of all of the procedures to be performed; in which case it would normally be appropriate to include a general description of the type of procedures expected to be undertaken in connection with the engagement.
13. An example of an engagement letter is included in Appendix 2 to this HKSIR.
14. ***In any discussion of procedures, reporting accountants should not indicate in any manner that any representations will be able to be provided regarding the sufficiency of the procedures for the sponsors’ purposes. (HKSIR 400.3)***
15. Typically, reporting accountants are asked to apply specified procedures to selected items of a financial nature included in the investment circular and to report the results. Such procedures may be applied to, for example, changes in selected financial statement items subsequent to the date of the historical financial information, and specific items of financial or other information included in the investment circular.
16. Reporting accountants may suggest a meeting with management and the sponsors, or consultation by telephone or other means, to discuss and agree upon the detailed procedures to be followed in connection with the comfort letter. Only sponsors can determine what is sufficient for their purposes, however, reporting accountants can advise the sponsors and management if, for any reason, it is not feasible to perform a requested procedure.
17. Reporting accountants will normally be willing to assist sponsors, but the assistance reporting accountants can provide by way of comfort letters is subject to limitations. One limitation is that reporting accountants can properly report in their professional capacity only on matters to which their professional expertise is substantially relevant. Another limitation is that procedures such as those contemplated in a comfort letter provide reporting accountants with

a basis for reporting no more than a list of procedures performed and the findings of those procedures. Such limited procedures may bring to the sponsors' attention significant matters affecting the financial information, but they do not provide assurance that the sponsors will learn of all information that the sponsors may wish to know. Because matters concerning the issuer's operations and financial results are the responsibility of management and may not be within the expertise of reporting accountants, they are best communicated to the sponsors by management.

18. To ensure a mutual understanding of the procedures to be followed, it is desirable that reporting accountants, after discussing the comfort letter with management and the sponsors, furnish both with a draft of the letter expected to be issued, clearly identified as a draft.

### **Contents of a comfort letter**

19. The detailed contents of a comfort letter to sponsors will vary according to the nature of the information in the investment circular and the procedures agreed on by management, the sponsors and the reporting accountants.

20. *At a minimum, a comfort letter should contain the following matters:*

- a. date;*
- b. reporting accountants' address;*
- c. addressees (ie, the issuer and the sponsors, as signatories to the engagement letter);*
- d. identification of the purpose for which the procedures were performed;*
- e. a statement that the procedures performed were those agreed upon with the addressees, as specified in the engagement letter;*
- f. a statement that the engagement was performed in accordance with this HKSIR;*
- g. identification of specific financial or non-financial information to which the procedures have been applied;*
- h. a description of the specific procedures performed and the factual findings, including sufficient details of errors and exceptions found;*
- i. a statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed;*
- j. a statement that the letter is restricted to the addressees of the letter and is to be used only in connection with the stated purpose of the letter; and*
- k. reporting accountants' signature. (HKSIR 400.4)*

21. An example of a comfort letter to sponsors is included in Appendix 1 to this HKSIR.

22. *Reporting accountants should have obtained knowledge of the internal controls, policies and procedures before reporting on:*

- a. selected financial information;*
- b. non-financial information derived from accounting records; or*

**c. subsequent changes. (HKSIR 400.5)**

23. Reporting accountants may be requested by sponsors to perform procedures and report in the comfort letter on the above kinds of information. Reporting accountants report on any such matters only after having obtained knowledge of the issuer's internal controls, policies and procedures as they relate to the preparation of the historical financial information or interim financial information. Knowledge of the issuer's internal controls includes knowledge of the control environment and control systems. Reporting accountants who have examined an issuer's historical financial information ordinarily would have acquired sufficient knowledge of the issuer's internal controls, policies and procedures as they relate to the preparation of the historical financial information, and may have acquired such knowledge with respect to interim financial information. Reporting accountants who have performed a review in accordance with SAS 700 "Engagements to review interim financial reports" ordinarily would have acquired such knowledge with respect to the period(s) encompassed by the review. When reporting accountants have not acquired sufficient knowledge of the issuer's internal controls, policies and procedures, additional procedures are performed to obtain that knowledge, that are considered necessary to carry out the agreed-upon procedures.
24. It would be inappropriate for reporting accountants to add credibility to information relating to a period without knowledge of the issuer's internal controls, policies and procedures. Reporting accountants would give comfort with respect to periods not covered by an examination or review engagement, only after having obtained or updated knowledge of internal controls, policies and procedures for the periods.

*Financial and non-financial information*

**25. When reporting accountants provide a comfort letter reporting procedures performed with respect to specific items of financial or quantitative information in the investment circular:**

**a. the comfort letter should:**

- i. specifically identify the information;**
- ii. describe in detail the procedures performed at the request of the sponsors;**
- iii. describe the results of applying the procedures;**

**b. the comfort letter should state that:**

- i. the information has not been audited;**
- ii. the reporting accountants make no representation regarding any matter of legal interpretation;**
- iii. the reporting accountants make no representation about the adequacy for the sponsors' purposes of the procedures followed;**
- iv. such procedures would not necessarily disclose material misstatements or omissions in the information to which the comments relate; and**
- v. the reporting accountants make no representations about the adequacy or completeness of the disclosure; and**

**c. the comfort letter should avoid the use of terms of uncertain meaning (such as general review, limited review, reconcile, test, or check) unless the procedures contemplated by these terms are described in the letter. (HKSIR 400.6)**

26. When reporting accountants perform procedures with respect to specific items of financial or other information in the investment circular, it is important that the comfort letter be worded so as to minimise the possibility of misinterpretation.
27. To avoid ambiguity, it is important that the specific information commented on in the comfort

letter be identified by reference to specific captions, tables, page numbers, paragraphs, or sentences. This information may be presented in any one of several ways. Descriptions of the procedures followed and the results obtained may be stated individually for each item of specific information commented on. Alternatively, if the procedures and findings are adequately described, some or all of the descriptions may be grouped or summarised, as long as the applicability of the descriptions to items in the investment circular is clear and the descriptions do not imply that the reporting accountants assume responsibility for the adequacy of the procedures. It may also be appropriate to present a matrix, listing the information and procedures applied to the specific items. Reporting accountants may also choose to identify procedures performed using specific symbols, and identify items to which those procedures have been applied directly on a copy of the applicable pages of the investment circular, which are attached to the comfort letter.

**28. Reporting accountants should report on financial information contained in the investment circular only when:**

- a. it has been obtained from the issuer's historical financial information, financial statements or accounting records that are subject to the issuer's internal controls, policies and procedures;**
- b. it has been derived directly from such historical financial information, financial statements or accounting records by analysis or computation (for example, percentages or financial ratios); or**
- c. it has been the subject of a separate assurance engagement performed in accordance with Professional Standards issued by the Hong Kong Society of Accountants. (HKSIR 400.7)**

29. Reporting accountants could agree to report on a procedure such as comparing information contained in an investment circular to a schedule prepared by management, but only if the information in the schedule has been derived from accounting records subject to the issuer's internal controls, policies and procedures of which the reporting accountants have knowledge. While responsibility for determining the appropriateness and sufficiency of the procedures required for the sponsors' purposes rests with the sponsors, reporting accountants have a professional responsibility not to be associated with information that they believe, or have reason to believe, is false or misleading.

30. Reporting accountants would generally not be in a position to comment on matters primarily involving the exercise of management's business judgement. For example, the causes of changes between periods in gross profit ratios or net income may not necessarily be within the reporting accountants' knowledge and expertise. It would be appropriate for reporting accountants to comment on management's explanation of such changes only if they have obtained the necessary information by performing a separate assurance engagement in accordance with Professional Standards issued by the Hong Kong Society of Accountants.

31. Reporting accountants would not comment on the appropriateness of allocations made to derive segment information, since the accountants' report encompasses that information. In some cases, reporting accountants may be requested to make a statement as to the acceptability of methods of analysis or allocation used in deriving figures not reported in the segment disclosures in the historical financial information. Whether reporting accountants may properly comment on the methodology applied will depend on the extent to which such allocation is made in, or can be derived directly by analysis or computation from, the issuer's accounting records. In any event, such comments, if made, would make clear that such allocations are to a substantial extent arbitrary, that the method of allocation used is not the only acceptable one, and that other acceptable methods of allocation might produce substantially different results.

*Further guidance relating to non-financial information*

32. ***Reporting accountants should comment only on matters to which their professional competence is relevant. (HKSIR 400.8)***
33. Reporting accountants may be asked to comment on a wide variety of non-financial information, ranging from information taken directly from the historical financial information to information which has no connection with the accounting records of the issuer.
34. Reporting accountants would not comment on information subject to legal interpretation, such as beneficial share ownership or contracts, or on matters such as engineering data or mineral reserves.
35. Any procedures reporting accountants agree to perform on non-financial information would be such as to add a measure of credibility to the information being commented on. Reporting accountants would not comment on matters merely because they happen to be present and are capable of reading, counting, measuring, or performing other functions that might be applicable. In most such cases, sponsors can derive the same degree of comfort with respect to the information by performing the procedures themselves. For reporting accountants to comment in the comfort letter on the performance of such mechanical functions on non-financial information can only add a degree of comfort which is unwarranted and may prove to be misleading.
36. ***Reporting accountants should comment on quantitative information other than financial information only when:***
- a. ***it has been obtained from accounting records that are subject to internal controls, policies and procedures of which reporting accountants have knowledge; or***
  - b. ***it has been the subject of a separate assurance engagement performed in accordance with Professional Standards issued by the Hong Kong Society of Accountants. (HKSIR 400.9)***
37. Examples of matters on which procedures would generally be inappropriate are the proposed use of proceeds of the issue, area of facilities, number of employees (except as related to a given payroll period), and backlog information.

*Subsequent changes*

38. ***For the change period, the reporting accountants' comments should be solely based on the limited procedures actually performed with respect to that period and that fact should be made clear in the comfort letter. (HKSIR 400.10)***
39. Frequently, reporting accountants are requested to comment on subsequent changes in items in the historical financial information. These changes, which would be restricted to components reported in the historical financial information, may include, for example, changes in share capital, increases in long-term debt, or decreases in other specified financial statement items during a period (commonly referred to as the "change period") beginning subsequent to the date and period of the historical financial information, and ending at the cut-off date. Reporting accountants may also be requested to address such matters as subsequent changes in the amount of net current assets or net assets, net sales, and the total and per-share amounts of both profit from ordinary activities and net profit. The comments on subsequent changes would be limited to reporting changes in amounts, and would avoid addressing the reasons for such changes.

40. There may be internal financial statements such as management accounts available for one or more accounting periods following the date of the historical financial information. As a basis for commenting on subsequent changes, reporting accountants would read any such available internal financial statements, and enquire of management officials as to whether such statements are stated, in all material respects, on a basis consistent with that of the historical financial information examined by the reporting accountants.
41. For both the period(s) covered by the available internal financial statements referred to in the preceding paragraph, and for the period between the date of the historical financial information and the cut-off date, the reporting accountants' procedures with respect to such changes would include reading minutes of meetings of shareholders, directors, and various committees and making enquiries of management officials relating to the whole of the change period.
42. Usually there will be a period immediately preceding the cut-off date for which complete accounting information is not yet available. Reporting accountants would consider whether it is appropriate to provide comfort with respect to changes, increases or decreases that may have occurred during this period. Frequently it would be possible for the officials consulted to speak about changes in some items (for example, long-term debt and share capital), but not others (for example, revenues and net income). It would be inappropriate for reporting accountants to give comfort if the officials consulted were unable to respond fully to enquiries about changes that may have occurred.
43. It may be desirable for reporting accountants to obtain written representations from management with respect to changes subsequent to the date of the historical financial information. An illustration of such representations is included in Appendix 3 to this HKSIR.
44. Usually a change in an accounting principle made during the change period would be disclosed in the historical financial information. If such disclosure is not made in the historical financial information, reporting accountants would describe the change in the comfort letter.
45. ***In order that comments on subsequent changes be unambiguous and their determination be within the reporting accountants' expertise, reporting accountants should not refer to "adverse changes" or "material adverse changes", or make similar general statements about developments during the change period. (HKSIR 400.11)***
46. Reporting accountants are sometimes asked to state in the comfort letter that there have been "no adverse changes" or "no material adverse changes", or to make similar general statements about developments during the change period. In order to avoid subjective determinations that are susceptible of misinterpretation, it is important that reporting accountants not agree to provide such a comment in the comfort letter.
47. ***When it has come to the reporting accountants' attention that a change, increase or decrease in a financial statement item on which the reporting accountants have been asked to comment has occurred during the change period:***
  - a. ***if the amount of the change, increase or decrease is not disclosed in the investment circular, reporting accountants should note the amount of such change, increase or decrease in the comfort letter; or***
  - b. ***if the change, increase or decrease, actual or contemplated, is disclosed in the investment circular, the phrase "except for changes, increases or decreases that the investment circular discloses have occurred or may occur" should be included in the letter. (HKSIR 400.12)***

48. Comments on matters such as the occurrence of changes in share capital, increases in long-term debt, and decreases in other specified financial statement items are ordinarily limited to changes, increases or decreases not disclosed or contemplated in the investment circular.
49. In the context of a comfort letter, an increase (or a decrease) occurs when the amount of a financial statement item at the cut-off date or for the change period (as if financial statements had been prepared at that date and for that period) is more (or less) than the amount of the same item at a specified earlier date or for a specified earlier period.
50. The change period for which the reporting accountants provide comfort ends on the cut-off date and ordinarily begins, for balance sheet items, immediately after the date of the last balance sheet in the historical financial information and, for income statement items, immediately after the latest period for which such items are presented in the document.
51. The comparison relates to the entire period and not to portions of that period. For example, a decrease during one part of the period may be offset by an equal or larger increase in another part of the period; however, because there was no decrease for the period as a whole, the comfort letter would not report the decrease occurring during one part of the period.
52. The engagement letter usually specifies the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared. For balance sheet items, the comparison date is normally that of the latest balance sheet included in the historical financial information (that is, immediately prior to the beginning of the change period). For income statement items, the comparison period or periods would ordinarily be the corresponding period of the preceding year, but might be instead or might include in addition any period of corresponding length chosen by the sponsors.
53. Whether or not specified in the engagement letter, the date and period used in comparison would be identified in the comfort letter in both draft and final form so that there is no misunderstanding about the matters being compared and so that the sponsors can determine whether the comparison date and period are suitable for the sponsors' purposes.

## **Due diligence meetings**

54. As part of their investigation, sponsors frequently request a meeting (a "due diligence meeting") with the issuer, the reporting accountants, and legal counsel, at which the respective parties are requested to respond to specific questions raised by the sponsors. A due diligence meeting provides sponsors with an opportunity to obtain information required to fulfil their responsibilities. The questions asked may relate to the business of the issuer, information contained in the listing document, the nature of the engagement undertaken by the reporting accountants, financial reporting, corporate governance, and other matters of interest to the sponsors.
55. ***Before attending a due diligence meeting with sponsors, reporting accountants should establish an understanding and agreement with the issuer's management and the sponsors as to the terms of the engagement. The terms of the engagement should be recorded in writing. (HKSIR 400.13)***
56. Matters to be agreed on might include management's consent to the reporting accountants' participation, management's undertaking to be represented in the meeting, and a waiver of normal confidentiality requirements, clearly specifying any limits on the reporting accountants' freedom to speak openly to the sponsors. For example, it would be established whether or not the reporting accountants are free to discuss any management letters or internal control letters issued previously.

57. Reporting accountants would normally request, and sponsors may agree to provide in advance of the meeting, a list of the questions addressed to the reporting accountants. The reporting accountants may wish to meet with the issuer's management to discuss the intended responses.
58. *In a due diligence meeting, the reporting accountants' comments should be confined to matters properly relating to the engagement, such as:*
- a. *the nature and duration of the engagement as reporting accountants;*
  - b. *the reporting accountants' professional standing and experience;*
  - c. *the scope of the examination and other professional work in connection with the listing document;*
  - d. *the accountants' report and other published reports issued by the reporting accountants;*
  - e. *the reporting accountants' relationship with the issuer's management, directors and audit committee or equivalent;*
  - f. *the reporting accountants' ability to deliver reports, consents, comfort letters and any other letters or reports in connection with the offering of securities; and*
  - g. *new developments in accounting, or pending accounting changes which have had or may have in future an effect on the issuer's financial statements. (HKSIR 400.14)*
59. Reporting accountants would confine comments in the meeting to matters properly relating to the engagement as reporting accountants and to work undertaken in connection with the listing document. It is essential that comments be restricted to what the reporting accountants would be prepared to put in writing, and such a communication could be made only if it met the requirements in this HKSIR. Reporting accountants would not comment on matters primarily involving discussion and analysis of the results of operations and financial position of the issuer, unless this is the subject of a separate assurance engagement performed by the reporting accountants. Reporting accountants would generally decline to answer questions such as enquiries as to details within the accounts, questions about the aggressiveness of the issuer's accounting policies or income tax practice, or questions as to the adequacy of the issuer's insurance coverage (except in relation to the fairness of presentation of the historical financial information). Any questions on such matters are properly addressed to the issuer's management, and would be responded to by management.
60. Further guidance as to the manner in which reporting accountants might respond to requests in a due diligence meeting is provided in Appendix 4 to this HKSIR.

## **Cross-border and international offerings**

61. When all or part of a securities offering is made in other countries, reporting accountants may be requested to perform procedures and provide a comfort letter for such offerings. In circumstances where there are no relevant standards governing the provision of a comfort letter in the jurisdiction in which the offer is being made, reporting accountants may refer to this HKSIR in establishing the scope of work to be performed and the form and content of the comfort letter to the sponsors (or persons fulfilling a similar role to sponsors in that particular jurisdiction).



## Appendix 1

### Example comfort letter to a sponsor

*The following example comfort letter is provided for illustrative purposes only. It is intended to be used only as a guide to the possible form and content of a comfort letter that reporting accountants may wish to provide, and is not intended to suggest standard wording to be used in any particular set of circumstances. The contents of the comfort letter will vary according to the nature of the information in the investment circular, and the procedures agreed between the reporting accountants, the sponsors, and the issuer. When preparing a comfort letter to sponsors, reporting accountants will need to ensure that the letter meets the requirements of this HKSIR.*

---

(letterhead of the reporting accountants)

Date

To: The Directors, Sponsors Limited

The Directors, XYZ Limited

Dear Sirs,

#### **Proposed flotation of XYZ Limited on the [Main Board/Growth Enterprise Market] of The Stock Exchange of Hong Kong Limited**

This letter is written to you pursuant to the terms agreed between us in our engagement letter dated [date]. Our engagement to prepare this letter has been performed in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 400 “Comfort letters and other assistance to sponsors” issued by the Hong Kong Society of Accountants.

#### Other Financial Information

For the purposes of this letter, we have read the items that you have identified as indicated on the attached copy of the prospectus of XYZ Limited (Company) and its subsidiaries (Group) by the symbols explained below and confirm that the relevant items have been accurately extracted or derived from their respective sources or have been correctly calculated as follows:

- # Compared to the historical financial information of the Group for the years ended 31 December 20X1, 20X2 and 20X3 as set out on pages [ ] to [ ] of the prospectus, as applicable, and found them to be in agreement.
- ^ Compared to and found to be in agreement with the applicable summary schedules which the management of the Company has represented were derived from the accounting records. We have not traced the information to the accounting records themselves.
- π Recomputed the percentages/ratios etc. and found them to be arithmetically accurate.
- Ψ Recomputed the adjusted net tangible assets value of the Group based on the consolidated net tangible assets of the Group as at 31 December 20X3 as set out in Appendix 1 of the

prospectus after taking into account [*state the adjustments*], and found it to be arithmetically accurate.

- ∞ Recomputed the adjusted net tangible asset value per share, based on [ ] shares issued and to be issued and found it to be arithmetically accurate.

We make no representations regarding questions of legal interpretation or regarding the sufficiency of the aforementioned procedures; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data in the prospectus and we make no representations regarding the adequacy of disclosures or regarding whether any material facts have been omitted.

#### Changes in Financial Position

For the purpose of this letter, we have performed the following limited procedures:

- (1) We have:
  - (a) read the minutes of meetings of shareholders and the board of directors of the Company and its subsidiaries held since 31 December 20X3, as set out in minute books at 22 May 20X4 (the “cut off date”), which the directors have advised us are complete; and
  - (b) read the unaudited management accounts for the 4 months ended 30 April 20X4 (the “April 20X4 management accounts”) (which the directors have advised us are the most recent management accounts available) and the corresponding unaudited management accounts for the previous year (the “April 20X3 management accounts”).

Our objective in reading the documents referred to in paragraphs (a) and (b) above is to identify those matters which in our view might prima facie be expected to impact the figures and ratios set out in paragraph (3) below.

- (2) We have made enquiries of certain officials of the Company with responsibility for financial and accounting matters (the “person responsible for financial and accounting matters”) as to whether:
  - (a) those matters identified by us in the course of the work undertaken pursuant to paragraph (1) above have been reflected in the April 20X4 management accounts upon which the amounts and ratios referred to in paragraph (3) below are based; and
  - (b) the April 20X4 management accounts have been prepared and presented on a basis consistent with the accounting policies normally adopted by the Group and applied in preparing the historical financial information.
- (3) We have compared the amounts shown in the Appendix to this letter prepared by management of the Company, relating to turnover, profit on ordinary activities before taxation, net interest expense, depreciation of fixed assets, issued share capital, borrowings due after more than one year (“long-term debt”), net current assets, total current assets and total current liabilities, to the April 20X4 management accounts, April 20X3 management accounts or the historical financial information as appropriate and found them to be in agreement. We have recomputed the ratios set out in the schedule on the bases set out therein and found them to be arithmetically accurate.
- (4) The procedures described above do not constitute an audit or review made in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. Nor do

they provide any assurance that the April 20X4 management accounts have been prepared on a basis consistent with the April 20X3 management accounts, that such management accounts have been prepared in a reliable manner or that either have been prepared on a basis consistent with the historical financial information. Consequently, our procedures would not necessarily reveal matters of significance with respect to the comments made in the following paragraphs and we make no representations as to the sufficiency for your purposes of any such procedures.

- (5) Except in all instances for increases or decreases that the prospectus discloses have occurred or may occur, in respect of the foregoing procedures:
- (a) at 30 April 20X4 we did not find any decreases in the issued share capital, net current assets or total current assets or increase in long-term debt or total current liabilities of the Group compared with the corresponding amounts in the historical financial information; and
  - (b) in the period from 1 January 20X4 to 30 April 20X4 we did not find any decreases in turnover, profit on ordinary activities before taxation or increase in net interest expense, or depreciation of fixed assets, compared to the corresponding period in the preceding year as shown in the April 20X3 management accounts.
- (6) Since the directors have advised us that no management accounts have been prepared up to any date subsequent to 30 April 20X4, the procedures carried out by us with respect to changes in financial statement items after 30 April 20X4 have of necessity been even more limited than those carried out for the period up to that date. Up to the cut-off date, we have made enquiries of the persons responsible for financial and accounting matters as to:
- (a) whether there has been any decrease in issued share capital, net current assets or total current assets or increase in long term debt or total current liabilities of the Group at the cut off date as compared with the amounts shown in the historical financial information; and
  - (b) whether for the period from 1 January 20X4 up to the cut off date there have been any decreases in turnover, profit on ordinary activities before taxation, or increase in net interest expense or depreciation of fixed assets as compared with the corresponding period in the preceding year.

The persons responsible for financial and accounting matters confirmed that save for in all instances of increases or decreases that the prospectus discloses have occurred or may occur, they were not aware of any such increase in long-term debt, total current liabilities, net interest expense or depreciation of fixed assets or decreases in any of the other items in paragraph (6) (a) or (b) above. On the basis of the responses to these enquires and our reading of the minutes as described in paragraph (1) above, save for in all instances of increases or decreases that the prospectus discloses have occurred or may occur, we did not find any such increase or decrease.

We have not examined any historical financial information of the Company or the Group as of any date or for any period subsequent to 31 December 20X3. Therefore we are unable to and do not express any opinion on the financial position, results of operations or cash flows as of any date or for any period subsequent to 31 December 20X3.

This letter is solely for your information to assist you in conducting and commenting on your investigation of the affairs of the Company in connection with the issue of new shares covered by the prospectus and it is not to be used, circulated, quoted, or otherwise referred to for any other purpose, nor is to be filed with or referred to in whole or in part in the prospectus or any other document.

Yours faithfully,

ABC & Co  
Certified Public Accountants

## Appendix 2

### Example engagement letter relating to the issuance of a comfort letter

*The following example engagement letter is provided for illustrative purposes only. It is intended to be used only as a guide to the possible form and content of an engagement letter that reporting accountants may wish to provide, and is not intended to suggest standard wording to be used in any particular set of circumstances. The contents of the engagement letter will vary according to the nature of the information in the investment circular, and the procedures agreed between the reporting accountants, the sponsors, and the issuer.*

*Reporting accountants would seek their own advice as to the form of contract they wish to adopt. In particular, if reporting accountants wish to include statements in the engagement letter:*

- a. limiting their liability in respect of the engagement; or*
- b. dealing with their responsibility in the event that material is withheld, concealed, or misrepresented,*

*then they would take legal advice concerning the wording of such statements and how they are communicated.*

---

(letterhead of the reporting accountants)

Date

To: The Directors, Sponsors Limited

The Directors, XYZ Limited

Dear Sirs,

**Comfort letter relating to the proposed flotation of XYZ Limited (“the Issuer”) on the [Main Board/Growth Enterprise Market] of the Stock Exchange of Hong Kong Limited**

#### **Introduction**

1. This engagement letter sets out the scope and limitations of the work to be performed by us in connection with the issuance of a comfort letter in respect of above transaction, namely the proposed issue of [ ] (“the Issue”) which will involve the preparation by the Issuer, and for which the Issuer will be solely responsible, of a Prospectus in accordance with the [Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited/ Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited] (“the Listing Document”). Other work to be performed by us in connection with the Issue, including the preparation of accountants’ reports on the historical and pro forma financial information, is covered by a separate letter to the Directors of XYZ Limited dated [ ]. This letter is written in the context of the respective roles of the directors of the Issuer, Sponsors Limited (“the Sponsor”) and ourselves, in relation to the Issue.

## Comfort Letter

2. Our comfort letter will be provided to the addressees of this letter solely in the context of the due diligence procedures that you undertake, or procure to be undertaken, in connection with the contents of the Listing Document [for the purpose of any defence in such context that you may wish to advance in any claim or proceeding in connection with the contents of the Listing Document.] Accordingly, our comfort letter will be addressed to you for that purpose and may not be relied on by you for any other purpose.
3. The Sponsor confirms that, in connection with the Issue, [it is aware of guidance relating to due diligence issued by the International Primary Market Association from time to time and as at the date of the Listing Document which will be followed by it in connection with the Issue, and that receipt of the comfort letter is one of a number of procedures that the Sponsor may use to establish the investigation that it has conducted] [the review process that it will perform is substantially consistent with the due diligence review process that it would perform in connection with a placement of securities subject to registration pursuant to the United States Securities Act of 1933] [*or state other applicable guidance followed*].
4. For the avoidance of doubt and subject to the limitations or exclusions which are contained in or referred to in Paragraphs 5, 6, 25, 30 and 31 of this letter, nothing in this letter shall preclude the Sponsor from obtaining compensation from us in respect of any liability that the Sponsor incurs to an investor arising out of the contents of the Listing Document to the extent that such liability arises because the work undertaken pursuant to this engagement letter or the comfort letter was undertaken negligently.
5. Any comfort letter issued pursuant to this engagement letter will not have been provided in accordance with the professional standards of the US American Institute of Certified Public Accountants and accordingly, should not be relied upon in connection with any obligations or responsibilities that you may have under any legislation, regulations and/or rule of law in the United States and, in the event of any such use in the United States, we accept no responsibility in this regard.
6. Our work and findings shall not in any way constitute advice or recommendations (and we accept no liability in relation to any advice or recommendations) regarding any commercial decisions associated with the Issue, including, in particular, but without limitation, any which may be taken by the Sponsor (or any person connected to the Sponsor or any one of them) in the capacity of investor or in providing investment advice to their clients.
7. Our comfort letter will be provided solely for your private information and should not be used for any purpose other than as set out in Paragraph 2. Our comfort letter may not be referred to in any other document (except that reference may be made to its existence in any contract or other communication between the Issuer and/or the Sponsor, and/or ourselves when in relation to the Issue), nor made available to any other party [(except that a copy may be included in the bible of transaction documents memorialising the Issue prepared for the Issuer and the Sponsor)].
8. Nothing in Paragraphs 5 and 7 shall prevent you from disclosing our comfort letter to your professional advisers or as may be required by law or regulation, and/or referring to and/or producing our comfort letter in court proceedings relating to the Issue or the Listing Document. Provided that you first obtain our prior written consent, you may disclose our comfort letter to third parties where to do so would reasonably be necessary in the interest of a resolution of a dispute with that third party.
9. Other than to those who have validly accepted this engagement letter, we will not accept any responsibility to any party to whom our comfort letter is shown or into whose hands it may come.

10. You may only rely on information and comments set out in our comfort letter on the basis of this engagement letter.

### **Work and procedures**

11. Our work will be conducted in accordance with Hong Kong Standard of Investment Circular Reporting Engagements 400 “Comfort letters and other assistance to sponsors” issued by the Hong Kong Society of Accountants. In other jurisdictions, standards and practice relevant to reporting accountants may be different and may not provide for reporting in the manner contemplated herein. Accordingly our report should not be relied on as if it had been provided in accordance with the standards and practice of any professional body in any other jurisdiction.
12. We have not carried out an audit or examination in accordance with Statements of Auditing Standards of any financial information relating to the Issuer for any period subsequent to [date of last examined balance sheet]. The procedures we will use to perform the work set out in this engagement letter will not constitute an audit or review made in accordance with Statements of Auditing Standards. Furthermore, they will not necessarily reveal matters of significance with respect to any material misstatement of the information referred to below.
13. The procedures that we plan to conduct have been discussed between and agreed by the Issuer, the Sponsor and us and will be recorded in the comfort letter itself. If during the course of carrying out such procedures as are planned and agreed upon under this letter, and solely as a result of information provided to us in so doing, we conclude that there has been any withholding, concealment or misrepresentation in relation to such information, (or otherwise we conclude that such information contains an inconsistency which clearly indicates that there may have been such a withholding, concealment or misrepresentation), we will discuss with you whether further procedures can be designed to seek to resolve the matter. Where such procedures are agreed between us, we will carry them out and amend the comfort letter accordingly.
14. We will only carry out those procedures expressly provided for in the comfort letter. Accordingly, we make no representations as to the sufficiency for your purposes of such procedures and, therefore, our responsibility shall be limited to performing the work agreed upon in this engagement letter and/or recorded in the comfort letter with due skill, care and attention. If we were to perform additional procedures or if we were to conduct an audit or review of the financial information of the Issuer to which the procedures have been applied in accordance with Statements of Auditing Standards, other matters might come to our attention which we would report to you. The procedures to be performed by us should not be taken to supplant any additional enquiries or procedures that may be appropriate in the performance of your role under the proposed offering.
15. In relation to the contents of the Listing Document, we will address ourselves solely to such financial [and other] information in the Listing Document as is identified in the comfort letter and we will make no representations as to the adequacy of disclosure in the Listing Document or as to whether any material facts have been omitted by the Issuer. Further, we make no, nor will make any, representations regarding any questions of legal interpretation.
16. Our work to provide the comfort letter will be carried out on the assumption that information provided to us by the management of the Company and of the Group is reliable, accurate and complete. We will not subject the information contained in the comfort letter to checking or verification procedures except to the extent expressly stated. You will therefore understand that the procedures carried out by us are not designed to and are not likely to reveal fraud or misrepresentation by the management of the Company or the Group.

17. Any opinions expressed on financial information outside the context of this engagement letter were or are expressed solely in the context of the specific terms and conditions governing their preparation. In particular, the terms of this engagement letter and any action pursuant to it shall be additional to and shall not detract from or change in any way any legal rights which any party to this letter may otherwise have acquired, whether in contract or in tort, in connection with our examination of the financial information of the Issuer.
18. Save as may be expressly recorded in the comfort letter, we do not accept any responsibility for any other reports or letters beyond any responsibility that we owed to those to whom our reports or letters were addressed at the date of their issue.

### **Contents of the Comfort Letter**

19. We will prepare and expect to issue a comfort letter addressed to the Issuer and the Sponsor in connection with their due diligence enquiries in connection with the contents of the Listing Document on the basis described above. Based upon our present understanding of your requirements we expect to be able to provide you with a comfort letter substantially in the form contained in Appendix [ ], setting out the procedures that we expect to carry out prior to issuing our comfort letter. [*Where a draft comfort letter is not appended briefly explain the procedures to be performed.*] Your acceptance of our comfort letter in final form constitutes your agreement to the scope and extent of such procedures.
20. We would be grateful if you would review the draft comfort letter that we expect to be able to provide you with and let us have any amendments you propose to the procedures as soon as possible, so that we can provide you with a revised draft for your further consideration and approval.
21. Once an advanced draft of the Listing Document is available and you have identified, and we have agreed, the detailed financial information whose extraction or calculation you require to be covered in the comfort letter, we will provide you with a further revised draft of the comfort letter for your approval of its scope prior to finalisation.
22. For the avoidance of doubt, we will not comment on, or otherwise give comfort in relation to, the prospects or trading position or, save as expressly stated in the comfort letter, comment on or provide any opinion or other conclusion as to the current overall financial position of the Issuer<sup>1</sup>.

### **Drafts**

23. During the course of the engagement we may show drafts of, or report orally on, our comfort letter to you. In so far as any such draft or oral report is inconsistent with the subsequent final comfort letter, it will be deemed to be superseded by such final comfort letter.

### **Meetings**

24. It will be necessary for us to receive copies of the draft Listing Document as it is produced and it may be necessary for us to attend meetings (including, but not limited to, meetings with the Issuer, and its directors and/or employees, and the Sponsor and its employees or agents) at which the Listing Document is discussed and drafted or at which other related matters are discussed. We shall answer queries raised at such meetings on an informal basis but you should neither act nor refrain from acting on the basis of such informal answers unless and until they are confirmed in writing by us, whether in the final comfort letter or otherwise. In the absence of such written confirmation we shall have no liability to you in contract or in tort (including negligence) for our answers<sup>2</sup>



25. Unless otherwise specifically agreed between the parties, we are authorised by the Issuer to speak to the Sponsor and other professional advisers advising on the proposed Issue. In connection with our work pursuant to this letter, we may release to the Sponsor and such other professional advisers any information relating to the Issuer, whether confidential or not and obtained during the course of our work or otherwise and shall not be liable to the Issuer for any use subsequently made of that information.

### **Timetable**

26. Our work will depend upon receiving without undue delay full co-operation from all relevant officials of the Company and the Group and their disclosure to us of all accounting records of the Group and all other records and related information (including certain representations) we may need for the purposes of our work. We will endeavour to carry out our work in accordance with a timetable to be agreed between all parties that will satisfy the requirements of the Issue<sup>3</sup>. We intend to provide you with our comfort letter on the date of the final Listing Document relating to the Issue and to provide you with an updating comfort letter or to reissue our comfort letter on the date of closing of the Issue. We will discuss with you any difficulties we encounter with this engagement or with meeting the timetable as soon as any problems arise.

### **Applicable law and jurisdiction**

27. This engagement letter shall be governed by, and construed in accordance with, Hong Kong law. The Courts of Hong Kong shall have exclusive jurisdiction in relation to any claim, dispute or difference concerning the engagement letter or any comfort letter and any matter arising from them. Each party irrevocably waives any right it may have to object to an action being brought in any of those Courts, to claim that the action has been brought in an inconvenient forum or to claim that those Courts do not have jurisdiction.

### **Staffing**

28. [Name] will be the partner in charge of the services we will provide. [Name] will act as manager, with the help of [name], calling upon specialist staff as appropriate.

### **Fees**

29. Details of our fees and proposed billing arrangements have been set out in a separate letter to the Issuer, who will bear the responsibility for the payment thereof.

### **Other Terms and Conditions**

30. In no circumstances shall we be liable, other than in the event of our bad faith or wilful default, for any loss or damage, of whatsoever nature, arising from information material to our work being withheld or concealed from us or misrepresented to us by the directors, employees, or agents of the Issuer or any other person of whom we may make enquiries. This clause, and any assessment of our work made pursuant to it, will have regard to the limited scope of procedures agreed under this letter.

### **Prohibition on Assignment**

31. No party may assign any of its rights in relation to this engagement letter without the prior written consent of the others against whom the rights may be asserted, save that the sponsor may assign any of such rights, or such rights may pass by operation of law, to any successor to all or part of its business without such consent, provided that notice is given to us prior to any step being taken by you to enforce any rights hereunder.

**Entire Agreement**

- 32. This engagement letter and the Appendices to it constitute the entire agreement between us and, save as provided in this engagement letter, no change in the terms of our engagement will be effective unless agreed in writing and signed by all parties to this engagement letter.
- 33. Please acknowledge your acceptance of the terms of our engagement by signing and returning the enclosed copy of this letter.
- 34. If you have any questions regarding this engagement letter please do not hesitate to contact us.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

---

**Acknowledgement and Acceptance**

We acknowledge receipt of this letter and agree with the terms of your engagement set out therein:

.....Director	..... Director
for and on behalf of the board of XYZ Limited	for and on behalf of Sponsors Limited

---

*Notes*

- 1. *If specific procedures and appropriate terms (e.g. as to timing) are agreed between all parties, the reporting accountants may undertake additional work (for example in relation to the Issuer's current overall financial position) in accordance with HKSIR 400.*
- 2. *If specific matters are discussed which the Sponsor wishes to be able to rely upon in accordance with this engagement letter, the Issuer and the Sponsor should arrange for them to be confirmed in writing by the reporting accountants. If the reporting accountants are willing to confirm such matters in writing, further work and an extension of the terms of the engagement are likely to be required.*
- 3. *It may not be appropriate to include this sentence if the engagement letter is signed contemporaneously with the comfort letter.*

### Appendix 3

#### Example issuer's representation letter on subsequent changes

*The following example representation letter is provided for illustrative purposes only. It is intended to be used only as a guide to the possible form and content of a representation letter, and is not intended to suggest standard wording to be used in any particular set of circumstances.*

---

(letterhead of the issuer)

Date

To the reporting accountants

Dear Sirs

**Proposed floatation of XYZ Limited on the [Main Board/Growth Enterprise Market] of The Stock Exchange of Hong Kong Limited**

In connection with the proposed floatation of XYZ limited we certify to the best of our knowledge and belief that during the period from 31 December 20X3 to date, no events have occurred which have a material effect on the historical financial information or which should be disclosed in order to keep those information from being misleading<sup>1</sup>.

With respect to the unaudited management accounts as at 30 April 20X4 and 20X3 and for the four-month periods ended 30 April 20X4 and 20X3, we certify to the best of our knowledge and belief that:

- a. such management accounts were prepared in accordance with accounting principles and practices consistent in all material respects with those followed in the preparation of the historical financial information contained in the prospectus, except as set forth in the prospectus;
- b. such management accounts present fairly the information purported to be shown thereby;
- c. no material adjustment of such management accounts is required and no adjustments other than those necessary for fair presentation of the results for those periods have been reflected therein.

Also to the best of our knowledge and belief, except in all instances for changes that the prospectus discloses have occurred or may occur:

- d. at 22 May 20X4 there have not been any decreases in the issued share capital, net current assets or increases in long-term debt or total current liabilities of the Group, as compared with amounts shown in the 31 December 20X3 balance sheet of the historical financial information;
- e. for the period 1 January 20X4 to 22 May 20X4 there has been no decrease, as compared with the corresponding period in the preceding year, in turnover, profit on ordinary activities before taxation or increase in net interest expense or depreciation of fixed assets.

Further, we confirm that:

- f. no financial statements of the Group are available as at any date or for any period subsequent to 31 December 20X3, and no management accounts are available as at any date or for any period subsequent to 30 April 20X4;
- g. the minutes of all meetings of the shareholders and the board of directors are entered up to 15 May 20X4 in the minute books, and no such meetings have been held since that date.

Yours faithfully

For and on behalf of XYZ Limited

---

[name]  
Managing Director

---

[name]  
Finance Director

---

*Note*

- 1. Any exception should be spelled out in the letter.*

## Appendix 4

### Examples of questions commonly asked in due diligence meetings and comments on the reporting accountant's response

*The following examples are to be read in conjunction with the guidance contained in paragraphs 54 - 59.*

*Usually, the reporting accountant's response to questions asked by the sponsor in a due diligence meeting can be brief.*

*The comments on the questions cited below are more detailed than the responses that would usually be required, and are intended as general guidance about matters the reporting accountant would normally consider in determining a response. The comments are not intended as illustrations of the answer that would be appropriate in every situation.*

*Questions 1-13 — Questions the reporting accountant is usually able to answer*

*Questions 14-18 — Questions to which the reporting accountant is unable to respond in the terms in which they are asked*

*Questions 19-21 — Questions properly addressed to management*

---

### Questions the reporting accountant is usually able to answer

Following are a number of questions to which the reporting accountant is usually able to respond, with comments as to the response that might be appropriate.

**Question 1**            **How long have you (or your firm) been reporting accountant (or auditor) of the issuer?**

Response considerations            This question demands a factual answer.

**Question 2**            **Describe the nature and scope of your examination of the issuer's historical financial information included in the listing document. Were any limitations imposed upon the scope of your examination by management of the issuer or others?**

Response considerations            The reporting accountant would make it clear that the examination covered only the historical financial information for the dates and periods referred to in the reporting accountant's report.

The scope of an examination is set out in the accountant's report:

- An examination is conducted in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 200 (HKSIR 200), which requires that the reporting accountant plan and perform the examination to obtain reasonable assurance whether the historical financial information is free of material misstatement.
- An examination includes examining, on a test basis, evidence supporting the amounts and disclosures in the historical financial information.
- An examination also includes assessing the accounting principles used and significant estimates made by management.

In the normal case, the scope of the examination would enable the reporting accountant to express an opinion without reservation on the historical financial information. If there was any limitation imposed on the scope of the examination, the matter would be dealt with in the accountant's report.

The reporting accountant might be willing to describe the examination procedures performed on certain financial information elements in forming an opinion on the historical financial information as a whole; however, the reporting accountant would make it clear that no assurance is provided on these specific items beyond that conveyed by the historical financial information.

If there is unaudited financial information included in the listing document, the reporting accountant would refer to the (draft) comfort letter to the sponsor, which describes the nature and scope of the reporting accountant's procedures.

**Question 3**                    **Management has provided us with a list of pending litigation, commitments, contingent liabilities, guarantees, and any indebtedness or other off-balance sheet items (a list would be provided to the reporting accountant). In the course of your examination, did you discuss with management or otherwise identify any other items of the same type not included on this list that exceed (an amount provided by the sponsor)?**

Response considerations

The reporting accountant could reply that, based on the procedures performed, including discussions with management, no other items of the types mentioned were identified, or discuss any such items that were so identified. The reporting accountant may wish to point out that reporting accountants must rely to a large extent on management, and sometimes on legal counsel, in identifying outstanding contingencies.

If the reporting accountant wishes to ensure that the sponsor understands the procedures reporting accountants apply to contingencies, commitments and other such items, the procedures that are performed in gathering evidence to determine whether any such contingent items require accrual or disclosure in the historical financial information could be outlined, such as:

- review of the issuer's written summary of known and threatened claims;
- discussion with management of contingencies, commitments, and other obligations;
- discussion with the issuer's general counsel of all litigation and threatened litigation of which the issuer is aware, including litigation and claims or threatened claims covered by insurance;
- search for unrecorded liabilities by a review of disbursements subsequent to period-end and open invoices;
- receipt of written confirmation of obligations from third parties such as banks and lenders;
- receipt of written representations from management;
- review of events which have occurred between the date of the historical financial information and the date of the accountant's report; and
- review of accounting treatment and disclosure in the historical financial information.

**Question 4**                    **Management has informed us that it does not plan to change any of the significant accounting policies as set forth in note 1 to the historical financial information of the issuer. Has management informed you, or had any discussions with you, regarding any change in the accounting policies?**

Response considerations

The reporting accountant may properly respond to these questions. If the reporting accountant is aware of any recent or pending changes in accounting standards or

regulatory requirements that would make a change in the issuer's accounting policies necessary or desirable in the future, attention would be drawn to such recommendations or requirements.

**Question 5**                    **Management has informed us that it does not plan any material potential write-downs in the current year. Has management informed you, or had any discussions with you, regarding any potential write-downs in connection with the examination of historical financial information?**

Response considerations                    Normally the reporting accountant can answer this question without difficulty. The reporting accountant may wish to convey to the sponsor that reporting accountants and management usually have an ongoing dialogue with respect to potential future issues, and may choose to identify some of the accounting matters on which discussions have taken place.

The reporting accountant may also wish to refer the sponsor to any measurement uncertainty disclosures in the historical financial information, in particular any disclosures regarding historical financial information items where there is a reasonable possibility that the recognized amount of the historical financial information item could change by a material amount in the near term.

**Question 6**                    **Management has informed us that it is aware of any facts that would give rise to any extraordinary or unusual items appearing in the issuer's historical financial information. Has management informed you, or had any discussions with you, regarding any such items?**

Response considerations                    The reporting accountant can answer this question without difficulty. However, while extraordinary items may have a precise meaning in accounting terms, unusual items do not. To avoid misunderstanding, it is therefore important that the sponsor define what is meant by "unusual" items.

**Question 7**                    **How often do you meet with the issuer's audit committee or board of directors, and what are the procedures at and nature of such meetings?**

Response considerations                    The reporting accountant would describe the frequency of meetings with the audit committee and, if applicable, the board of directors.

Meetings with the audit committee would generally encompass a review and approval by the committee of the reporting accountant's examination plan and discussion of accounting and financial presentation issues. The committee would generally meet to review the historical financial information and recommend its approval by the board of directors. The reporting accountant would indicate whether meetings of the committee were held at the request of the committee or the reporting accountant.

Meetings with the board are likely to be less common, and would generally be related to a special assignment undertaken by the reporting accountant, such as delivering a special report, or discussing financing alternatives.

**Question 8**                    **Do you have full and open access to all materials which you consider necessary to enable you to perform your examination functions?**

Response considerations                    It would be expected that the reporting accountant would have full and open access to all necessary materials.

**Question 9**                    **Discuss your relationship with the issuer's management. Have you had any disagreements with management that have not been resolved to your**

**satisfaction?**

Response considerations

Generally the reporting accountant would be in a position to state that management was cooperative, and provided all of the information and explanations that the reporting accountant required. The reporting accountant may choose to point out that in the course of normal communications with the issuer, the reporting accountant frequently meets with management to discuss emerging accounting issues, and has always been able to resolve the issues with senior management satisfactorily. Otherwise, the reporting accountant would have included a reservation in the accountant's report.

**Question 10**

**Have there been any significant weaknesses in internal control that you have identified during the course of your examination of the historical financial information that were communicated to the audit committee or management committee that, to the best of your knowledge, have not been acted upon by management?**

Response considerations

The reporting accountant would state whether or not significant weaknesses in internal control have been reported to the issuer, and might identify the areas of weakness. In the course of the engagement related to the listing document, the reporting accountant will have updated knowledge of the internal controls, and may be in a position to comment on changes that have been effected since the time when the weaknesses were reported. However, the question of management's actions would properly be addressed to, and answered by, management. The reporting accountant is not normally in a position to comment on the effectiveness of any action that has been taken by management to address the internal control weaknesses that have been reported.

In responding to this question, the reporting accountant may also wish to outline the limited nature of the review of internal controls in connection with the examination of the historical financial information, to ensure that there is no misunderstanding by the sponsor of the nature and extent of the reporting accountant's review of internal controls and the type of weakness that the reporting accountant would consider to be "significant".

**Question 11**

**Other than as disclosed in the listing document, are you aware of any related party transactions involving the issuer that require disclosure in the historical financial information under generally accepted accounting principles?**

Response considerations

The reporting accountant will likely be able to answer this question in the negative, but should be concerned about any possible related party transactions subsequent to the most recent balance sheet date that would require financial statement disclosure in the current period.

If the reporting accountant wishes to be sure that the sponsor understands the procedures reporting accountants apply to identify significant related party transactions, the procedures applied may be outlined, such as the following:

- preparation of a list of directors, officers and related entities, to be consulted by audit staff when they are reviewing the issuer's transactions;
- receipt of written representations from management regarding related party transactions; and
- review of material contracts entered into during the year.

**Question 12**

**Please discuss the most significant areas of audit risk you have encountered in respect of the issuer and how you gained comfort in these areas.**



Response considerations      The reporting accountant might identify the most critical audit areas and issues discussed with the audit committee in the years and periods covered by the historical financial information. However, it is important that the reporting accountant explains that the assessment of audit risk is concerned with the fairness of presentation of the historical financial information in accordance with generally accepted accounting principles, and should not be taken to provide comfort on individual elements within the historical financial information, or on the absence of other significant business risks which, because of their nature, were not considered by the reporting accountant to constitute areas of significant audit risk.

**Question 13**      **Is there anything of which you are aware that would inhibit your delivery, in accordance with HKSIRs, and the terms of your engagement, of an unqualified report on the historical financial information, consent letters, and the comfort letter to the sponsor?**

Response considerations      The reporting accountant would be careful to explain any development (such as a delay in the issuer's providing necessary information, or an unresolved problem regarding disclosure in the listing document) which might delay the completion of the reporting accountant's work.

### **Questions to which the reporting accountant is unable to respond in the terms in which they are asked**

The sponsor may ask questions to which the reporting accountant is unable to respond in the terms in which they are asked. In such circumstances, the reporting accountant may wish to respond by explaining the reasons why he or she is unable to provide the information requested. Some examples of these types of questions, together with a commentary on how the reporting accountant might respond to the question, are set out below.

**Question 14**      **Based on your reading of the prospectus, have you any reason to believe that it is not fairly presented? (Or, Are you aware of any other matters that should be disclosed in the prospectus? Or, Are there any other questions that we should have asked in completing our due diligence investigation?)**

Response considerations      There is no accepted standard by which the reporting accountant can judge whether a prospectus is fairly presented. Professional standards require that the reporting accountants read the prospectus with a view to assessing the overall impression given by the document, having regard to the purposes for which it has been prepared, as well as considering whether there are any inconsistencies between his or her report and the information in the rest of the document.

These procedures would not necessarily disclose material misstatements or omissions in the information included in the listing document. Accordingly, except for the historical financial information included in the prospectus, the reporting accountant is not in a position to make any representations as to completeness or adequacy of disclosures in the prospectus.

The sponsor applies many other considerations in forming an opinion as to what constitutes a fair presentation, but the reporting accountant has no way of knowing what would be of interest to the sponsor. As well, a great deal of the information in a prospectus (and, perhaps, significant omissions) is outside of the knowledge of the reporting accountant.

**Question 15**      **Are you aware of any matters that may directly or indirectly affect the value of the securities offered under the prospectus?**

Response considerations      The reporting accountant is not competent to express a view as to matters that may affect the value of securities. This subject is within the province of a securities dealer such as an underwriter.

**Question 16**      **Are provisions for losses (e.g., bad debts, inventory obsolescence) adequate?**

Response considerations      An examination is designed to assess the presentation of the historical financial information as a whole, and not to provide assurance on individual financial information items. The reporting accountant determines materiality by reference to the historical financial information taken as a whole. The only appropriate answer to the question is that the reporting accountant would not have given an opinion without reservation if in the reporting accountant's opinion the historical financial information did not give a true and fair view. The reporting accountant may be willing to describe the examination procedures performed in order to conclude on the adequacy of loss provisions in the context of the examination of the historical financial information as a whole.

**Question 17**      **Are the accounting policies and methods used by the issuer appropriate? Please comment on the general fairness (adequacy) of the issuer's accounting policies and the presentation of its historical financial information. Are these accounting policies consistent with the majority of enterprises in the same business as the issuer? Would you describe the financial reporting policies of the issuer as conservative/liberal relative to other companies in the industry?**

Response considerations      Assuming that the reporting accountant has expressed an opinion without reservation on the issuer's historical financial information, it would ordinarily be possible to confirm that the accounting policies and methods used by the issuer are appropriate.

The reporting accountant would advise the sponsor that management has the responsibility for the accurate recording of transactions and the preparation of historical financial information in accordance with generally accepted accounting principles. This responsibility includes the selection and application of accounting policies. An examination of the historical financial information does not relieve management of its responsibilities. The reporting accountant may make suggestions as to the form or content of the historical financial information, and ensure that the accounting principles and policies are in accordance with generally accepted accounting principles; however, the reporting accountant is not required to assess the preferability of an accounting principle or method when acceptable alternatives exist. The reporting accountant would also consider discussing the alternative accounting policies available under generally accepted accounting principles, generally, and in the issuer's industry.

From time to time, the reporting accountant may discuss with the audit committee the quality of various accounting policies, and express a view as to the relative merits of differing methods. The reporting accountant may wish to refer to these discussions. However, in dealing with a third party such as a sponsor, the reporting accountant would be very cautious about answering any question about the relative conservatism of the issuer's accounting policies, as any answer is likely to be based on the reporting accountant's personal experience, and not on any generally accepted criteria.

**Question 18**      **What was the extent of your involvement in the preparation of the historical financial information and the other financial information in the listing document?**

Response considerations      The responsibility for the preparation of historical financial information, and also of listing documents, rests with management of the entity. It is the reporting accountant's responsibility to perform an examination of the historical financial information prepared by management.

### **Questions properly addressed to management**

The sponsor may ask questions that are properly addressed to management, rather than the reporting accountant.

**Question 19**      **Is the historical financial information for the periods contained in the prospectus of the issuer accurate in all material respects?**

Response considerations      The reporting accountant would remind the sponsor that the historical financial information is the responsibility of the issuer's management and that this question is best answered by management. The reporting accountant would explain that the responsibility as reporting accountant is to express an opinion on the historical financial information based on an examination. As noted in the accountant's report, it is the reporting accountant's opinion that the historical financial information included in the listing document gives a true and fair view, the financial position of the company as at (dates) and the results of its operations and its cash flows for the years then ended.

**Question 20**      **What is the reason for the increase / decrease in (certain historical financial information items) in 20X4 as compared to 20X3?**

Response considerations      The reporting accountant's responsibility is to form an opinion as to whether the historical financial information gives a true and fair view. A change in the recorded amount of an asset, liability, revenue or expense item from period to period is normally the result of numerous transactions. Management has the responsibility of operating the business, has first-hand knowledge of these transactions, and is in a position to analyse changes. Therefore, any questions as to the reasons for a change in a historical financial information item would be addressed to management, and responded to by management. The reporting accountant could comment on management's response only if a separate assurance engagement was carried out on the matters in question.

**Question 21**      **Please provide us with an assessment (comment on the adequacy) of the Company's internal control systems. Are you satisfied that internal controls are in place to prepare adequate financial information? Have you relied upon internal controls in performing your examination?**

Response considerations      The reporting accountant would advise the sponsor that this question can only be answered by the issuer's management, because responsibility for ensuring the adequacy of internal control is part of the issuer's management's overall responsibility.

The reporting accountant may respond by stating that management's internal control objectives go beyond financial information objectives. Internal controls relevant to the examination comprise those policies and procedures established and maintained by management that relate to specific financial information

assertions.

The reporting accountant would explain that a reporting accountant has a responsibility to obtain a sufficient understanding of internal control to plan the examination. This understanding includes knowledge about the design of policies and procedures and whether they have been implemented, but does not extend to evaluating the operating effectiveness of these policies and procedures. The reporting accountant only evaluates, and tests, those internal controls on which it is planned to rely on during the examination. Accordingly, an opinion in an accountant's report provides no assurance as to the efficiency or effectiveness with which operations, including internal controls, have been conducted.

The reporting accountant may then wish to discuss the approach adopted in performing the examination including reliance on internal controls. The reporting accountant may also wish to point out that these controls would not normally include all of the controls over the preparation of the historical financial information; accordingly, the reporting accountant is not in a position to provide any assurance regarding such controls.

Notwithstanding this, the reporting accountant would consider informing the sponsor as to any significant weaknesses in the issuer's internal control structure which were reported to management.

**ISSUED FOR COMMENTS BY 14 AUGUST 2004**

## PRACTICE NOTE

2000

### OTHER LETTERS ISSUED IN RELATION TO INVESTMENT CIRCULARS

*(Issued [    ])*

*The purpose of Practice Notes issued by the Hong Kong Society of Accountants is to assist auditors in applying Statements of Auditing Standards (SASs), Standards on Assurance Engagements (SAEs) and Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs) of general application to particular circumstances and industries.*

*They are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in SASs, SAEs and HKSIRs, even though they may be developed without the full process of consultation and exposure used for SASs, SAEs and HKSIRs. Members should be prepared to explain departures when called upon to do so.*

*This Practice Note is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

## Introduction

1. HKSIR 100 “Investment circulars and reporting accountants” establishes the generic standards and provides guidance applicable to all engagements involving investment circulars. The definitions set out in paragraph 13 of HKSIR 100 are to be applied in the interpretation of this Practice Note (PN).
2. The purpose of this PN is to provide guidance for reporting accountants engaged by the directors to provide letters on certain financial information relating to an investment circular.
3. When issuing these letters, reporting accountants comply with the general principles set out in HKSIR 100.

## Letters on cash flow forecasts or projections

4. The Listing Rules require the directors of the company to state whether in their opinion the company has sufficient working capital for the requirements of the business or, if not, how it is proposed to provide the additional working capital thought by the directors to be necessary. The directors are solely responsible for this statement. As a basis for making this statement the directors will prepare a cash flow forecast or projection.
5. It is common for the directors to request the reporting accountants to examine such cash flow forecast or projection as prepared by the directors for this purpose.
6. In an engagement to issue a letter on a cash flow forecast in relation to an investment circular, the reporting accountants comply with [Statement of Auditing Standards 730 “The examination of prospective financial information”] and this PN.

7. An example letter on a cash flow forecast prepared on the basis of best estimate assumptions is set out in Appendix 1 to this PN. An example letter on a cash flow projection prepared on the basis of hypothetical assumptions is set out in Appendix 2 to this PN. The reporting accountants ensure that for the purpose of identification a copy of the cash flow forecast or projection together with a schedule of the underlying assumptions are attached to their letter.

## **Letters on schedules of indebtedness**

8. The Third Schedule and the Listing Rules require disclosure of details of any loan capital, borrowings, mortgages or charges and indebtedness and contingent liabilities, as at the most recent practicable date or an appropriate negative statement. In this context borrowings include bank overdrafts, liabilities under acceptances (other than normal trade bills), acceptance credits, hire purchase commitments, and other guarantees. Significant finance lease commitments should also be disclosed.
9. The date at which borrowings and bank indebtedness are stated will not usually be the end of an accounting period. Therefore audited financial statements are unlikely to be available. Accordingly, the reporting accountants will have less evidence on which to base their opinion than they would at the end of an accounting period. In these circumstances they will have to place substantial reliance on management as to the identification of those parties from whom there are outstanding borrowings and whether these are secured.
10. In an engagement to issue a letter on a schedule of indebtedness in relation to an investment circular, the reporting accountants comply with Standards on Assurance Engagements (SAEs), particularly SAE 200 “High level assurance engagements” and this PN.
11. The reporting accountants’ examination of the issuer’s schedule of indebtedness includes, as a minimum, the following procedures:
  - a. obtaining the schedule of indebtedness prepared by the directors;
  - b. agreeing amounts to the issuer’s records;
  - c. obtaining bank reconciliations;
  - d. checking that cash book figures are included in the schedule of indebtedness;
  - e. investigating any unusual or large uncleared items;
  - f. obtaining direct confirmation from banks and other lenders and finance providers regarding the amounts outstanding at the relevant date; and
  - g. obtain written representations from the directors regarding the completeness and accuracy of the amounts disclosed in the schedule of indebtedness.
12. The reporting accountants report whether in their opinion the schedule of indebtedness has been properly prepared from the records of the issuer.
13. An example letter on the schedule of indebtedness is set out in Appendix 3 to this PN.

**Appendix 1**

**Example letter on a cash flow forecast  
prepared on the basis of best-estimate assumptions**

The Board of Directors  
XYZ Limited

Dear Sirs,

We have examined the attached forecast<sup>1</sup> of XYZ Limited and its subsidiaries in accordance with [Statement of Auditing Standards 730 “The examination of prospective financial information”] and with reference to Practice Note 2000 “Other letters issued in relation to investment circulars” issued by the Hong Kong Society of Accountants. The directors are responsible for the forecast including the assumptions<sup>2</sup> on which it is based.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the forecast. Further, in our opinion the forecast is properly prepared on the basis of the assumptions.

Actual cash flows are likely to be different from the forecast since other anticipated events frequently do not occur as expected and the variation may be material.

We consent to a copy of this letter being made available to [sponsor]. However, for the avoidance of doubt, all duties and liabilities (including without limitation, those arising in negligence) to [sponsor] are specifically disclaimed.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

---

*Notes*

- 1. Include the period covered by the forecast and provide suitable identification for the forecast, such as by reference to page numbers.*
- 2. Provide suitable identification for the assumptions, such as by reference to page numbers.*

## Appendix 2

### Example letter on a cash flow projection prepared on the basis of hypothetical assumptions

The Board of Directors  
XYZ Limited

Dear Sirs

We have examined the attached projection<sup>1</sup> of XYZ Limited and its subsidiaries in accordance with [Statement of Auditing Standards 730 “The examination of prospective financial information”] and with reference to Practice Note 2000 “Other letters issued in relation to investment circulars” issued by the Hong Kong Society of Accountants. The directors are responsible for the projection including the assumptions<sup>2</sup> on which it is based.

This projection has been prepared for (describe purpose). As the entity is in a start-up phase the project has been prepared using a set of assumptions that include hypothetical assumptions about future events and management’s actions that are not necessarily expected to occur. Consequently, you are cautioned that this projection may not be appropriate for purposes other than that described above.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the projection, assuming that (state or refer to the hypothetical assumptions). Further, in our opinion the projection is properly prepared on the basis of the assumptions.

Even if the events anticipated under the hypothetical assumptions described above occur, actual cash flows are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.

We consent to a copy of this letter being made available to [sponsor]. However, for the avoidance of doubt, all duties and liabilities (including without limitation, those arising in negligence) to [sponsor] are specifically disclaimed.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

---

#### Notes

1. *Include the period covered by the projection and provide suitable identification for the projection, such as by reference to page numbers.*
2. *Provide suitable identification for the assumptions, such as by reference to page numbers.*



**Appendix 3**

**Example letter on a schedule of indebtedness**

The Board of Directors  
XYZ Limited

Dear Sirs

We have examined the attached schedule of indebtedness<sup>1</sup> of XYZ Limited and its subsidiaries (Group) in accordance with Standards on Assurance Engagements and with reference to Practice Note 2000 “Other letters issued in relation to investment circulars” issued by the Hong Kong Society of Accountants. The directors are responsible for the schedule of indebtedness.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to conclude as to whether the schedule of indebtedness has been properly prepared from the records of the Group. We believe that our work provides a reasonable basis for our opinion.

Based on our examination, in our opinion the schedule of indebtedness has been properly prepared from the records of the Group.

We consent to a copy of this letter being made available to [sponsor]. However, for the avoidance of doubt, all duties and liabilities (including without limitation, those arising in negligence) to [sponsor] are specifically disclaimed.

Yours faithfully,

ABC & Co.  
Certified Public Accountants

---

*Note*

- 1. Include the date of the indebtedness schedule and provide suitable identification for the schedule of indebtedness, such as by reference to page numbers.*

ISSUED FOR COMMENTS BY 14 AUGUST 2004

## ACCOUNTING GUIDELINE

### 2.211

#### PREPARATION OF HISTORICAL FINANCIAL INFORMATION FOR INCLUSION IN INVESTMENT CIRCULARS

(Issued [ ])

*This Guideline sets out recommendations, intended to represent best practice, on the preparation of historical financial information for inclusion in investment circulars.*

*The provisions of this Guideline should be read in conjunction with the Preface to Hong Kong Financial Reporting Standards and need not be applied to immaterial items.*

*This Guideline is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

### Introduction

1. The purpose of this Accounting Guideline is to provide guidance concerning the preparation and presentation of historical financial information for inclusion in investment circulars.
2. The definitions of some of the special terms used in this Accounting Guideline can be found in the “Definitions” section of HKSIR 100 “Investment circulars and reporting accountants”.
3. The Listing Rules/GEM Rules are required to be amended to prescribe the following:  
The directors are responsible for preparing historical financial information for inclusion in investment circulars, which gives a true and fair view of the state of affairs of the relevant reporting entity at each balance sheet date and of the results and cash flows of that entity for each of the periods ending on those dates. Accordingly, historical financial information for inclusion in investment circulars is prepared in accordance with accounting principles generally accepted in Hong Kong (or other recognised GAAP).
4. In the case of historical financial information prepared in connection with an initial public offering, the relevant reporting entity is the entity which is inviting the public to subscribe for its shares or otherwise listing its shares by way of placement or introduction. For historical financial information prepared in connection with a transaction under the Takeover Code, the relevant reporting entity is the entity which is the subject of the proposed securities transaction.

### Preparation of historical financial information

5. Historical financial information for inclusion in an investment circular is prepared from the underlying financial statements (see paragraphs 6 to 12 below) after making such adjustments as considered necessary by the directors (see paragraphs 24 to 34 below).

## **Underlying financial statements**

6. Described in paragraphs 7 to 12 below are the different underlying financial statements that may be used as the basis for the preparation of the historical financial information.

### **Company financial statements**

7. Where the entity to be reported on has prepared financial statements during the period, the financial information will, subject to any adjustments considered necessary, be the information set out in those financial statements.

### **Consolidated financial statements**

8. Where the entity to be reported on has prepared financial statements consolidating all its subsidiaries during the period, the financial information will, subject to any adjustments considered necessary, be the information set out in those consolidated financial statements.

### **Unconsolidated financial statements**

9. There may be cases, particularly in the event of an acquisition, but also occasionally in connection with applications for listing, where the entities to be reported on have audited financial statements, but where consolidated financial statements do not exist. This may arise for example where there is an acquisition of a sub-group, the parent company of which was exempt from the requirement to prepare consolidated financial statements, or where there is an acquisition of companies under common ownership but which were not constituted as a legal sub-group.
10. Where there has been a legal sub-group, it will usually be appropriate for ease of analysis and comprehension for the financial statements of the subsidiaries to be consolidated into the financial statements of the parent company. For this purpose, specially prepared consolidated financial statements may be compiled by the relevant entity, subject to audit and reported upon. Such audited consolidated financial statements will then form the basis of the financial information. Alternatively, the financial information may be compiled directly based on the audited financial statements of the parent and subsidiary companies.

### **Entities under common management and control**

11. Where the entities have been under common management and control but have not formed a legal group throughout the track record period, the financial information will nevertheless be presented on a combined basis using the principles of merger accounting provided that the group reorganization under which the legal group is formed is completed before the date of approval of the financial information by the directors. Under this method, the results and net assets of the relevant entities are aggregated (with eliminations made for intercompany transactions and balances), as are the related share capitals and reserves. If the information is not presented on a combined or aggregated basis then separate financial information may be required.

### **Unincorporated entities and entities producing limited accounting information**

12. Financial information may occasionally be required to incorporate entities which do not prepare financial information which meets the standards required for statutory financial statements in Hong Kong. Businesses which operate as divisions of an entity may, for example, not be accounted for separately other than in certain key areas such as sales, direct costs and operating assets. Even where accounting information exists, the accounting

conventions adopted may be devised for internal management accounting purposes rather than to meet accounting standards. The preparation of special purpose financial statements by management of the entity representing the information in an appropriate format may in some cases provide a suitable basis for the financial information.

## **Presentation of historical financial information**

13. The directors would present the financial information on a consistent and comparable basis from period to period and would make such presentational changes as are necessary to the financial information to achieve this.
14. Presentational changes might be to:
  - a. present the historical financial information in a comparable way; and
  - b. give due prominence to matters of particular importance in the context of the investment circular in which the historical financial information is included.

## **Comparability**

15. The financial information contained in the entity's records may not have been presented on a comparable basis from period to period because the convention for presenting financial information adopted in earlier periods may have been different from that adopted in later periods (for example a business classed as a continuing operation in one year may have been designated a discontinued activity in financial statements drawn up for a later period).
16. The purpose for which the financial information is produced means that, if practicable, the financial information is presented in such a way that information which a user of the investment circular might wish to compare is in fact comparable. However, changes will not be made to the presentation adopted in the financial statements on which the financial information is based unless in the opinion of the directors such changes are consistent with the requirement to give a true and fair view for the purpose of the investment circular.
17. Where it is considered that the significance of certain items to an understanding of the financial information may be obscured by the presentation adopted in the financial statements, it is usually appropriate for the presentation to be changed, relevant disclosures to be made or relevant explanations to be introduced to highlight their significance. However, consequent changes in presentation would be inappropriate if they are in conflict with accounting standards unless it is necessary to invoke the true and fair override; in which case disclosure in accordance with the requirements of SSAP 1 should be made in the notes to the financial information giving the reason for such override.

## **Consistency of disclosure**

18. Where the basis of presentation in the entity's financial reporting has changed during the period to be reported on, presentational changes are made to bring the financial information onto a consistent basis. Presentational changes of this nature, which do not have an impact on net profits or net assets, may be categorized as follows:
  - a. reclassifications (for example, cost of sales reclassified as distribution costs);
  - b. re-analyzes (for example, restatements of analyzes between continuing and discontinued activities);

- c. grossing up of items netted off in earlier periods (for example, matched assets and liabilities previously left off balance sheet); and
- d. derivation or computation of information undisclosed in earlier periods (for example, income statement subtotals or cash flow statements).

### **Highlighting matters of particular importance**

- 19. It may be appropriate for certain of the financial information to be given greater prominence in the context of the investment circular than such information was accorded in the previously published financial statements. This approach may be adopted for example to highlight certain categories of expense, such as proprietors' remuneration, in the trading record of a company seeking flotation. It may also be adopted to highlight the results of different classes of business, particularly in cases where there are proposals that a class of business is to be discontinued.

### **Acquisitions**

- 20. In respect of a new listing, where the acquisition of a subsidiary (or business) during the period does not fundamentally affect the suitability for listing of the new applicant, in some circumstances, either the financial information may include details of the acquired company throughout the period or separate financial information may be required. Where the subsidiary (or business) is acquired, agreed to be acquired or proposed to be acquired after the end of the period but before the date of issue of the prospectus, paragraph 4.04 of the Listing Rules requires financial information to include its results in respect of each of the three financial years immediately preceding the issue of the listing document or, if shorter, in respect of each of the financial years since commencement of such business or incorporation. Such information will be provided either by way of disclosure in the financial information or by way of the preparation of separate financial information.

### **Disposals**

- 21. Disposals of subsidiaries or a discontinuation of a material section of the business are reflected by separate analysis between the continuing and the disposed or discontinued business under the relevant headings in the income statement or notes thereto. Accordingly, it is not appropriate to make adjustments to eliminate the results of subsidiaries that have been disposed of or discontinued operations.

### **Earnings per share**

- 22. In cases where there has been a capital reorganisation since the date at which the last balance sheet included in the financial information was drawn up, it will usually be appropriate for the earnings per share figures disclosed to be adjusted to reflect the reorganisation (to the extent that it involves issues of shares for no consideration, issues containing a bonus element, share splits etc). In such cases, the number of shares used in the earnings per share calculation will be adjusted so that the shares originally in issue are replaced by the number of new shares, representing the shares originally in issue, following the reorganisation. Where shares have been issued during the period, this would be taken into account in calculating the equivalent weighted average number of post-reorganization shares. Where the reconstruction involves conversions for example of preference shares or loan stock, the earnings figures used in the calculation of earnings per share may also need to be adjusted to eliminate the effect of any related preference dividends or interest.

## **Additional financial information**

23. It may be necessary, in certain cases, in order to meet the disclosure requirements of the Stock Exchange, for certain information which has not previously formed part of an entity's financial reporting information to be added to the existing disclosure. Examples are:
- a. information on earnings per share, which a company that is a new applicant for listing may not have published as a private company;
  - b. additional disclosure of directors' emoluments; and
  - c. segmental information.

## **Adjustments to the underlying financial statements**

24. Adjustments to the underlying financial statements are made by and are the responsibility of the directors. Except in the circumstances envisaged in paragraph 28 the directors would only make adjustments in respect of material items in order to:
- a. present the financial information for all years on the basis of consistent, acceptable and appropriately applied accounting policies (including GAAP adjustments); and
  - b. correct fundamental errors.
25. The historical financial information prepared for inclusion in an investment circular is a version of the historical record as presented by the issuer's management, reflecting their stewardship, and adjustments are only made by management to achieve those specific objectives set out above, which are discussed further below.
26. The historical financial information is intended to provide a record of the business as operated and accounted for by the issuer's management. Therefore, it is not appropriate for the directors to make adjustments to recognize notional items of income or expense.

### **Trend of results**

27. The historical financial information presents a trend of results for the period covered by an auditors' report. In this respect the historical financial information may be distinguished from the financial information contained in statutory financial statements. There may be rare cases where, notwithstanding the appropriateness of an accounting treatment for the purposes of statutory financial statements and the possibility of disclosure, it is necessary to make an adjustment in the historical financial information in order that a true and fair view, properly reflecting the trend in results, may be given by such financial information. Where this is the case, disclosure of the basis adopted is made within the historical financial information.
28. It is sometimes suggested that it is appropriate to introduce notional, or other, adjustments in order to make the "track record" more consistent with the issuer's expected operations or structure following the transaction. As such adjustments would anticipate future events it is inappropriate to reflect them in historical financial information.

### **Adjustments for change in basis of accounting**

29. Adjustments are made to ensure that, wherever practicable, the historical financial information is stated on the basis of the current accounting policies. The relevant date for determining which accounting policies are current will normally be the most recent year end

date. When, however, the issuer has disclosed that it intends to change an accounting policy, the historical financial information is usually prepared on the basis of the new policy. Where a company is seeking a new listing, it would be usual for the accounting policies to be critically re-examined by management.

30. Where a new Statement of Standard Accounting Practice has been introduced during or subsequent to the period to be reported on, consideration needs to be given to whether it is intended that the new accounting standard would be applied retroactively once adopted. Where adoption of a new accounting standard has led or will lead to the inclusion in the financial statements of a prior year adjustment, adjustments are made, to the extent practicable, to reflect the effect of the policy in earlier periods. Where there has been or will be no prior year adjustment, for example where the accounting standard is stated to apply to transactions first accounted for after a certain date, no such adjustment is made to the historical financial information unless (exceptionally) the considerations set out in paragraph 27 apply. Where an issuer intends or has chosen previously to adopt a new accounting standard early and this is permitted or encouraged, although not required, by that standard, the historical financial information reflects the same treatment as was adopted or is intended to be adopted by the issuer.
31. Although adjustments may be made for changes in accounting policies, adjustments are not normally made for changes in the methods of applying an accounting policy (whether a one-off change or a series of gradual refinements) or otherwise to correct the issuer's accounting estimates, provided that there were no fundamental errors. The effect of correcting an estimate in a later period is normally reflected in the result of that period. The directors consider whether separate disclosure of changes in the methods of applying accounting policies or the impact of a correction of an accounting estimate is necessary in the income statement tabulations. Consideration is also given to any additional disclosure which may be necessary in order to assist in an understanding of the trend of results.
32. Occasionally, an accounting policy may have been applied on the basis of considerations other than relevant economic ones (for example where financial statements measure the carrying amount of depreciable fixed assets in accordance with depreciation policies which are influenced by taxation considerations - as is the case in certain jurisdictions). The directors may determine that an adjustment is necessary in order for the historical financial information to give a true and fair view.

### **Audit qualifications**

33. Where the auditors' report(s) on the underlying financial statements were qualified on grounds for example of failure to comply with an applicable accounting standard or disagreement over an accounting treatment, it may be possible to make adjustments so as to avoid a similar qualification in the accountants' report.

### **Statement of adjustments**

34. The Listing Rules/GEM Rules are required to be amended to prescribe the following:  
The historical financial information is required to include a "statement of adjustments" as a note showing how the underlying financial statements have been adjusted by the directors, to arrive at the historical financial information for inclusion in an investment circular.

**ISSUED FOR COMMENTS BY 14 AUGUST 2004**

## **ACCOUNTING GUIDELINE**

### **2.212**

#### **PREPARATION OF PRO FORMA FINANCIAL INFORMATION FOR INCLUSION IN INVESTMENT CIRCULARS**

*(Issued [    ])*

*This Guideline sets out recommendations, intended to represent best practice, on the preparation of pro forma financial information for inclusion in investment circulars.*

*The provisions of this Guideline should be read in conjunction with the Preface to Hong Kong Financial Reporting Standards and need not be applied to immaterial items.*

*This Guideline is based on the Listing Rules/GEM Rules, the Takeover Code and the Companies Ordinance that were in effect as at 31 March 2004.*

### **Introduction**

1. The purpose of this Accounting Guideline is to provide guidance concerning the preparation and presentation of pro forma financial information for inclusion in investment circulars.
2. The definitions of some of the special terms used in this Accounting Guideline can be found in the “Definitions” section of HKSIR 100 “Investment circulars and reporting accountants”.
3. This Accounting Guideline does not cover pro forma financial information prepared for other purposes, for example, information in annual financial statements.
4. Listing Rules/GEM Rules require the presentation of pro forma financial information in the cases as specified in paragraph 6 below. The requirements for the contents of the pro forma financial information are set out in Listing Rule 4.29/GEM Rule 7.31. Where pro forma financial information is included in an investment circular, it is prepared and presented in accordance with this Accounting Guideline.
5. The purpose of the pro forma financial information is to provide investors with relevant information about the impact of the transaction by illustrating how that transaction might have affected the financial information presented in the investment circular, had the transaction been undertaken at an earlier date. This indicates how the transaction might affect the broad outline of the issuers’ financial performance or position at this earlier date. With such purpose in mind, the pro forma adjustments would need to meet the following criteria:
  - a. clearly shown and explained;
  - b. directly attributable to the transaction concerned and not relating to future events or



- decisions;
- c. factually supportable; and
- d. in respect of a pro forma profit or cash flow statement, clearly identified as to those adjustments which are expected to have a continuing effect on the issuer and those which are not.

## **Why pro forma financial information is presented**

6. A listing applicant or a listed issuer is required to present pro forma financial information in the cases of:
  - a. a major transaction, Listing Rules 14.67(4)(a)(ii) and 14.67(4)(b)(ii) and GEM Rules 19.67(4)(a)(ii) and 19.69(4)(b)(ii) require pro forma financial information of the enlarged group;
  - b. a reverse takeover or a very substantial acquisition, Listing Rules 14.69(4)(a)(i) and 14.69(4)(b)(ii) and GEM Rules 19.69(4)(a)(ii) and 19.69(4)(b)(ii) require pro forma information of the enlarged group;
  - c. a very substantial disposal, Listing Rules 14.68(2)(a)(ii) and 14.68(2)(b)(ii) and GEM Rules 19.68(2)(a)(ii) and 19.68(2)(b)(ii) require pro forma financial information of the remaining group; and
  - d. a new applicant which has acquired or proposed to acquire any businesses or companies, which would at the date of application or such later date of acquisition before listing of the applicant be classified as a major subsidiary, since the date to which the latest audited financial statements of the issuer have been made up, Listing Rule 4.28 and GEM Rule 7.30 require pro forma financial information in respect of the enlarged group.
  - e. an issuer some part of whose share capital is already listed, paragraph 31(3)(b) of Appendix 1B to the Listing Rules and paragraph 31(3)(b) of Appendix 1B to the GEM Rules require a pro forma statement combining the assets and liabilities and profits or losses for the latest financial years where the issuer acquires any company since the date of the last published audited financial statements of the group in respect of which an accountants' report has already been submitted to shareholders or which was itself during the last 12 months a listed issuer.
7. Other investment circulars may also contain pro forma financial information to illustrate the impact of a transaction. The following are examples:
  - a. For an issue of capital on an initial public offering or a subsequent rights issue, open offer or placing, the purpose of pro forma financial information is often to illustrate the possible increase in earnings per share and the reduction in gearing and interest costs that result from the application of the proceeds of the issue in repaying debt;

- b. Where a number of businesses are brought together prior to an initial public offering, the purpose of pro forma financial information may be to illustrate how selected aspects of performance might have been reported had the businesses been brought together at an earlier date;
  - c. On a repayment of capital through a scheme of arrangement or a share reorganization and repurchase, the purpose of pro forma financial information is generally to illustrate an increase in gearing or a reduction in cash balances; and
  - d. When a business is demerged, the purpose of pro forma financial information may be to illustrate the impact of the demerger on gearing or other balance sheet ratios.
8. Despite the prevalence of pro forma financial information in the circumstances described above, it is important that directors of listed issuers are aware of the possibility of not preparing such information, especially when to prepare it would, in their opinion, be misleading.

## **Nature of information**

9. Listing Rule 4.29(1)/GEM Rule 7.31(1) requires that the pro forma financial information must provide investors with information about the impact of the transaction the subject of the investment circular by illustrating how that transaction might have affected the financial information presented in the investment circular, had the transaction been undertaken at the commencement of the period being reported on or, in the case of a pro forma balance sheet or net asset statement, at the date reported on.
10. The pro forma financial information presented must not be misleading, must assist investors in analyzing future prospects of the issuer and must include all appropriate adjustments permitted by Listing Rule 4.29(6)/GEM Rule 7.31(6), of which the issuer is aware, necessary to give effect to the transaction as if the transaction had been undertaken at the commencement of the period being reported on or, in the case of a pro forma balance sheet or net asset statement, at the date reported on.
11. A listed issuer prepares pro forma financial information for inclusion in an investment circular relating to a transaction by:
- a. presenting financial information that is included elsewhere in the investment circular or that has been previously published; and
  - b. making adjustments to that information to illustrate how it might have been affected had the transaction covered by the investment circular occurred at an earlier date.
12. Listing Rule 4.29(6)/GEM Rule 7.31(6) makes it clear that pro forma financial information is the result of adjusting information about the issuer at a specific date or for a particular period. Even though adjustments can be based on information at a different date or for a different period or relate to subsequent very substantial acquisitions or major acquisitions, the result is still described as pro forma financial information at the date or for the period covered by the unadjusted source information about the issuer. In addition, the process of deriving pro forma

financial information is always characterized as one of adjusting information about the issuer. For example, even where several acquisitions are being reflected, the pro forma financial information is not the result of aggregating information about a number of businesses but of adjusting information about the issuer to reflect acquisitions.

### **Judging whether information is misleading**

13. Directors are responsible for presenting pro forma financial information that is not misleading. To enable them to judge whether pro forma financial information is misleading, directors of an issuer need to identify the purpose of that information. Paragraphs 24 and 25 discuss this fundamental precondition in further detail. In making their judgement, directors consider the pro forma financial information as a whole having regard to each of the following components of information:
  - a. the introductory narrative explaining the purpose and nature of the pro forma financial information;
  - b. the statements, formats and captions selected for presentation;
  - c. the unadjusted information about the issuer and whether it is audited or unaudited;
  - d. the adjustments;
  - e. the pro forma totals; and
  - f. the notes explaining sources of information, adjustments and the assumptions underlying the basis of preparation.
14. The requirement that pro forma financial information is not misleading does not imply that pro forma financial information can give a true picture of the effect of a transaction. Listing Rule 4.29(2) and GEM Rule 7.31(2) confirm this. Pro forma financial information does not purport to represent what the issuer's financial position or results would have been had the transaction occurred at the date assumed for the purpose of its preparation. Nor does it purport to show what the issuer's financial position or results will be once the transaction does occur. Pro forma financial information indicates instead how a transaction might affect the broad outline of the issuer's financial performance or position.
15. Historical financial information about financial performance and position is part of a range of information that investors use to consider the future prospects of an issuer. Pro forma financial information provides investors with illustrative information about the impact of proposed transactions on historical financial information and so may provide some assistance in their analysis of future prospects. In judging whether pro forma financial information is misleading, directors of an issuer would have regard, amongst other things, to the relevance of the information to any assessment of the issuer's future prospects. For example, they might consider whether it represents a suitable starting point for investors wishing to make adjustments to reflect possible post-transaction events and management actions.
16. Issuers would view the term "appropriate adjustments" in the paragraphs 9 and 10 above in the context of the purpose for which they prepare pro forma financial information. The

requirement to include all such adjustments emphasizes the need to avoid cherry-picking. In judging whether pro forma financial information may be misleading, directors would ensure that overall the adjustments are not materially biased or one-sided. For example, where the purpose of pro forma financial information is to show the potential effect of an acquisition on asset backing and profitability, it would be inappropriate to include fixed assets in a net asset statement at their fair values without reflecting depreciation charges based on those values in any pro forma income statement information. Similarly, it would be inappropriate to illustrate an identified cost saving without reflecting a potential related cost increase or revenue reduction. For example, where the proceeds of a share issue will be used to fund a debt repayment and this leads to a pro forma adjustment to reduce interest expense, the issuer would also reflect any related increase in its tax charge.

17. Issuers are required to include all appropriate adjustments of which they are aware. In satisfying this requirement, directors are not generally expected to make additional enquiries for the specific purpose of preparing the pro forma financial information. Consequently, pro forma financial information needs only reflect adjustments of which the directors are aware as a result of satisfying both the demands of the Listing Rules/GEM Rules in respect of other information in the investment circular and their continuing obligations to disclose information likely to influence the decisions of investors. For example, it would be unusual to commission an asset valuation in the context of an acquisition solely in order to assist in applying SSAP 30 “Business combinations” when preparing pro forma financial information. If any related fair value adjustment was likely to be material, it should have been brought to the attention of investors elsewhere in the document.
18. The reference to all appropriate adjustments would also be read on the basis that the concept of materiality applies to the process of preparing pro forma financial information. Therefore, issuers need only reflect those adjustments which are likely to influence the decisions of investors. Indeed, by making adjustments for immaterial items, directors may give a false impression of the precision and reliability of the resulting pro forma financial information and detract from disclosures they make under paragraph 21 below about the nature and limitations of the information. Nevertheless, issuers would bear in mind that the materiality of an item is determined not only by its size but also by the qualitative factors of its nature and circumstances.

### **Articulation**

19. Pro forma financial information is intended to give effect to a transaction as if the issuer had undertaken the transaction at the commencement of the period being reported on or, in the case of a pro forma balance sheet or net asset statement, at the date being reported on. These requirements mean that where pro forma financial information is presented both for a period and at a date it will not “articulate” in the way described in Statement 2.01 “Framework for the preparation and presentation of financial statements”. Financial statements exhibit articulation when different primary statements, such as the balance sheet and income statement, reflect different aspects of the same transaction. Because of the requirements of paragraphs 9 and 10 above, this is not true of pro forma financial information.
20. As a consequence of this lack of articulation, a pro forma balance sheet or net asset statement does not reflect the cumulative impact of pro forma income statement adjustments. By way of example, it is appropriate to assume for pro forma income statement purposes that the

proceeds of a share issue are received at the beginning of the period. The proceeds might then be applied to the repayment of debt so that interest costs are reduced. However, a pro forma balance sheet at the end of the period will not reflect the benefits of reduced interest costs since, in preparing the pro forma balance sheet, the issuer assumes that it only receives the proceeds at the balance sheet date. Nevertheless, where there is disclosure of the differing assumptions that underlie pro forma financial information, lack of articulation does not make such information misleading.

## **Presentation of information**

### **Purpose and nature of information**

21. Listing Rule 4.29(2)/GEM Rule 7.31(2) requires that the pro forma financial information must clearly state:
  - a. the purpose for which it has been prepared;
  - b. that it is prepared for illustrative purposes only; and
  - c. that because of its nature, it may not give a true picture of the issuer's financial position or results.
22. The three disclosures required by the preceding paragraph caution readers of pro forma financial information about the value of the information and the use to which it would be put.
23. Users of pro forma financial information cannot generally expect it to show a true picture of the issuer's financial position or results. Reasons for this include the following:
  - a. the actual transaction will take place at a date later than that at which it is included in the pro forma financial information and so subsequent trading and changes in the mix of assets and liabilities will not be reflected; and
  - b. if the issuer had undertaken a transaction at the beginning of the period, as is assumed for pro forma profit and cash flow purposes, then it might have taken different commercial decisions during the subsequent period. Such hypothetical decisions cannot be reflected in pro forma financial information or objectively determined for disclosure elsewhere in the investment circular.

### ***Identifying the purpose of the information***

24. Disclosure of the purpose for which pro forma financial information is prepared is fundamental to its presentation. The generic purpose of pro forma financial information is to illustrate the effects of one or more transactions on certain unadjusted financial information or aspects of that information. It would therefore clearly identify the specific transactions and unadjusted financial information involved. As well as identifying the purpose of pro forma financial information in overall terms, for example to illustrate the effects of a share issue, directors would also make more specific references, for example to the effects on gearing and interest cover. Unless the directors of the issuer identify a specific purpose, it will not be

apparent to investors why they have selected particular pro forma statements for presentation and why they have highlighted particular captions within those statements.

25. In principle, where historical financial information that gives a true and fair view is available for an issuer, the directors of the issuer could choose to illustrate the effect of a transaction on all that information. However, it would be highly unusual for directors to prepare complete pro forma financial information comprising a balance sheet, income statement, statement of changes in equity, cash flow statement and supporting notes. This is because their purpose in presenting pro forma financial information rarely requires the presentation of more than the analysis of assets and liabilities shown on the face of the balance sheet, a summarised income statement and earnings per share. The provision of additional pro forma financial information could actually frustrate the purpose of the information and give a false impression of its reliability. Directors would nonetheless consider whether the provision of additional pro forma financial information would serve a useful purpose and whether the selection of specific items for presentation could itself be misleading.

### **Format, accounting policies and prominence of information**

26. Listing Rule 4.29(3)/GEM Rule 7.31(3) requires that the pro forma financial information must be presented in columnar form showing separately the unadjusted financial information, the pro forma adjustments and the pro forma financial information. The pro forma financial information is prepared in a manner consistent with both the format and accounting policies adopted by the issuer in its financial statements and must identify :
- a. the basis upon which it is prepared; and
  - b. the source of each item of information and adjustment.

Pro forma figures must be given no greater prominence in the investment circular than the historical financial information reported on by the reporting accountants.

#### ***Format***

27. An issuer would present pro forma financial information in columnar format. The first column shows unadjusted financial information for the issuer on which the effect of one or more transactions is illustrated. Subsequent columns would reflect adjustments for the effect of the transaction or transactions which are the subject of the investment circular. The issuer may aggregate adjustments to simplify the presentation so long as there is sufficient note disclosure to explain clearly the components of each column and, where more than one transaction is involved, the separate effects of each transaction. The final column displays the resultant adjusted amounts.

#### ***Accounting policies***

28. Paragraph 26 requires pro forma financial information to be presented in a manner consistent with both the format and accounting policies adopted by the issuer in its financial statements. This does not preclude simplification of the presentation where such simplification assists in a clear reading of the pro forma financial information and is consistent with the specific purpose of the pro forma financial information. In quantifying adjustments, the issuer would

apply accounting policies on the same basis as the issuer would normally adopt in preparing its annual financial statements. However, the format and purpose of the pro forma financial information are likely to constrain the extent of the related disclosures.

*Application of acquirer's policies on an acquisition*

29. The requirement to apply the issuer's accounting policies in preparing pro forma financial information applies to adjustments made in respect of an acquisition target. This requirement will not normally cause any difficulties. Where there is an accountants' report on an acquisition target in a very substantial acquisition or a major acquisition, this will be prepared in accordance with the issuer's accounting policies.
30. Difficulties in presenting pro forma financial information are more likely to arise in contested bids when the directors of a proposed acquisition, which is itself normally listed, choose not to recommend the issuer's offer to its shareholders. It will usually be difficult for an issuer with limited knowledge of how the target applies its accounting policies to be satisfied that a reconciliation reflects all material adjustments and that any resulting pro forma financial information is not misleading. In these circumstances, the issuer would consider not to present the pro forma financial information. However, if the presentation of pro forma financial information is required by the Listing Rules/GEM Rules as mentioned in paragraph 6 above, the issuer will need to consult the Stock Exchange.

*New accounting standards*

31. In general, pro forma financial information is prepared in accordance with the policies adopted in the unadjusted financial information of the issuer at the relevant date or for the relevant period even where new accounting standards will apply subsequently. It is never appropriate for adjustments in pro forma financial information to reflect the retrospective impact of new financial reporting standards on previously published financial information. Nevertheless, when adoption of a new standard will not result in restatement of such unadjusted financial information and the new standard will need to be applied to the transaction that is the subject of the pro forma financial information, issuers may calculate adjustments on the basis of the new standard. An issuer would make appropriate disclosure where it accounts for a transaction in pro forma financial information on a different basis from that which a new standard will require it to apply in its subsequent financial statements.

*Acquisition accounting*

32. It is essential that the directors of the issuer determine the accounting treatment adopted for any proposed business combination and that they disclose the treatment adopted in the notes to the pro forma financial information. Where acquisition accounting rather than merger accounting is to be adopted, such disclosure would also include the basis on which the pro forma financial information deals with goodwill.
33. Where the application of acquisition accounting results in the recognition of fair value adjustments and goodwill in a pro forma net asset statement or balance sheet, there will also be consequences for any pro forma income statement or earnings information that the issuer presents. The adjustments in respect of the acquisition are shown after allowing for the impact on depreciation or amortisation charges. Issuers would also disclose the relevant depreciation

or amortisation policies and estimated economic lives.

***Prominence***

34. The requirement that pro forma figures must be given no greater prominence in the investment circular than the historical financial information reported on by the reporting accountants does not affect the preparation or presentation of the pro forma financial information itself. Its relevance is in ensuring that the pro forma financial information does not overshadow the actual historical financial information elsewhere in the investment circular. This is likely to be of particular relevance in considering the relative prominence of information presented in financial highlights and summaries extracted from sections of an investment circular dealing with pro forma and historical financial information.

**Reporting period or date**

35. Listing Rule 4.29(4)/GEM Rule 7.31(4) requires that pro forma financial information may only be published in respect of:
- a. the current financial period;
  - b. the most recently completed financial period; and/or
  - c. the most recent interim period for which relevant unadjusted information has been or will be published or is being published in the same investment circular.

and, in the case of a pro forma balance sheet or net asset statement, as at the date on which such periods end or ended.

36. In interpreting the preceding paragraph, a financial period is only regarded as completed when financial information for that period has been published.
37. The selection of the periods or dates used for presenting pro forma financial information depends on the situation under consideration and the specific purpose of the information. Requirements set out in paragraph 35 allow the presentation of pro forma financial information for more than one period or at more than one date. For example, an issuer could present pro forma financial information for the last completed period and the most recent interim period. In practice, however, it will be difficult to envisage situations where the presentation of pro forma net asset statements or balance sheets at more than one date will serve a useful purpose. The prohibition on presenting pro forma financial information for more than one completed period also prevents issuers from presenting a three year record on a pro forma basis as this may frustrate the purpose of the pro forma financial information and give a false impression of its precision and reliability.

***Subsequent events***

38. The period or the date of the unadjusted information relating to the issuer determines the period or date in respect of which pro forma financial information is published. This is true even where an issuer makes adjustments in respect of information drawn up for other periods or at other dates and subsequent transactions that are the subject of the investment circular



itself. As a general principle, no other adjustments are made in respect of subsequent events. Unless a subsequent event qualifies as an adjusting event under SSAP 9 “Events after the balance sheet date” and is reflected in the unadjusted financial information of the issuer or an acquisition target, it is not be reflected in pro forma financial information.

39. If the directors of the issuer believe that pro forma financial information is misleading because it does not reflect significant non-adjusting post balance sheet events, they would need to consider whether disclosing the events in the notes to the pro forma financial information would prevent the information from being misleading. They would not expect to be able to make adjustments to the pro forma financial information itself to reflect such subsequent events, a practice that might raise concerns about cherry-picking. Nevertheless, as discussed further in paragraph 71 below, exceptions may be permitted to ensure that the pro forma financial information is not misleading, by allowing adjustments for transactions or capital issues that have been the subject of announcements or circulars under the Listing Rules/GEM Rules.
40. It is recommended practice to draw attention to the approach taken with regard to subsequent events by making a disclosure in the notes to pro forma financial information to the effect that it does not take account of any trading or other transactions subsequent to the date of the financial statements included in the pro forma financial information.

#### *Acquisitions and accounting periods*

41. Where pro forma profit and loss or cash flow information is presented for two or more entities or businesses, such as may be the case in a very substantial acquisition or a major acquisition, the unadjusted information about the issuer and the adjustments in respect of the other entity or entities would cover periods of the same length.
42. Whilst desirable, it is not normally necessary to use coterminous accounting periods when preparing pro forma profit and loss or cash flow information for two or more entities or businesses. For example, an issuer may be preparing a pro forma income statement based on its latest 31 December year end results for inclusion in a circular for a very substantial acquisition or a major acquisition. If 12 month income statement information is only available for the business to be acquired up to the preceding 30 June, that information could generally be used for the purpose of making an adjustment to derive a pro forma income statement.
43. Even where businesses are seasonal, the use of non-coterminous accounting periods would not usually distort pro forma profit and loss and cash flow information so long as all the information covers a complete year. Nevertheless, where pro forma interim information is presented and seasonal factors are significant, co-terminus accounting periods may be required to prevent the information from being misleading.
44. Non-coterminous accounting periods may also be of concern when preparing pro forma net asset statements or balance sheets. An issuer needs to consider any significant seasonal variations. In the situation of a very substantial acquisition or a major acquisition it might not be appropriate to make adjustments to an acquirer’s 31 December information using 30 June information for the acquired business if it is known that seasonal factors would make the financial position of the acquired business significantly different at 31 December.

### **Source of the unadjusted information**

45. Listing Rule 4.29(5)/GEM Rule 7.31(5) requires that the unadjusted information would be derived from the most recent:
- a. audited published financial statements, published interim reports or published interim or annual results announcements;
  - b. accountants' report;
  - c. previously published pro forma financial information reported on in accordance with Listing Rule 4.29(7)/GEM Rule 7.31(7); or
  - d. published profit forecast or estimate.
46. This requirement would be read in conjunction with the guidance in paragraph 38. It does not require the issuer to use information from the most recent source amongst those listed in the preceding paragraph but it does require the most recent information to be used once the issuer has chosen one or more of the options set out in the preceding paragraph . For example, an issuer may be allowed to present pro forma profit and loss and cash flow information based on the most recent audited published financial statements even if the more recent interim financial statements have been published. This would be possible where the presentation of pro forma financial information for a full year would better serve the stated purpose of the pro forma financial information.

### **Adjustments**

47. Listing Rule 4.29(6)/GEM Rule 7.31(6) requires that any adjustments which are made to the unadjusted information referred to in Listing Rule 4.29(5)/ GEM Rule 7.31(5) in relation to any pro forma financial information must be:
- a. clearly shown and explained;
  - b. directly attributable to the transaction concerned and not relating to future events or decisions;
  - c. factually supportable; and
  - d. in respect of a pro forma profit or cash flow statement, clearly identified as to those adjustments which are expected to have a continuing effect on the issuer and those which are not.
48. It is important that issuers clearly show and explain adjustments so that investors can understand those adjustments. With this objective of transparency in mind, issuers would include notes to the pro forma financial information that set out:
- a. any assumptions on which the adjustments are based;

- b. the range of possible outcomes where there is significant uncertainty;
  - c. the sources of the amounts concerned;
  - d. where relevant, how adjustments have been aggregated or allocated to financial statement captions; and
  - e. where relevant, the fact that certain adjustments, such as fair value adjustments, would not be included in the subsequent interim or annual financial statements.
49. The purpose of the requirement that adjustments are directly attributable to the transaction concerned is to prevent pro forma financial information reflecting matters that are not an integral part of the transaction which is the subject of the investment circular. In particular, pro forma financial information would not include adjustments which are dependent on actions to be taken once the transaction has been completed, even where such actions are central to the issuer's purpose in entering into the transaction, e.g. eliminating duplicate facilities after an acquisition.
50. In order to provide assurance as to the reliability of pro forma financial information, adjustments must be supported by facts. The nature of the facts supporting an adjustment will vary according to the circumstances. Nevertheless, facts are expected to be capable of some reasonable degree of objective determination. Support might typically be provided by audited financial statements, other financial information and valuations contained in the investment circular, purchase and sale agreements and other agreements integral to the transaction covered by the investment circular.
51. Directors of an issuer may be aware of the need to make an adjustment whilst lacking the appropriate factual support to satisfy paragraph 47. In these circumstances, they would bear in mind the stated purpose of the related pro forma financial information and consider whether disclosing the omission of the adjustment will be sufficient to prevent the pro forma financial information from being misleading. Where disclosure will not suffice, the directors would either make further efforts to obtain appropriate support or reconsider whether the proposed purpose of the pro forma financial information is realistic. Preparers of pro forma financial information would not lose sight of the fact that they are not obliged to publish pro forma financial information except in the case of a very substantial acquisition or a major acquisition. This is particularly important where pro forma financial information may be misleading for reasons that are beyond the control of the preparer. As in other areas of financial reporting, there is sometimes a trade-off between the relevance and reliability of financial information. This may mean that an issuer does not report information that may be relevant because it is not sufficiently reliable.

### **Continuing effects**

52. In respect of pro forma profit or cash flow statements, paragraph 47(d) requires issuers to identify clearly those adjustments which are expected to have a continuing effect on the issuer and those which are not. An issuer is not permitted either:
- a. to omit adjustments that are directly attributable to a transaction and factually supportable on the grounds that they do not have a continuing effect; or

- b. to make adjustments to eliminate items solely on the grounds that they are considered not to have a continuing effect.
53. Ultimately, it is the responsibility of investors to make their own individual assessments of future earnings and cash flows. Consequently, it is recommended that an issuer interprets the requirement of paragraph 47(d) in line with the requirements of SSAP 33 “Discontinuing operations” and SSAP 15 “Cash flow statements” which cover appropriate disclosure of the results of continuing and discontinuing operations and items of income and expense from ordinary activities that are of such size, nature or incidence. Items attributed to discontinuing operations will not have a continuing effect and items identified as items of income and expense from ordinary activities that are of such size, nature or incidence will generally be presumed not to have such an effect.
54. The following paragraphs describe the application of paragraph 48 to a number of items that are frequently considered for adjustment in pro forma financial information.

### **Tax and similar effects**

55. The directors of an issuer would consider the tax effects of adjustments directly attributable to a transaction, along with other non-discretionary effects, such as any material impact on profit-related bonuses. In quantifying tax effects, directors would look at the incremental impact on tax liabilities and assets using the issuer’s accounting policies for taxation rather than simply applying the issuer’s overall effective tax rate.

### **Transaction costs**

56. An adjustment is made for costs directly attributable to a transaction that do not relate to future events or decisions and are factually supportable. Written estimates from advisers that are disclosed in total elsewhere in an investment circular will normally provide sufficient factual support.

### **Debt repayment**

57. The transaction that is the subject of an investment circular is frequently an issue of securities that will be used to repay debt. The directors of the issuer generally wish to present pro forma financial information to illustrate the potential effect of such transactions on gearing, interest cover and earnings. Two questions that commonly arise in determining the relevant adjustments are:
- a. how to allocate the proceeds of the issue to the repayment of different debt instruments when insufficient funds will be raised to repay all debt; and conversely
  - b. how to treat any excess of the amount raised over the debt shown in the unadjusted financial information of the issuer.
58. In addressing the first question, proceeds of the issue are allocated to the repayment of debt instruments on the basis of commitments stated in the investment circular or legal agreements existing at the date of the investment circular which specify how the issuer will apply the proceeds. In rare circumstances where there are no stated commitments or legal agreements,

the repayment of debt would not be directly attributable to the transaction that is the subject of the investment circular. It would relate instead to future events or decisions and no consequential adjustment would be made to reduce debt balances or interest costs in the pro forma financial information.

59. Where the proceeds of an issue result in an increase in cash balances in a pro forma net asset statement or balance sheet, it is normally inappropriate to make an adjustment to pro forma income statement or earnings information to effect interest or other income that cash balances might generate. This is because where management has discretion over how to use positive cash balances, any adjustment for interest or other income on those balances would not satisfy the requirement of paragraph 47 that it be factually supportable and unrelated to future events or decisions. Exceptions would only arise where an issuer was committed to invest funds in a particular way which meant that it could demonstrate that income would be earned and could quantify it. This could arise, for example, where a financial institution is raising funds to meet capital adequacy requirements. The directors of the issuer would draw investors' attention to the pro forma income statement treatment of issue proceeds where they consider it to be of particular significance in helping investors understand the issuer's prospects.

### **Fair value adjustments**

60. An issuer entering into a transaction accounted for as an acquisition will need, as a direct consequence of the transaction, to ascertain the fair values of the underlying assets and liabilities of the acquired business in accordance with SSAP 30 "Business combination". The principles on which SSAP 30 is based essentially preclude making fair value adjustments that depend on future events or decisions. However, the extent of factual support for potential fair value adjustments will often be a key issue in determining whether an issuer can reflect them in pro forma financial information. Factual support may be provided through formal valuations which the directors commission or carry out either for commercial purposes or to satisfy Stock Exchange requirements in respect of the investment circular.
61. To ensure that pro forma financial information is not misleading, directors would weigh the following factors when considering whether they need to record fair value adjustments:
- a. the nature of the acquisition and its commercial justification (e.g. there is an expectation that asset-based deals would be more likely to require fair value adjustments than those involving significant amounts of goodwill);
  - b. the extent to which uncertainties regarding fair values are commercially addressed through warranties, indemnities or adjustments to the purchase consideration (e.g. the fair valuation of environmental liabilities or pension surpluses might not be significant for a pro forma net asset statement if any fair value adjustments are compensated by changes in the consideration paid by the issuer);
  - c. the stated purpose of the pro forma financial information and the consequential significance of any misallocation of the purchase consideration between, on the one hand, assets and liabilities that would be subject to a fair valuation exercise and, on the other hand, goodwill;
  - d. the likely materiality of fair value adjustments based upon the issuer's investment

appraisal and acquisition due diligence; and

- e. any other matters elsewhere in the investment circular that have been brought to the attention of investors and which indicate that a fair value adjustment might be material.

62. Where directors judge that fair value adjustments are unlikely to be material in the context of the stated purpose of pro forma financial information, such adjustments are not necessary. For example, where a pro forma net asset statement is intended to illustrate the impact of an acquisition on gearing, as opposed to tangible net assets per share, then any misallocation of the purchase consideration between goodwill and a fair value adjustment on properties is unlikely to be significant. In such a case, the directors would make appropriate disclosure in the notes to the pro forma financial information. In other circumstances, directors may need to record fair value adjustments, supported, as appropriate, by note disclosure of their provisional nature and any related uncertainties and contingencies. Where initial estimates are subject to significant subsequent changes, directors will need to ensure that they make appropriate disclosure to investors.

### **Businesses being sold**

63. Information about a business to be disposed of is generally considered to be factually supportable in so far as it is comprised of amounts which have been incorporated in the historical financial information previously published by the issuer. For example, where an issuer presents pro forma interim financial information, it is allowed to make adjustments based on interim financial statements of the business to be disposed of, notwithstanding that these amounts will not have been separately disclosed in the disposal circular or separately published elsewhere.

### **Foreign currency translation**

64. It may be necessary to translate adjustments into the reporting currency of the issuer. For a pro forma net asset statement or balance sheet, the rate applied would usually be the rate ruling at the date of the issuer's unadjusted balance sheet. For a pro forma income statement or cash flow statement, the rate applied would be the average rate for the relevant period which would normally be calculated on the basis used by the issuer in preparing its information for the relevant period.

### **Consideration in cash or shares**

65. It may be necessary to make an assumption where there is a choice as to the form in which consideration is received or paid. For example, in a public takeover, it may not be possible to determine in advance the extent to which a mixed cash and shares offer would be taken up in cash or shares. Consequently, an issuer will need to make an assumption as to the mix and state that assumption clearly. Any assumption that is made would be determined by the issuer in conjunction with its financial advisers and would need to represent an appropriate basis, given the stated purpose of the pro forma financial information. In some circumstances, it may be necessary to present an extension to the pro forma financial information to illustrate the effect of a different mix of consideration. This may be done either in a columnar presentation or in a note.

### **Contingent consideration**

66. To the extent that consideration is payable or receivable in the future and is dependent on the outcome of future events, the issuer needs to make an appropriate assumption as to the most likely amount to be paid. This does not violate the paragraph 47(b)'s prohibition on making adjustments relating to future events. The need to make a best estimate of the amount of contingent consideration that is payable or receivable is a direct consequence of an acquisition or disposal. The relevant future events determine how accurate such an accounting estimate turns out to be but do not determine whether an estimate needs to be made. Where initial estimates are subject to significant subsequent changes, directors will need to ensure that appropriate disclosure is made to investors.
67. It may appear prudent to assume that the maximum amount payable under an acquisition agreement will be paid or that the minimum amount receivable under a sale agreement will be received. However, the overriding requirement is to make an appropriate estimate, given the stated purpose of the pro forma financial information. In circumstances where the impact of paying or receiving additional consideration could be significant, it may be necessary to present an extension to the pro forma financial information illustrating the potential impact of such additional consideration. This may be done either in a columnar presentation or in a note. It is recommended that the notes to a pro forma net asset statement summarize the terms on which additional consideration is computed and any cap on that consideration.

### **Synergy benefits**

68. It is often the case that acquisitions are justified in terms of the synergies to be obtained from bringing two businesses together, either through savings in costs or through enhanced cross-selling of products and services. Pro forma financial information provides a common basis that investors can adjust to allow for estimated synergy benefits and other post-transaction events. It is not, however, to be seen as indicating the issuer's post-transaction performance or financial position.
69. Synergies are normally dependent on the future actions of the management of the enlarged group after completion of the transaction. Consequently, synergies would not be the subject of adjustments made in deriving pro forma financial information, although it may be appropriate to indicate opportunities for synergy benefits elsewhere in the investment circular.

### **Cost and revenue eliminations**

70. When considering an initial public offering or the bringing together of two or more businesses on an acquisition, it is sometimes possible to identify past costs or revenues that will not occur in future financial periods under the terms of the transaction. For example, levels of remuneration paid prior to an acquisition or initial offering can be inconsistent with agreements entered into at the time of such transactions. Whilst it may be reasonable to consider eliminating such costs as an adjustment in a pro forma income statement, they will often need to be offset against increases in other costs which the issuer will incur that are not capable of being factually supported. In such circumstances, issuers would disclose past costs or revenues which will not occur in future as separate line items instead of eliminating them through pro forma adjustments.

### **Reflecting other small transactions**

71. Issuers may wish to make adjustments to reflect other transactions which have taken place since the latest balance sheet date but which are not the subject of the investment circulars within which the pro forma financial information is presented. As explained in paragraph 39, as a matter of general principle, issuers do not make adjustments for such transactions. Nevertheless, it will permit adjustments for other transactions or issues of capital that have led to announcements or circulars under the Listing Rules/GEM Rules where this is necessary to ensure that pro forma financial information is not misleading. The requirement that the resulting pro forma financial information is not misleading precludes cherry-picking transactions for which adjustments are made.

### **Earnings per share**

72. Where pro forma earnings per share information is given for a transaction which includes the issue of securities, the calculation is based on the weighted average number of shares outstanding during the period, adjusted as if that issue had taken place at the beginning of the period.
73. A note is required to disclose the basis of calculation of pro forma earnings per share information. In particular, the note sets out the amount of the earnings and the number of equity shares used in the calculation. As a consequence, it will also be necessary to present sufficient pro forma income statement information to show the derivation of pro forma earnings.
74. Where the proceeds of an issue are applied to the repayment of debt but the proceeds exceed the debt outstanding for all or part of the period for which pro forma earnings per share is calculated, it is generally not appropriate to take account of interest which might have been earned on the excess. The reasons are the same as those given above in paragraph 59. The directors of the issuer explain this aspect of the calculation of pro forma earnings per share in the notes to the pro forma financial information where they believe that it is of particular significance in helping investors understand the issuer's prospects.

\*\*\*\*\*