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[online version](http://www.charltonslaw.com/hong-kong-stock-exchange-publishes-guidance-letter-on-the-accounting-and-disclosure-requirements-for-acquisitions-of-subsidiaries-and-businesses-conducted-during-or-after-the-trading-record-period/)

# Hong Kong Stock Exchange Publishes Guidance Letter On The Accounting And Disclosure Requirements For Acquisitions Of Subsidiaries And Businesses Conducted During Or After The Trading Record Period

The Stock Exchange of Hong Kong (**Exchange**) published on 28 March 2012 a guidance letter (HKEx-GL32-12) on the accounting and disclosure requirements for subsidiaries and businesses acquired or agreed/proposed to be acquired by a new listing applicant during or after the trading record period. The guidance letter provides guidance and clarification on the following areas:

1. The scope of the requirement under (i) Main Board Rules 4.04(2) and 4.04(4) (GEM Rules 7.03(2) and 7.03(4)) (**Rules 4.04(2) and (4)**) and (ii) Main Board Rule 4.05A (GEM Rule 7.04A) (**Rule 4.05A**) (collectively the **Relevant Rules**);
2. The size test requirements under the Relevant Rules;
3. The interpretation of “agreed to be acquired or proposed to be acquired” under Rules 4.04(2) and (4);
4. The accounting and disclosure requirements under the Relevant Rules; and
5. The relevant conditions and factors that the Exchange will take into account when considering granting waivers of the Relevant Rules.

The following provides a summary of the guidance letter.

## Relevant Requirements

### Rules 4.04 (2) and (4)

Pursuant to Main Board Rules 4.04(2) and (4), a new listing applicant is required to disclose in its accountants’ report the results and balance sheet of any subsidiary or business acquired, agreed to be acquired or proposed to be acquired since the date to which the applicant’s latest audited accounts have been made up. The results and balance sheet of any such subsidiary or business must be included in respect of each of the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document, or for each of the financial years from the incorporation of such subsidiary or the commencement of such business if this occurred less than three years (two years for GEM applicants) prior to the issue of the listing document (or such shorter period as may be acceptable to the Exchange for Main Board applicants).

### Rule 4.05(A)

Pursuant to Main Board Rule 4.05(A) (GEM Rule 7.04A), if a new applicant acquires a material subsidiary or business during the trading record period and such an acquisition, if made by a listed issuer would have been classified at the date of application as a major transaction or a very substantial acquisition, it must disclose pre-acquisition financial information on that material subsidiary or business from the commencement of the trading record period (or if the material subsidiary or business commenced its business after the commencement of the trading record period, then from the date of the commencing of its business) to the date of acquisition. Pre-acquisition financial information on the material subsidiary or business must normally be drawn up in conformity with the accounting policies adopted by the new listing applicant and be disclosed in the form of a note to the accountants’ report or in a separate accountants’ report.

## Scope of Requirements

### Rules 4.04(2) and (4)

The accounting and disclosure requirements apply to any subsidiary and business acquired, agreed to be acquired or proposed to be acquired after the trading record period.

### Rule 4.05A

The accounting and disclosure requirements apply to acquisitions of any material subsidiary or business during the trading record period where such acquisition would have been classified at the date of listing application of the new listing applicant as a major transaction or a very substantial acquisition.

### Relevant Rules

The Exchange’s guidance letter clarifies that:

1. acquisitions of business for the purpose of the Relevant Rules include acquisitions of associates and any equity interest in another company, but generally exclude acquisitions of assets; and
2. the trading record period under the Relevant Rules includes: (i) the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document; and (ii) the stub period reported on by the reporting accountants under Main Board Rule 8.06 (GEM Rule 11.11) so that the latest financial period reported on will not have ended more than 6 months before the date of the listing document.

## Size Test Requirements

### Rules 4.04(2) and (4)

There is no materiality threshold for Rules 4.04(2) and (4). The accounting and disclosure requirements apply to any subsidiary and business acquired, agreed to be acquired or proposed to be acquired after the trading record period, without regard to the size of such acquisition. Therefore, any such acquisition after the trading record period will trigger the obligation to disclose the financial information of the relevant subsidiary or business for the trading record period in the applicant’s listing document unless a waiver is granted by the Exchange.

### Rule 4.05A

Rule 4.05A provides that the total assets, profits, and revenue of the subsidiary or business being acquired for the most recent financial year of the trading record period should be compared to those of the applicant for the same financial year for the purpose of the size test. Unless a waiver is granted by the Exchange, Rule 4.05A will apply if the size of the subsidiary or business being acquired would have been classified at the date of the application to list as a major transaction or a very substantial acquisition (i.e. more than 25%) pursuant to Main Board Rules 14.06(3) and 14.06(5) respectively (GEM Rule 19.06(3) and 19.06(5) respectively).

The Exchange’s guidance letter gives the following example of the operation of the size test under Rule 4.05A:

An applicant’s trading record period covers year 1, year 2 and year 3 and it acquires a subsidiary during year 2. For the purpose of the size test, the total assets, profits and revenue of the subsidiary for year 3 should be compared to those of the applicant for year 3.

## Agreed to be Acquired/Proposed to be Acquired under Rules 4.04(2) & (4)

The Exchange clarifies that Rules 4.04(2) and (4) apply to a new listing applicant which has entered into a legally binding acquisition agreement after the trading record period, regardless of whether the acquisition will be completed upon listing. The rules will also apply to an applicant which intends to acquire a subsidiary or business, regardless of whether a legally binding agreement has been entered into. If the applicant enters into any legally binding agreement in respect of such potential acquisition after its listing on the Exchange, it must comply with the relevant Listing Rules including the disclosure and approval requirements under Chapters 14 and 14A of the Main Board Rules/ Chapters 19 and 20 of the GEM Rules.

The guidance letter also includes a reminder that a new listing applicant must observe the requirement under paragraph 32 of the Third Schedule to the Companies Ordinance to include an accountants’ report in the listing document on a business where any part of the listing proceeds is to be applied directly or indirectly for the purpose of purchasing of such business.

## Accounting and Disclosure Requirements

### The Relevant Rules

The Relevant Rules require that financial information on a relevant subsidiary or business must normally be drawn up in conformity with accounting policies adopted by the listing applicant. It may be disclosed in a note to the accountants’ report or in a separate accountants’ report.

### Rules 4.04(2) and (4)

The Exchange states in the guidance letter that the financial information disclosed under Rules 4.04(2) and (4) should preferably include full financial statements of the relevant subsidiary or business but at least the income statement and balance sheet (including information required by Main Board Rule 4.05 (GEM Rule 7.04)) in respect of:

1. each of the three financial years (two financial years for GEM applicants) immediately preceding the issue of the listing document or since the incorporation of such subsidiary/ the commencement of such business if this occurred less than three years (two years for GEM applicants) prior to such issue; and
2. any stub period.

### Rule 4.05A

The guidance letter provides that the pre-acquisition financial information disclosed under Rule 4.05A should include full financial statements (including information required by Main Board Rules 4.04 and 4.05 (GEM Rules 7.03 and 7.04)) of the relevant subsidiary or business for the period from the commencement of the trading record period (or since the incorporation of such subsidiary or the commencement of such business) to the date of acquisition.

## Waivers

### Rules 4.04(2) and (4)

As set out in Listing Decision HKEx-LD78-1, the Exchange may consider granting waivers of Rules 4.04(2) and (4) on a case-by-case basis. In that case, the Exchange granted a Main Board listing applicant a waiver from including in its accountants’ report three financial years’ results and balance sheets of three businesses acquired after the latest audited balance sheet date. In that particular case, a waiver was granted based on the following reasons and on condition that the waiver had to be disclosed in the prospectus:

1. unavailability of the three-year financial information of the businesses acquired due to genuine reasons because there difficulties in obtaining all necessary information from the previous owner and management;
2. the acquisitions were considered immaterial as the total consideration for the acquisitions was less than 1% of the listing applicant’s total market capitalisation and the total assets acquired were less than 1% of the listing applicant’s total assets; and
3. the listing applicant’s prospectus would provide alternative disclosure regarding the acquired businesses including (i) full addresses, net assets, gross floor area and trading volumes (for the last year of the track record period); and (ii) fair values of their identifiable principal assets and liabilities.

### Rule 4.05A

While the Exchange may consider granting waivers of Rule 4.05A on a case-by-case basis, it notes in the guidance letter that so far it has only granted waivers in limited exceptional cases based on the special circumstances of each case.

In listing decision HKEx-LD85-1, the Exchange granted to a secondary listing applicant a waiver from including pre-acquisition financial information in respect of a material subsidiary which was acquired during the relevant trading record period. The acquisition would have been a major transaction since it exceeded the revenue ratio of 25%.

The Exchange took into account the following factors when granting the waiver of Rule 4.05A:

1. it considered that the revenue test was inappropriate to determine the size of acquisition because the revenue ratio was not indicative of the importance of the acquisition due to the fact that the material subsidiary was engaged in a different line of business and the business of the secondary listing applicant was still under development with limited revenue; and
2. the secondary listing applicant was primarily listed on the Toronto Stock Exchange and the subject acquisition was not big enough to trigger the requirement to disclose pre-acquisition financial information in relation to the subsidiary on the acquisition under the rules of the Toronto Stock Exchange. The Exchange considered that it was acceptable for the listing applicant to follow the disclosure requirements of its primary regulator.

The guidance letter and the relevant listing decisions are available below:

[Guidance letter HKEx-GL32-12](gl32-12.pdf)

[Listing Decision HKEx-LD78-1](LD78-1.pdf)

[Listing Decision HKEx-LD85-1](LD85-1.pdf)

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