Hong Kong Monetary Authority 香港金融管理局

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The Chief Executive
All Licensed Banks

Dear Sir/Madam,

Best Practice Guide on Financial Disclosure by Authorised Institutions

Further to my letter of 30 August, we have finalised the Best Practice Guide on Financial Disclosure by Authorised Institutions which sets out minimum standards which the HKMA recommends authorised institutions to adopt in respect of information to be disclosed in their annual accounts for financial years ending on or after 31 December 1994. A copy of the Guide is attached. The recommendations are the same as those set out in Annex A of my letter of 30 August.

Whilst it is recognised that this Guide is not statutory, the HKMA expects authorised institutions to which this Guide is applicable to adopt the recommendations on a voluntary basis in drawing up their 1994 accounts.

The HKMA will further discuss with the Stock Exchange (SEHK) and the Securities and Futures Commission (SFC) the additional disclosures to be included in authorised institutions' 1995 accounts. These include items which the HKMA Working Party on Financial Disclosure recommended for implementation in the 1995 accounts and certain items originally recommended for disclosure in the 1994 accounts by the Working Party that have been deferred in response to institutions' request for more time to prepare for their disclosure. The broad scope of the items under consideration is set out in Annex B. We will be in touch with the industry Associations about this in due course.

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The HKMA will undertake a review in mid-1995 on the disclosure of balance inner reserves in the light of the experience of the additional disclosures in the 1994 accounts. The HKMA will discuss its findings with the banking industry and with the SEHK and SFC with a view to considering whether balance sheet inner reserves should be published in the 1995 accounts.

The Best Practice Guide should be self-explanatory but should you have any queries, please feel free to contact Raymond Li (878 1698) or Michelle Quek (878 1651).

Yours faithfully,

D T R Carse
Deputy Chief Executive (Banking)

c.c. The Chairman, HKAB
President, Hong Kong Society of Accountants
Securities & Futures Commission
(Attn : Mrs Laura M Cha)
The Stock Exchange of Hong Kong
(Attn : Mr Herbert Hui)

BEST PRACTICE GUIDE ON FINANCIAL DISCLOSURE BY AUTHORISED INSTITUTIONS

I. Introduction

1.1 This Best Practice Guide ("the Guide") is issued by the Hong Kong Monetary Authority (HKMA) to set out the minimum standards which the HKMA recommends authorised institutions to adopt in respect of information to be disclosed in their annual accounts for financial years ending on or after 31 December 1994.

1.2 The recommendations in this Guide are supplementary to and do not supplant any other disclosures required under relevant legislation, accounting standards, or which are necessary to show a true and fair view. Hence, in addition to the disclosures recommended in this Guide, authorised institutions will need to take account of the other existing disclosure requirements under the Companies Ordinance, the Stock Exchange Listing Rules, and the applicable Statements of Standard Accounting Practice where relevant.

II. Background

2.1 Banks and deposit-taking institutions play a significant and influential role in the efficient running of an economy and its monetary system. Most individuals and corporate bodies have an interest in such institutions either as depositors, borrowers or investors. There is considerable public interest in their well-being and in the adequacy of the financial information which institutions disclose in their published annual accounts i.e. whether such information sufficiently reflects the performance and financial strength of the institution during and at the end of the reporting period.

Present position

2.2 By virtue of an exemption from the disclosure requirements set out in the Tenth Schedule of the Companies Ordinance, banks incorporated in Hong Kong are permitted to disclose less information than other companies. In essence, the exemption means that :

(a) banks need only provide limited balance sheet information;

(b) banks do not need to provide a breakdown of income, operating expenses and charge for bad and doubtful debts in their profit and loss

account; and

(c) banks are able to maintain inner reserves and can make undisclosed transfers to or from them.

2.3 The exemptions do not apply to restricted licence banks (RLBs) and deposit-taking companies (DTCs). Nonetheless, the disclosure made by these companies is still modest relative to most other international financial centres.

2.4 The exemption under the Companies Ordinance was originally introduced in recognition of the special nature of banks. They are heavily reliant on external funding from customer deposits or interbank borrowing and their capital and earnings are vulnerable to fluctuations in asset values, creditworthiness of their borrowers, the business cycle and monetary conditions. The exposure of banks to such fluctuations means that they are vulnerable to a loss of confidence on the part of depositors. Banking problems can quickly spread, calling into question the stability of the system as a whole. This led to the view, in a number of countries including Hong Kong, that it was preferable for banks not to disclose full information about their performance and business so as to prevent bad news from causing a loss of confidence.

The need for change

2.5 The need to maintain the stability of the banking system should be given considerable weight in considering the appropriate extent of financial disclosure by banks. However, the Hong Kong banking system is now well-capitalised and profitable, and the supervisory regime has been strengthened. Moreover, the international trend is towards greater transparency and accountability, and the present level of disclosure by banks in Hong Kong is very limited. This could become counterproductive as it may lead to a lower than justified perception of authorised institutions in Hong Kong by depositors, counterparties, overseas regulators and rating agencies. This may affect their ability to conduct international business or to raise capital.

The new approach

2.6 The HKMA has been working closely with the banking industry since December 1993 to develop proposals to increase the scope of financial disclosure by authorised institutions in Hong Kong. A Working Party on Financial Disclosure

chaired by the HKMA and comprising representatives of authorised institutions formulated a set of recommendations which were embodied in a consultation paper issued in mid-May to the banking industry and the accounting profession.

2.7 The Stock Exchange of Hong Kong (SEHK), which has a locus in relation to listed banks, presented its own proposals for greater financial disclosure by listed banks in a discussion paper issued in March 1994 to the public.

2.8 Comments from the banking industry and the accounting profession reflected a general support for a common disclosure framework for both listed and non-listed authorised institutions. A joint technical working group comprising representatives from the HKMA, SEHK and the Securities and Futures Commission (SFC) developed by end August 1994 joint recommendations in respect of additional information to be disclosed in authorised institutions' 1994 accounts. The recommendations, which have been endorsed in principle by the Hong Kong Association of Banks, the Deposit-taking Companies Association and the Hong Kong Society of Accountants, are set out in section III below.

III. Recommendations of the Joint Technical Working Group

Profit and Loss Statement

3.1 An authorised institution should include the following information in the profit and loss statement or the notes to the financial statements. Institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Interest income
Interest expense
Other operating income
- Gains less losses arising from dealing in foreign currencies
- Gains less losses from other dealing activities
- Net fees and commission income (see paragraph 3)
- Dividend income (Analyse into listed and unlisted)
- Others

Operating expenses
- Staff costs
- Premises and equipment expense, excluding depreciation (Analyse where material)
- Depreciation charge
- Other operating expenses

Charge for bad and doubtful debts
Gains less losses from disposal of tangible fixed assets and long-term investments (Analyse where material)
Exceptional item (In accordance with HK SSAP 2)
Taxation charge
Extraordinary item (In accordance with HK SSAP 2)
As an appropriation :
Transfers to or from inner reserves
Transfers to or from reserves

3.2 In relation to the taxation charge, the basis on which the Hong Kong profits tax is computed should be disclosed.

3.3 In relation to the net fees and commission income, the gross figures should be disclosed where they are material and are necessary for the appreciation of the true extent of fee-based activities engaged in by the institution.

3.4 An authorised institution should disclose any material amount set aside to provisions other than those for depreciation, renewals or diminution in value of assets or any material amount withdrawn from such provisions and not applied for the purposes thereof.

Balance Sheet

3.5 An authorised institution should disclose the following information in the balance sheet or in the notes to the financial statements. Again, institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Assets
Cash and short-term funds
- Cash and balances with other banks and financial institutions
- Money at call and short notice
- Treasury bills (including Exchange Fund Bills)

Placements with banks and financial institutions maturing between one and twelve months
Trade bills (provisions should be shown if material)
Certificates of deposit
Securities held for dealing purposes (Analyse into listed and unlisted)
Advances and other accounts
- Advances to customers
- Advances to banks and financial institutions
- Accrued interest and other accounts (Analyse where material)
- Provisions for bad and doubtful debts (Analyse between those against advances to customers, advances to banks and financial institutions, accrued interest and other accounts if material)
  - general
  - specific

Investment securities (Analyse into listed and unlisted and disclose market values of listed securities)
Investments in associated companies
Tangible fixed assets (for each major class of assets including investment properties disclose the information as set out below)
- cost or valuation
- the additions, revaluations and disposals made during the period
- the amount provided or written off for depreciation or diminution in value of these assets during the period
- the accumulated depreciation, and
- the net book value

Liabilities
Deposits and balances of other banks and financial institutions
Current, fixed, savings and other deposits of customers
Certificates of deposits
Issued debt securities
Other accounts and provisions including inner reserves

Capital Resources
Loan capital (Types, coupon rates and maturities should be disclosed)
Minority interests
Share capital
Reserves (Analyse into the various material types of reserves including property and other revaluation reserves, where maintained)

3.6 The gross amount (before accumulated depreciation) of tangible fixed assets included in the financial statements should be analysed between those included

at cost and those included at valuation, if any. For those fixed assets that have been included at valuation, the years in which those assets were valued and the values should be disclosed and in the case of assets that have been valued during the financial period, the following should be disclosed:

the names of the persons who valued them and particulars of their qualifications for doing so, and
the bases of valuation used by such persons.

3.7 Of the premises (including investment properties) which are contained in tangible fixed assets how much is ascribable to those held freehold and those held on a lease (categorised into long lease, medium-term lease and short lease) should be disclosed. A distinction should also be made between those held on lease in Hong Kong and those held outside Hong Kong.

3.8 An institution should disclose details of the movements in reserves during the period, including the surplus or deficit on revaluation of properties.

Transactions with Group Companies

3.9 Where an authorised institution has entered into transactions with group companies, it should disclose the nature of the relationship and analyse the balances due to or from the various categories of group companies as at balance sheet date.

Principal Accounting Policies

3.10 The principal accounting policies adopted in determining the profit or loss for the period and in stating the financial position should be disclosed by way of note to the accounts.

Comparative Figures

3.11 The corresponding amounts for the immediately preceding financial year should be given for the above disclosures.

Terminology

3.12 Institutions should consider the guidance note on terminology at Annex

A in determining the classification of items within the disclosures contained in the Guide. Institutions should provide sufficient descriptions in their accounting policy notes or other notes on the accounts to enable the users of the financial statements to understand how material items have been dealt with.

Presentation and layout

3.13 The above recommendations present a broad framework of financial disclosure by authorised institutions. The precise method of presentation in the accounts and the layout is a matter for individual institutions to agree with their auditors.

IV. Implementation

Applicability

4.1 The recommendations in section III are intended to apply to all licensed banks and the larger RLBs and DTCs incorporated in Hong Kong in respect of the annual accounts for their financial years ending on or after 31 December 1994.

4.2 Larger RLBs and DTCs are defined for this purpose as those which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more (for further details see Annex B). The HKMA will contact individually those RLBs and DTCs which it considers fall within this category. To maintain consistency in reporting, RLBs and DTCs which adopt the disclosure recommendations in their 1994 accounts are expected to continue reporting on that basis notwithstanding that they may fall below the exemption thresholds in subsequent financial years. The HKMA will hold discussions with the Deposit-taking Companies Association on the applicability of the recommendations to the smaller RLBs and DTCs in respect of their 1995 accounts.

4.3 The recommendations set out in Section III are intended as a minimum standard of disclosure. Institutions which wish to disclose information in addition to that recommended in this Guide, and RLBs and DTCs below the exemption thresholds which intend to adopt the recommendations in their 1994 accounts are welcome to do so.

Compliance

4.4 The SEHK intends to require listed banks to comply with the recommendations in Section III starting with their 1994 accounts. The Listing Rules will be amended to apply the recommendations to listed banks.

4.5 While it is recognised that this Guide is not statutory, the HKMA expects non-listed locally incorporated authorised institutions to which this Guide is applicable to adopt the recommendations on a voluntary basis in drawing up their accounts for their financial years ending on or after 31 December 1994.

4.6 The HKMA is considering an amendment to the Banking Ordinance to include adequate disclosure of financial information in the annual audited accounts as a condition of authorisation.

Statement of Compliance

4.7 It is recommended that authorised institutions to which the recommendations in section III apply should include a statement in their directors' report on the extent of compliance with the Guide and the reason for any non-compliance. In cases of full compliance, a general statement that the annual accounts have complied with the recommendations of this Guide would suffice. In cases of partial compliance, the statement in the directors' report should specify the areas of, and reasons for, non-compliance.

Hong Kong Monetary Authority

September 1994

Annex A

Financial Disclosure Package for the 1994 Accounts
Guidance note on Terminology

"Banks and financial institutions" refer to institutions authorised under the Banking Ordinance and similar overseas institutions.

"Cash & balances with other banks and financial institutions" means cash in the till and demand deposits with other banks and financial institutions.

"Money at call and short notice" refers to deposits which have a fixed period of maturity of up to one month or those with a notice period of one month or less.

"Treasury bills (including Exchange Fund Bills) include all such bills regardless of maturity and including those held for dealing purposes.

"Trade bills" refer to all purchased bills of exchange in relation to trade transactions.

"Certificates of Deposit" include all Certificates of Deposit regardless of maturity (including those held for dealing purposes).

"Securities held for dealing purposes" are defined as all other money market or capital market securities held for trading.

"Advances to banks and financial institutions" include placements with banks and financial institutions of more than one year.

"Investment securities" include all other money market or capital market securities held for purposes other than dealing purposes.

"Loan Capital" refers to subordinated liabilities such as loans, debentures, floating rate notes, etc.

"Deposits & balances of other banks and financial institutions" refer to all amounts (excluding those in the form of debt securities and certificates of deposits) arising out of banking transactions owed to other banks and financial institutions.

"Issued debt securities" refer to all negotiable securities other than stocks, shares, and Certificates of Deposit.

"Gains less losses arising from dealing in foreign currencies" refer to the profits less losses from foreign exchange transactions including those from foreign exchange derivatives.

"Gains less losses from other dealing activities" include profits less losses from dealing in instruments such as securities, commodities, precious metals, derivatives based on these items and other derivatives such as interest-rate derivatives.

"Premises and equipment expense" include rents and rates, insurance of premises and equipment, lighting, heating, maintenance costs and Electronic Data Processing expenses.

"Charge for bad and doubtful debts" refers to the net amount charged or credited to the profit and loss account in respect of provisions for bad and doubtful debts and bad debt recoveries.

"Long-term investments" include investment securities and investments in associated companies.

"Group companies" refer to the following categories : the ultimate holding company, any subsidiary of the ultimate holding company (including any intermediate holding company of the institution) and any subsidiary of the institution.

Annex B

Application of the recommendations to RLBs and DTCs

Paragraph 4.1 and 4.2 of the Best Practice Guide indicate that the recommendations in the Guide are intended to apply to RLBs and DTCs which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more. Any RLB or DTC which meets either one of the size criteria is recommended to adopt the recommendations in the Best Practice Guide.

The HKMA intends to use the figures which RLBs and DTCs report in respect of item 21 (Total assets less provisions) and item 5.4 (Total deposits from customers) of the Return of Assets and Liabilities of an Authorised Institution (Form MA(BS)I) to determine whether a RLB or DTC meets the above size criteria. To ensure that institutions know in advance whether or not they should adopt the recommendations in the Best Practice Guide and to avoid the effects of one-off fluctuations at the end of financial year, the average of the relevant figures reported in the twelve month period up to end-August 1994 will be adopted for this purpose.