AG 7

~~Issued March 2006~~Revised September 2024

Effective upon issuance

Accounting Guideline 7

Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Contents

Accounting Guidelines have effect as guidance statements and indicators of best practice. They are persuasive in intent. Although Accounting Guidelines are not mandatory on members of the Hong Kong Institute of Certified Public Accountants (HKICPA), they help define accounting practice in the particular area or sector to which they refer. Therefore, they should normally be followed and members of the HKICPA should be prepared to explain departures if called upon to do so.

This Accounting Guideline is based on the Listing Rules/GEM Rules that were in effect as at 30 June 2024.

Hong Kong Accounting Guideline 7

Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars

Definitions

The definitions used in this Accounting Guideline are:

(a)	*GEM Rules:*	*Rules Governing the Listing of Securities on GEM of The Stock Exchange of Hong Kong Limited.*
(b)	*Investment circular:*	*A document, including a prospectus, circular to shareholders or similar document, issued by an issuer pursuant to the Listing Rules/GEM Rules, the Takeovers 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.*
(c)	*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.*
(d)	*Listing Rules:*	*Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.*
(e)	*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.*
(f)	*Reporting accountant:*	*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.*
(g)	*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.*
(h)	*Stock Exchange:*	*The Stock Exchange of Hong Kong Limited*
(i)	*Takeovers Code:*	*The Codes on Takeovers and Mergers and Share Buy-backs issued by the Securities and Futures Commission.*

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. The guidance is intended primarily for the purpose of assisting directors of issuers in preparing and presenting pro forma financial information under the Listing Rules/GEM Rules. It may also provide guidance on the preparation of pro forma financial information for inclusion in investment circulars other than those prepared under the Listing Rules/GEM Rules.

2. Listing Rules/GEM Rules require the presentation of pro forma financial information in the cases as specified in paragraph 5 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.

3. The purpose of 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 as set out in Listing Rule 4.29(6)/GEM Rule 7.31(6) 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.

4. This Accounting Guideline does not cover pro forma financial information prepared for other purposes, for example, information in annual financial statements.

Why pro forma financial information is presented

5. A listing applicant or a listed issuer is required to present pro forma financial information in the cases of:

   (a) an acquisition constituting a major transaction, Listing Rules 14.67(6)(a)(ii) and 14.67(6)(b)(ii) and GEM Rules 19.67(6)(a)(ii) and 19.67(6)(b)(ii) require pro forma financial information of the enlarged group;

   (b) a very substantial acquisition, an extreme transaction or a reverse takeover, Listing Rules 14.69(4)(a)(ii) and 14.69(4)(b)(ii) and GEM Rules 19.69(4)(a)(ii) and 19.69(4)(b)(ii) require pro forma financial 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;

   (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; and

(e) [Deleted]

(f) an issuance of new securities, paragraph 21 of Appendix D1A and paragraph 13 of Appendix D1B to the Listing Rules and GEM Rules require a statement of net tangible asset backing for each class of security for which listing is sought, after making allowance for any new securities to be issued, as detailed in the listing document.

6. It is important that the directors of the issuer ensure that the pro forma financial information presented is not misleading. Where they are of the opinion that the pro forma financial information presented as required by the Listing Rules/GEM Rules as set out in paragraph 5 above is misleading, they should consult the Stock Exchange.

7. The compilation of pro forma financial information is the gathering, classification and summarisation of relevant financial information. The process followed by the preparer would be expected to include the following:

(a) the accurate extraction of information from sources permitted under Listing Rule 4.29(5)/GEM Rule 7.31(5);

(b) the making of adjustments to the source information that are arithmetically correct, appropriate and complete for the purpose for which the pro forma financial information is presented;

(c) arithmetic computation of the pro forma financial information;

(d) consideration of accounting policies;

(e) appropriate disclosure to enable the intended users to understand the pro forma financial information; and

(f) appropriate consideration of the pro forma financial information and approval by the directors of the issuer.

Nature of information

8. 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 statement of financial position or net asset statement, at the date reported. The pro forma financial information presented must not be misleading, must assist investors in analysing 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 statement of financial position or net asset statement, at the date reported on.

9. An 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.

10. Listing Rule 4.29(1)/GEM Rule 7.31(1) 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, very substantial disposals or acquisitions constituting major transactions, 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 characterised as one of adjusting information about the issuer. For example, where the transaction involves several acquisitions, the pro forma financial information will show information about the issuer with adjustments to reflect the acquisitions.

Judging whether information is misleading

11. The directors of an issuer are responsible for presenting pro forma financial information that is not misleading. To enable them to judge whether pro forma financial information is misleading, the directors of an issuer need to identify the purpose of that information. Paragraphs 22 and 23 discuss this fundamental precondition in further detail. In making their judgement, the directors consider the pro forma financial information as a whole whilst 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 the sources of information, the adjustments and the assumptions underlying the basis of preparation.

12. 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.

13. 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, the 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.

14. Issuers would view the term "appropriate adjustments" in paragraph 8 above in the context of the purpose for which they prepare pro forma financial information. The requirement to include all such adjustments emphasises the need to avoid cherry-picking. In judging whether pro forma financial information may be misleading, the directors of an issuer 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 items of property, plant and equipment 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.

15. Issuers are required to include all appropriate adjustments of which they are aware. Pro forma financial information need only reflect adjustments of which the directors are aware as a result of satisfying both the requirements 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 HKFRS 3 *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.

16. 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, the directors of an issuer 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 19 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

17. Financial statements exhibit articulation when different primary statements, such as the statement of financial position and income statement, reflect different aspects of the same transaction. Because of the requirements of paragraphs 8 above, this is not always true of pro forma financial information.

18. As a consequence of this lack of articulation, a pro forma statement of financial position 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 statement of financial position at the end of the period will not reflect the benefits of reduced interest costs since, in preparing the pro forma statement of financial position, the issuer assumes that it only receives the proceeds at the end of the reporting period. Nevertheless, as long as 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

19. 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.

20. 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.

21. 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

22. 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 the transaction 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 disclosed particular pro forma statements for presentation and why they have highlighted particular captions within those statements.

23. 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. Where the historical financial information was audited and where the audit report thereon was modified or qualified, the directors should consider whether appropriate disclosure of that fact and the related reasons should be included. However, it would be highly unusual for directors to prepare complete pro forma financial information comprising a statement of financial position, 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 statement of financial position, a summarised income statement, a summarised cash flow 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. The directors of an issuer 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

24. Listing Rule 4.29(3)/GEM Rule 7.31(3) requires that the pro forma financial information must be presented in columnar format 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

25. 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 the transaction is illustrated. Subsequent columns would reflect adjustments for the effect of the transaction which is the subject of the investment circular. The final column displays the resultant adjusted amounts. It may be possible that there are several alternatives to be put forth to investors involving a proposed transaction which will be put in one investment circular. The issuer would clearly disclose separate pro forma financial information for the effects of each alternative.

Accounting policies

26. Paragraph 24 notes that pro forma financial information should 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.

Application of acquirer's policies to an acquisition

27. 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 an acquisition constituting a major transaction, this will be prepared in accordance with the issuer's accounting policies.

28. 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 5 above, the issuer would indicate clearly in the circular the difficulties encountered by the issuer in ensuring compliance with the issuer's accounting policies and disclose the relevant amounts involved and the accounting policies adopted by the target. The issuer will also need to consult the Stock Exchange.

New accounting standards

29. 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 generally inappropriate 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

30. 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 fair value adjustments and goodwill.

31. Where the application of acquisition accounting results in the recognition of fair value adjustments and goodwill in a pro forma net asset statement or statement of financial position, 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, amortisation or impairment policies and estimated economic lives.

Prominence

32. 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

33. 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 document;

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

34. In interpreting the preceding paragraph, a financial period is only regarded as completed when the full period has ended and financial information for that period has been published.

35. 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 33 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 statements of financial position at more than one date will serve a useful purpose. The prohibition on presenting pro forma financial information for any period preceding the most recently completed financial 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

36. 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 attributable to the transaction that is 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 HKAS 10 *Events after the Reporting Period* and is reflected in the unadjusted financial information of the issuer or an acquisition target, it would not be reflected in pro forma financial information.

37. If the directors of the issuer believe that pro forma financial information is misleading because it does not reflect significant non-adjusting events after the reporting period, 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 non-adjusting events, as such a practice might raise concerns about cherry-picking.

38. 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

39. 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, the unadjusted information about the issuer and the adjustments in respect of the other entity or entities would cover periods of the same length and would normally be for a full financial year of the issuer. This is to ensure that there is no distortion due to seasonal factors and that the estimated contribution of the transaction to a full year's results of the issuer can be assessed by the investors.

40. 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. 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.

41. 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-terminous accounting periods may be required to prevent the information from being misleading.

42. Non-coterminous accounting periods may also be of concern when preparing pro forma net asset statements or statement of financial position. An issuer needs to consider any significant seasonal variations. In the situation of a very substantial acquisition or an acquisition constituting a major transaction 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

43. Listing Rule 4.29(5)/GEM Rule 7.31(5) requires that the unadjusted information must 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.

44. The requirement in paragraph 43 would be read in conjunction with the guidance in paragraph 35. It requires 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 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

45. 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.

Clearly shown and explained

46. 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; and

(d) where relevant, how adjustments have been aggregated or allocated to financial statement captions.

Attributable to the transaction

47. 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. The transaction which is the subject of the investment circular may include interlocking dependant elements or components, e.g. the subject of the investment circular is the acquisition of a major asset but there is a condition to raise bank loans from Bank A at specified terms to finance it. Although the transaction may be regarded as two separate transactions, namely, the raising of the bank loans as the first transaction and the use of the funds to acquire the asset as the second transaction, as they are an integral part of the whole transaction, they are regarded as interlocking components of the transaction subject to the investment circular. To enable readers to more easily understand the whole transaction, the interlocking elements of the transaction may be separately described with supporting note disclosure of each component.

Factually supportable

48. 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.

49. The directors of an issuer may be aware of the need to make an adjustment whilst lacking the appropriate factual support to satisfy paragraph 45. 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 of the issuer 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 should not lose sight of the fact that they are not obliged to publish pro forma financial information except in the cases required by the Listing Rules/GEM Rules as set out in paragraph 5 above. 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

50. In respect of pro forma profit or cash flow statements, paragraph 45(d) notes requirements on 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.

51. 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 45(d) in light of the requirements of HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* which covers appropriate disclosure of the results of continuing and discontinued operations and considers other examples of items that may not generally be of a continuing nature. These items may include, for example, write-off of share issuance expenses or some of the items disclosed in financial statements pursuant to paragraph 98 of HKAS 1 *Presentation of Financial Statements*.

Common adjustments

52. The following paragraphs describe the application of paragraph 45 to a number of items that are frequently considered for adjustment in pro forma financial information.

Tax and similar effects

53. 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

54. 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

55. 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.

56. 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.

57. Where the proceeds of an issue result in an increase in cash balances in a pro forma net asset statement or statement of financial position, 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 requirements detailed in paragraph 45 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

58. 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 HKFRS 3. The principles on which HKFRS 3 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 the requirements of the Listing Rules/GEM Rules in respect of the investment circular.

59. To ensure that pro forma financial information is not misleading, the directors of an issuer 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. asset-based deals would normally require fair value adjustments);

(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.

60. Where the directors of an issuer 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, the 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, the directors will need to ensure that they make appropriate disclosure to investors.

Business being sold

61. 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

62. It may be necessary to translate adjustments into the presentation currency of the issuer. For a pro forma net asset statement or statement of financial position, the rate applied would usually be the rate ruling at the date of the issuer's unadjusted statement of financial position. 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

63. 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

64. 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 prohibition in paragraph 45(b) 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.

65. 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 summarise the terms on which additional consideration is computed and any cap on that consideration.

Synergy benefits

66. 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.

67. 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. Nevertheless, it is consistent with this principle that any pro forma profit forecast might reflect synergy benefits anticipated in the post-acquisition period that affect the issuer or the target. Recognition of any such benefits will be subject to the Listing Rules/GEM Rules in relation to directors' profit forecasts and, where applicable, the requirements of the Takeovers Code.

Cost and revenue eliminations

68. 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 transactions

69. Issuers may wish to make adjustments to reflect other transactions which have taken place since the end of the reporting period but which are not the subject of the investment circular within which the pro forma financial information is presented. As explained in paragraph 36, as a matter of general principle, issuers do not make adjustments for such transactions. Nevertheless, in rare circumstances, adjustments for other transactions or issues of capital that have led to announcements or circulars under the Listing Rules/GEM Rules may be permitted 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

70. 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.

71. 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.

72. 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 57. 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.