

Consultancy on the Impact of HKFRS Convergence Project

A Review of
the Hang Seng
Index Constituent Stocks

Final Report

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Foreword

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The Hong Kong Financial Reporting Standards (HKFRSs) were fully converged with International Financial Reporting Standards (IFRSs) with effect from 1 January 2005. This came from a decision by the council of the Hong Kong Institute of Certified Public Accountants in 2001, after broad discussion with interested parties.

As an international financial centre, Hong Kong was among the first jurisdictions to have fully converged with IFRSs and stands on a par with other capital markets, including those in Europe. In all, more than 100 countries have converged with IFRSs for all or some companies or are in the process of converging. Key jurisdictions that have a convergence programme in place but have not completed their convergence include the United States, Canada and Japan. Mainland China released its new China Accounting Standards for Business Enterprises that brings about substantial convergence with IFRSs from 2007 for Mainland listed companies.

The Institute has monitored the effect on the market of the adoption of HKFRSs and decided to assess the results of adoption on listed companies. The Institute's Professional Accountants in Business Committee noted that, effective from 1 January 2005, the majority of Hong Kong incorporated companies were required to adopt the new standard which potentially changed accounting policies used in their annual reports for the financial year ending on or after 31 December 2005. The Committee commissioned this research with the objective of assessing the impact of HKFRSs on constituents of the Hang Seng Index for the first year they were effective and identify the changes in operating performance and financial position resulting from the adoption of the new HKFRSs. The study also identified specific standards that contributed the most to those changes.

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We Value Your Opinion

If you have any comments on the report or would like to contribute additional ideas or materials, please contact us by sending your comments to the Institute by email at hkicpa@hkicpa.org.hk or phone at (852) 2287-7228.

Executive summary

1 January 2005 marks a new era and a significant breakthrough for financial reporting in Hong Kong, when companies were required to adopt Hong Kong Financial Reporting Standards (HKFRS) that had fully converged with IFRS. To understand the impact of the HKICPA convergence project, we have reviewed the annual reports of the Hang Seng Index Constituent Stocks for the year of adoption and analyzed the effect of the adoption on profitability and opening equity. Focusing on the 2005 pool for which the major adoption of HKFRS took place in 2005, our review and analysis find the following:

Impact on Profitability

- (1) 31 constituent companies have, on average, reported an increase of 53.63% in net income, while the median increase is 2.59%.
- (2) All industry groups experience profit increases, and the largest impact is reported by Commerce & Industry, followed by Properties, Finance, and Utilities.
- (3) The magnitude of profitability change varies substantially among the 31 companies reporting profitability change.

Standards Impacting Profit

- (4) Sixteen standards affect profit.
- (5) The top five standards according to the number of companies affected are: HKAS32&39 (Financial Instruments), HKFRS2

(Share-based Payment), HKAS40 (Investment Property) & Int21 (Income Taxes - Recovery of Revalued Non-Depreciable Assets), HKAS17 (Leases), and HKFRS3 (Business Combination) & HKAS36 (Impairment of Assets).

- (6) On average, HKFRS2 and HKAS17 bring a negative impact, while the others result in profit increases.
- (7) While there is a certain level of comparability among companies within the same industry in terms of the direction of profitability change, the magnitude varies substantially, especially in adopting HKAS32&39 and HKAS40&Int21.

Impact on Opening Equity

- (8) On average, the new standards decrease opening equity by 2.00% of 32 constituent companies, which is not too different from the median decrease of 0.92%.
- (9) All industry groups report a decrease in opening equity except Finance.
- (10) The Utilities group is affected the most, followed by Commerce & Industry, Properties, and Finance.
- (11) Compared with the impact on profitability, the impact on opening equity varies less among the 32 companies reporting equity adjustment.

Standards Impacting Opening Equity

- (12) Fourteen standards affect opening equity and the following five standards contribute the most: HKAS32&39 (Financial Instruments), HKAS40 & Int 21 (Investment Property & Income Taxes - Recovery of Revalued Non-Depreciable Assets), HKAS17 (Leases), HKAS16 (Property, Plant and Equipment), and HKFRS3&HKAS36 (Business Combination & Impairment of Assets).
- (13) All of these standards reduce opening equity except HKAS32&39 and HKFRS3&HKAS36.
- (14) There is a certain level of comparability among companies within the same industry in terms of the direction of changes caused by the top five standards.
- (15) However, in terms of the magnitude of change, less comparability exists especially in adopting HKAS32&39, HKAS17 and HKAS40&Int21.

As early adoption was encouraged by the standard-setters, some HSI constituent companies partially/fully adopted HKFRS before 2005. We therefore supplement the above analysis with the impact on these early adopters, namely three companies that had their major adoption earlier and five companies that had a few standards adopted earlier. Two out of the three Major Early Adopters experience a decrease in net income and an increase in beginning equity. As for the Partial Early Adopters, the majority have their net income increased substantially while their beginning equity decreases slightly.

Furthermore, due to the additional disclosure required by HKFRS, the financial report sections (including both financial statements and notes) of the annual reports are mostly longer when compared to the previous year. Overall, we do not find any indication of companies referring to HKFRS in their information releases or performance analyses. In searching for reasons to explain the variation in profitability change, we do not find any discernible relationships between the magnitude of profit change and company characteristics such as size, debt level, and profitability level or change before the new standards.

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1. Introduction and main findings

Despite the fact that the project of harmonization with International Financial Reporting Standards (IFRS) was launched a few years ago, January 1st of 2005 marks a new era and a significant breakthrough of financial reporting in Hong Kong. For all the accounting periods starting on or after that date, companies are required to adopt Hong Kong Financial Reporting Standards (HKFRS) which basically have been fully converged with IFRS. While such convergence is considered to bring substantial benefits in terms of improving disclosure transparency and accounting quality, how these new accounting standards affect companies' performance and financial position remains a question to be answered.

Upon the request of the Professional Accountants in Business Committee (PAIBC) of the Hong Kong Institute of Certified Public Accountants (HKICPA), we have carried out a pilot study to examine how the new HKFRS makes a difference in the financial reporting of the Hang Seng Index (HSI) Constituent Stocks. In particular, we look at the following:

- (i) the changes of financial performance and financial positions of these companies as a result of adopting the new HKFRS, and
- (ii) identify those specific standards that have contributed most to these changes.

Out of the 39 HSI Constituents Stocks, we are able to identify impact on profitability and beginning equity for 31 and 32 companies respectively. Our main findings are summarized as follows:

- (i) Overall impact on profitability – Net Income (NI)
 - The 31 constituent companies have an average increase of 53.63% in NI, while the median change is an increase of 2.59%, suggesting that a relatively smaller number of the companies report large changes after the adoption.
 - The impact on profitability varies among the four industry groups. The most affected is the Commerce & Industry group. The largest increase is 1,066.19%, the largest decrease is 20.74%, and the average change is 80.31%, and the median change is 7.01%. Properties, Finance, and Utilities follow in that order in terms of average changes.
 - Among the 31 companies, more report profit increases than decreases. The magnitude of profitability change varies substantially. The largest increase comes from New World Dev (0017) whose NI increases from a loss of HKD104.4m under the old accounting standards to a profit of HKD1,008.7m based on HKFRS, representing a positive change of 1,066.19%. The largest decrease is reported by Hutchison (0013) whose NI decreases from HKD18,096m to HKD14,343m, a negative change of 20.74%.

(ii) Impact on profitability by individual standards

- Altogether, 16 standards affect profit. The top 5 standards according to the number of companies affected are:
 - HKAS 32 & 39 (Financial Instruments) affecting 23 companies,
 - HKFRS2 (Share-based Payment) affecting 16 companies,
 - HKAS40 (Investment Property) & Int21 (Income Taxes - Recovery of Revalued Non-Depreciable Assets) affecting 14 companies,
 - HKFRS3 (Business Combination) & HKAS36 (Impairment of Assets) affecting 12 companies, and
 - HKAS17 (Leases) affecting 11 companies.

On average, HKFRS2 and HKAS17 bring a negative impact, while the others result in profit increases.

- The impact of the top 5 standards varies across industries:
 - HKAS32&39 increase NI for all the industry groups except for Properties,
 - For HKFRS2, the Utilities companies are not affected while the other three groups report a negative impact,

- HKAS40&Int21 contributes the largest in terms of the average increases in NI including 176.42% for Commerce & Industry, 6.28% for Finance, 87.79% for Properties, and 12.96% for Utilities,
- HKAS17 slightly increases NI for Finance and Utilities but decreases that for Commerce & Industry and Properties, and
- HKFRS3&HKAS36 are mostly positive except for Utilities where a small decrease of 0.08% is found.

- For the top 5 standards, there is a certain level of comparability among companies within the same industry in terms of the direction of profitability changes. However, in terms of the magnitude of these changes, we observe less comparability in adopting HKAS32&39 or HKAS40&Int21 than in HKFRS2, HKFRS3&HKAS36 or HKAS17.

(iii) Overall impact on beginning equity (BeginEqty)

- For the 32 constituents companies, on average, the new standards decrease BeginEqty by 2.00% and this does not differ too much from the median decrease of 0.92%.

- The Commerce & Industry group reports the largest increase of 18.23% as well as the largest decrease of 19.07%. Both the average and median changes show a decrease for all the industries except Finance. Although the Utilities group reports the largest average decrease of 4.83% as well as the second largest median decrease of 1.77%, these figures are not too much different from those of the Commerce & Industry group, where the average and median decreases are 2.52% and 2.34% respectively.

(iv) Impact on beginning equity by individual standards

- Altogether, 14 standards affect BeginEqty. The top 5 standards contributing the most are:
 - HKAS32&39 (Financial Instruments) affecting 25 companies,
 - HKAS40&21 (Investment Property & Income Taxes - Recovery of Revalued Non-Depreciable Assets) affecting 12 companies,
 - HKAS17 (Leases) affecting 10 companies,
 - HKAS16 (Property, Plant and Equipment) affecting 7 companies, and
 - HKFRS3&HKAS36 (Business Combination & Impairment of Assets) also affecting 6 companies.

On average, HKAS32 & 39 and HKFRS3&HKAS36 bring a positive impact, while the others result in decreases in beginning equity.

- The impact of the top 5 standards varies across industries:
 - HKAS32&39 increase BeginEqty except for the Utilities group, and the increases are relatively large for the Commerce & Industry as well as the Finance groups,
 - HKAS40&Int21 have a negative impact across all the industries with the Commerce & Industry and the Properties groups reporting relatively larger decreases,
 - HKAS17 causes a decrease across all the industry groups with the largest impact on the Utilities group,
 - HKAS16 reduces BeginEqty for the Commerce & Industry and the Properties groups with such impact being relatively small, and
 - HKFRS3&HKAS36 together increase BeginEqty for all the industry groups except Finance, with a relatively larger impact on the Commerce & Industry and Utilities companies.

- For the top 5 standards, there is a certain level of comparability among companies within the same industry in terms of the direction of changes in BeginEqty. However, in terms of the magnitude of these changes, we observe less comparability in adopting HKAS32&39 or HKAS40&Int21 than in HKAS 16 or HKFRS3&HKAS36. The comparability of adopting HKAS17 seems somewhere in between.

2. Scope of review

Our preliminary review targets the annual reports of the HSI Constituent Stocks. As of July 31st, 2007, the HSI Constituents consist of 39 companies that spread over four major industry groups including Commerce & Industry, Finance, Properties and Utilities. Table 1 presents a full list of these companies, out of which 8 are excluded (or partly excluded) from this Review for different reasons. We find that instead of following the compulsory adoption starting from January 1st of 2005, quite a few companies have been involved in various levels of early adoption. We therefore define the year of adoption as the year during which the major block of HKFRS is adopted¹. As a result, 3 companies (Cheung Kong (0001), Esprit Hldgs (0330) and HKEx (0388)) are identified as the Major Early Adopter for which the major adoption is not in 2005 while

5 companies (Henderson Land (0012), Hutchison (0013), Hang Lung Prop (0101), Sino Land (0083) and New World Dev (0017))² are considered to be Partial Early Adopter. To avoid the complexity brought by the different economic circumstances of different years and enhance the comparability of our cross-sectional analysis, the Review is mainly focused on the 2005 Pool which includes those companies that have their major adoption of HKFRS in 2005. We also find that 6 companies use IFRS instead of HKFRS. Since HKFRS are basically the results of the full convergence to IFRS, for the purpose of this review, we consider the two sets of standards as equivalent to each other. Our final sample consists of 31 companies for the analysis of profitability impact and 32 companies for the analysis of equity impact^{3,4}.

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1. For companies that early adopted a few standards before 2005, we count, for each year involving the adoption of HKFRS, the number of standards that have been disclosed in the financial statements as having caused significant impact. Then we pick up the year with a higher number of significant standards as the year of major adoption.
 2. These companies early adopted a few standards for the accounting periods starting before January 1st of 2005. However, as the numbers of standards having significant impact are higher for their 2005/2006 report, we do not classify these cases as the major early adoption.
 3. For the year of adoption, HSBC Hldgs (0005) has information for the impact on beginning equity but not for the impact on profitability.
 4. The identification of the HKFRS adoption and its impact is mainly based on notes to financial statements.

Table 1: Scope of Review

| No. | Company Name | Company Code | Industry Group | Reporting Currency | Financial Year End | IFRS(1) Vs. HKFRS (0) | Year of Major Adoption | Reasons for Exclusion |
|-----|-------------------|--------------|-------------------|--------------------|--------------------|-----------------------|------------------------|---|
| 1 | Cheung Kong | 1 | Properties | HKD | 1231 | 0 | 2004 | Not in the 2005 Pool |
| 2 | CLP Hldgs | 2 | Utilities | HKD | 1231 | 0 | 2005 | |
| 3 | HK & China Gas | 3 | Utilities | HKD | 1231 | 0 | 2005 | |
| 4 | Wharf (Hldgs) | 4 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 5 | HSBC Hldgs | 5 | Finance | HKD | 1231 | 1 | 2005 | Excluded for the impact on profitability as such information is not available |
| 6 | HK Electric | 6 | Utilities | HKD | 1231 | 0 | 2005 | |
| 7 | PCCW | 8 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 8 | Hang Seng Bank | 11 | Finance | HKD | 1231 | 0 | 2005 | |
| 9 | Henderson Land | 12 | Properties | HKD | 630 | 0 | 2005/2006 | |
| 10 | Hutchison | 13 | Commerce&Industry | HKD | 1231 | 0 | 2006 | |
| 11 | SHK Prop | 16 | Properties | HKD | 630 | 0 | 2005/2006 | |
| 12 | New World Dev | 17 | Commerce&Industry | HKD | 630 | 0 | 2005/2006 | |
| 13 | Swire Pacific 'A' | 19 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 14 | Bank of E Asia | 23 | Finance | HKD | 1231 | 0 | 2005 | |
| 15 | MTR Corporation | 66 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 16 | Sino Land | 83 | Properties | HKD | 630 | 0 | 2005/2006 | |
| 17 | Hang Lung Prop | 101 | Properties | HKD | 630 | 0 | 2005/2006 | |
| 18 | China Mer Hldgs | 144 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 19 | CITIC Pacific | 267 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 20 | China Resources | 291 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 21 | Cathay Pac Air | 293 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 22 | Esprit Hldgs | 330 | Commerce&Industry | HKD | 630 | 1 | 2003/2004 | Not in the 2005 Pool |
| 23 | Sinopec Corp | 386 | Commerce&Industry | RMB | 1231 | 1 | NA | IFRS already in use |
| 24 | HKEx | 388 | Finance | HKD | 1231 | 0 | 2004 | Not in the 2005 Pool |
| 25 | Li & Fung | 494 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 26 | Yue Yuen Ind | 551 | Commerce&Industry | USD | 930 | 0 | 2005/2006 | |
| 27 | China Unicom | 762 | Commerce&Industry | RMB | 1231 | 0 | 2005 | |
| 28 | CNOOC | 883 | Commerce&Industry | RMB | 1231 | 0 | 2005 | |
| 29 | China Netcom | 906 | Commerce&Industry | RMB | 1231 | 0 | 2005 | |
| 30 | CCB | 939 | Finance | RMB | 1231 | 1 | NA | IPO2005 |
| 31 | China Mobile | 941 | Commerce&Industry | RMB | 1231 | 0 | 2005 | |
| 32 | CKI Hldgs | 1038 | Commerce&Industry | HKD | 1231 | 0 | 2005 | |
| 33 | COSCO Pacific | 1199 | Commerce&Industry | USD | 1231 | 0 | 2005 | |
| 34 | ICBC | 1398 | Finance | RMB | 1231 | 0 | NA | IPO2006 |
| 35 | FIH | 2038 | Commerce&Industry | USD | 1231 | 1 | 2005 | |
| 36 | Ping An | 2318 | Finance | RMB | 1231 | 1 | 2005 | |
| 37 | BOC Hong Kong | 2388 | Finance | HKD | 1231 | 0 | 2005 | |
| 38 | China Life | 2628 | Finance | RMB | 1231 | 0 | 2005 | |
| 39 | Bank of China | 3988 | Finance | RMB | 1231 | 0 | NA | IPO2006 |

At both company and industry group levels, this Review involves the investigation of the impact on profitability and opening equity as a result of fully adopting HKFRS. Such impact is further separated into different standards so as to identify the main forces that drive the most significant changes. In addition, we check out the extent

to which companies refer to the new HKFRS in their performance analysis by going through the Chairman's statements in the annual reports. Finally, we compare the length of financial statements for the year of adoption with that of the previous year to infer the additional effort the preparers have to spend in adopting HKFRS.

3. Impact on profitability: overall analysis

3.1 Overall Change

Out of the 39 HSI Constituents, we are able to identify changes of the profit attributable to shareholders (NI) under the new HKFRS for 31 companies that qualify for the 2005 Pool. Table 2 shows these changes for both NI and earnings per share (EPS). As the magnitude of change in terms of percentage is the same

for NI and EPS, we only concentrate on NI for the following analysis. Because the focus of this Review is for the impact brought by the full convergence to IFRS, we exclude those changes on NI caused by changes in accounting policy other than HKFRS⁵.

5. Accounting policy changes affect two companies. New World Dev (0017) has an increase of HKD51.1m as a result of change in accounting policy for handset subsidies. China Unicom (0762) has an increase of RMB178m as a result of change in accounting policy for revenue recognition.

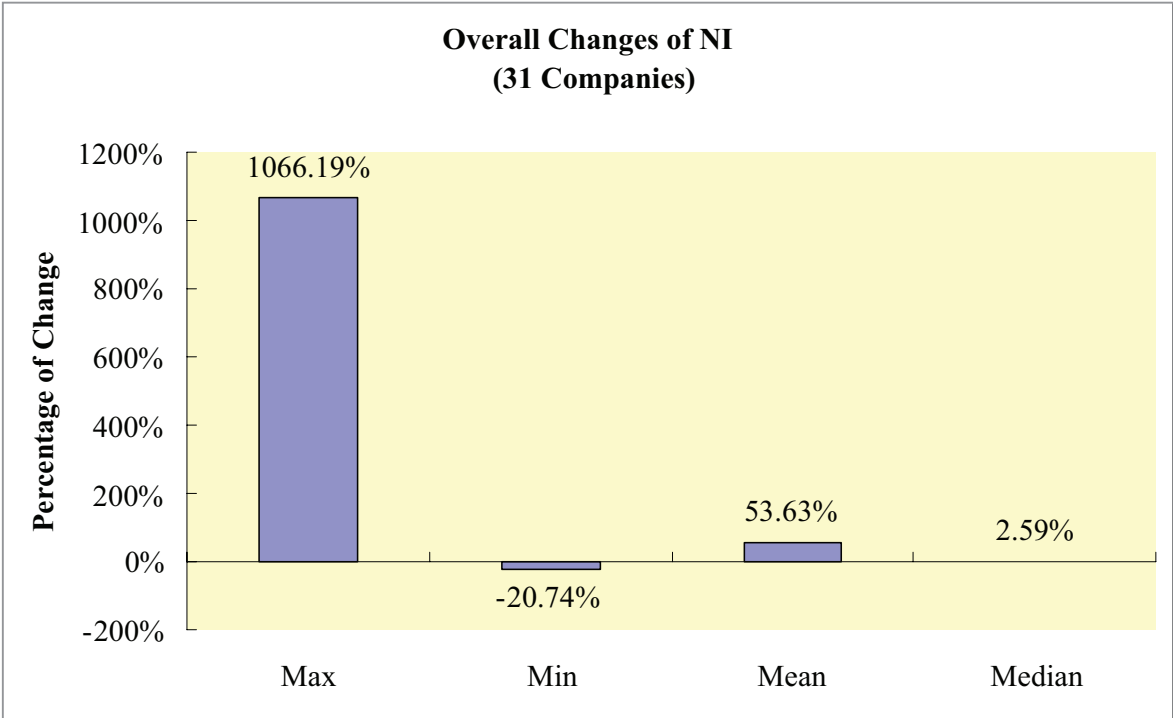
Table 2: Impact on Profit Attributable to Shareholders (NI) and EPS – By Companies

| No. | Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | NIFRS(\$) | NI(\$) | ΔNI(\$) | ΔNI% | EPSFRS(\$) | EPS(\$) | ΔEPS(\$) | ΔEPS% |
|-----|-------------------|--------------|-------------------|-----------|-----------------|----------|----------------|----------------|-----------------|----------|------------|---------|----------|----------|
| 1 | CLP Hldgs | 2 | Utilities | 2005 | 1231 | HKD | 11,368,000,000 | 11,368,000,000 | 0 | 0.00% | 4.72 | 4.72 | 0.00 | 0.00% |
| 2 | HK & China Gas | 3 | Utilities | 2005 | 1231 | HKD | 5,281,400,000 | 4,613,300,000 | 668,100,000 | 14.48% | 0.96 | 0.84 | 0.12 | 14.48% |
| 3 | Wharf (Hldgs) | 4 | Commerce&Industry | 2005 | 1231 | HKD | 13,888,000,000 | 4,470,000,000 | 9,418,000,000 | 210.69% | 5.67 | 1.83 | 3.85 | 210.69% |
| 4 | HK Electric | 6 | Utilities | 2005 | 1231 | HKD | 8,562,000,000 | 8,487,000,000 | 75,000,000 | 0.88% | 4.01 | 3.98 | 0.04 | 0.88% |
| 5 | PCCW | 8 | Commerce&Industry | 2005 | 1231 | HKD | 1,595,000,000 | 1,095,000,000 | 500,000,000 | 45.66% | 0.24 | 0.16 | 0.07 | 45.66% |
| 6 | Hang Seng Bank | 11 | Finance | 2005 | 1231 | HKD | 11,342,000,000 | 10,353,000,000 | 989,000,000 | 9.55% | 5.93 | 5.42 | 0.52 | 9.55% |
| 7 | Henderson Land | 12 | Properties | 2006 | 630 | HKD | 13,548,700,000 | 13,719,600,000 | (170,900,000) | -1.25% | 7.47 | 7.56 | (0.09) | -1.25% |
| 8 | Hutchison | 13 | Commerce&Industry | 2005 | 1231 | HKD | 14,343,000,000 | 18,096,000,000 | (3,753,000,000) | -20.74% | 3.36 | 4.24 | (0.88) | -20.74% |
| 9 | SHK Prop | 16 | Properties | 2006 | 630 | HKD | 19,850,000,000 | 10,627,000,000 | 9,223,000,000 | 86.79% | 8.23 | 4.41 | 3.82 | 86.79% |
| 10 | New World Dev | 17 | Commerce&Industry | 2005/2006 | 630 | HKD | 1,008,700,000^ | (104,400,000) | 1,113,100,000 | 1066.19% | 0.29 | (0.03) | 0.32 | 1066.19% |
| 11 | Swire Pacific 'A' | 19 | Commerce&Industry | 2005 | 1231 | HKD | 18,757,000,000 | 8,572,000,000 | 10,185,000,000 | 118.82% | 12.25 | 5.60 | 6.65 | 118.82% |
| 12 | Bank of E Asia | 23 | Finance | 2005 | 1231 | HKD | 2,748,725,000 | 2,572,497,000 | 176,228,000 | 6.85% | 1.82 | 1.70 | 0.12 | 6.85% |
| 13 | MTR Corporation | 66 | Commerce&Industry | 2005 | 1231 | HKD | 8,450,000,000 | 6,156,000,000 | 2,294,000,000 | 37.26% | 1.56 | 1.13 | 0.42 | 37.26% |
| 14 | Sino Land | 83 | Properties | 2005/2006 | 630 | HKD | 6,017,327,254 | 6,076,801,217 | (59,473,963) | -0.98% | 1.40 | 1.41 | (0.01) | -0.98% |
| 15 | Hang Lung Prop | 101 | Properties | 2005/2006 | 630 | HKD | 4,402,600,000 | 4,402,600,000 | 0 | 0.00% | 1.19 | 1.19 | 0.00 | 0.00% |
| 16 | China Mer Hldgs | 144 | Commerce&Industry | 2005 | 1231 | HKD | 2,364,000,000 | 2,194,000,000 | 170,000,000 | 7.75% | 1.08 | 1.00 | 0.08 | 7.75% |
| 17 | CITIC Pacific | 267 | Commerce&Industry | 2005 | 1231 | HKD | 3,989,000,000 | 3,147,000,000 | 842,000,000 | 26.76% | 1.82 | 1.44 | 0.38 | 26.76% |
| 18 | China Resources | 291 | Commerce&Industry | 2005 | 1231 | HKD | 2,220,403,000 | 1,849,703,000 | 370,700,000 | 20.04% | 1.02 | 0.85 | 0.17 | 20.04% |
| 19 | Cathay Pac Air | 293 | Commerce&Industry | 2005 | 1231 | HKD | 3,298,000,000 | 3,082,000,000 | 216,000,000 | 7.01% | 0.98 | 0.91 | 0.06 | 7.01% |
| 20 | Li & Fung | 494 | Commerce&Industry | 2005 | 1231 | HKD | 1,790,279,000 | 1,828,243,000 | (37,964,000) | -2.08% | 0.61 | 0.63 | (0.01) | -2.08% |
| 21 | Yue Yuen Ind | 551 | Commerce&Industry | 2005/2006 | 930 | USD | 353,591,000 | 346,861,000 | 6,730,000 | 1.94% | 0.22 | 0.21 | 0.00 | 1.94% |
| 22 | China Unicom | 762 | Commerce&Industry | 2005 | 1231 | RMB | 4,753,052,000^ | 4,690,052,000 | 63,000,000 | 1.34% | 0.38 | 0.37 | 0.01 | 1.34% |
| 23 | CNOOC | 883 | Commerce&Industry | 2005 | 1231 | RMB | 25,323,122,000 | 25,744,574,000 | (421,452,000) | -1.64% | 0.62 | 0.63 | (0.01) | -1.64% |
| 24 | China Netcom | 906 | Commerce&Industry | 2005 | 1231 | RMB | 13,888,000,000 | 14,022,000,000 | (134,000,000) | -0.96% | 2.11 | 2.13 | (0.02) | -0.96% |
| 25 | China Mobile | 941 | Commerce&Industry | 2005 | 1231 | RMB | 53,549,000,000 | 53,110,000,000 | 439,000,000 | 0.83% | 2.70 | 2.68 | 0.02 | 0.83% |
| 26 | CKI Hldgs | 1038 | Commerce&Industry | 2005 | 1231 | HKD | 6,007,000,000 | 5,488,000,000 | 519,000,000 | 9.46% | 2.66 | 2.43 | 0.23 | 9.46% |
| 27 | COSCO Pacific | 1199 | Commerce&Industry | 2005 | 1231 | USD | 360,381,000 | 351,266,000 | 9,115,000 | 2.59% | 0.16 | 0.16 | 0.00 | 2.59% |
| 28 | FIH | 2038 | Commerce&Industry | 2005 | 1231 | USD | 385,699,000 | 405,775,000 | (20,076,000) | -4.95% | 0.06 | 0.06 | (0.00) | -4.95% |
| 29 | Ping An | 2318 | Finance | 2005 | 1231 | RMB | 4,226,000,000 | 4,226,000,000 | 0 | 0.00% | 0.68 | 0.68 | 0.00 | 0.00% |
| 30 | BOC Hong Kong | 2388 | Finance | 2005 | 1231 | HKD | 13,494,000,000 | 11,220,000,000 | 2,274,000,000 | 20.27% | 1.28 | 1.06 | 0.22 | 20.27% |
| 31 | China Life | 2628 | Finance | 2005 | 1231 | RMB | 9,306,000,000 | 9,306,000,000 | 0 | 0.00% | 0.35 | 0.35 | 0.00 | 0.00% |

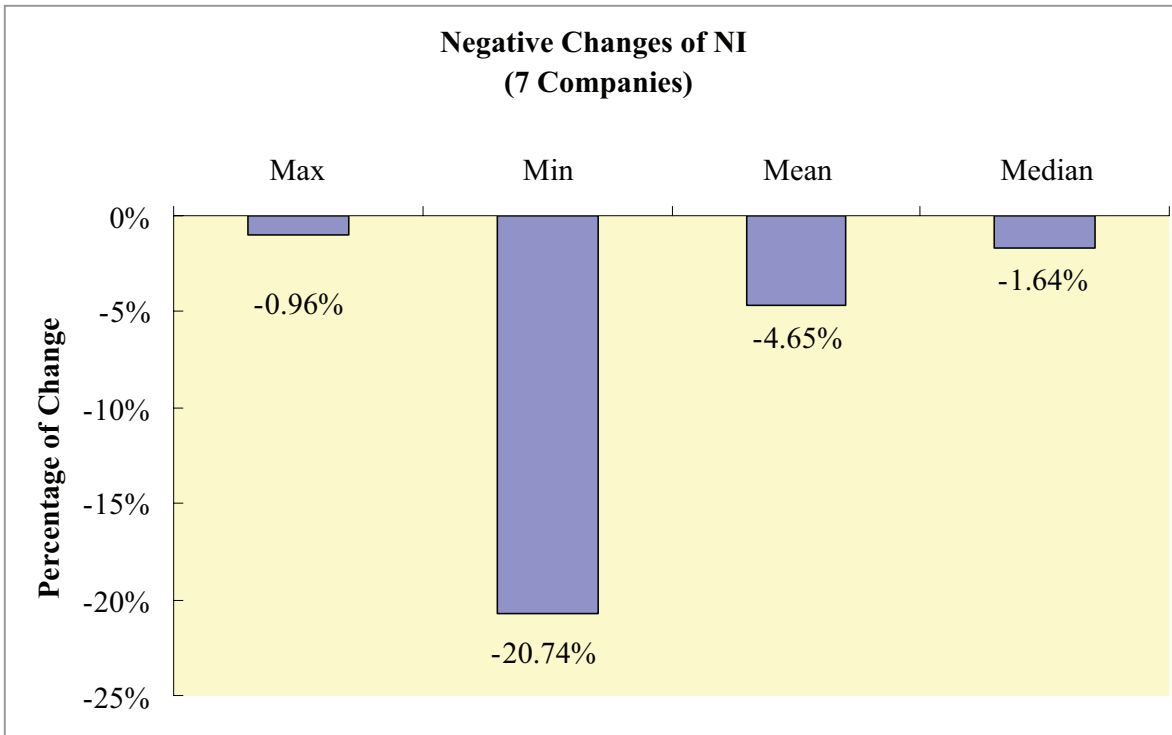
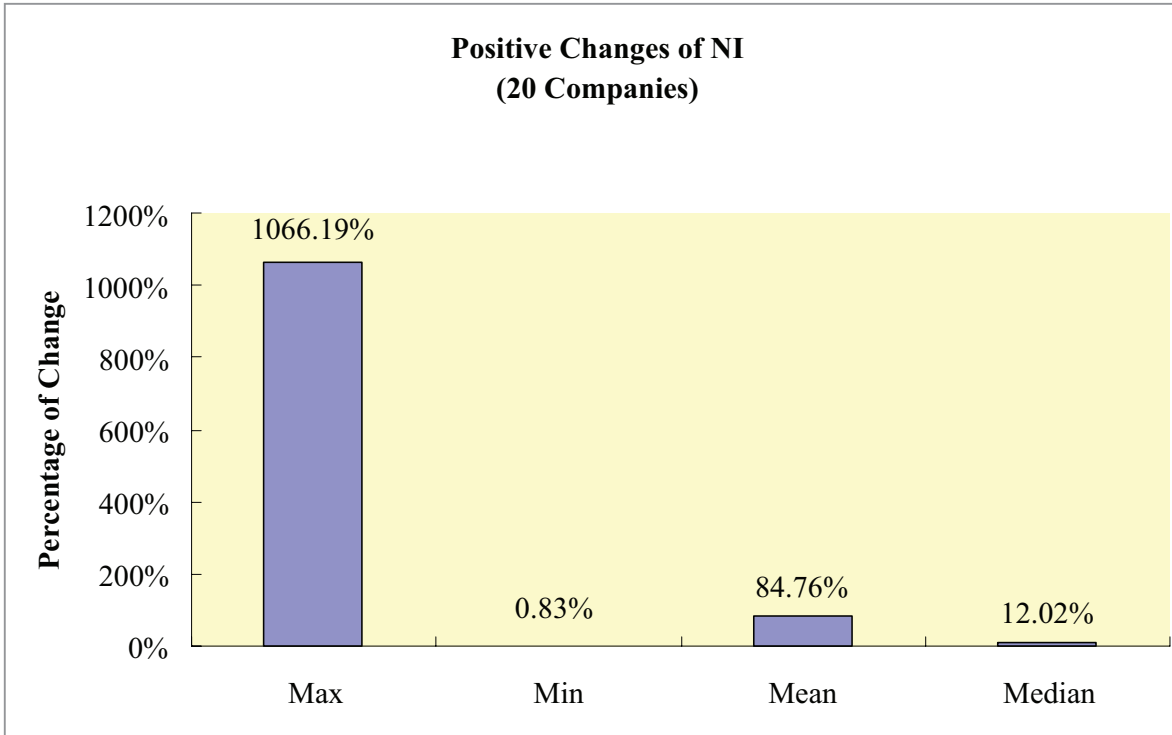
Figure 1 shows that after the full adoption of HKFRS, the 31 constituent companies have an average increase of 53.63% (19.88% without New World Dev (0017)⁶) in NI. NI of 4 companies (CLP Hldgs (0002), Hang Lung Prop (0101), Ping An (2318), China Life (2628)) is not affected. For the 20 companies with a positive change in NI, the average increase is 84.76% (33.10% without New World Dev (0017)⁶); for the 7

companies with a negative change in NI, the average decrease is 4.65%. While these average numbers are fairly large, the median changes are substantially smaller (for example, the overall median change of 2.59%, the positive median change of 12.02%, and the negative median change of 1.64%), suggesting that a small number of the companies report large changes after the adoption.

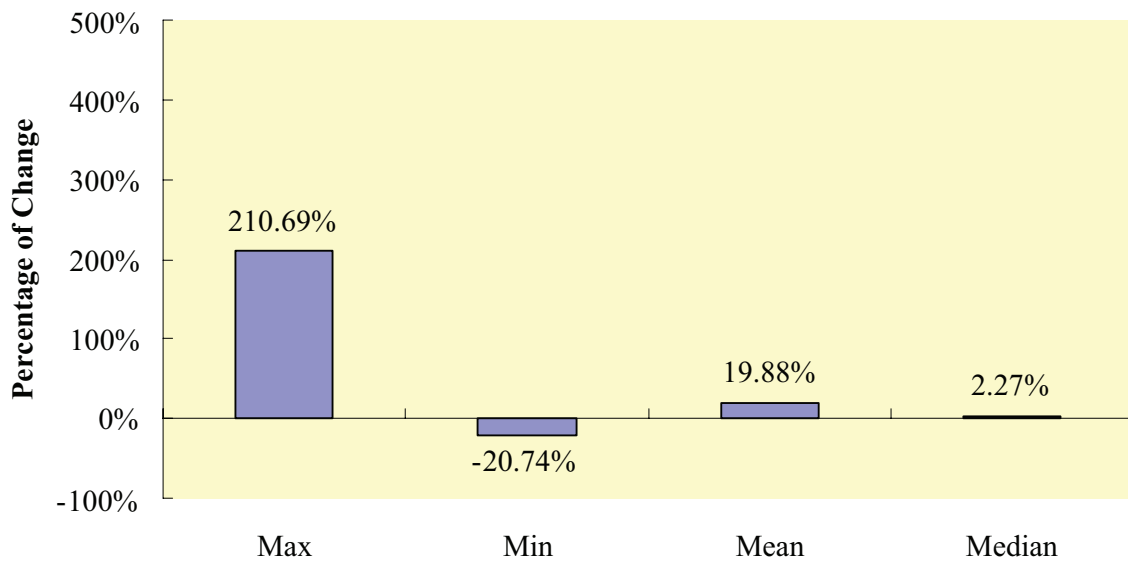
Figure 1: Impact on NI – Basic Statistics



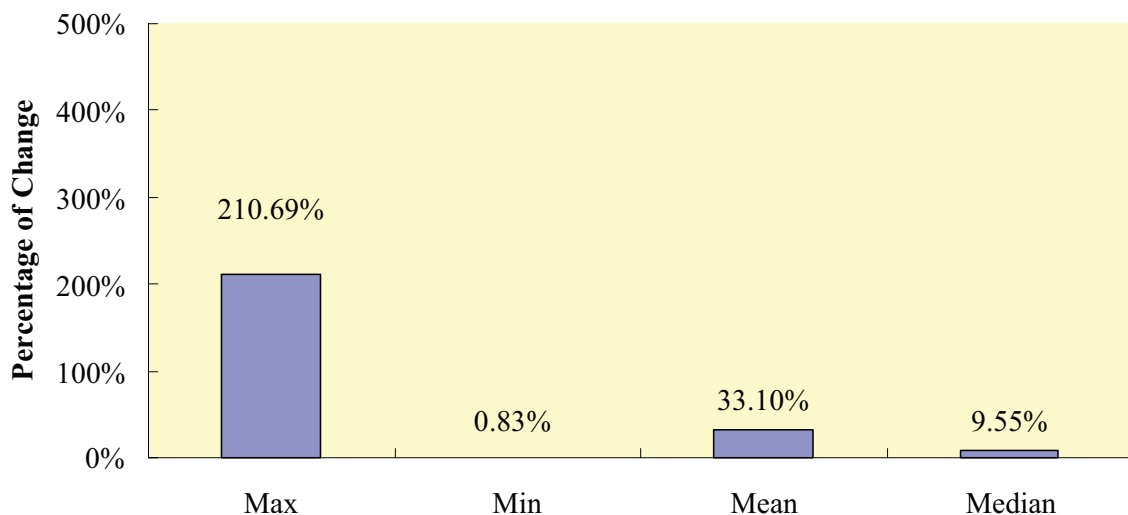
6. Such comparative figures are provided because we consider New World Dev (0017) as an outlier in the group.



**Overall Changes of NI
(30 Companies, 0017 Excluded)**



**Positive Changes of NI
(19 Companies, 0017 Excluded)**



3.2 Change by Industry

Figure 2 indicates that these 31 companies covers all the industry groups, namely Commerce & Industry (19 companies),

Finance (5 companies), Properties (4 companies), Utilities (3 companies).

Figure 2: Impact on NI - Distribution of Companies by Industry

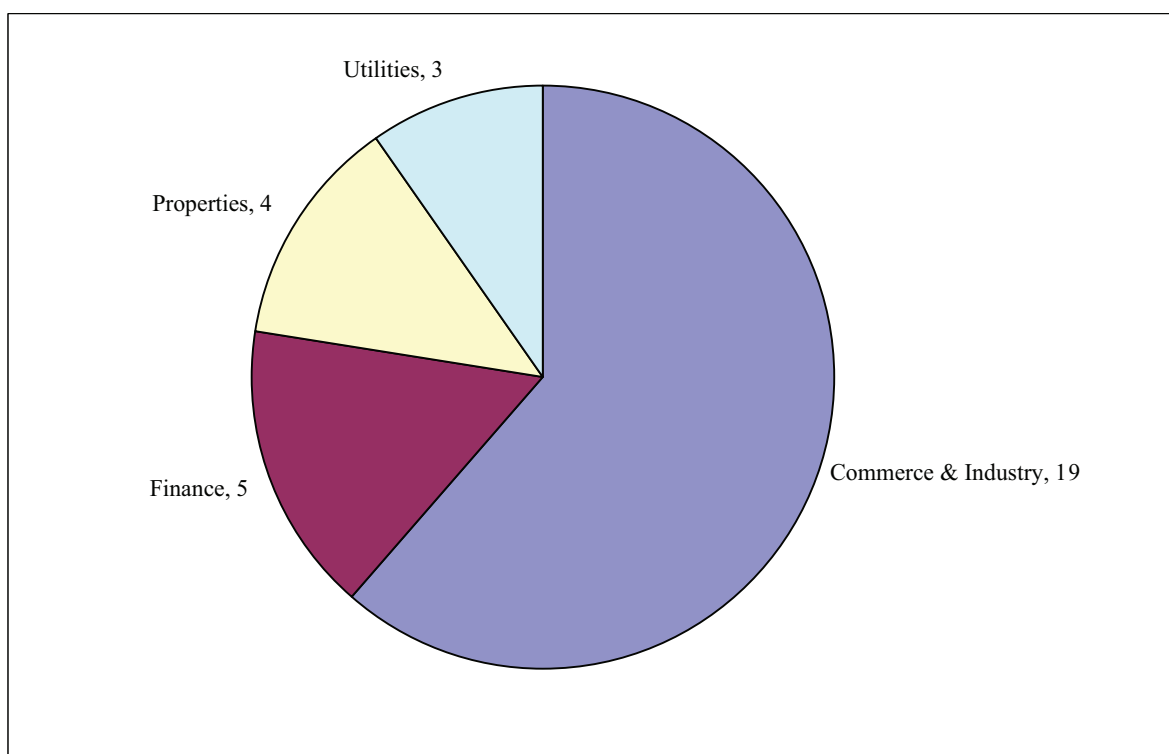
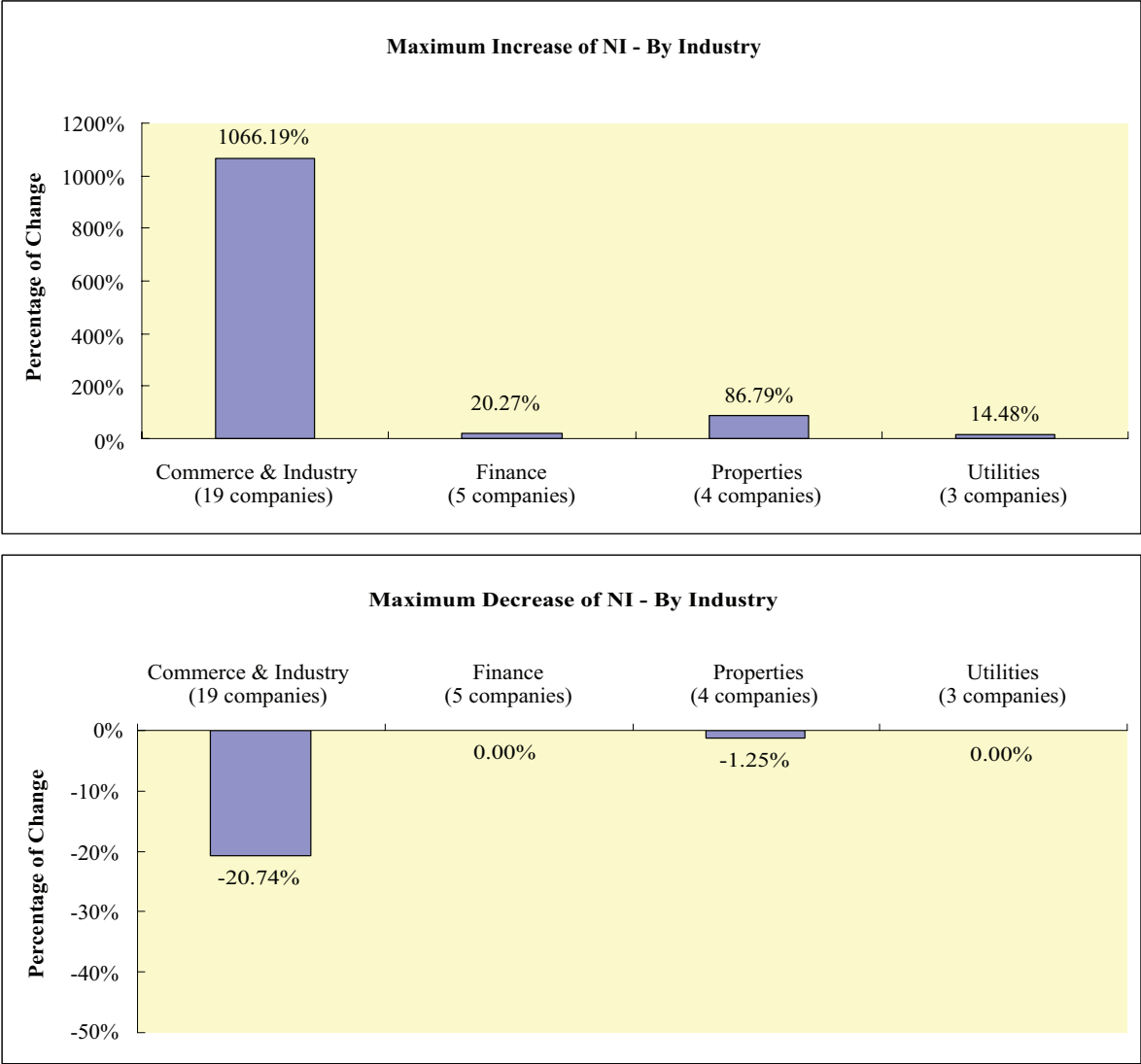
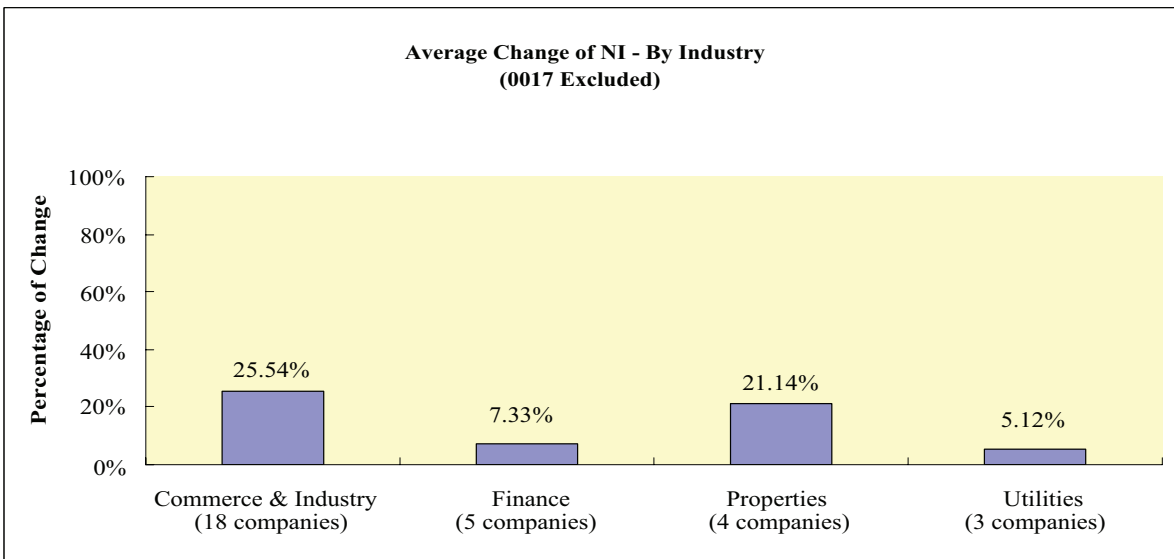
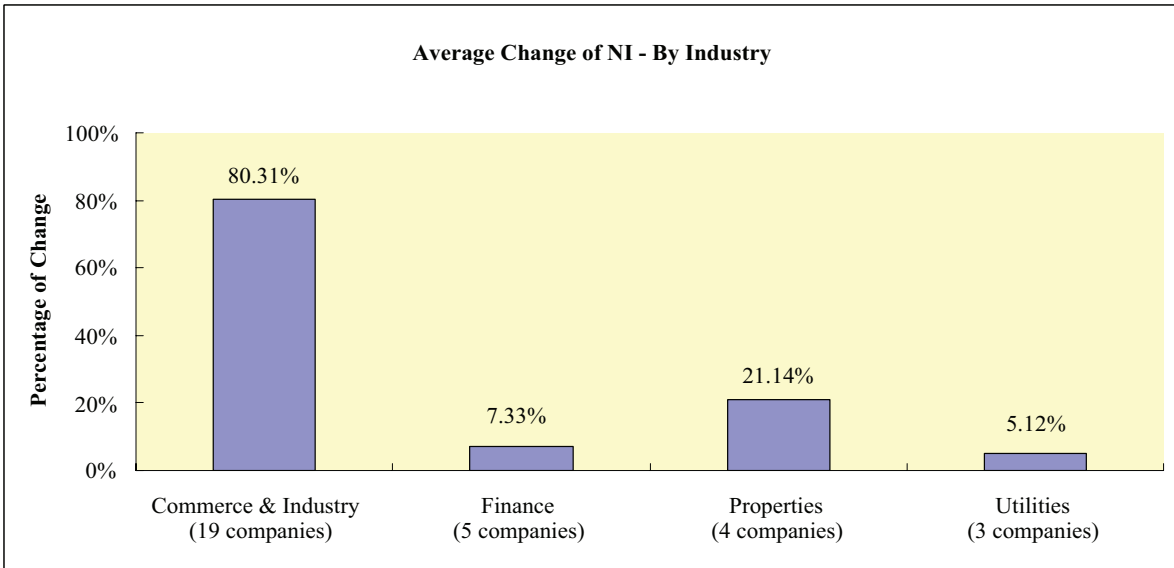


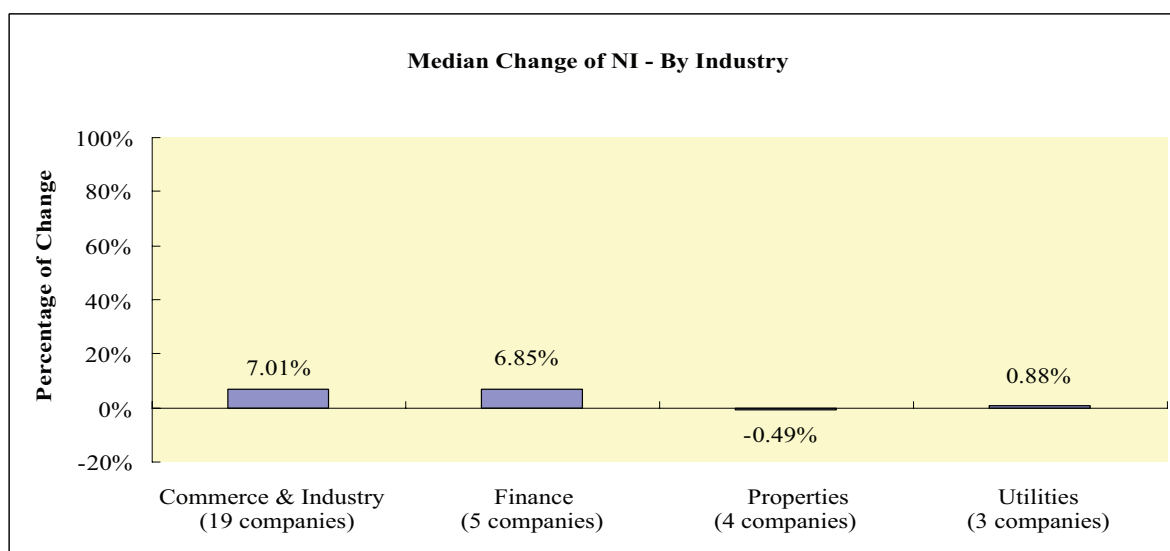
Figure 3 compares the profitability impact for the 4 industry groups. The largest group, Commerce & Industry, also occupies the first place in terms of the largest increase (1,066.19%), the largest decrease (-20.74%), the average change (80.31% or 25.54% without New World Dev (0017)) as well as the median change (7.01%). Then it is followed

by Properties and Finance groups, with an average increase of NI by 21.14% and 7.33% respectively. The 3 companies in the Utilities group all report an increase in their HKFRS-based NI. Nevertheless, this group still reaps the smallest 'benefit' (an average increase of 5.12%) from the new standards.

Figure 3: Impact on NI – Basic Statistics by Industry







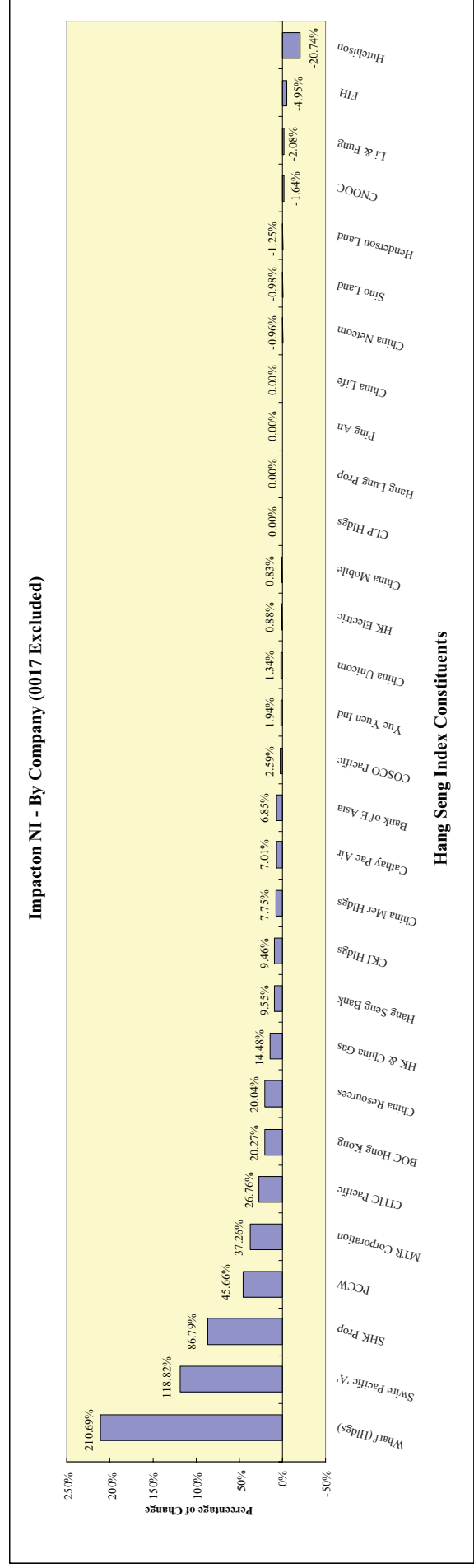
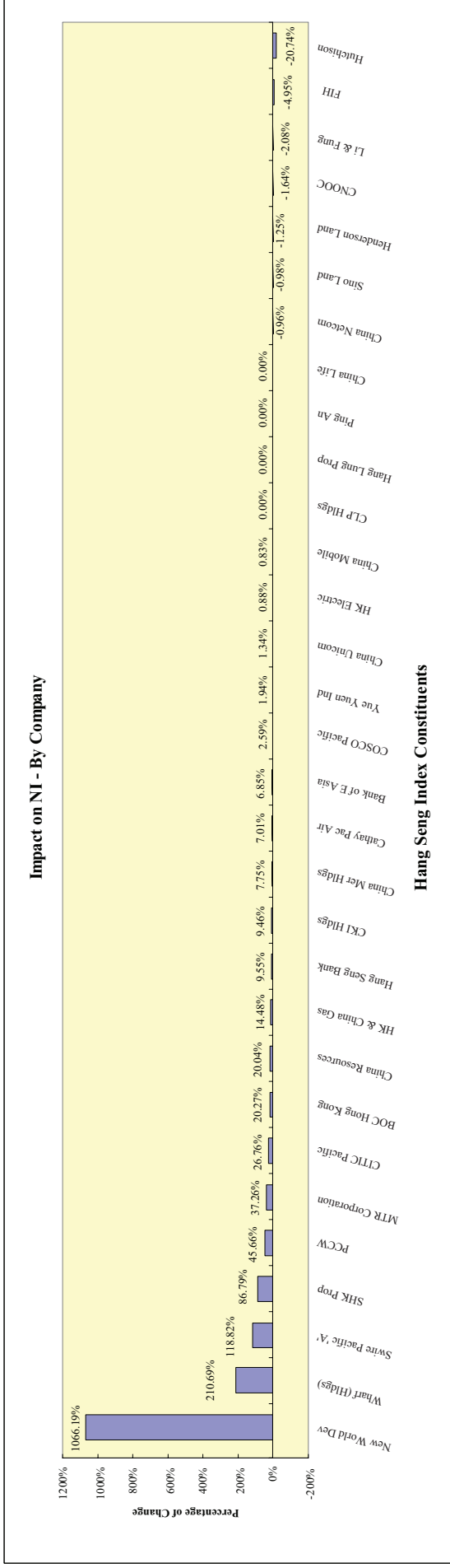
3.3 Change by Individual Company

Figure 4 depicts the percentage change of NI for each of the 31 companies, ranking from the largest increase to the largest decrease. The largest increase comes from New World Dev (0017) whose NI increases from a loss of HKD104.4m under the old accounting standards to a profit of HKD1,008.7m based on HKFRS, representing a positive change of 1,066.19%. The largest decrease is with Hutchison (0013) whose NI decreases from

HKD18,096m to HKD14,343m, a negative change of 20.74%.

Figure 4 also shows that more companies report profit increases than decreases. There is a wide variation in the profitability impact of adopting the new standards among the 31 companies. Even among the 20 profit increase companies, 10 report an increase of more than 10%.

Figure 4: Impact on NI – By Company



4. Impact on profitability: analysis by standards

We further look into the impact on NI caused by different standards for each constituent. Except for CKI Hldgs (1038) where the disclosure is not clear, we are able to do the decomposition for 30 constituents. A total of 16 standards under new HKFRS have been identified to make a difference on companies' NI. Table 3 presents both the dollar amount and the percentage change caused for each of the 16 standards. Among the 30

companies, the maximum number of standards affecting a company is 10 for Hutchison (0013), while on average a company is affected by 3 standards. Those companies with no change in their NI basically are not affected by any standard except for Hang Lung Prop (0101) where the impact of HKAS32&39 (Financial Instruments) and HKFRS2 (Share-based Payment) cancel each other.

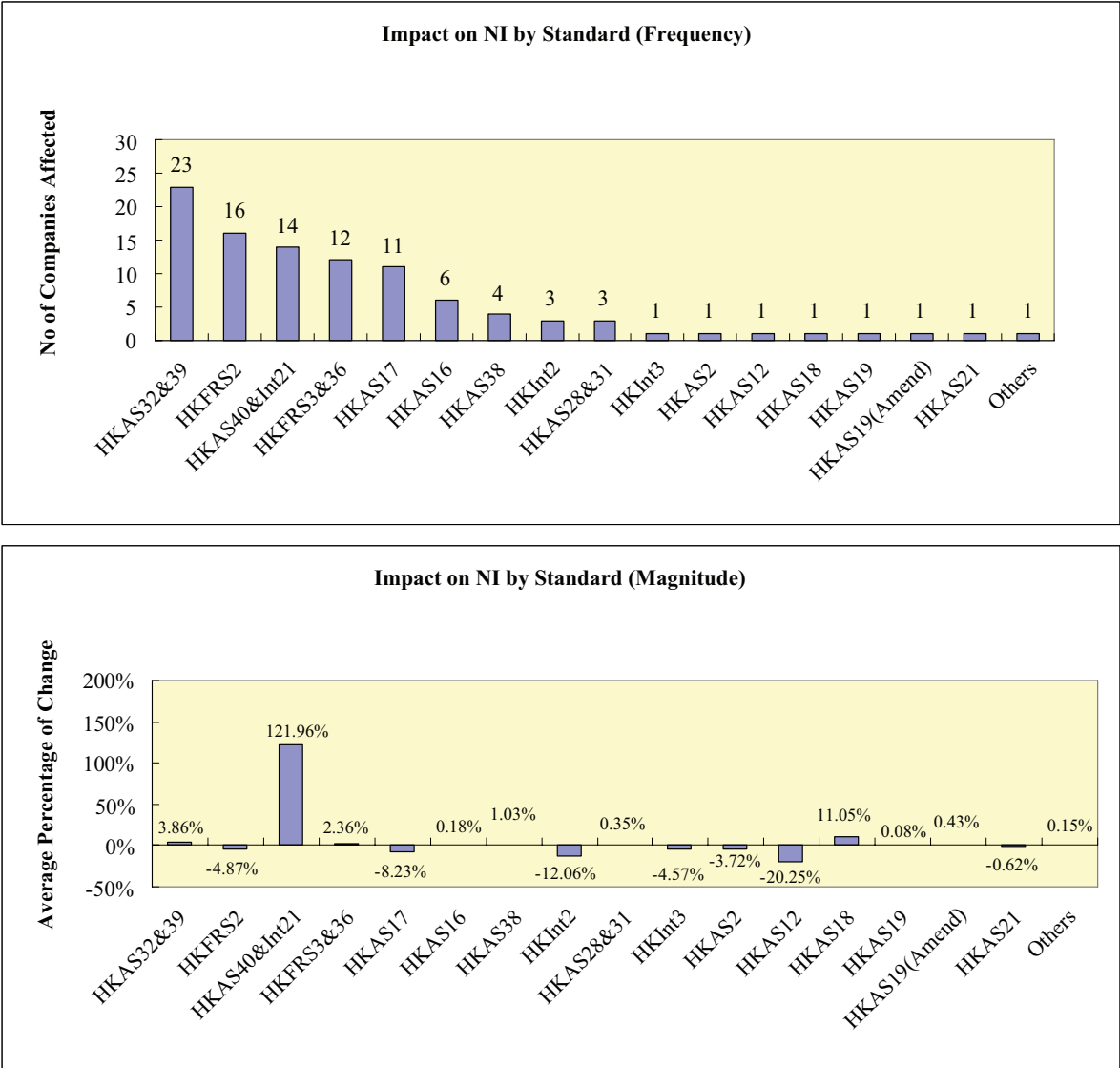
4.1 Overall Impact

Figure 5 shows the impact of each of the 16 standards in terms of both the number of companies and the dollar amount affected. The top 5 standards according to the number of companies affected are: HKAS32&39 (Financial Instruments) affecting 23 companies, HKFRS2 (Share-based Payment) affecting 16 companies, HKAS40 (Investment Property) & Int21 (Income Taxes - Recovery of Revalued Non-Depreciable Assets) affecting 14 companies, HKFRS3 (Business Combination) & HKAS36 (Impairment of Assets) affecting 12 companies, and HKAS17 (Leases) affecting 11 companies. On average, HKFRS2 and HKAS17 bring negative impact on NI while the rest of the top 5 all result in profit increases.

From Figure 5, we also observe that the top 5 standards affecting the largest numbers of companies are not necessarily the same as the standards that have a larger impact in terms of the average magnitude. However, most of these other standards affect only one or two companies. Therefore, it is much more meaningful to consider the top 5 standards as having the largest impact among the 16 standards that have affected the adoption of the new standards. In particular, HKAS40&Int21 has affected 14 firms with the highest average increase of 121.96%. As some companies have adopted this set of standards earlier in 2004 (Details refer to Section 7.1), the impact could have been understated. We attribute such significant increase to the booming of property market in 2005 and expect such trend to persist into 2006⁷.

7. HSI - Properties shows that the changes for 2005 and 2006 are 10.44% and 18.22% respectively.

Figure 5: Impact on NI – By Industry and Standard

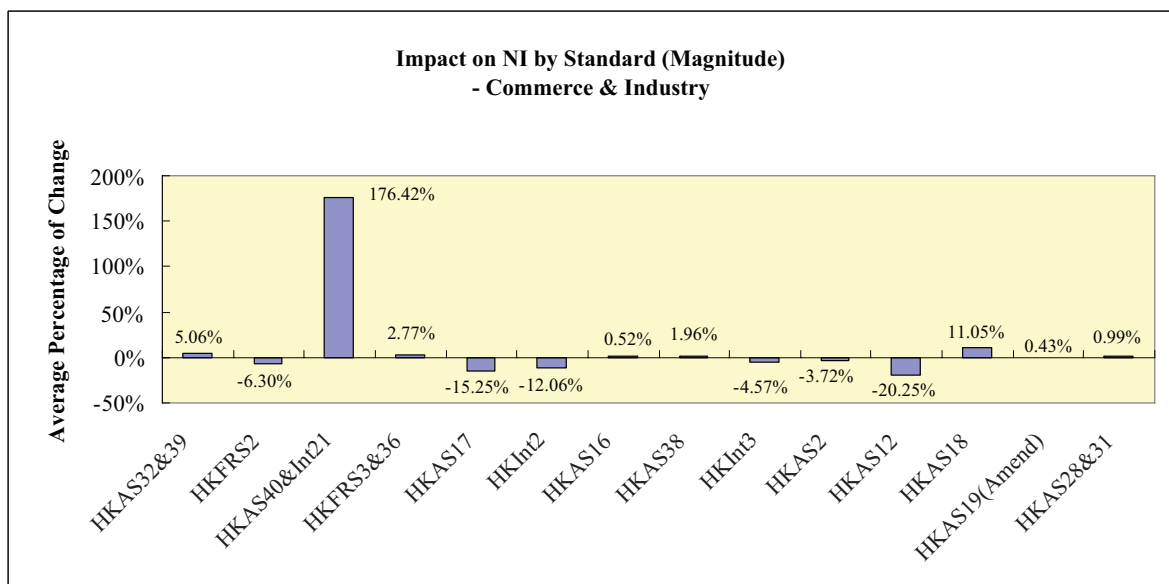
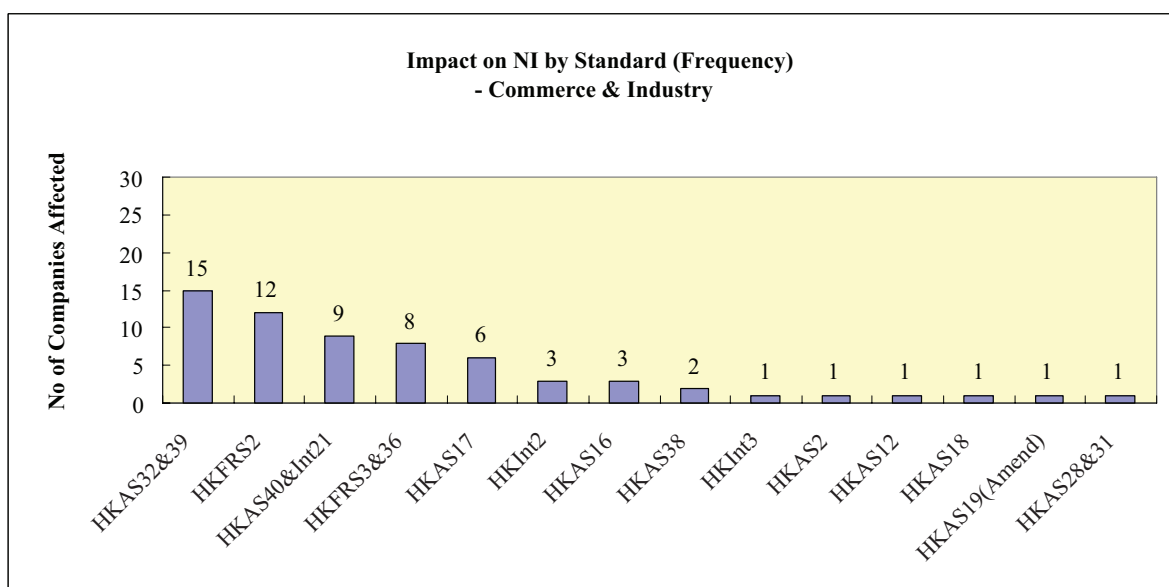


4.2 Impact by Industry

Figures 5a to 5d present the impact of the 16 standards by industry. From Figure 5a, we can see that the Commerce & Industry group is affected by 14 standards identified. The top 5

list for this group is the same as above and the dollar impact of these standards also exhibits a similar pattern.

Figure 5a: Impact on NI by Standard – Commerce & Industry



As shown in Figure 5b, the Finance group is mainly affected by 6 standards, out of which the top 5 list remains the same as that for all

the industry groups. All the top 5 standards have contributed positively to NI except for HKFRS2.

Figure 5b: Impact on NI by Standard – Finance

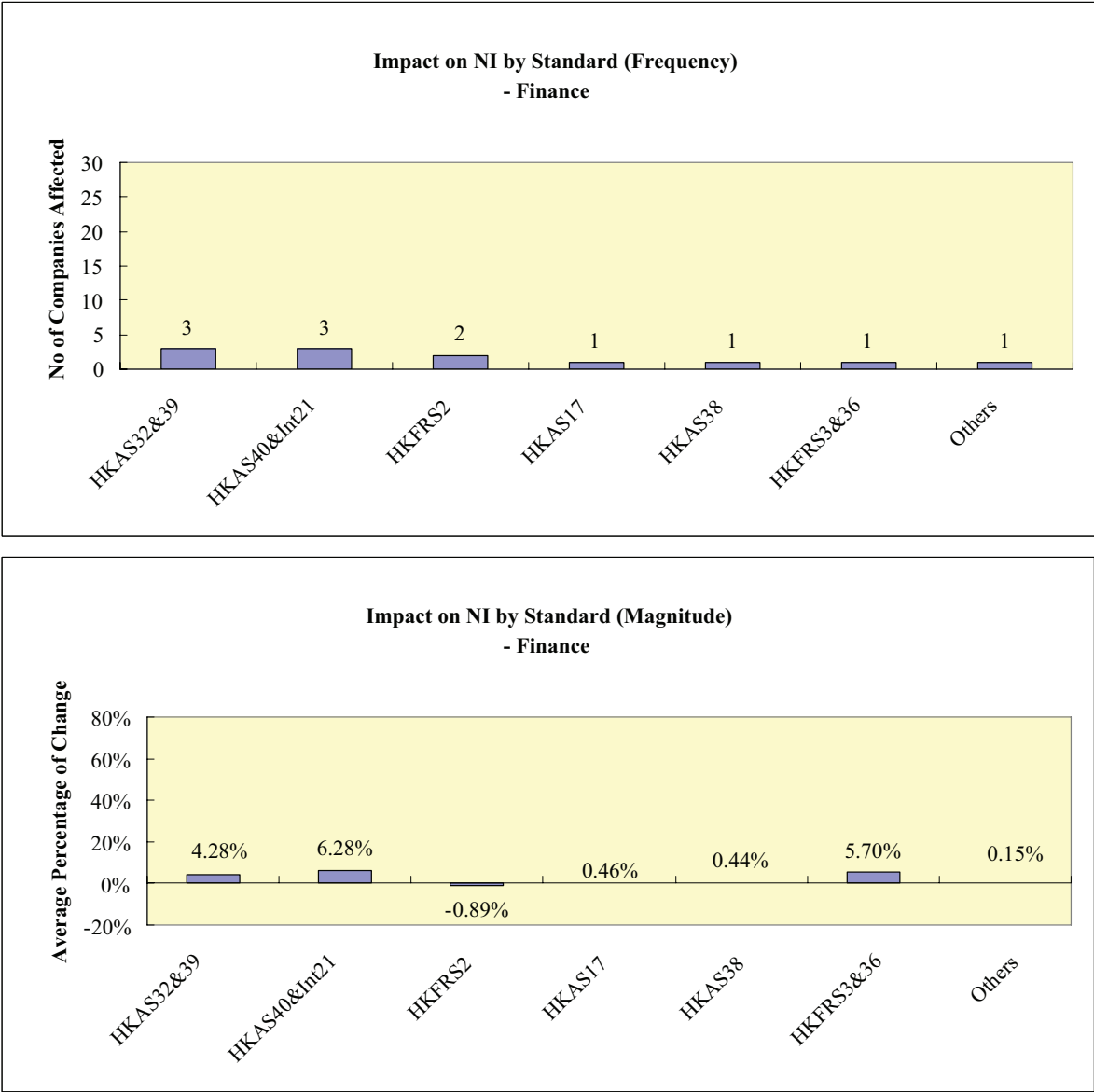
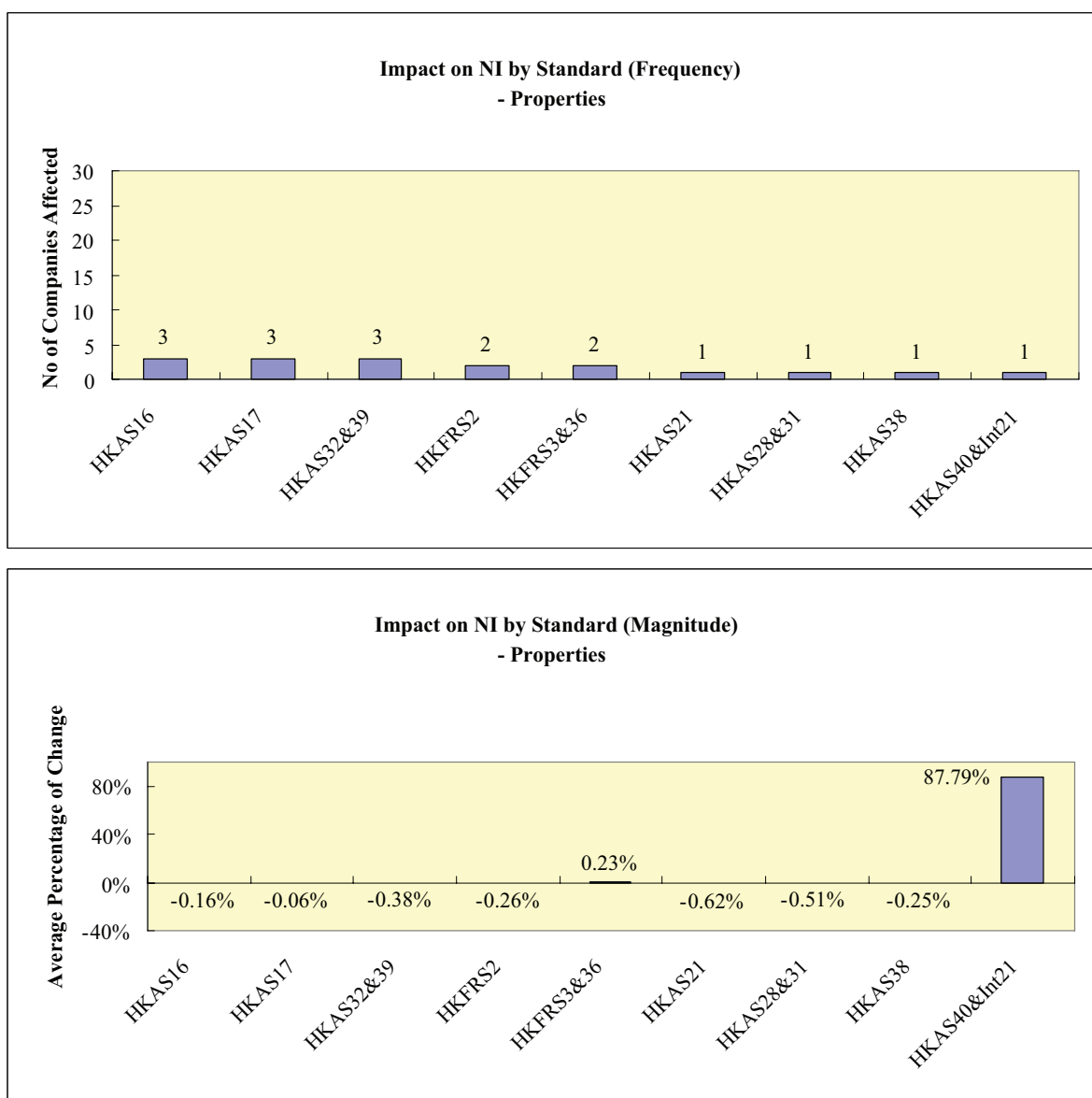


Figure 5c shows the impact for the Properties group. Altogether, 9 standards have affected 5 companies from this industry. In addition to the top 5 list identified above, HKAS16 (Properties and Equipment) is another

main force that has, on average, pulled NI down by 0.16%. Besides, the impact of HKAS32&39 has also become negative with this group.

Figure 5c: Impact on NI by Standard - Properties



For the Utilities group, as there is no impact on the NI of CLP Hldgs (0002), all the impact from the 6 standards identified in Figure 5d are for HK & China Gas (0003) and HK Electric (0006). Both companies are affected by HKAS32&39 by less than 1%. HK &

China Gas (0003) is also affected by HKAS17 (0.66%), HKAS40&Int21 (12.96%) and HKFRS3&HKAS36 (-0.08%). HK Electric (0006) is also affected by HKAS19 (0.08%) and HKAS28&31 (0.58%).

Figure 5d: Impact on NI by Standard - Utilities

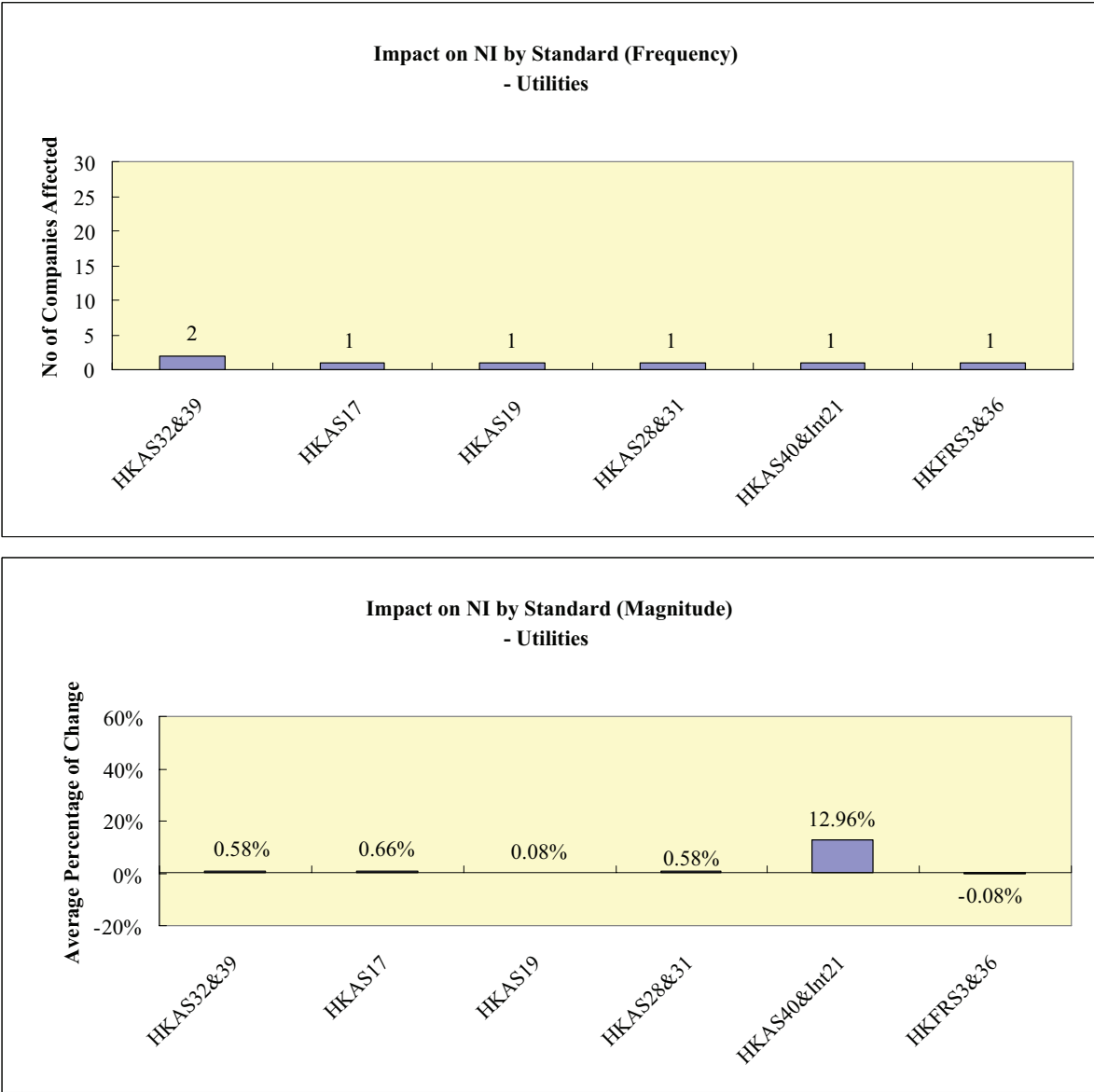


Figure 6 further shows the impact of the top 5 standards across different industries. HKAS40&Int21 contributes the largest in

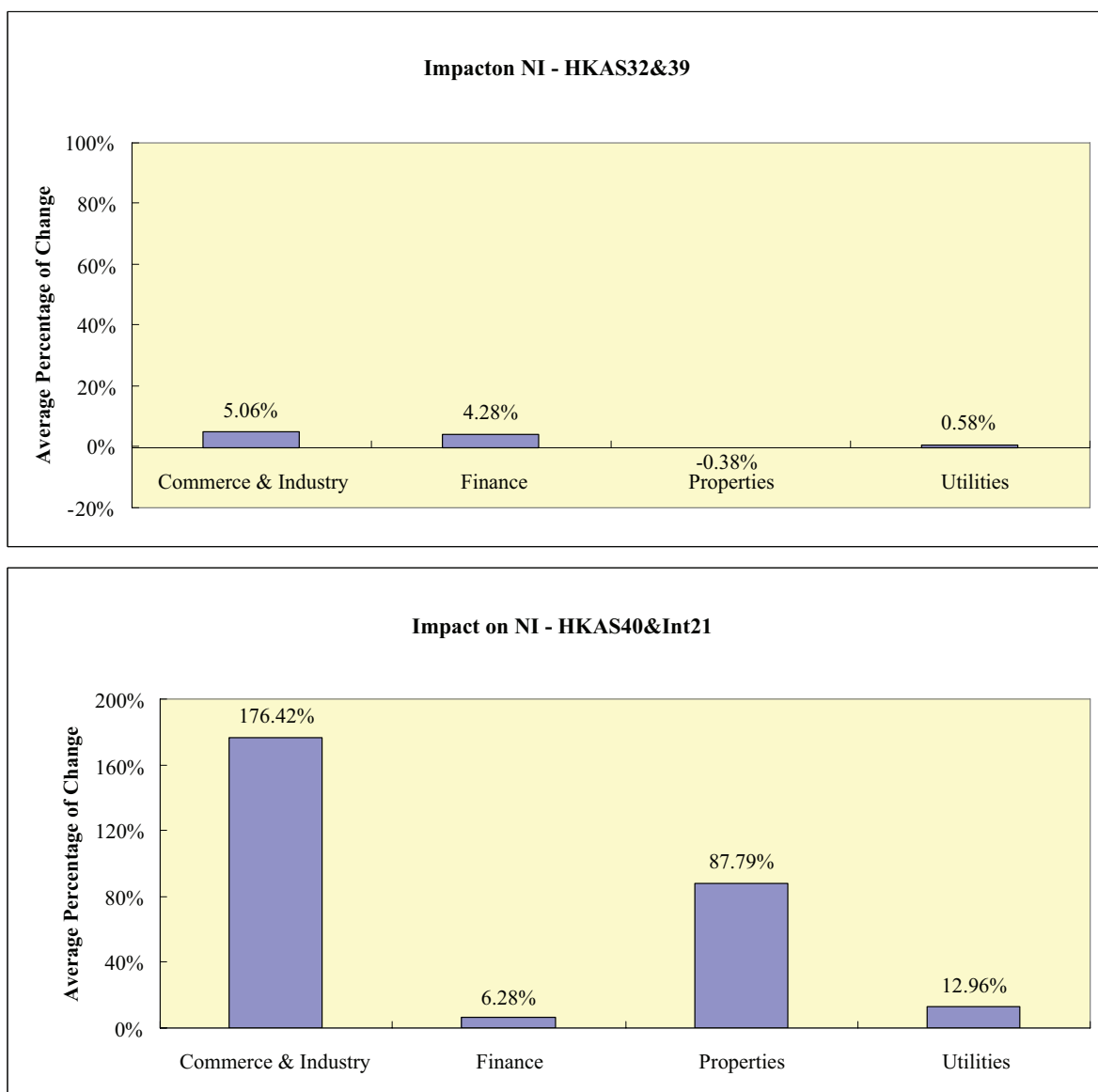
terms of the average increases in NI for all the industries⁸. Except for Properties, HKAS32&39 increase NI for all the industry

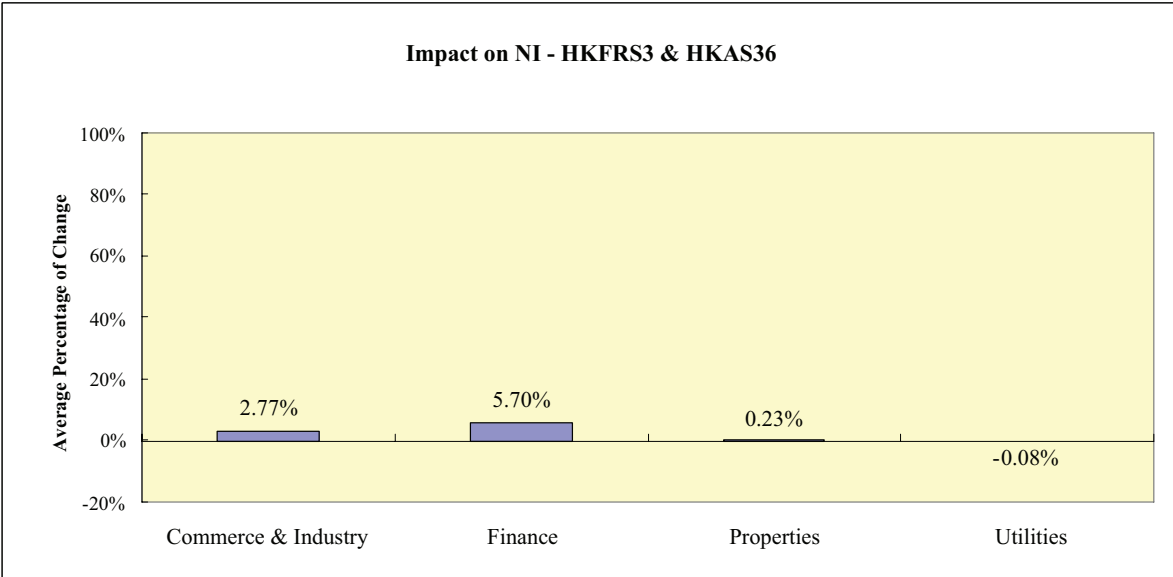
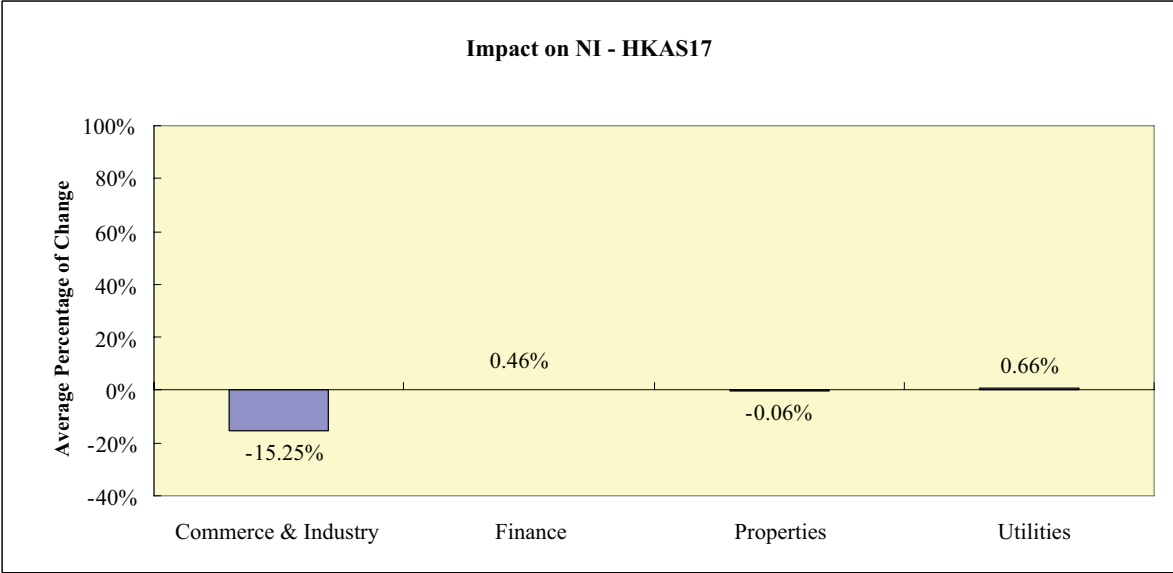
8. The impact of HKAS40&Int21 could have been understated due to the early adoption by Henderson Land (0012), Hutchison (0013) and Sino Land (0083) and Hang Lung Prop (0101) in their 2004 reports. The early adoption has, on average, increased the 2004/2005 NI of these 4 companies by 110.95%. Details are discussed in Section 7.1.

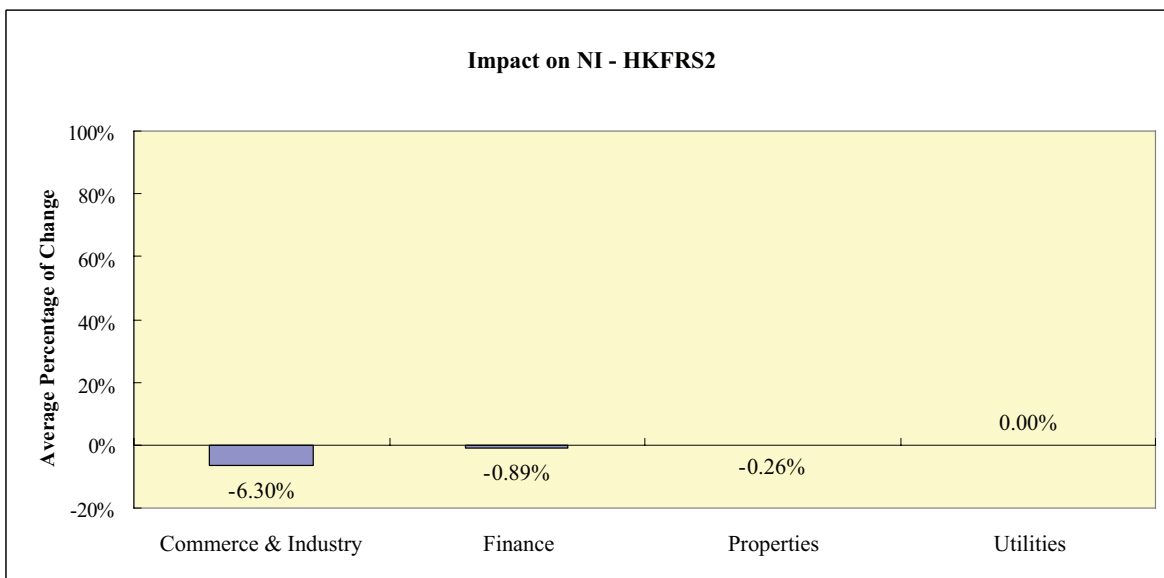
groups. In terms of HKFRS2, Utilities are not affected and the other three industries have reported a negative impact. HKAS17 slightly increases the NI for Finance and Utilities but decreases that for Commerce & Industry

and Properties for 15.25% and 0.06% respectively. The impact of HKFRS3&HKAS36 is mostly positive except for Utilities where a small decrease of 0.08% is found.

Figure 6: Impact on NI – By Top 5 Standards







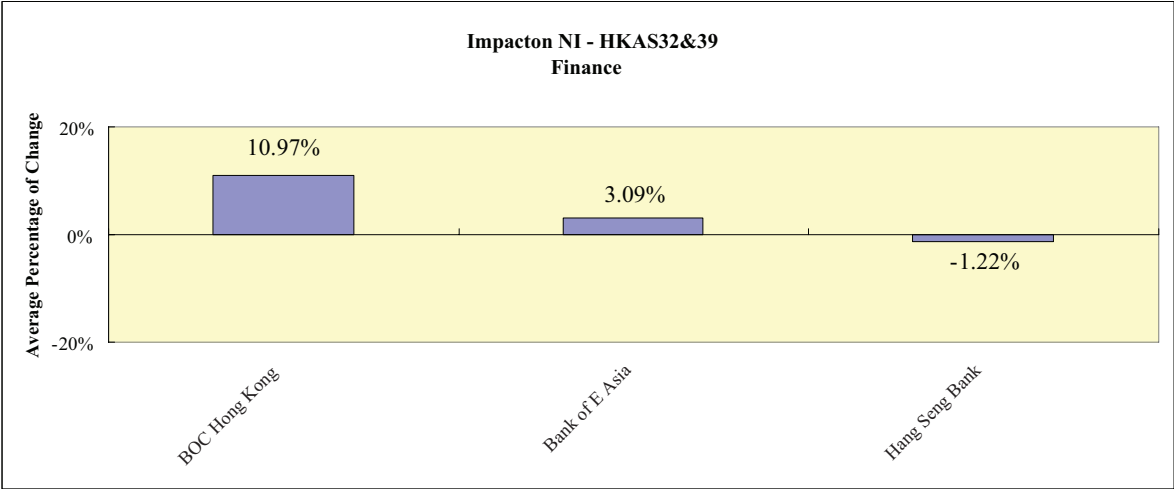
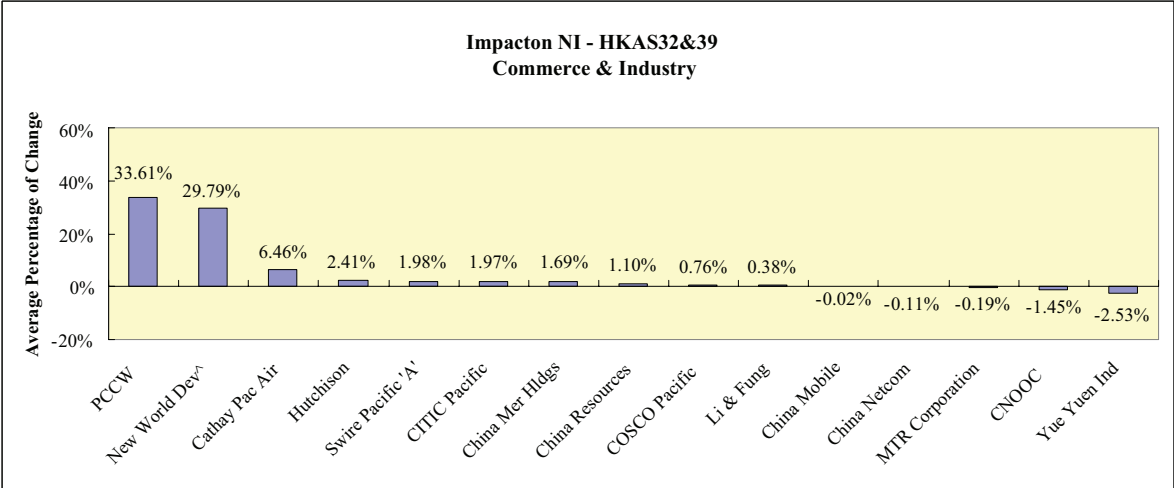
4.3 Impact by Individual Company within an Industry

To further analyze whether there is comparability among companies within the same industry, we present Figures 6a to 6e⁹ for the impact of each of the top 5 standards on individual companies within an industry. From Figure 6a, we observe that HKAS32&39 generally increase profit for the majority of companies within the same industry except for the Properties group. For

example, among the 15 companies within Commerce & Industry, 10 companies report an profit increase as a result of the standards. However, the magnitude of increase varies substantially between companies, with PCCW (0008) reporting an increase of 33.61% while Li & Fung (0494) only has 0.38%. The variability is less in the other three industry groups.

9. Since these Figures are mainly for intra-group comparison, we do not provide chart when only 1 company is affected by a certain standard within a certain industry group.

Figure 6a: Impact on NI – HKAS32&39



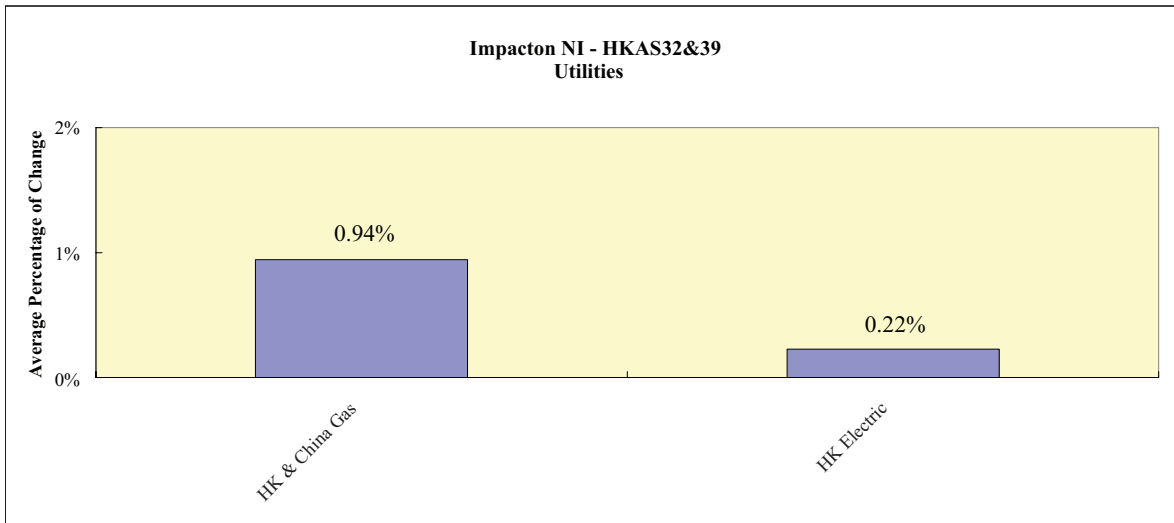
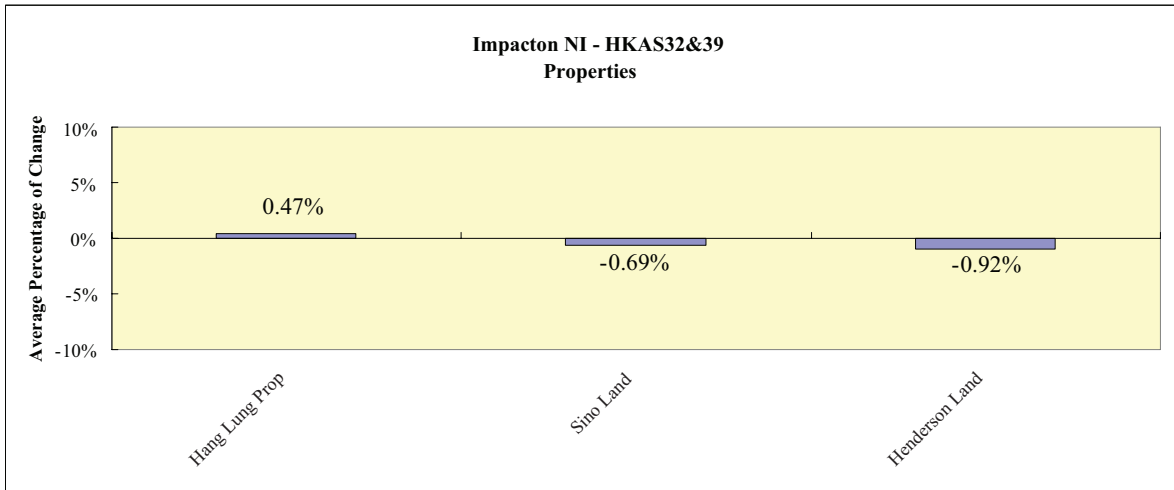
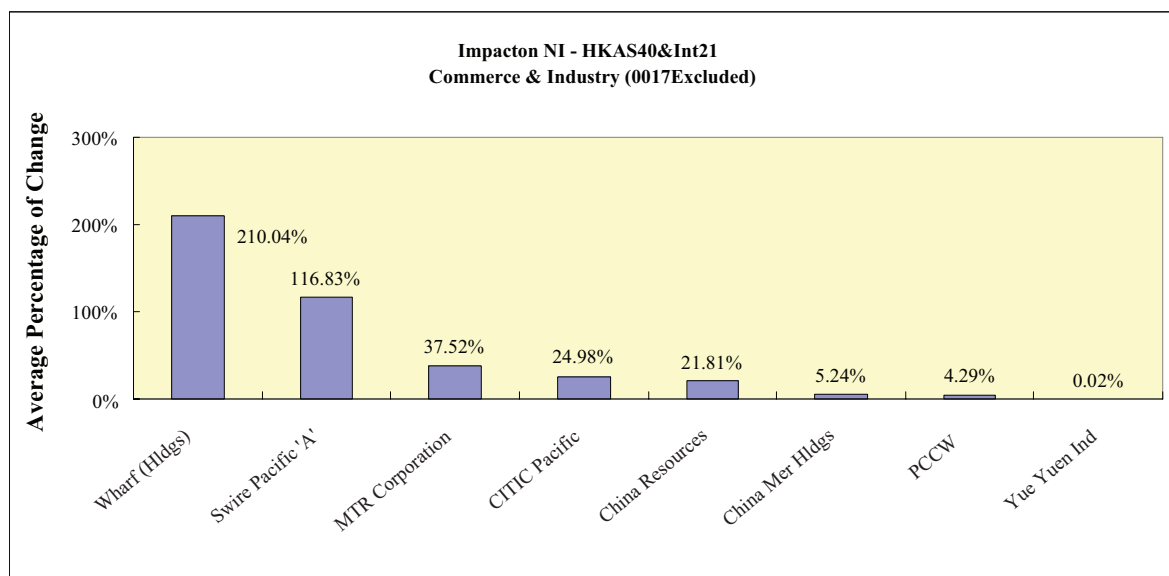
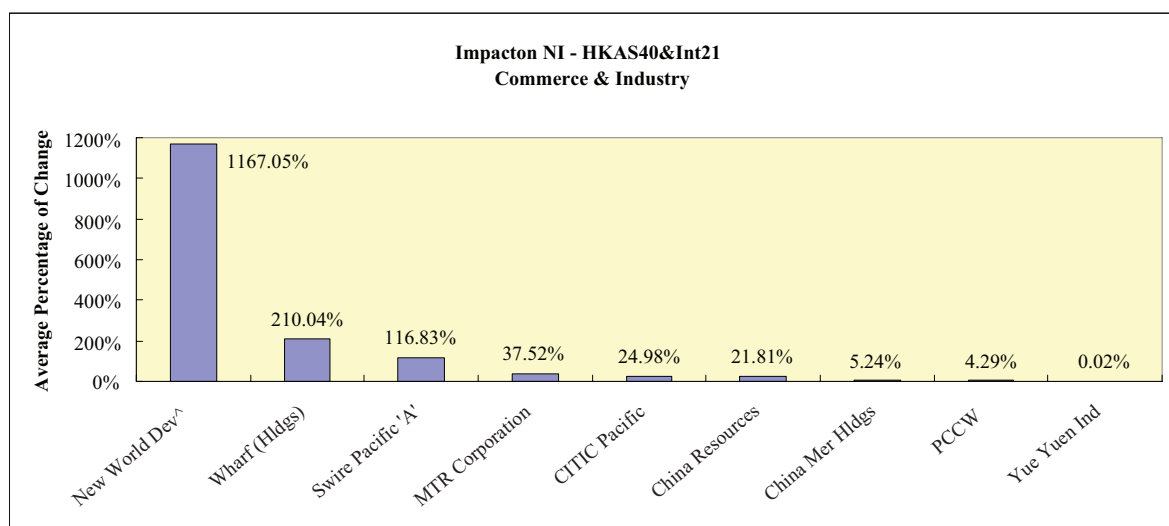
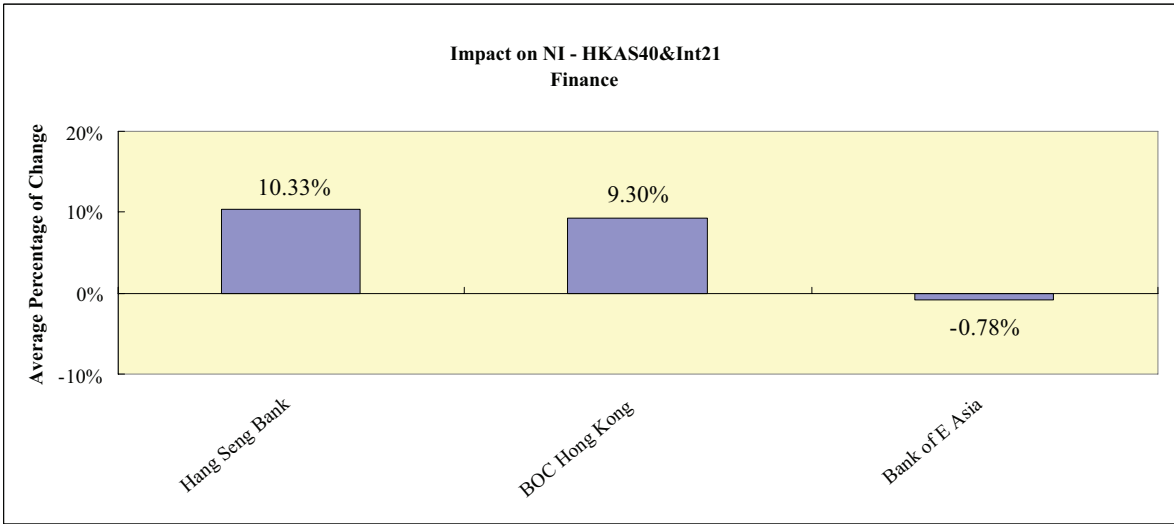


Figure 6b shows that HKAS40&Int21 mainly affect two industry groups, Commerce & Industry and Finance. SHK Prop (0016) and HK & China Gas (0003) are the only companies affected in Properties and Utilities groups, having increases of 87.79% and 12.96% respectively (not figured here). While the standard tend to increase

profit for most companies within the same industry, the variability of increase still does not support the concept of comparability, especially within Commerce & Industry. Even without the outlier of New World Dev (0017), the range of profit increases reported by other companies remains very large.

Figure 6b: Impact on NI – HKAS40&Int21

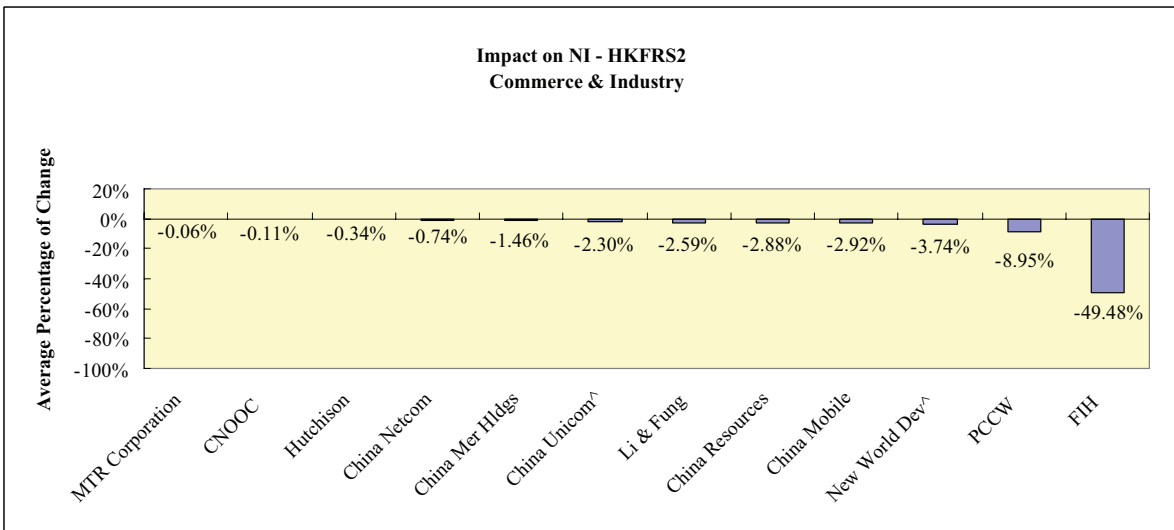




The impact of HKFRS2 is presented in Figure 6c, where a more consistent pattern seems to exist among different companies within Commerce & Industry except for FIH (2038). Similarly, the companies within the Finance

and Properties report a profit decrease due to the standard, and the sizes of the decrease are more comparable. For Utilities, there is no company affected by HKFRS2.

Figure 6c: Impact on NI – HKFRS2



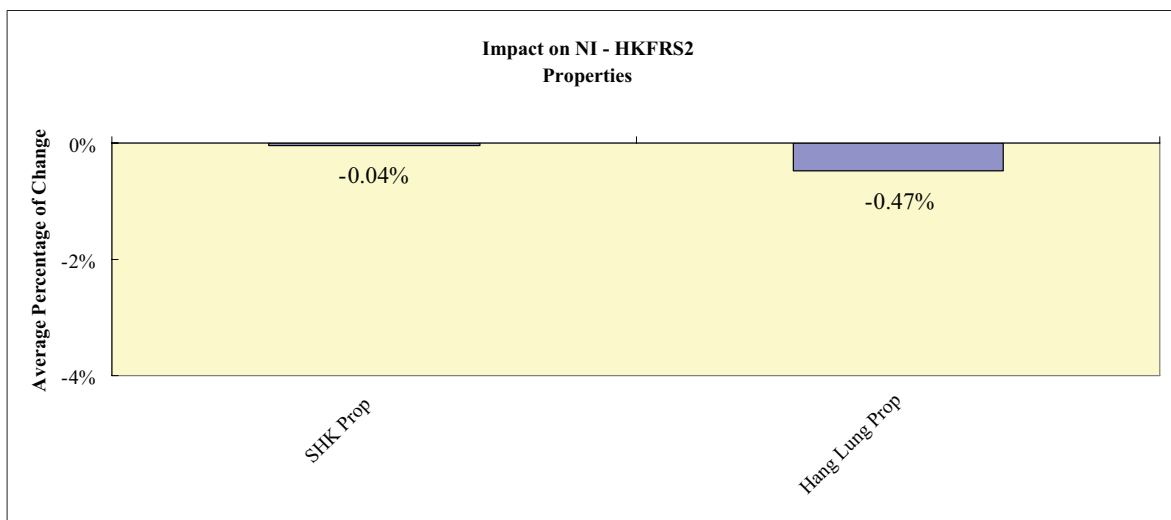
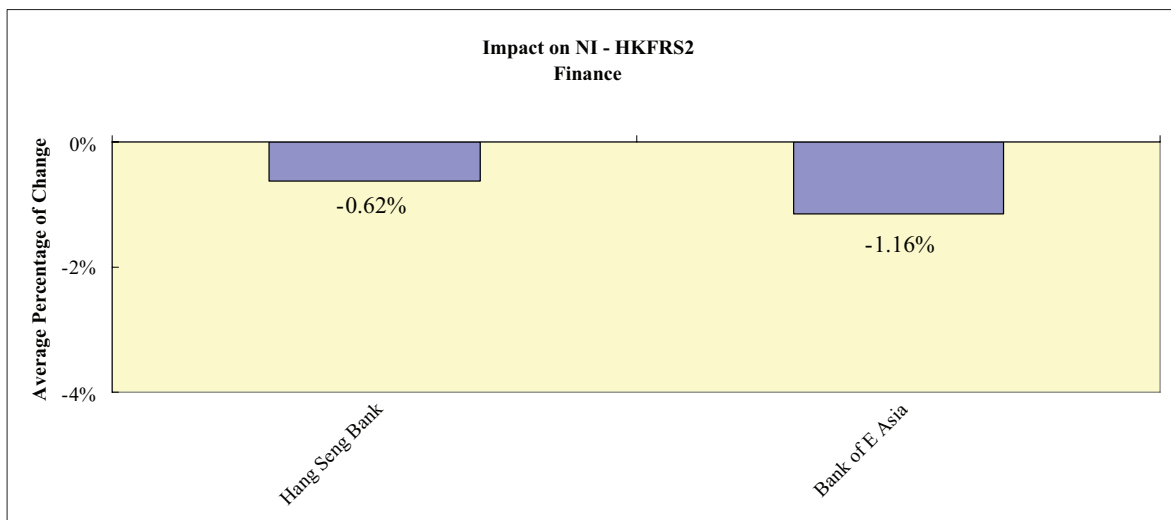
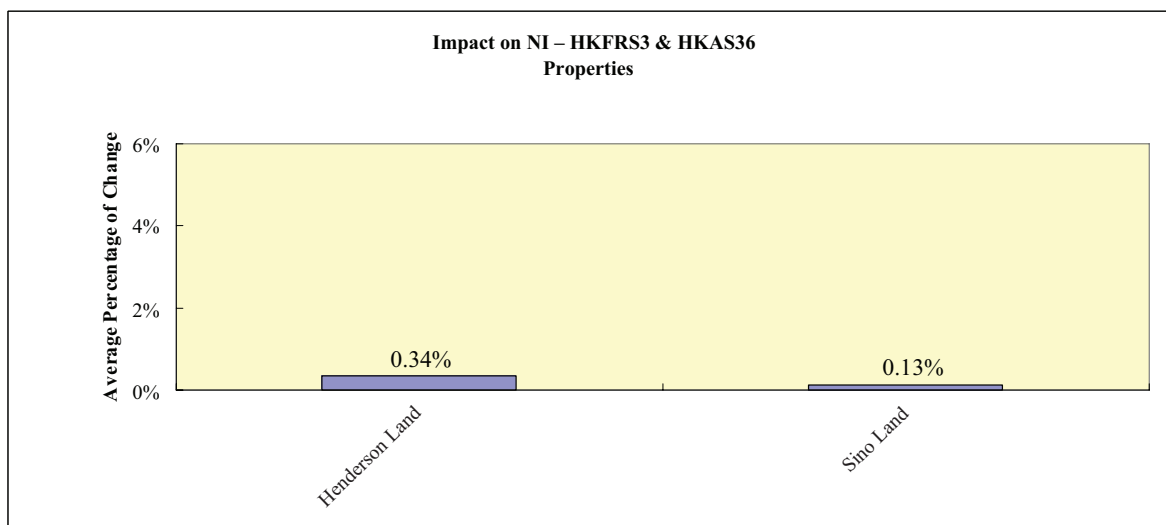
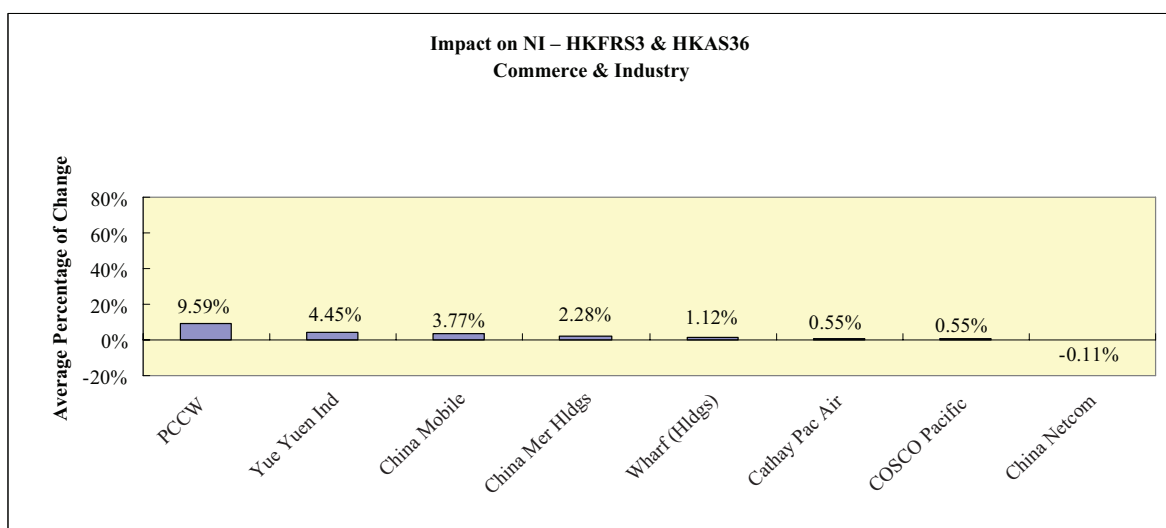


Figure 6d shows the effect of HKFRS3 & HKAS36. Since the number of companies affected by HKFRS3&HKAS36 for both the Finance (Bank of E Asia (0023) with an increase of 5.7%) and Utilities (HK & China Gas (0003) with a decrease of 0.08%) groups is only one (not figured here), we focus our analysis on the companies for the other two industry groups. Seven of the

eight companies for Commerce & Industry group report profit increases due to this standard, and the variability of the increases is smaller as compared with those caused by HKAS32&39 or HKAS40&Int21. Similarly, the impact on the 2 companies of the Properties group is rather comparable.

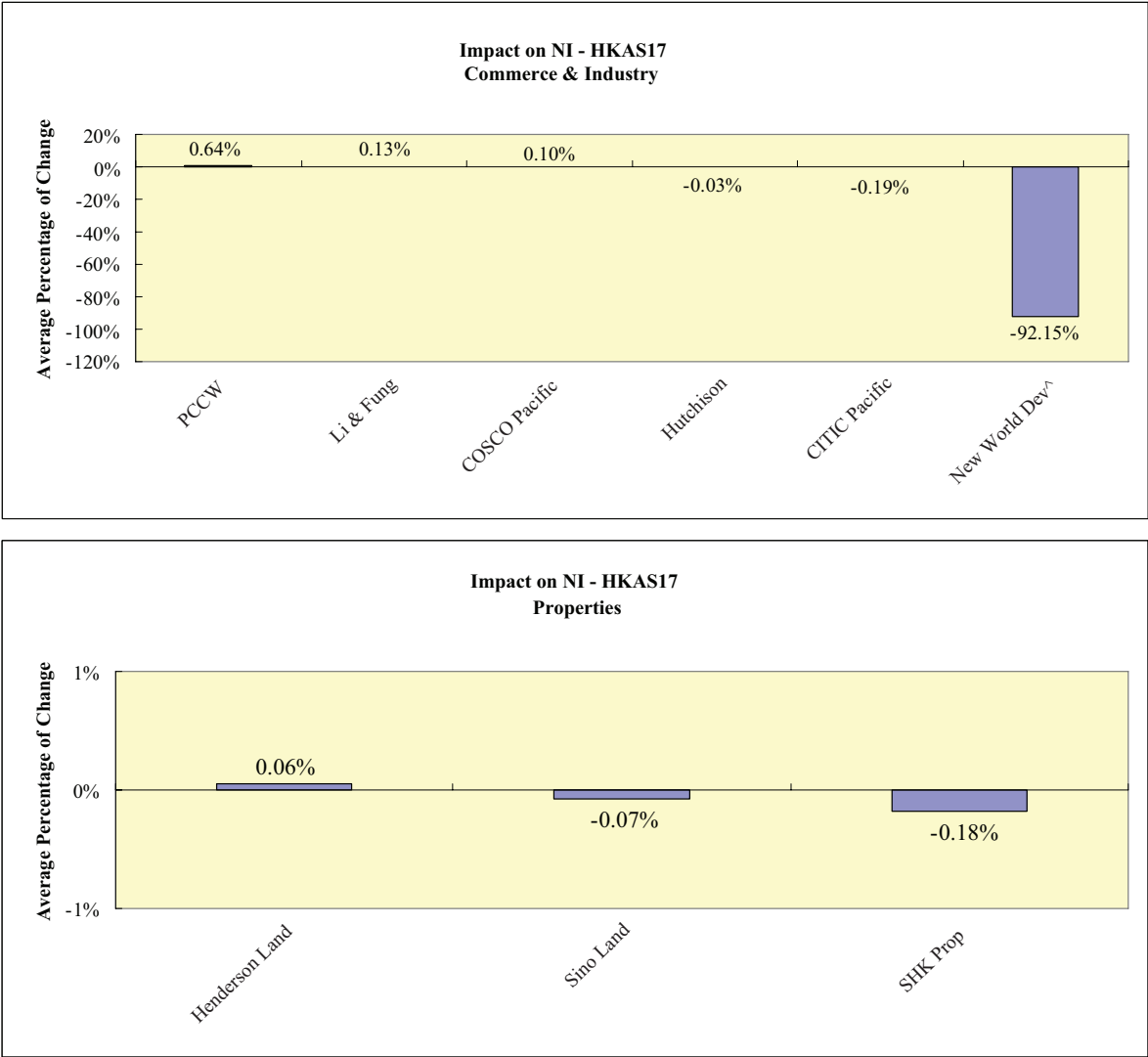
Figure 6d: Impact on NI – HKFRS3&HKAS36



The impact of HKAS17 can be seen in Figure 6e. Again, this standard only affects 1 company within both Finance (Hang Seng Bank (0011) with an increase of 0.66%) and Utilities (HK & China Gas (0003) with an increase of 0.46%). As for the other two industry groups, except for the impact on New World Dev (0017), HKAS17 appears to have a more similar effect on different companies within any industry as compared with HKAS32 & 39 or HKAS40 & Int21.

Overall, among the top 5 standards having the largest impact on NI as identified in Figure 6, we find that there is a certain level of comparability among companies within the same industry in terms of the direction of profit changes. However, in terms of the magnitude of these changes, we observe less comparability in adopting HKAS32&39 or HKAS40&Int21 than in HKFRS2, HKFRS3&HKAS36 or HKAS17.

Figure 6e: Impact on NI – HKAS17



5. Impact on beginning equity: overall analysis

5.1 Overall Change

Similar to the analysis of NI, we exclude the changes of beginning shareholders' equity (BeginEqty) caused by changes in accounting policy other than adopting HKFRS¹⁰. The adjustment to BeginEqty consists of prior year adjustment (PYA) and beginning adjustment (BeginAdj). PYA is resulted from those standards that are applied retrospectively to the previous accounting periods, while BeginAdj is related to those standards that are applied prospectively so the restatement is not available.¹¹ As shown in Table 4, for 32 out of the 39 HSI Constituent Stocks, we are able to identify

the total adjustment to BeginEqty including its components of PYA and BeginAdj. However, for simplicity, we only present the impact on BeginEqty in the following analysis without separating the total adjustment into PYA and BeginAdj.

Figure 7 displays the overall impact of adopting the new standards on BeginEqty. While the maximum increase in BeginEqty is 18.23%, the minimum is a decrease of 19.07%. On average, the beginning equity decreases by 2.00%; this does not differ too much from the median decrease of 0.92%.

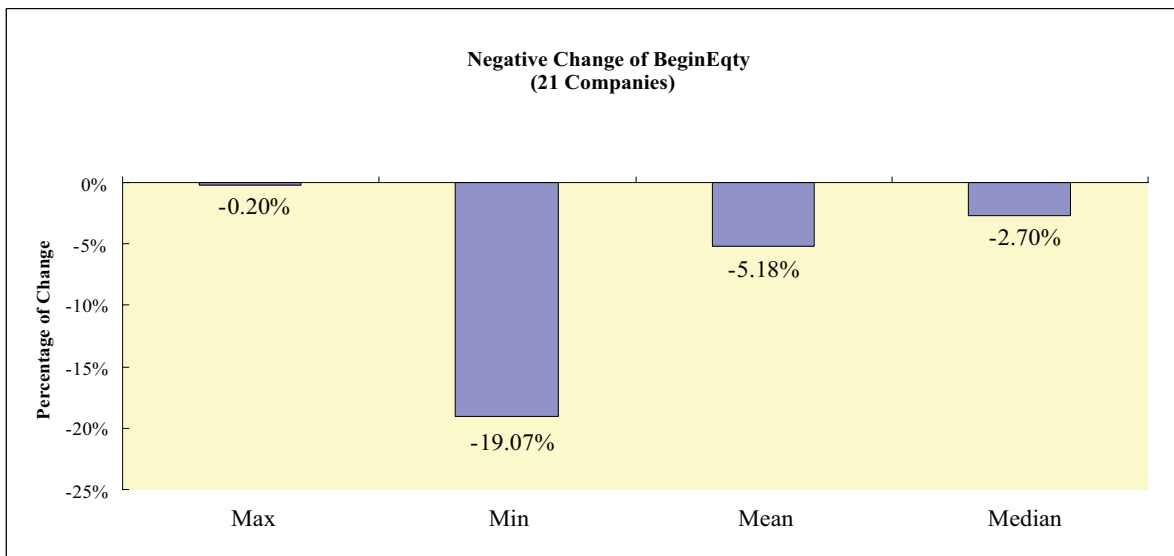
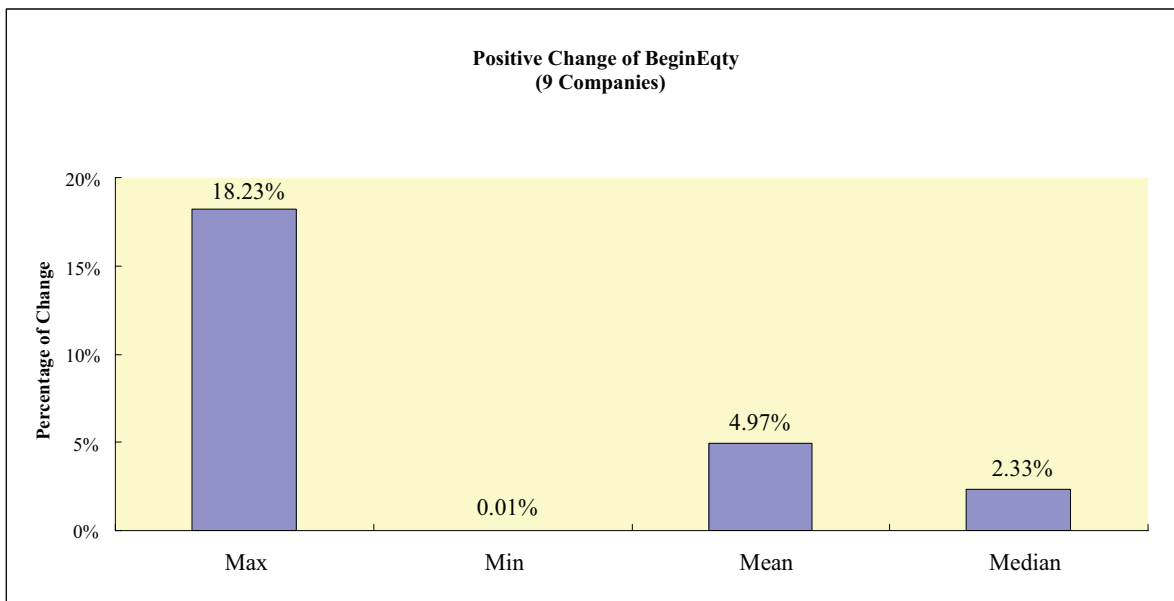
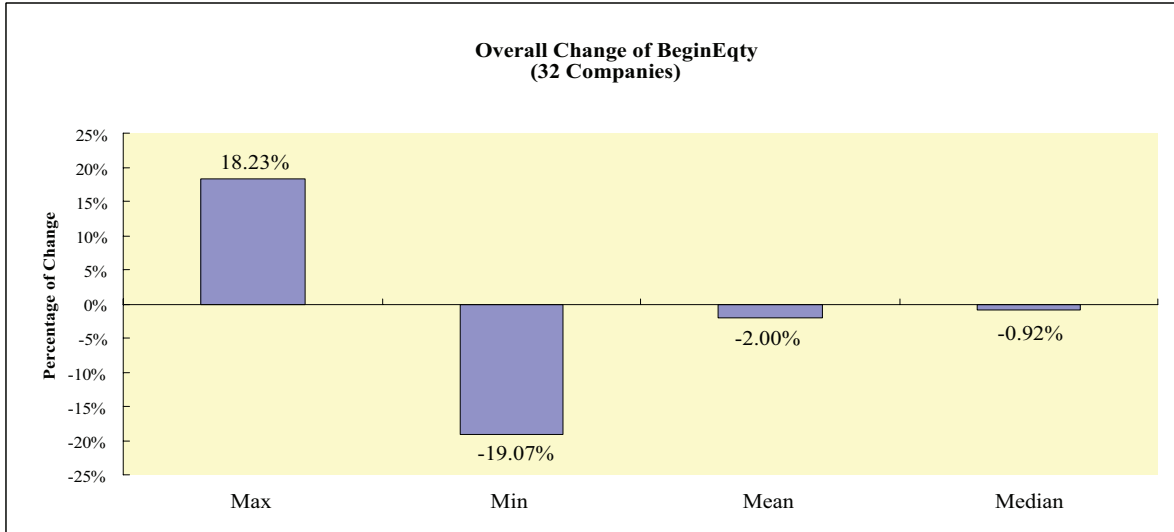
-
10. Not included in the changes of beginning shareholders' equity: (1) New World Dev (0017) has a decrease of HKD86.40m as a result of change in accounting policy for handset subsidies; (2) China Unicom (0762) has an increase of RMB368.21m as a result of change in accounting policy for revenue recognition.
11. BeginAdj is mainly caused by standards that are prohibited from retrospective application, namely HKAS39 and HKFRS3. On average, PYA has a negative impact on BeginEqty while BeginAdj has a positive impact.

Table 4: Impact on Beginning Shareholders' Equity (BeginEqty) – By Company

| No. | Company Name | Company Code | Industry | Year | Fiscal Year End | Currency | End of the Year | | Beginning of the Year of Adoption | Total Adjustment of Shareholders' Equity | | | | | |
|-----|----------------------------|--------------|-------------------|------|-----------------|----------|---------------------------------|--------------------------------|-----------------------------------|--|---------------|-----------------|--------------|------------------|---------|
| | | | | | | | Before Adoption - Reported (\$) | After Adoption - Restated (\$) | | (iii) | (iv)=(ii)-(i) | PYA | (v)=(iv)-(i) | BeginAdj | % |
| 1 | CLP Hldgs | 2 | Utilities | 2005 | 1231 | HKD | 44,199,000,000 | 44,199,000,000 | 45,229,000,000 | 0 | 0.00% | 1,030,000,000 | 2.33% | 1,030,000,000 | 2.33% |
| 2 | HK & China Gas | 3 | Utilities | 2005 | 1231 | HKD | 17,394,000,000 | 14,603,900,000 | 14,778,600,000 | (2,790,100,000) | -16.04% | 174,700,000 | 1.00% | (2,615,400,000) | -15.04% |
| 3 | Wharf (Hldgs) | 4 | Commerce&Industry | 2005 | 1231 | HKD | 65,168,000,000 | 54,949,000,000 | 54,909,000,000 | (10,219,000,000) | -15.68% | (40,000,000) | -0.06% | (10,259,000,000) | -15.74% |
| 4 | HSBC Hldgs | 5 | Finance | 2005 | 1231 | USD | 86,623,000,000 | 85,572,000,000 | 86,775,000,000 | (1,101,000,000) | -1.27% | 1,253,000,000 | 1.45% | 152,000,000 | 0.18% |
| 5 | HK Electric | 6 | Utilities | 2005 | 1231 | HKD | 37,856,000,000 | 37,522,000,000 | 37,185,000,000 | (284,000,000) | -0.75% | (387,000,000) | -1.02% | (671,000,000) | -1.77% |
| 6 | PCCW | 8 | Commerce&Industry | 2005 | 1231 | HKD | (6,716,000,000) | (7,559,000,000) | (7,997,000,000) | (843,000,000) | -12.55% | (438,000,000) | -6.52% | (1,281,000,000) | -19.07% |
| 7 | Hang Seng Bank | 11 | Finance | 2005 | 1231 | HKD | 43,185,000,000 | 40,929,000,000 | 41,994,000,000 | (2,256,000,000) | -5.22% | 1,065,000,000 | 2.47% | (1,191,000,000) | -2.76% |
| 8 | Henderson Land | 12 | Properties | 2006 | 630 | HKD | 66,698,980,000 | 65,637,700,000 | 65,760,700,000 | (1,061,280,000) | -1.59% | 123,000,000 | 0.18% | (938,280,000) | -1.41% |
| 9 | Hutchison | 13 | Commerce&Industry | 2005 | 1231 | HKD | 260,841,000,000 | 251,171,000,000 | 250,525,000,000 | (9,670,000,000) | -3.71% | (646,000,000) | -0.25% | (10,316,000,000) | -3.95% |
| 10 | SHK Prop | 16 | Properties | 2006 | 630 | HKD | 150,152,000,000 | 143,923,000,000 | 144,848,000,000 | (6,229,000,000) | -4.15% | 925,000,000 | 0.62% | (5,304,000,000) | -3.53% |
| 11 | New World Dev [^] | 17 | Commerce&Industry | 2006 | 630 | HKD | 61,657,800,000 | 50,900,100,000 | 51,340,500,000 | (10,671,300,000) | -17.31% | 440,400,000 | 0.71% | (10,230,900,000) | -16.59% |
| 12 | Swire Pacific 'A' | 19 | Commerce&Industry | 2005 | 1231 | HKD | 86,995,000,000 | 78,625,000,000 | 78,579,000,000 | (8,370,000,000) | -9.62% | (46,000,000) | -0.05% | (8,416,000,000) | -9.67% |
| 13 | Bank of E Asia | 23 | Finance | 2005 | 1231 | HKD | 21,727,481,000 | 21,693,139,000 | 22,288,927,000 | (34,342,000) | -0.16% | 595,788,000 | 2.74% | 561,446,000 | 2.58% |
| 14 | MTR Corporation | 66 | Commerce&Industry | 2005 | 1231 | HKD | 63,499,000,000 | 61,892,000,000 | 62,016,000,000 | (1,607,000,000) | -2.53% | 124,000,000 | 0.20% | (1,483,000,000) | -2.34% |
| 15 | Sino Land | 83 | Properties | 2006 | 630 | HKD | 34,628,539,852 | 34,627,106,095 | 34,711,724,643 | (1,433,757) | 0.00% | 84,618,548 | 0.24% | 83,184,791 | 0.24% |
| 16 | Hang Lung Prop | 101 | Properties | 2006 | 630 | HKD | 40,643,300,000 | 40,288,300,000 | 40,267,500,000 | (355,000,000) | -0.87% | (20,800,000) | -0.05% | (375,800,000) | -0.92% |
| 17 | China Mer Hldgs | 144 | Commerce&Industry | 2005 | 1231 | HKD | 13,944,000,000 | 13,528,000,000 | 13,816,000,000 | (416,000,000) | -2.98% | 288,000,000 | 2.07% | (128,000,000) | -0.92% |
| 18 | CITIC Pacific | 267 | Commerce&Industry | 2005 | 1231 | HKD | 37,892,000,000 | 36,921,000,000 | 36,883,000,000 | (971,000,000) | -2.56% | (38,000,000) | -0.10% | (1,009,000,000) | -2.66% |
| 19 | China Resources | 291 | Commerce&Industry | 2005 | 1231 | HKD | 15,781,568,000 | 15,124,828,000 | 15,250,535,000 | (656,740,000) | -4.16% | 125,707,000 | 0.80% | (531,033,000) | -3.36% |
| 20 | Cathay Pac Air | 293 | Commerce&Industry | 2005 | 1231 | HKD | 32,855,000,000 | 32,749,000,000 | 32,749,000,000 | 0 | 0.00% | (106,000,000) | -0.32% | (106,000,000) | -0.32% |
| 21 | Li & Fung | 494 | Commerce&Industry | 2005 | 1231 | HKD | 4,844,673,000 | 4,741,824,000 | 4,714,056,000 | (102,849,000) | -2.12% | (27,768,000) | -0.57% | (130,617,000) | -2.70% |
| 22 | Yue Yuen Ltd | 551 | Commerce&Industry | 2006 | 930 | USD | 1,924,267,000 | 1,927,050,000 | 1,913,537,000 | 2,783,000 | 0.14% | (13,513,000) | -0.70% | (10,730,000) | -0.56% |
| 23 | China Unicom [^] | 762 | Commerce&Industry | 2005 | 1231 | RMB | 72,810,454,000 | 72,442,241,000 | 72,449,666,000 | 0 | 0.00% | 7,425,000 | 0.01% | 7,425,000 | 0.01% |
| 24 | CNOOC | 883 | Commerce&Industry | 2005 | 1231 | RMB | 56,717,461,000 | 56,442,790,000 | 56,442,790,000 | 0 | -0.48% | 167,000,000 | 0.30% | (274,671,000) | -0.48% |
| 25 | China Netcom | 906 | Commerce&Industry | 2005 | 1231 | RMB | 55,165,000,000 | 64,595,000,000 | 64,762,000,000 | 9,430,000,000 | 17.09% | 33,000,000 | 0.01% | 9,597,000,000 | 17.40% |
| 26 | China Mobile | 941 | Commerce&Industry | 2005 | 1231 | RMB | 233,161,000,000 | 233,161,000,000 | 233,194,000,000 | 0 | 0.00% | 33,000,000 | 0.01% | 33,000,000 | 0.01% |
| 27 | CKI Hldgs | 1038 | Commerce&Industry | 2005 | 1231 | HKD | 31,170,000,000 | 30,774,000,000 | 29,670,000,000 | (396,000,000) | -1.27% | (1,104,000,000) | -3.54% | (1,500,000,000) | -4.81% |
| 28 | COSCO Pacific | 1199 | Commerce&Industry | 2005 | 1231 | USD | 1,472,807,000 | 1,476,187,000 | 1,741,368,000 | 3,380,000 | 0.23% | 265,181,000 | 18.01% | 268,561,000 | 18.23% |
| 29 | FH | 2038 | Commerce&Industry | 2005 | 1231 | USD | 630,809,000 | 630,809,000 | 630,809,000 | 0 | 0.00% | 0 | 0.00% | 0 | 0.00% |
| 30 | Png An | 2318 | Finance | 2005 | 1231 | RMB | 28,253,000,000 | 28,197,000,000 | 28,197,000,000 | (56,000,000) | -0.20% | 0 | 0.00% | (56,000,000) | -0.20% |
| 31 | BOC Hong Kong | 2388 | Finance | 2005 | 1231 | HKD | 68,521,000,000 | 68,521,000,000 | 71,082,000,000 | 0 | 0.00% | 2,561,000,000 | 3.74% | 2,561,000,000 | 3.74% |
| 32 | China Life | 2628 | Finance | 2005 | 1231 | RMB | 26,765,000,000 | 26,765,000,000 | 26,765,000,000 | 0 | 0.00% | 0 | 0.00% | 0 | 0.00% |

[^] Excluding changes of beginning equity caused by Non-HKFRS changes

Figure 7: Impact on Beginning Shareholders' Equity (BeginEqty) – Basic Statistics



5.2 Change by Industry

Figure 8 indicates these 32 companies covers all the industry groups, namely Commerce & Industry (19 companies), Finance

(6 companies), Properties (4 companies), Utilities (3 companies).

Figure 8: Impact on BeginEqty - Distribution of Companies by Industry

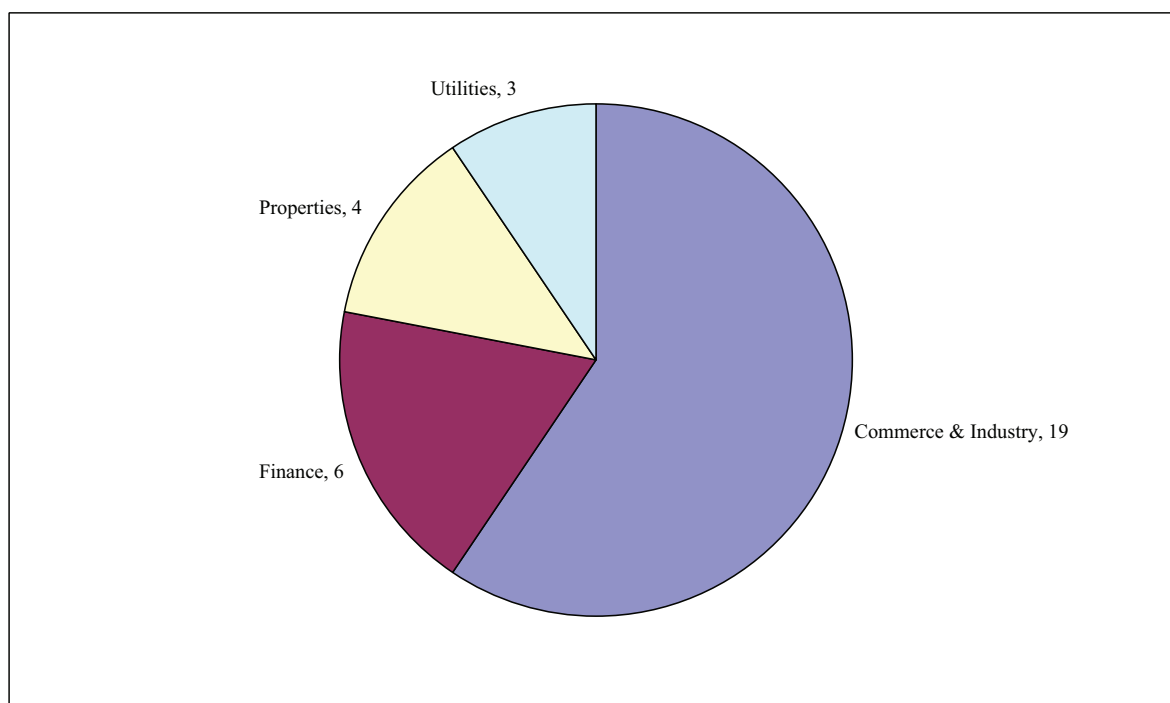
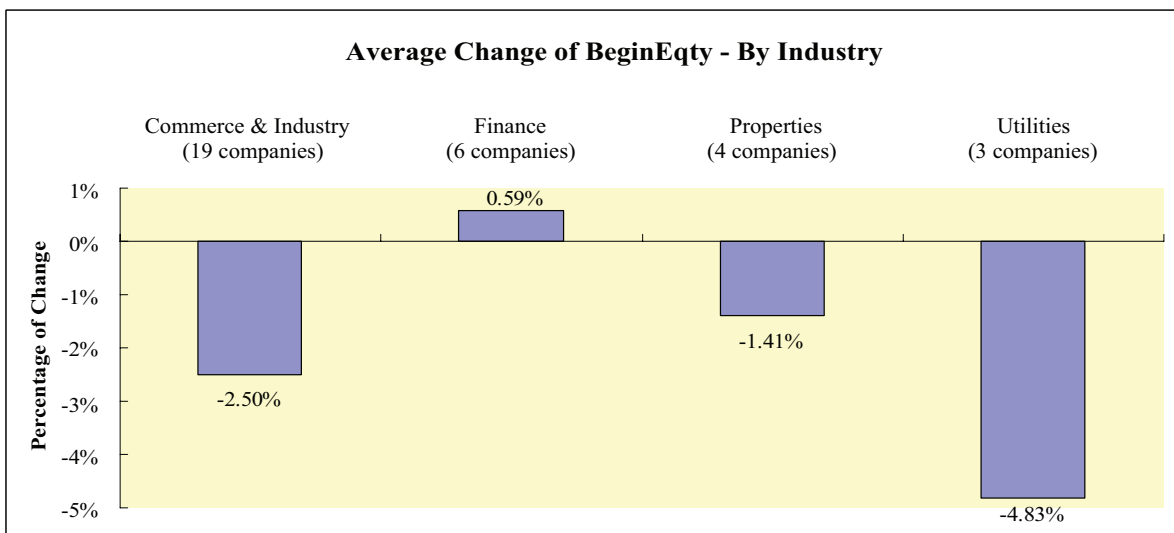
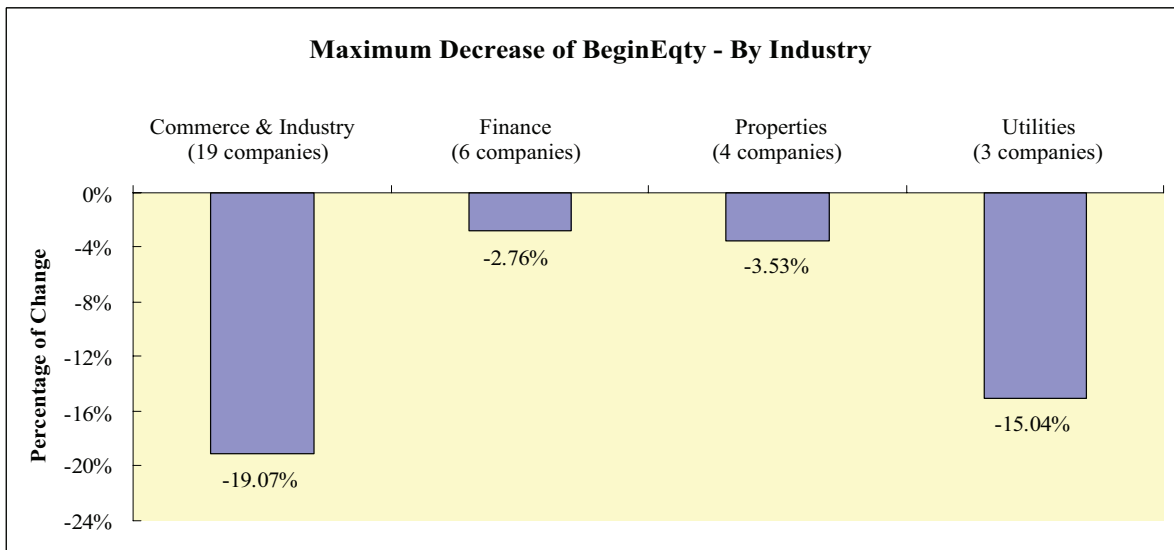
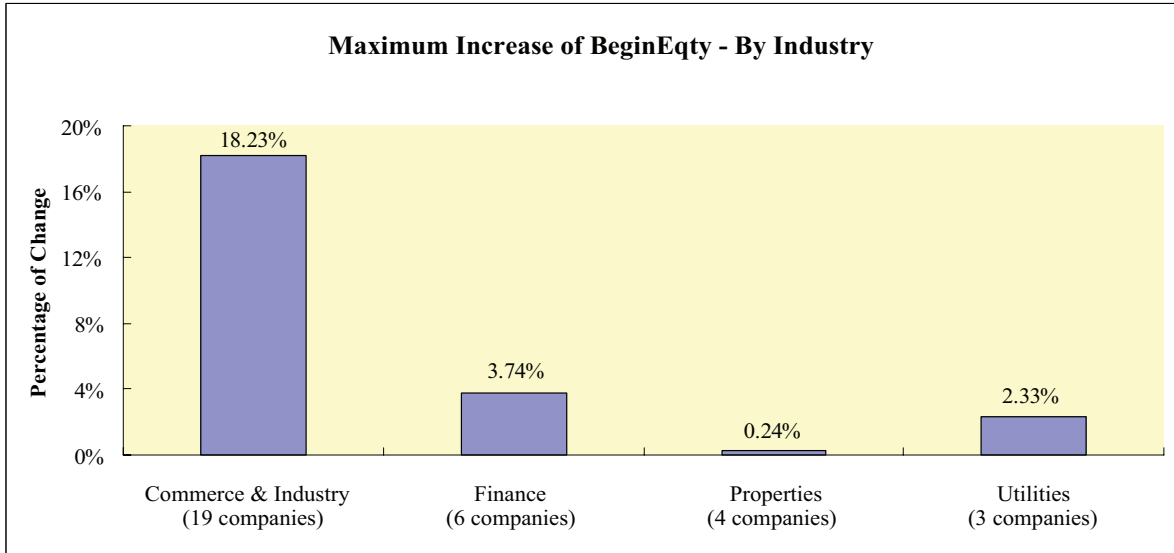
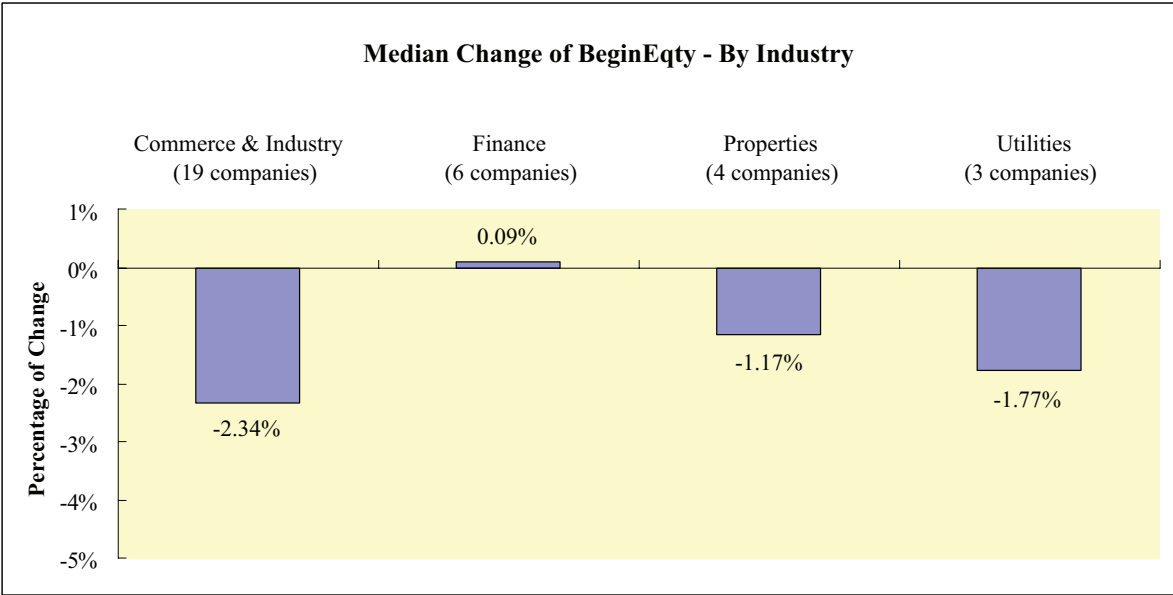


Figure 9 shows the patterns of changes in BeginEqty by the 4 industry groups. The largest group, Commerce & Industry, has the largest increase of 18.23% as well as the largest decrease of 19.07%. Both the average and median changes show a decrease in BeginEqty for all the industries except for the Finance group where the 6 companies record an average increase of 0.59% and a median increase of 0.09%. Although the Utilities group registers the

largest average decrease of 4.83% as well as the largest median decrease of 1.77%, these figures are not too much different from those of the Commerce & Industry group, where the average and median decreases are 2.50% and 2.34% respectively.

Figure 9: Impact on BeginEqty by Industry – Basic Statistics





5.3 Change by Individual Company

Figure 10 presents the percentage change of BeginEqty for each of the 32 companies, ranking from the largest increase to the largest decrease. The largest percentage changes in increase and decrease for BeginEqty are from COSCO Pacific (1199) and PCCW (0008), amounting to 18.23% and -19.07% respectively. Unlike the impact on NI where over half of the companies score an increase, 21 (66%) out of the 32 companies have reported a decrease in BeginEqty as a result of adopting HKFRS. Nine companies (28%) report an increase in BeginEqty with the remaining 2 companies (FIH (2038) and China Life (2628)) showing no change.

6. Impact on beginning equity: analysis by standards

We further look into the impact on BeginEqty caused by different standards for each constituent. Except for HSBC Hldgs (0005), China Resources (0291) and China Netcom (0906) where disclosure is either not clear or not available, we are able to determine the impact of 14 new standards on the beginning equity of 29 constituent companies.

Table 5 presents the dollar amount impact and the percentage change for each of the 14 standards. Among the 29 companies, Hutchison (0013) is affected by 11 standards, which is the largest number observed. On average, a company is affected by 3 new standards.

6.1 Overall Impact

Figure 11¹² shows the impact of each of the 14 standards in terms of both the number of companies and the dollar amount affected. We classify 5 standards as having the largest impact: HKAS32&39 (Financial Instruments) affecting 25 companies with an average impact of 0.71%, HKAS40&21 (Investment Property & Income Taxes - Recovery of Revalued Non-Depreciable Assets) affecting 12 companies with an average impact of -2.53%, HKAS17 (Leases) affecting 10 companies with an average impact of -2.51%, HKAS16 (Property, Plant and Equipment) affecting 7 companies with an average impact of -0.30%, and HKFRS3&HKAS36 (Business Combination & Impairment of Assets) also affecting 6 companies with an average impact of 0.88%. Compared with the impact on NI, the magnitude of the overall impact on BeginEqty is smaller.

12. Those sets of standards marked with “*” involve both PYA and BeginAdj.

Figure 10: Impact on BeginEqty – By Company

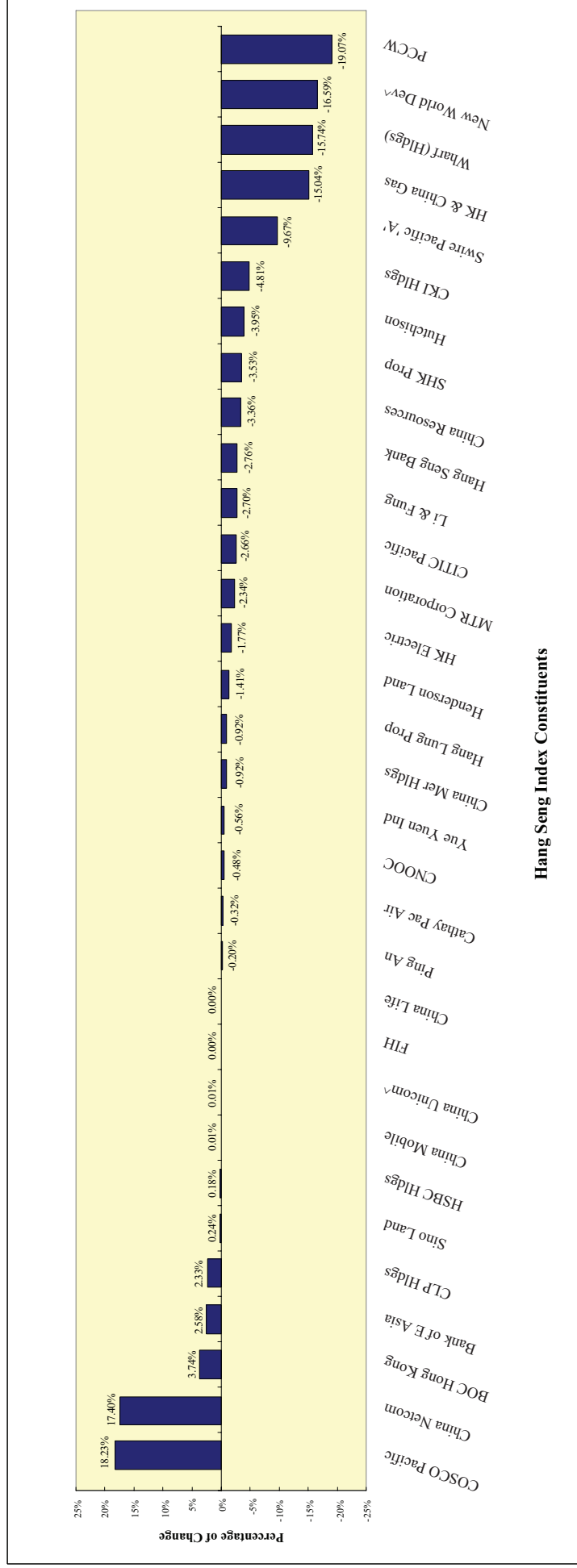
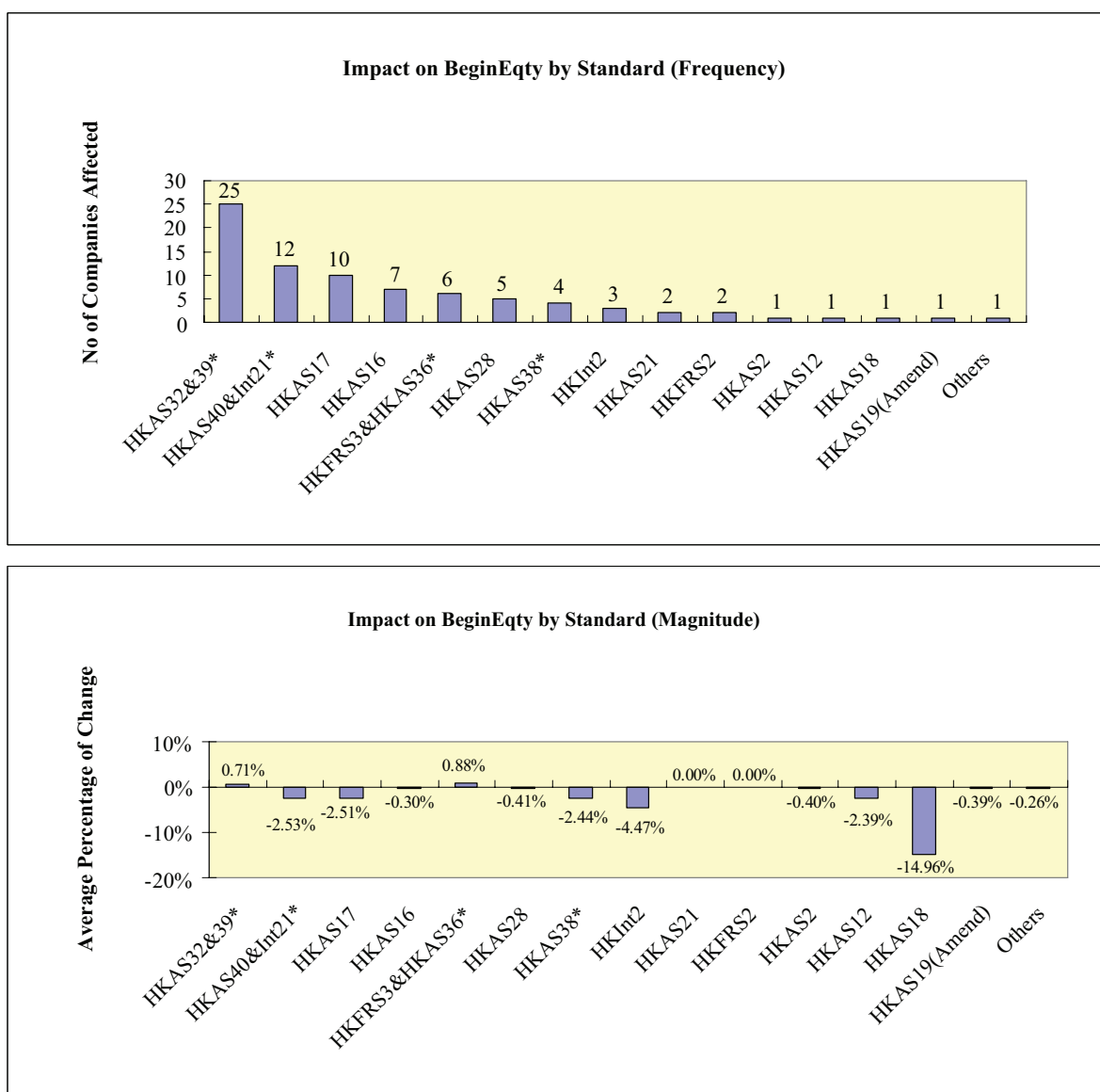


Figure 11: Impact on BeginEqty – By Standard

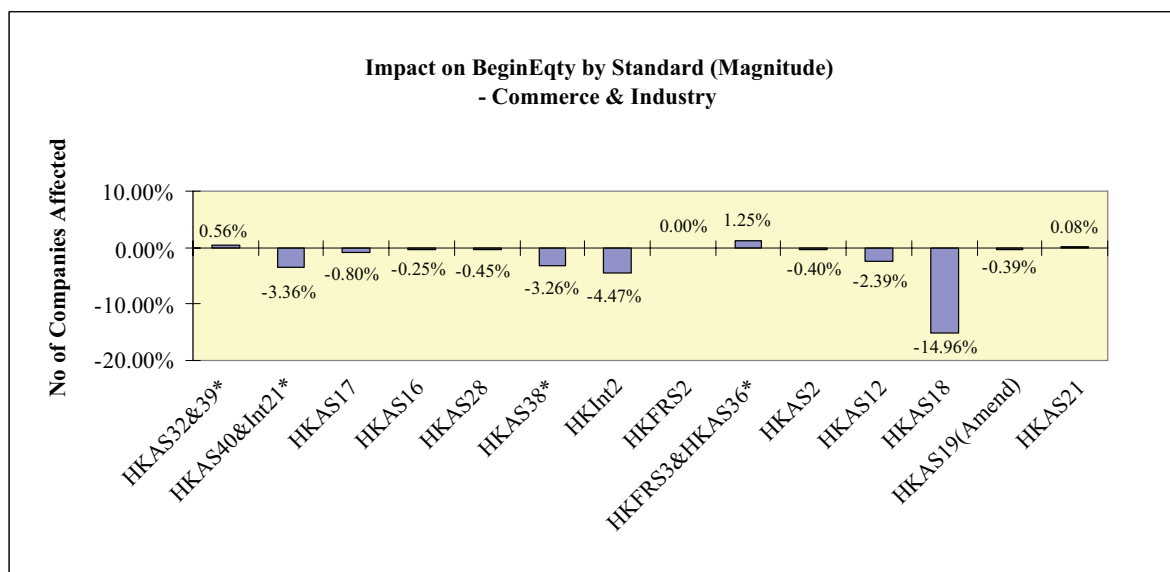
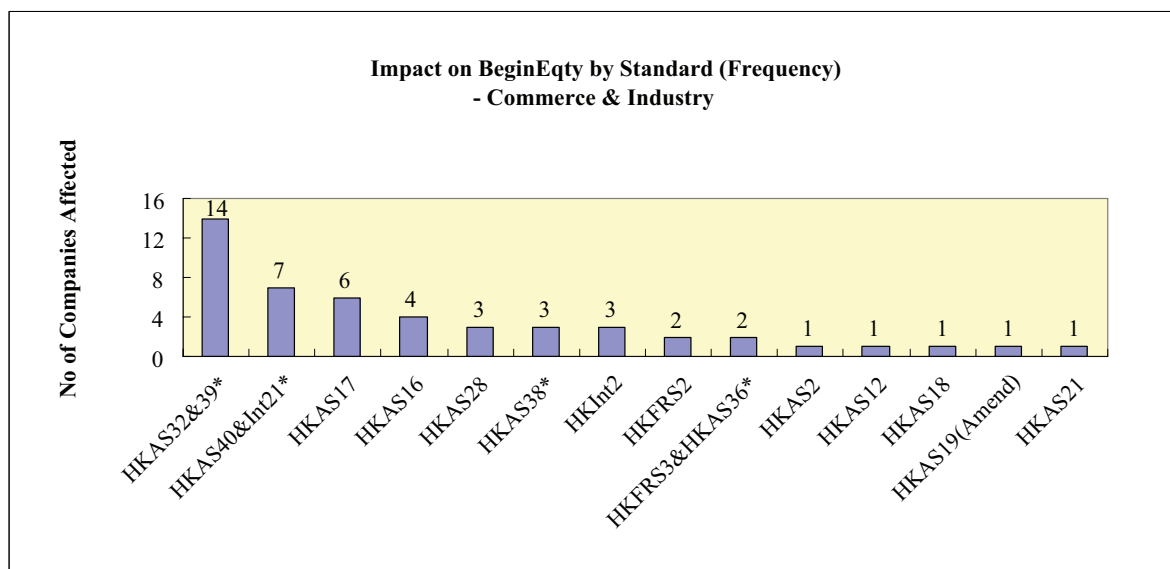


6.2 Impact by Industry

Similar to NI, Figure 11a shows that the BeginEqty of the Commerce & Industry group is affected by all of the 14 standards identified. Four of the top 5 standards having the largest overall impact remain at the top for this group: HAKS32&39 (14 companies, average impact of 0.56%), HKAS40&Int21

(7 companies, average impact of -3.36%), HKAS17 (6 companies, average impact of -0.80%) and HKAS16 (4 companies, average impact of -0.25%). HKAS28, HKAS38, HK-Int2 rank No. 5, all of which have an impact on 3 companies in this group.

Figure 11a: Impact on BeginEqty by Standard - Commerce & Industry



As shown in Figure 11b, the Finance group is mainly affected by HKAS32&39 and HKAS40&Int21, which affect 4 companies

and 3 companies with an average impact of 2.43% and -0.82% on BeginEqty respectively. HKSA17 only affects 1 company.

Figure 11b: Impact on BeginEqty by Standard – Finance

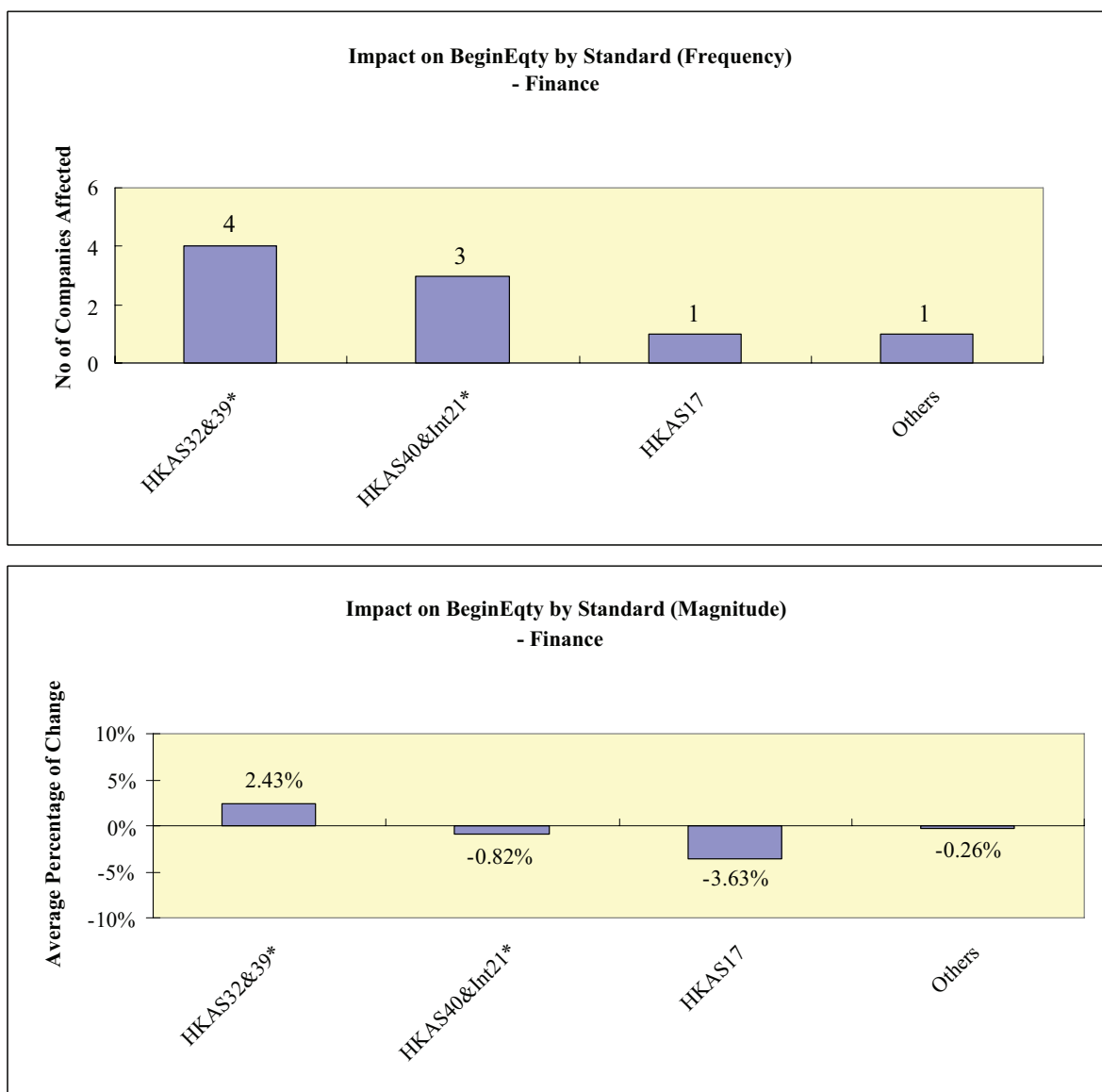
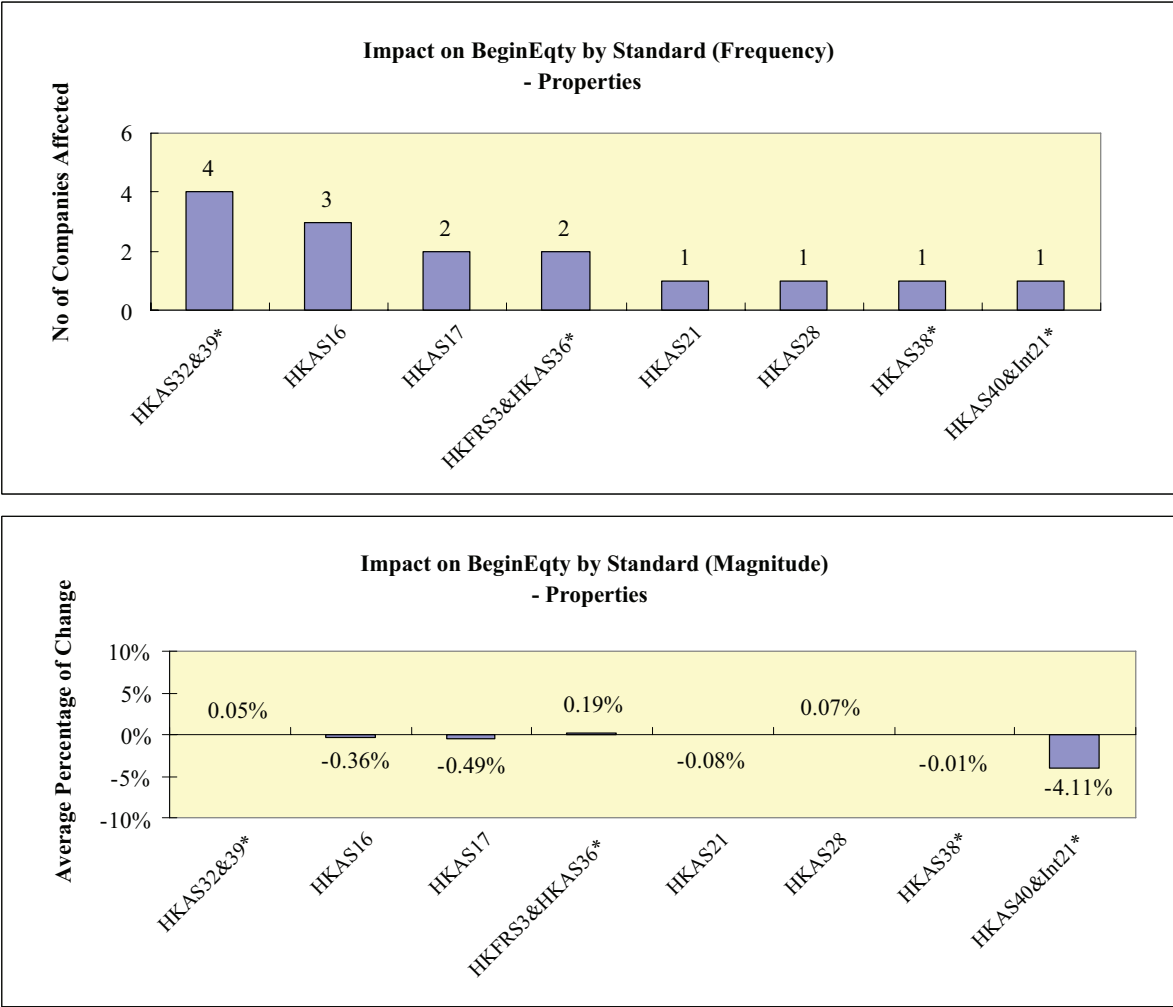


Figure 11c reveals that 8 standards have affected the 4 Properties companies which are all affected by HKAS32&39. Besides, 3 are affected by HKAS16, and 2 are affected by HKAS17 and HKFRS3&HKAS36. In terms

of magnitude, all the standards except HKAS40&Int21 (with an impact of -4.11% for SHK Prop (0016)) have caused change, either positive or negative, that is smaller than 0.5%.

Figure 11c: Impact on BeginEqty by Standard – Properties

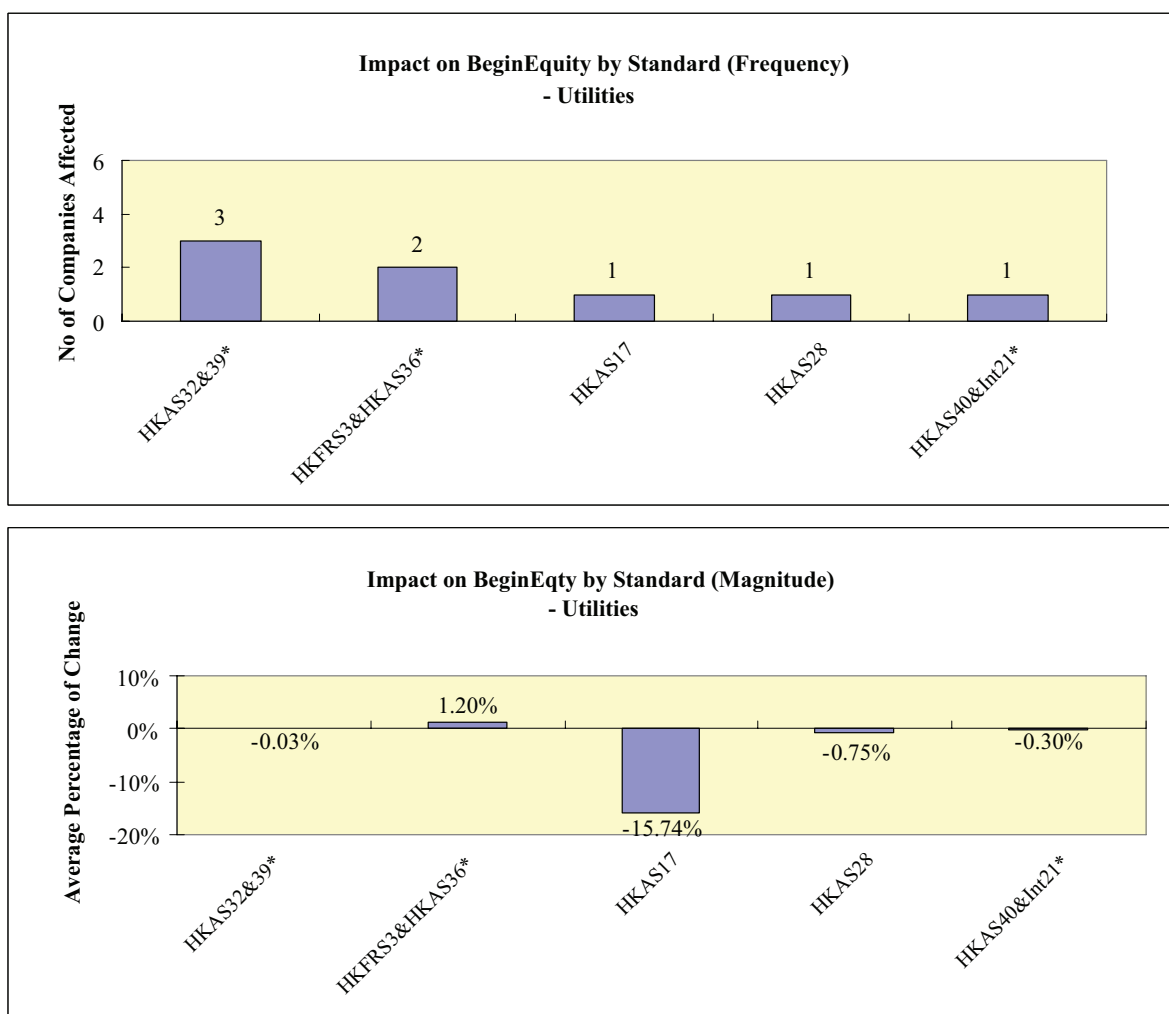


As presented in Figure 11d, all 3 companies in the Utilities group are affected by HKAS32&39 with an average impact of -0.03%. HKFRS3&HKAS36 has increased the BeginEqty of CLP Hldgs (0002) and HK & China Gas (0003) by an average of 1.20%. HKAS17 and HKAS40&21 both cause a decrease in BeginEqty for HK & China Gas (0003) by 15.74% and 0.30%. HK Electric (0006) is the only one that is negatively affected by HKAS28.

Figure 12 further summarizes the impact of the top 5 standards across different industries. HKAS32&39 basically increase BeginEqty except for the Utilities group, and the increases are relatively large for the Commerce & Industry as well as the Finance groups. HKAS40&Int21 have a negative impact on BeginEqty across all the industries¹³ with the Commerce & Industry and the Properties groups reporting relatively larger decreases. HKAS17 causes a decrease

13. The negative impact of HKAS40&Int21 could have been slightly understated due to the early adoption by four companies in the Commerce&Industry and Property sections, i.e., Henderson Land (0012), Hutchison (0013), Sino Land (0083) and Hang Lung Prop (0101). The early adoption has, on average, decreased the BeginEqty of the 4 companies by 3.94%. Details are discussed in Section 7.1.

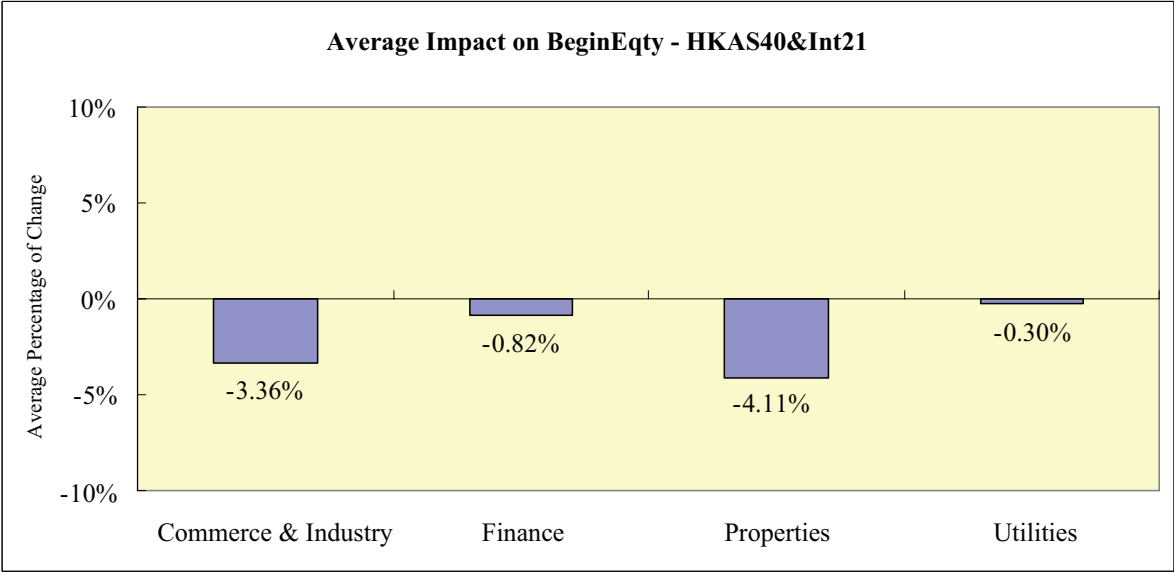
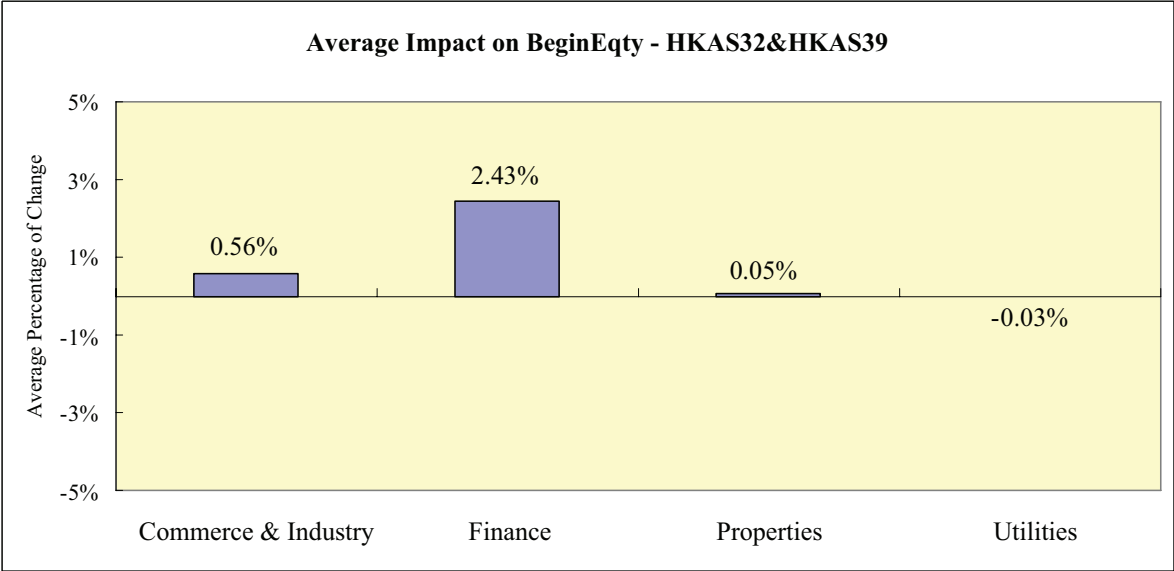
Figure 11d: Impact on BeginEqty by Standard – Utilities

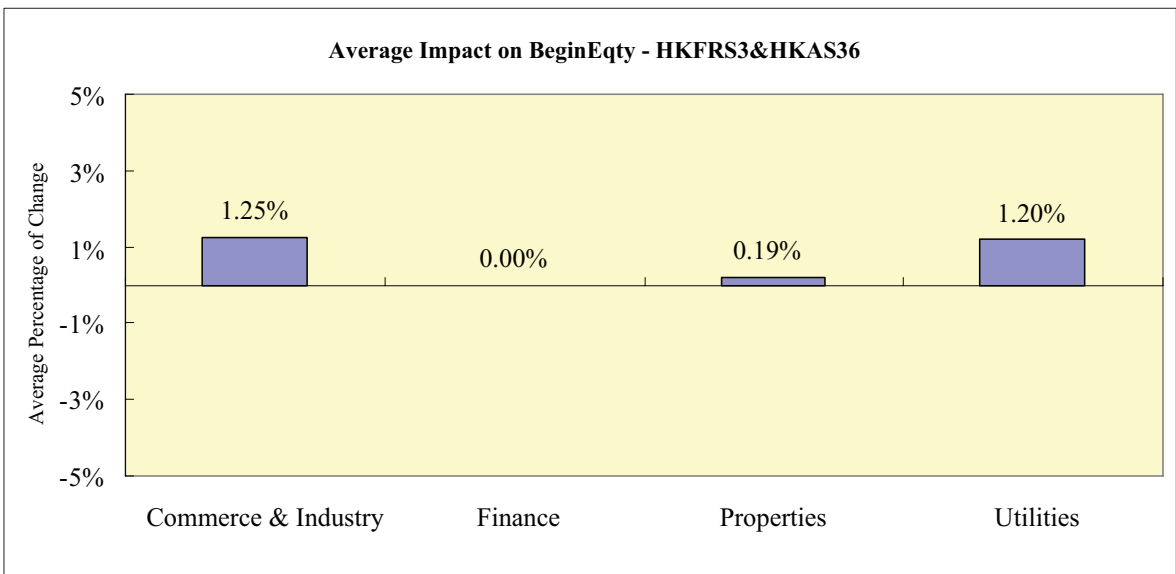
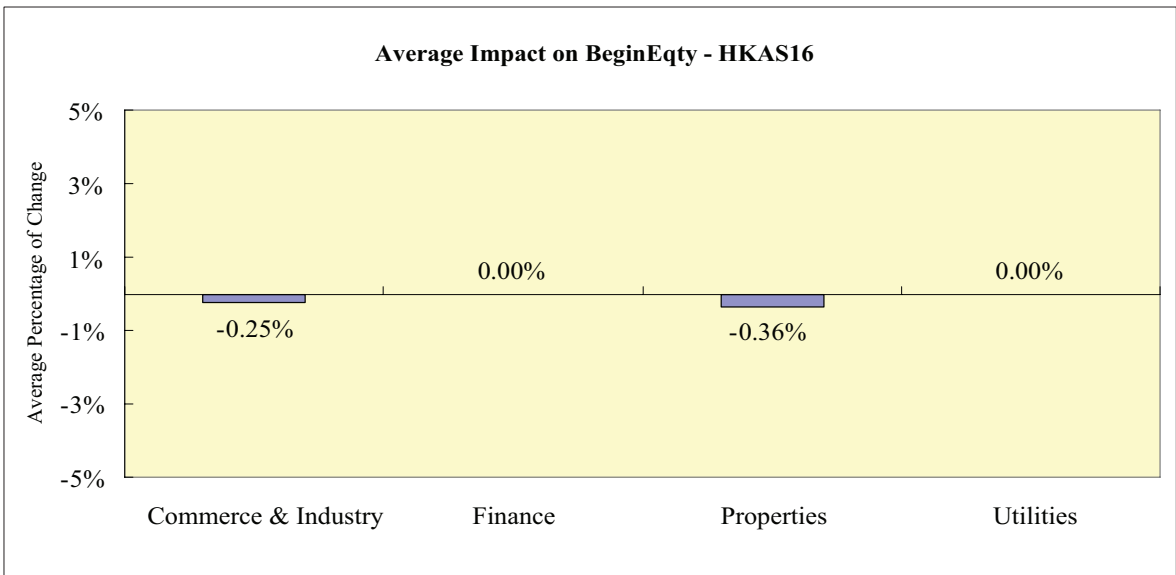
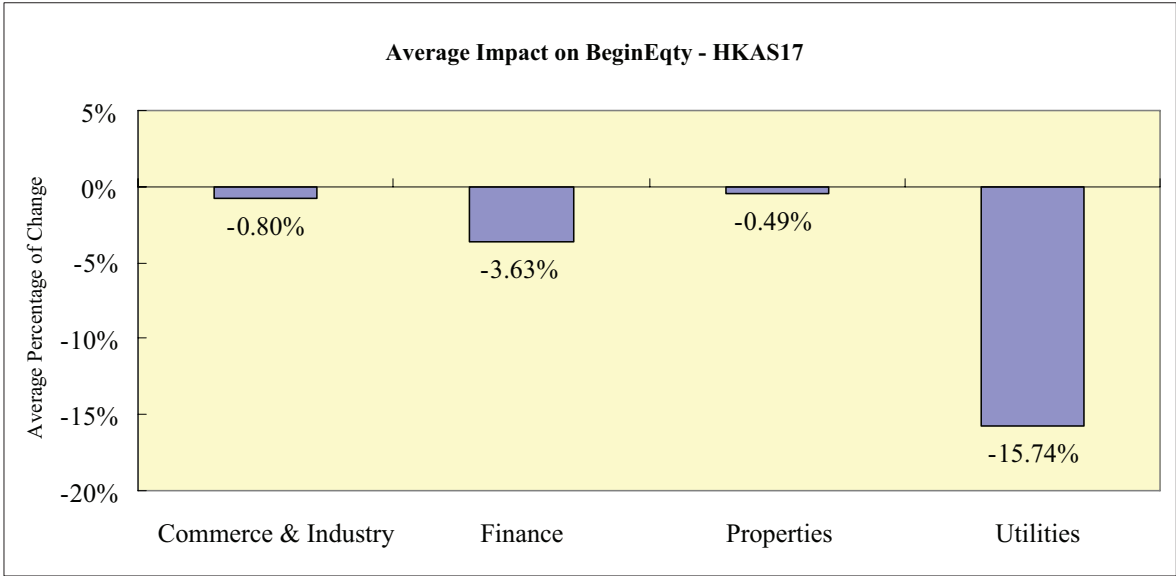


in BeginEqty across all the industry groups with the largest impact on the Utilities group at -15.74%. While HKAS16 also reduces BeginEqty for Commerce & Industry and Properties, the impact is relatively

small. Finally, HKFRS3&HKAS36 together increase BeginEqty for all the industry groups except Finance, with a larger impact on the Commerce & Industry and Utilities companies.

Figure 12: Impact on BeginEqty – By Top 5 Standards



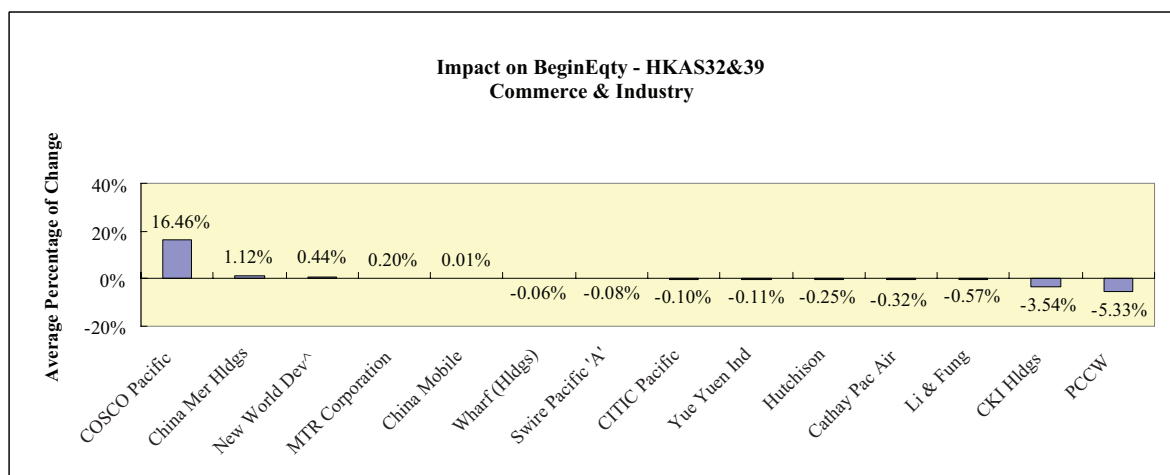


6.3 Impact by Individual Company within an Industry

To further analyze comparability among companies within the same industry, we present Figures 12a to 12e¹⁰ for the impact of each of the top 5 standards on individual companies within an industry. From Figure 12a, we observe little comparability within the Commerce & Industry group with respect to HKAS32&39 in terms of either the direction or the magnitude of adjustment

to BeginEqty. However, companies within the Finance or the Properties groups seem more comparable in adjusting the impact of HKAS32&39. Three of the four companies affected by the standards in each industry show an upward adjustment with a comparable magnitude. Three companies in the Utilities group are affected and two report a downward adjustment.

Figure 12a: Impact on BeginEqty – HKAS32&39



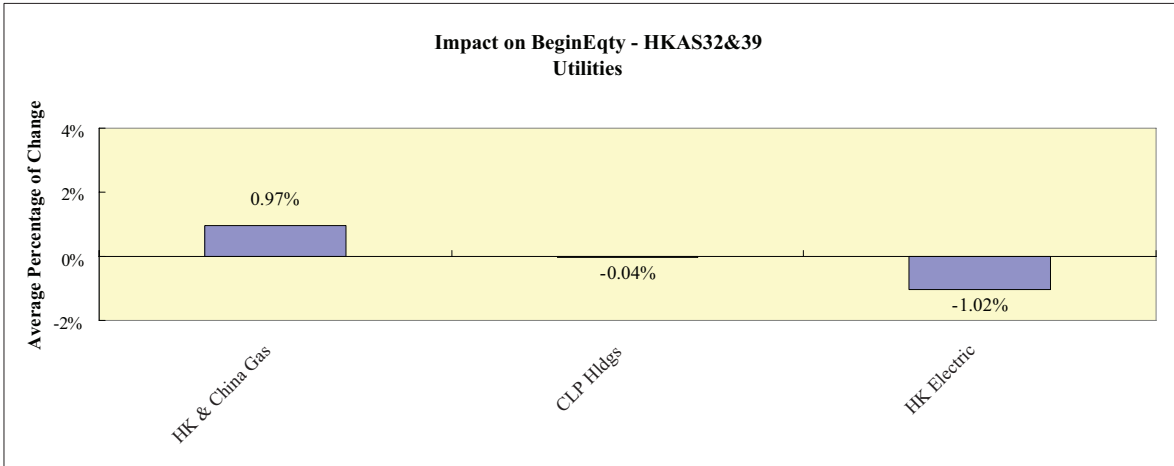
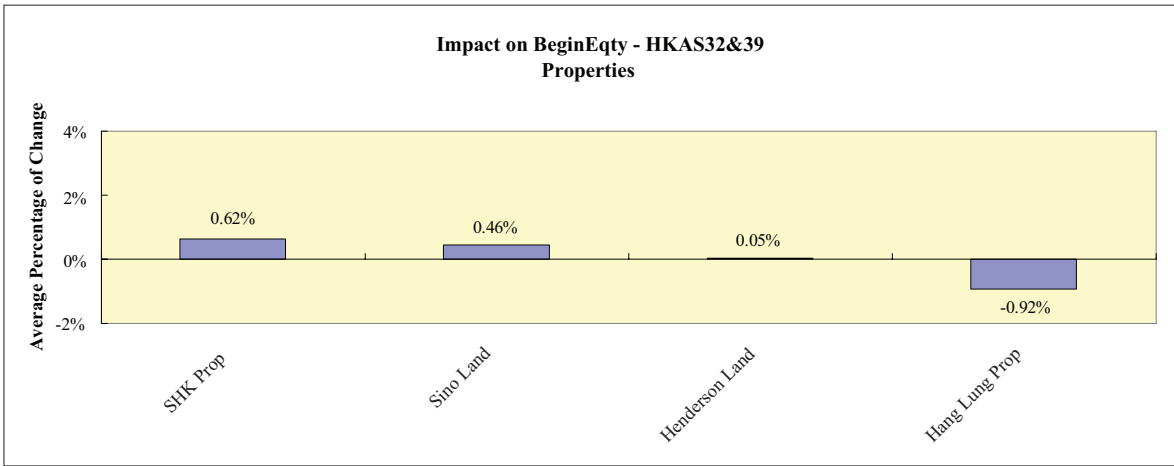
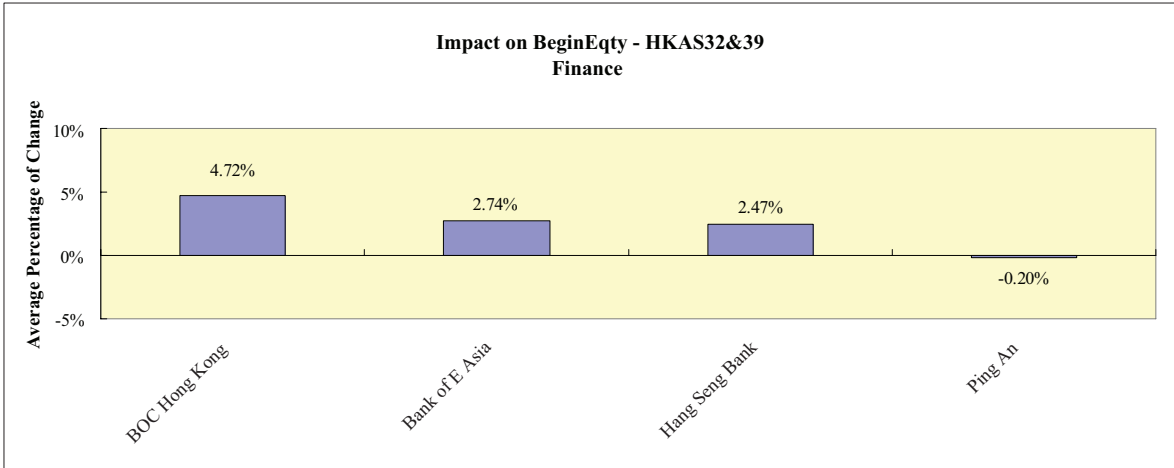
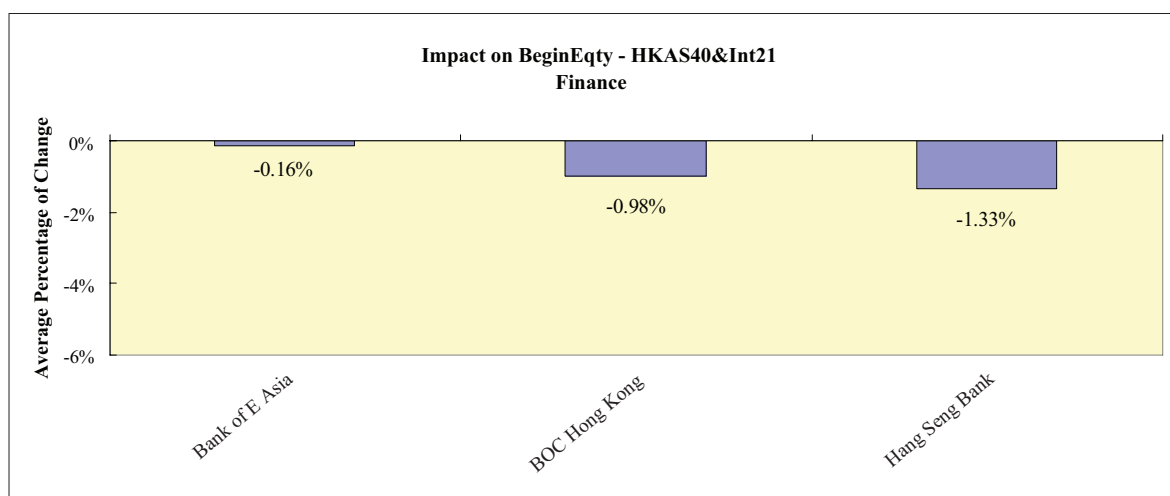
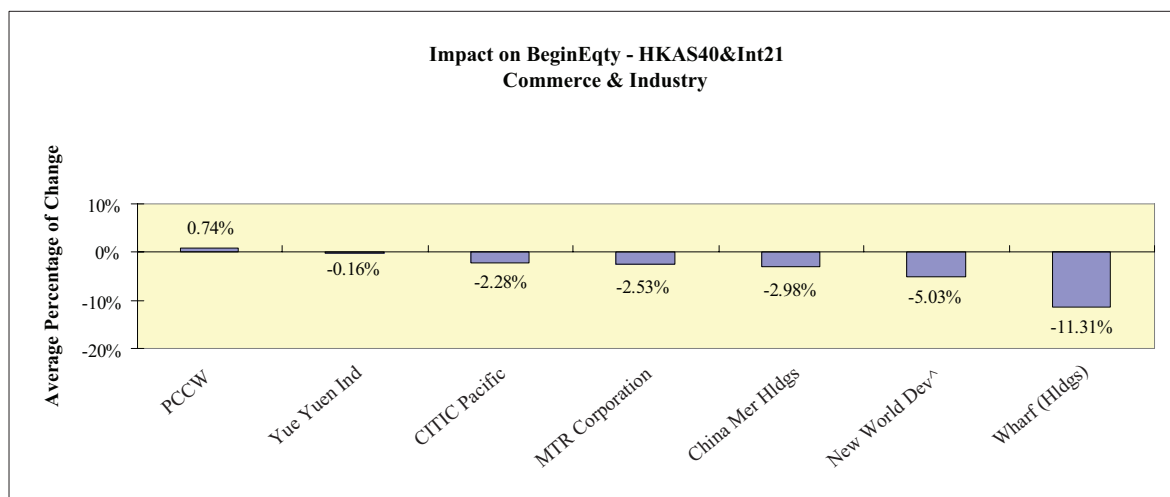


Figure 12b shows that HKAS40&Int21 have an across board impact of decreasing BeginEqty for all the industry groups except for PCCW (0008). SHK Prop (0016) and HK & China Gas (0003), with a decrease of 4.11% and 0.30% respectively, are the only companies affected from the Properties and Utilities groups (not figured here). While

the magnitude of adjustment does not vary too much within the Finance group, the variability is fairly large within the Commerce & Industry group, with Wharf (Hldgs) (0004) and New World Dev (0017) reporting a very large BeginEqty decrease of 11.31% and 5.03% respectively.

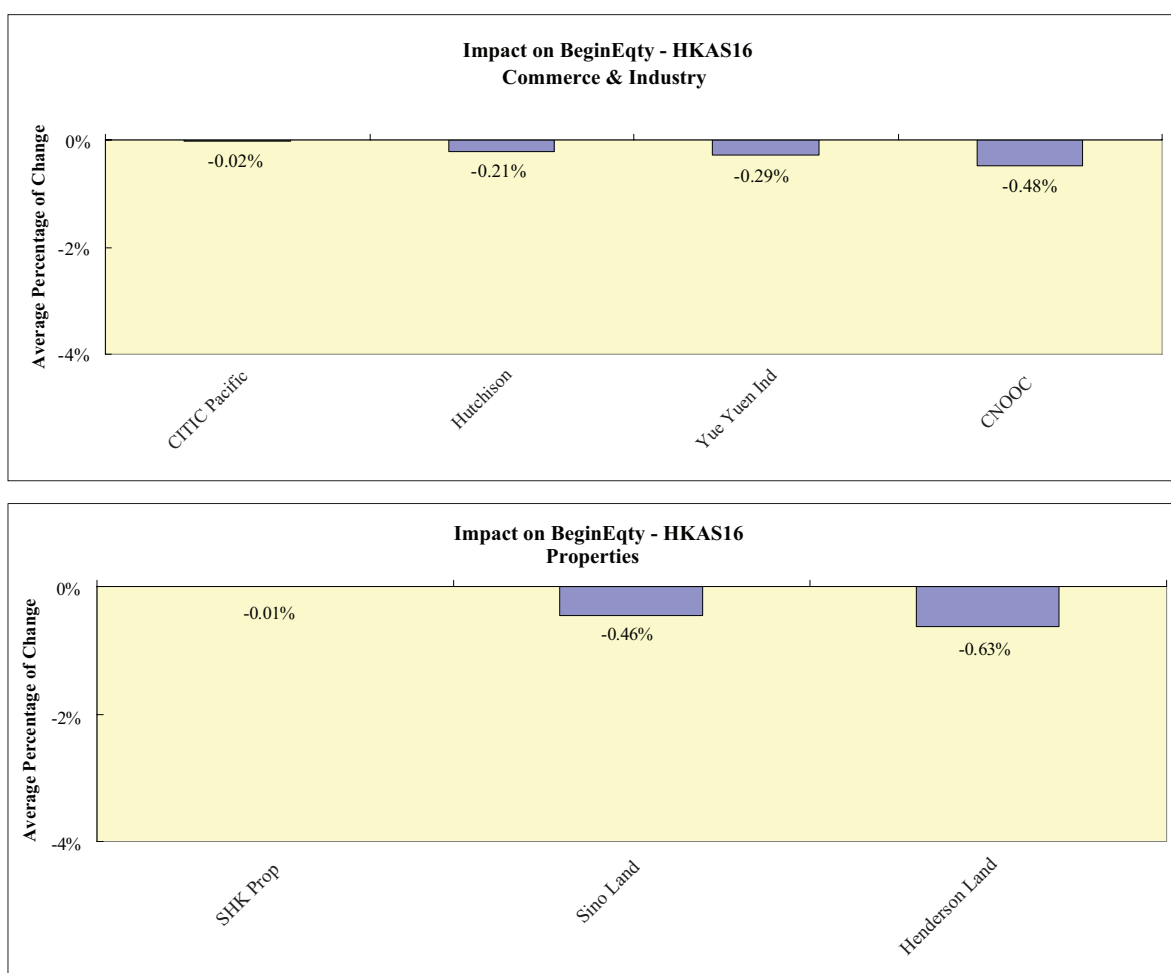
Figure 12b: Impact on BeginEqty – HKAS40&Int21



As shown in Figure 12c, HKAS16 primarily affects two industry groups: Commerce & Industry and Properties. All affected companies within the 2 groups report a

decrease in beginning equity. Further, the magnitude of adjustment seems to vary less as compared with HKAS32&39 or HKAS40&Int21.

Figure 12c: Impact on BeginEqty – HKAS16



The impact of HKAS17 on beginning equity can be seen in Figure 12d. With a decrease of 3.63% and 15.74% respectively, Hang Seng Bank (0011) and HK & China Gas (0003) are the only companies affected for Finance and Utilities groups (not figured here). As

for the other two industry groups, while the impact is mostly negative, the variability of adjustment magnitude remains relatively larger, especially among the companies within Commerce & Industry.

Figure 12d: Impact on BeginEqty – HKAS17

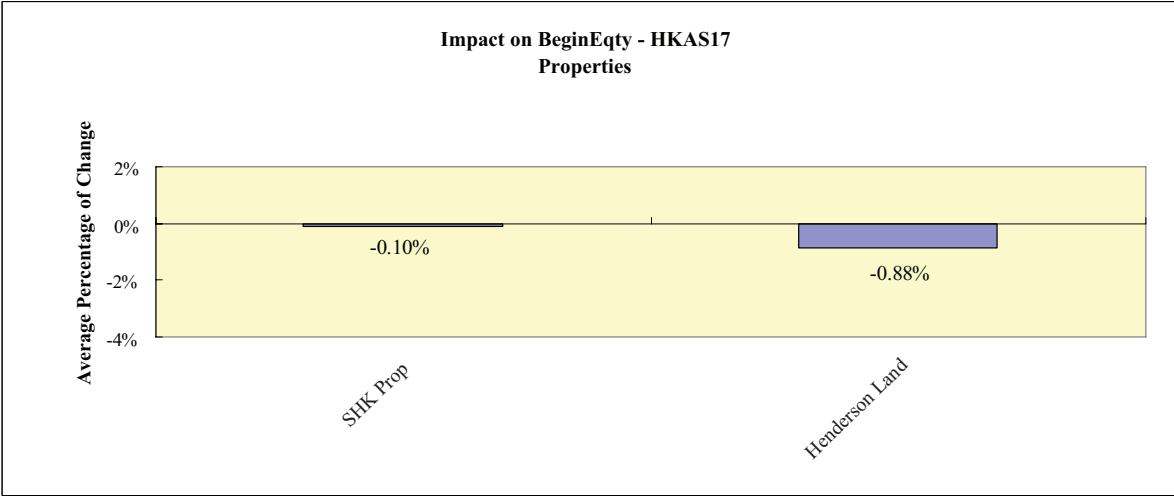
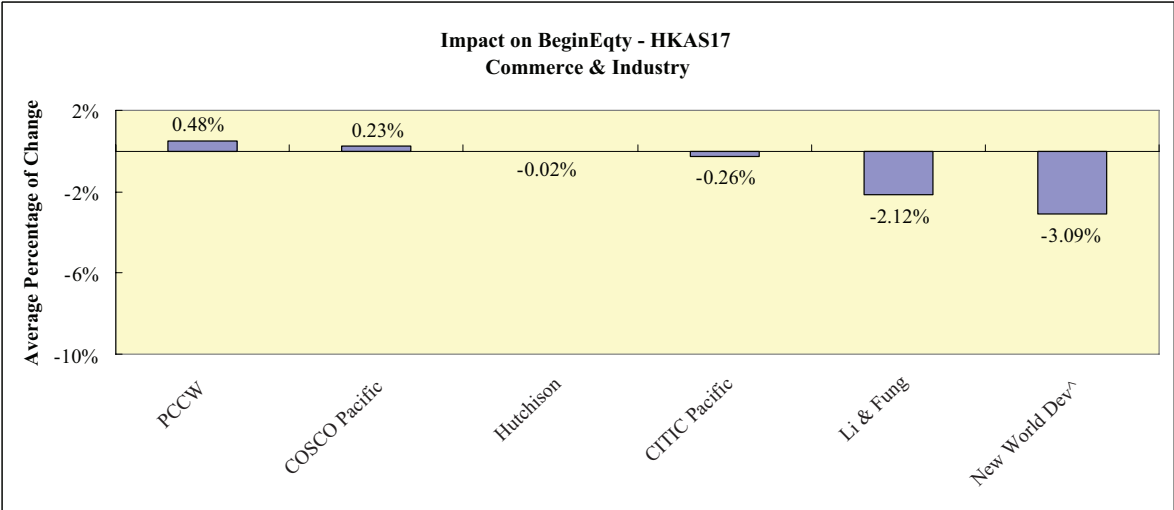


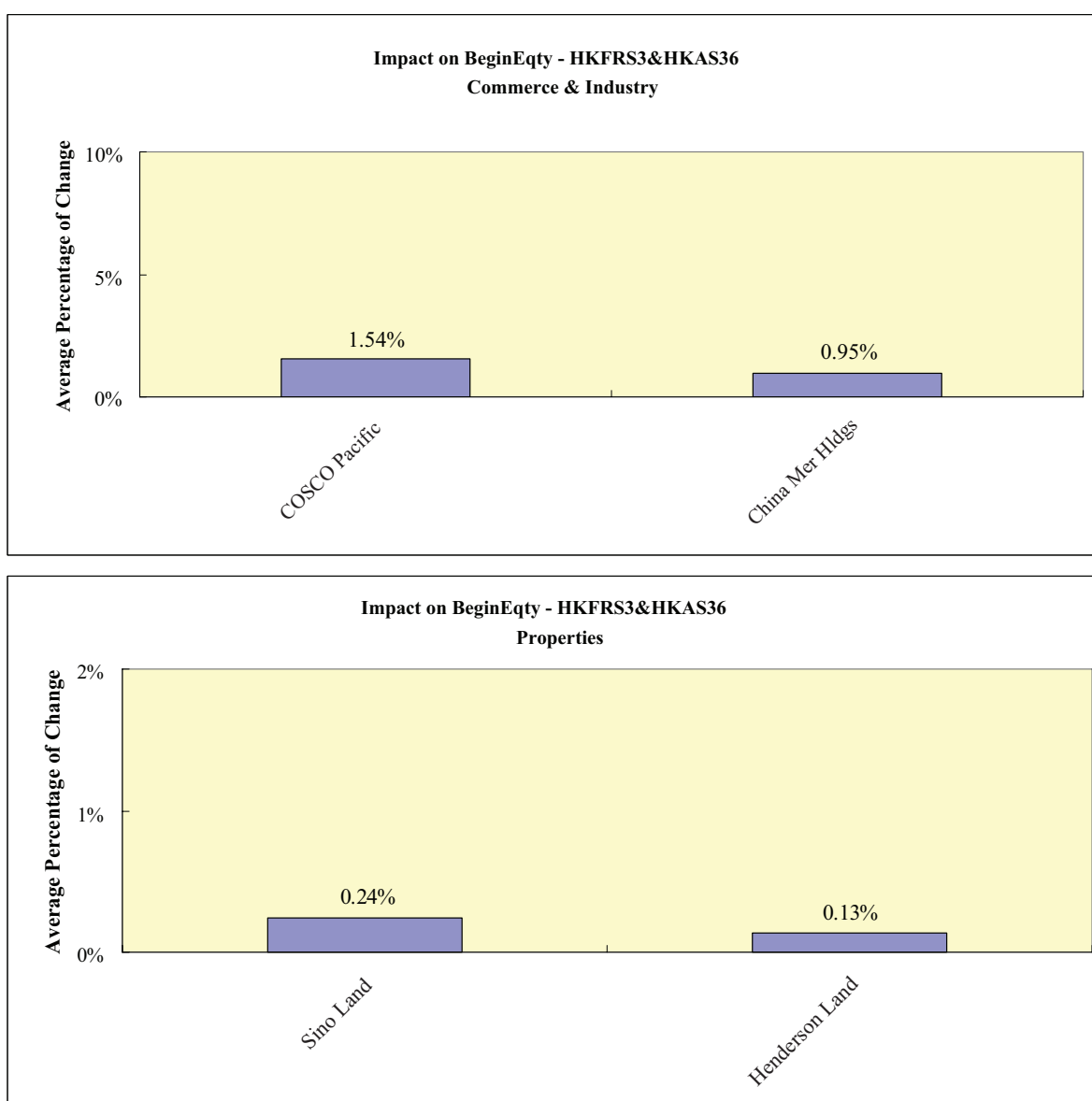
Figure 12e shows the effect of HKFRS3&HKAS36. While the standards affect 6 companies altogether, only 2 companies are affected in each of the three industry groups including Commerce & Industry, Properties, and Utilities. For

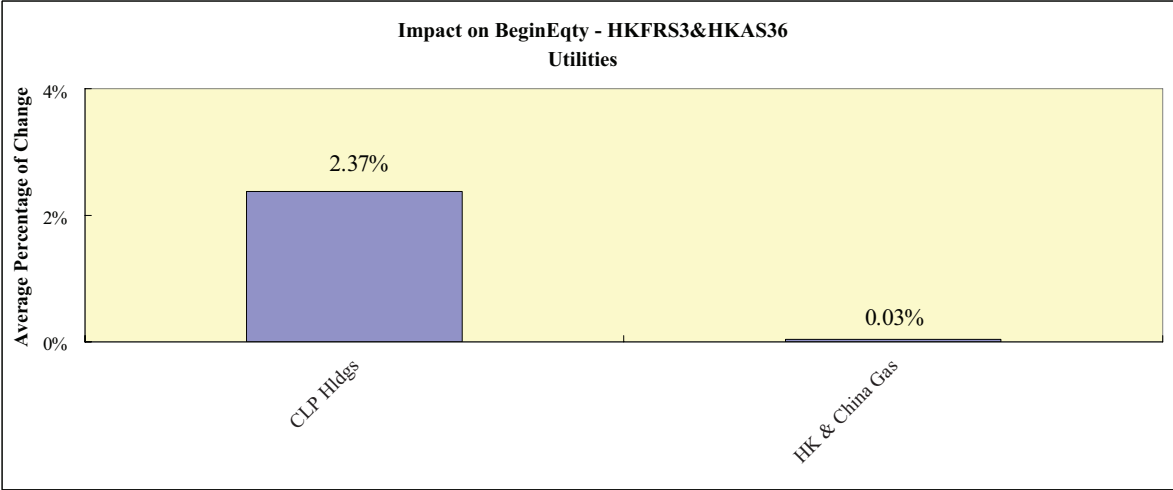
the Finance group, there is no company affected. Overall, these two standards cause an increase in beginning equity, and the size of adjustment seems more comparable within an industry.

Overall, among the top 5 standards having the largest impact on beginning equity as identified in Figure 9a, we find that there is a certain level of comparability among companies within the same industry in terms of the direction of changes in beginning

equity. However, in terms of the magnitude of these changes, we observe less comparability in adopting HKAS32&39 or HKAS40&Int21 than in HKAS16 or HKFRS3&HKAS36. The comparability of adopting HKAS17 seems somewhere in between.

Figure 12e: Impact on BeginEqty – HKFRS3&HKAS36





7. Additional analyses

7.1 Impact for Early Adopters

As pointed out at the beginning, different extent of early adoption has complicated our analysis. Therefore, we have focused our main review on the 2005 Pool where the major adoption of HKFRS took place in 2005. In this section, we provide additional information regarding the impact on NI and BeginEqty for the early adopters. In particular, we look at such impact for the following two groups of early adoption: (1) the 'Partial Early Adoption' group of which the major adoption is still 2005 while some HKFRS has been adopted earlier; (2) the 'Major Early Adoption' group of which the major adoption is earlier than 2005.

7.1.1 Partial Early Adoption

Five companies are involved in different extent of early adoption, Henderson Land (0012), Hutchison (0013), New World Dev (0017), Sino Land (0083), Hang Lung Prop (0101). Panel A of Table 6 presents the details. Hutchison (0013) is in this group because the numbers of standards having significant impact are 4 and 12 for 2004 and 2005 respectively. Therefore, the major adoption for this company is considered to be in 2005. Panel B and C report the impact on NI and BeginEqty for these Partial Early Adopters. The standards early adopted by Hutchison (0013) have resulted in an increase of 11.80% in NI (19.11% from HKFRS3, -36.02% from HKAS38, 30.06% from HKAS40, -1.35% from Int22) and a decrease of 1.41% in BeginEqty (-0.37% from HKAS38, -0.51% from HKAS40, -0.53% from Int22).

Benefited from the early adoption of HKAS40&Int21, Henderson Land (0012), Sino Land (0017)¹⁴ and Hang Lung Prop (0101) have all reported a magnificent increase in their NIs, being 147.76%, 96.17% and 169.76% respectively. But their BeginEqty are slightly decreased by -6.08%, -6.09% and -3.08%. For New World Dev (0017), the impact is mainly with BeginEqty which has an increase of 0.25% resulted from the changes in accounting for goodwill.

14. According to the disclosure by Sino Land (0083), HKFRS3 did not have significant impact.

Table 6: Impact on NI & BeginEqty – Partial Early Adoption

Panel A: Partial Early Adoption

| Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | Early Adopted Standards |
|----------------|--------------|-------------------|------|-----------------|----------|-------------------------------|
| Henderson Land | 12 | Properties | 2005 | 630 | HKD | HKAS40&Int21 |
| Hutchison | 13 | Commerce&Industry | 2004 | 1231 | HKD | HKFRS3, HKAS38, HKAS40, Int22 |
| New World Dev | 17 | Commerce&Industry | 2005 | 630 | HKD | HKFRS3&HKAS36, HKAS38 |
| Sino Land | 83 | Properties | 2005 | 630 | HKD | HKFRS3, HKAS40&Int21 |
| Hang Lung Prop | 101 | Properties | 2005 | 630 | HKD | HKAS40&Int21 |

Panel B: Partial Early Adoption – Impact on NI

| Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | NIFRS | NI | ChangeNI | ChangeNI% | EPSFRS | EPS | ChangeEPS | ChangeEPS% |
|----------------|--------------|-------------------|------|-----------------|----------|----------------|----------------|---------------|-----------|--------|------|-----------|------------|
| Henderson Land | 12 | Properties | 2005 | 630 | HKD | 10,853,521,000 | 4,380,573,000 | 6,472,948,000 | 147.76% | 5.98 | 2.41 | 3.57 | 147.76% |
| Hutchison | 13 | Commerce&Industry | 2004 | 1231 | HKD | 16,128,000,000 | 14,426,000,000 | 1,702,000,000 | 11.80% | 3.78 | 3.38 | 0.40 | 11.80% |
| New World Dev | 17 | Commerce&Industry | 2005 | 630 | HKD | 4,367,900,000 | 4,367,900,000 | 0 | 0.00% | 1.26 | 1.26 | 0.00 | 0.00% |
| Sino Land | 83 | Properties | 2005 | 630 | HKD | 5,513,199,737 | 2,810,436,276 | 2,702,763,461 | 96.17% | 1.28 | 0.65 | 0.63 | 96.17% |
| Hang Lung Prop | 101 | Properties | 2005 | 630 | HKD | 6,845,400,000 | 2,537,600,000 | 4,307,800,000 | 169.76% | 1.95 | 0.72 | 1.23 | 169.76% |

Panel C: Partial Early Adoption – Impact on BeginEqty

| Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | BeginEqtyFRS | BeginEqty | ChangeBeginEqty | ChangeBeginEqty% |
|----------------|--------------|-------------------|------|-----------------|----------|-----------------|-----------------|-----------------|------------------|
| Henderson Land | 12 | Properties | 2005 | 630 | HKD | 57,511,753,000 | 61,236,456,000 | (3,724,703,000) | -6.08% |
| Hutchison | 13 | Commerce&Industry | 2004 | 1231 | HKD | 244,017,000,000 | 247,515,000,000 | (3,498,000,000) | -1.41% |
| New World Dev | 17 | Commerce&Industry | 2005 | 630 | HKD | 54,540,200,000 | 54,405,000,000 | 135,200,000 | 0.25% |
| Sino Land | 83 | Properties | 2005 | 630 | HKD | 29,762,818,845 | 31,693,778,041 | (1,930,959,196) | -6.09% |
| Hang Lung Prop | 101 | Properties | 2005 | 630 | HKD | 30,083,900,000 | 31,039,000,000 | (955,100,000) | -3.08% |

7.1.2 Major Early Adoption

Three companies fall into this group, Cheung Kong (0001), Esprit Hldgs (0330) and HKEx (0388). All these companies are considered to have their major adoption in 2004. Cheung Kong (0001) adopted HKAS36, 38, 40, Int21 and HKFRS3 in 2004 and the rest in 2005. However, the numbers of standards having significant impact are 3 and 2 for 2004 and 2005 respectively. Therefore, the year of major adoption for Cheung Kong is considered to be in 2004. Relatively speaking, decision on the year of major adoption for Esprit Hldgs (0330) and HKEx (0388) is more straightforward because these two companies have clearly acknowledged the full adoption of IFRS/HKFRS in their financial statements ended in 2004.

As show in Panel A of Table 7, such early adoption has caused an increase of 6.85% in NI for Cheung Kong (0001) but decreases of 6.09% and 0.74% for Esprit Hldgs (0330) and HKEx (0388) respectively. Except for Esprit Hldgs (0330) for which the disclosure is not clear enough, we further segregate the impact on NI into different standards.

Panel B of Table 6 shows that increase in Cheung Kong's (0001) NI is mainly from HKAS38 (-22.41%), HKAS40&Int21 (18.22%), HKFRS3&HKAS36 (11.89%) and Int22 (-0.84%)¹⁵. For HKEx (0388) of which the NI impact seems to be relatively insignificant, HKFRS2, HKAS32&39, HKAS17, HKFRS3&HKAS36, HKAS40&Int21 are the ones that contribute to the change with the first two being negative while the rest being positive.

Similar to that of the 2005 Pool, the impact on BeginEqty with these three companies is relatively small. The two panels in Table 8 show that Cheung Kong (0001) experienced a 1.90% decrease in 2004's BeginEqty which mainly involves HKFRS3&HKAS36, HKAS38 and HKAS40&Int21. For Esprit Hldgs (0330) and HKEx (0388), the impact is both positive, being 1.09% and 0.19% respectively. Again, we could not segregate the impact into further details based on the information provided in Esprit Hldgs' (0330) 2003/2004 report. As for HKEx (0388), the change is mainly attributable to HKAS17, HKAS40&Int21 and HKFRS3&HKAS36.

15. Most of the impact is from the partial early adoption of Hutchison (0013) except that for HKAS40&Int21 where Cheung Kong (0001) discloses a negative impact of -0.48%. We calculated the impact from Hutchison (0013) based on: (1) Cheung Kong's (0001) 49.97% shareholding in Hutchison (0013) and (2) Hutchison's (0013) 2004 annual report disclosure. For example, the early adoption of HKAS38 has resulted in a decrease of HKD5196 million in Hutchison's (0013) 2004 profit. We thus calculate the impact from HKAS38 on Cheung Kong (0001) as a decrease of HKD2596 million, representing a decrease of 22.41% from the NI reported under original standards.

Table 7: Impact on NI - Major Early Adoption

Panel A: Impact on NI

| No. | Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | NIFRS(\$) | NI(\$) | ΔNI(\$) | ΔNI% | EPSFRS(\$) | EPS(\$) | ΔEPS(\$) | ΔEPS% |
|-----|---------------|--------------|-------------------|------|-----------------|----------|----------------|----------------|---------------|--------|------------|---------|----------|--------|
| 1 | Cheung Kong | 1 | Properties | 2004 | 1231 | HKD | 12,380,000,000 | 11,586,000,000 | 794,000,000 | 6.85% | 5.35 | 5.00 | 0.34 | 6.85% |
| 2 | Esprit Hldgs* | 330 | Commerce&Industry | 2004 | 630 | HKD | 2,003,440,000 | 2,133,440,000 | (130,000,000) | -6.09% | 1.68 | 1.79 | (0.11) | -6.09% |
| 3 | HKEX | 388 | Finance | 2004 | 1231 | HKD | 1,056,884,000 | 1,064,771,000 | (7,887,000) | -0.74% | 1.00 | 1.01 | (0.01) | -0.74% |

Panel B: Impact on NI (%) by Standards

| No. | Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | ChangeNI | HKAS17 | HKAS32&39 | HKAS38 | HKAS40&Int21 | HKFRS2 | HKFRS3&HKAS36 | Int22 |
|-----|---------------|--------------|-------------------|------|-----------------|----------|----------|--------|-----------|---------|--------------|--------|---------------|--------|
| 1 | Cheung Kong | 1 | Properties | 2004 | 1231 | HKD | 6.85% | NA | NA | -22.41% | 18.22% | NA | 11.89% | -0.84% |
| 2 | Esprit Hldgs* | 330 | Commerce&Industry | 2004 | 630 | HKD | -6.09% | NA | NA | NA | NA | NA | NA | NA |
| 3 | HKEX | 388 | Finance | 2004 | 1231 | HKD | -0.74% | 0.13% | -0.03% | 0.26% | -1.34% | 0.25% | 0.25% | |

* Not separable into individual standards

Table 8: Impact on BeginEqty - Major Early Adoption

Panel A: Impact on BeginEqty (%)

| No. | Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | End of the Year | | Beginning of the Year of Adoption (\$) | Total Adjustment of Shareholders' Equity | | | | Total Change% | |
|-----|---------------|--------------|-------------------|------|-----------------|----------|---------------------------------|--------------------------------|--|--|--------------|-----------------|----------------|------------------|-----------|
| | | | | | | | Before Adoption - Reported (\$) | After Adoption - Restated (\$) | | PYA | % | BeginAdj | % | | BeginEqty |
| | | | | | | | (i) | (ii) | (iii) | (iv)=(ii)-(i) | (v)=(iv)/(i) | (vi)=(iii)-(ii) | (vii)=(vi)/(i) | (viii)=(v)+(vii) | |
| 1 | Cheung Kong | 1 | Properties | 2004 | 1231 | HKD | 174,843,000,000 | 171,522,000,000 | 171,522,000,000 | (3,321,000,000) | -1.90% | 0 | 0.00% | (3,321,000,000) | -1.90% |
| 2 | Esprit Hldgs* | 330 | Commerce&Industry | 2004 | 630 | HKD | 4,191,986,000 | 4,237,727,000 | 4,237,727,000 | 45,741,000 | 1.09% | 0 | 0.00% | 45,741,000 | 1.09% |
| 3 | HKEX | 388 | Finance | 2004 | 1231 | HKD | 5,603,263,000 | 5,614,125,000 | 5,614,153,000 | 10,862,000 | 0.19% | 28,000 | 0.00% | 10,890,000 | 0.19% |

Panel B: Impact on BeginEqty (%) by Standards

| No. | Company Name | Company Code | Industry Group | Year | Fiscal Year End | Currency | Total Change in Shareholders' Equity (%) | | | |
|-----|---------------|--------------|-------------------|------|-----------------|----------|--|--------|--------------|---------------|
| | | | | | | | HKAS17 | HKAS38 | HKAS40&Int21 | HKFRS3&HKAS36 |
| 1 | Cheung Kong | 1 | Properties | 2004 | 1231 | HKD | -1.90% | -0.49% | -0.73% | -0.69% |
| 2 | Esprit Hldgs* | 330 | Commerce&Industry | 2004 | 630 | HKD | 1.09% | NA | NA | NA |
| 3 | HKEX | 388 | Finance | 2004 | 1231 | HKD | 0.19% | 0.15% | -0.01% | 0.05% |

* Not separable into individual standards

7.2 Correlations and Associations

To further explore the factors that could have contributed to the impact on NI, we have done correlation test and regression analysis. For correlation test, we run Pearson correlation for the percentage of change of NI and percentage of change brought by individual standards. Results are similar to the top 5 standards that have been identified (Figure 5), i.e. the correlations in between change caused by these standards and the change of NI are statistically significant. For regression analysis, we try to investigate whether the impact of HKFRS on NI is associated with company size, change and level of NI under the old reporting standards, debt equity ratio and industry groups. However, we are not able to find any association that is statistically significant.

7.3 Reference to HKFRS

In order to obtain an understanding of how companies refer to HKFRS in their information released to the public, we have reviewed the Chairman's Statement within the annual reports to look for any relevant comments. For this purpose, we have also reviewed those reports where early adoptions are identified. As summarized in Table 9, we find that 23 companies do not mention anything about adopting the new HKFRS. The most relevant information provided by the remaining 12 companies is comparative figures with/without revaluation surpluses (9 companies). Two companies (Cheung Kong (0001) and HK Electric (0006)) simply mention the word 'restated' without any further explanation.

For the companies that have early adopted the new standards partially, New World Dev (0017) provides no information regarding the adoption of HKFRS3. For HKAS40&Int21, Henderson Land (0012) points out the early adoption with comparative figures, while Sino Land (0083) and Hang Lung Prop (0101) briefly explain the requirement of the new standards without any information about the impact of the early adoption.

Table 9: Reference to HKFRS – Chairman's Statement

| Company Name | Company Code | Industry | Year | Fiscal Year End | Chairman's Statement |
|-------------------|--------------|-------------------|------|-----------------|---|
| Cheung Kong | 1 | Properties | 2004 | 1231 | mention 'Restated' in 2003's financial information |
| Cheung Kong | 1 | Properties | 2005 | 1231 | nil |
| CLP Hldgs | 2 | Utilities | 2005 | 1231 | nil |
| HK & China Gas | 3 | Utilities | 2005 | 1231 | nil |
| Wharf (Hldgs) | 4 | Commerce&Industry | 2005 | 1231 | for Group profit, comparative figures provided with/without revaluation surplus (Without: 20% increase, With: 10%) |
| HSBC Hldgs | 5 | Finance | 2005 | 1231 | No Chairman's statement, explained new adoption of IFRS and point out 2004 impact disclosed on certain pages in 'Financial Highlights' |
| HK Electric | 6 | Utilities | 2005 | 1231 | mention 'restated' |
| PCCW | 8 | Commerce&Industry | 2005 | 1231 | nil |
| Hang Seng Bank | 11 | Finance | 2005 | 1231 | mentioned that 'attributable profit benefit fm a \$1.2 billion revaluation surplus on our investment properties' |
| Henderson Land | 12 | Properties | 2005 | 630 | Mentioned early adoption of HKAS40 & Int21, provide comparative numbers with/without the new standards |
| Henderson Land | 12 | Properties | 2006 | 630 | Restated' and disclosure of net profit with/without revaluation surplus for investment properties (around 70% to 40% increase) |
| Hutchison | 13 | Commerce&Industry | 2004 | 1231 | mentioned the profit is 'restated from the retrospective adoption of HKAS'; point out major components of profit including that from the revaluation of investment properties |
| Hutchison | 13 | Commerce&Industry | 2005 | 1231 | mentioned 'restated for the adoption of HKFRS'; point out major components of profit including that from the revaluation of investment properties |
| SHK Prop | 16 | Properties | 2006 | 630 | net profit with/without revaluation surplus for investment properties was mentioned (10% increase Vs. 2% increase) |
| New World Dev | 17 | Commerce&Industry | 2005 | 630 | nil |
| New World Dev | 17 | Commerce&Industry | 2006 | 630 | nil |
| Swire Pacific 'A' | 19 | Commerce&Industry | 2005 | 1231 | mention'adoption of new HKFRS' / 'adjust for HKAS40 and Int21's comparative profit |
| Bank of E Asia | 23 | Finance | 2005 | 1231 | nil |
| MTR Corporation | 66 | Commerce&Industry | 2005 | 1231 | provide comparative figures with/without revaluation surplus |
| Sino Land | 83 | Properties | 2005 | 630 | mentioned the adoption of HKAS40 and hkas-Int 21 and briefly described the standards |
| Sino Land | 83 | Properties | 2006 | 630 | provide comparative figures with/without revaluation surplus |
| Hang Lung Prop | 101 | Properties | 2005 | 630 | briefly mentioned the requirement of new accounting standards and pointed out that comparatives restated figure is provided |
| Hang Lung Prop | 101 | Properties | 2006 | 630 | provide comparative figures with/without revaluation surplus |
| China Mer Hldgs | 144 | Commerce&Industry | 2005 | 1231 | nil |
| CITIC Pacific | 267 | Commerce&Industry | 2005 | 1231 | nil |
| China Resources | 291 | Commerce&Industry | 2005 | 1231 | provide comparative figures with/without revaluation surplus |
| Cathay Pac Air | 293 | Commerce&Industry | 2005 | 1231 | nil |
| Esprit Hldgs | 330 | Commerce&Industry | 2004 | 630 | nil |
| HKEx | 388 | Finance | 2004 | 1231 | nil |
| Li & Fung | 494 | Commerce&Industry | 2005 | 1231 | nil |
| Yue Yuen Ind | 551 | Commerce&Industry | 2006 | 930 | nil |
| China Unicom | 762 | Commerce&Industry | 2005 | 1231 | nil |
| CNOOC | 883 | Commerce&Industry | 2005 | 1231 | nil |
| China Netcom | 906 | Commerce&Industry | 2005 | 1231 | nil |
| China Mobile | 941 | Commerce&Industry | 2005 | 1231 | nil |
| CKI Hldgs | 1038 | Commerce&Industry | 2005 | 1231 | nil |
| COSCO Pacific | 1199 | Commerce&Industry | 2005 | 1231 | nil |
| FIH | 2038 | Commerce&Industry | 2005 | 1231 | nil |
| Ping An | 2318 | Finance | 2005 | 1231 | nil |
| BOC Hong Kong | 2388 | Finance | 2005 | 1231 | nil |
| China Life | 2628 | Finance | 2005 | 1231 | nil |

7.4 *Length of Financial Statements*

Due to the additional disclosure required by the first-time adoption of HKFRS, the financial report section (including both financial statements and notes) in the annual reports of the HSI constituent companies included in our review are mostly longer than the previous year. An average increase in the number of relevant pages is nearly 40% and

the largest change is from Swire Pacific 'A' (0019) where the financial section is 130% longer. HK Electric (0006) and China Mobile (0941) are the two exceptional cases where the financial section is shorter in the year of adoption. However, the differences are only 2 and 1 pages respectively.

8. Summary

Despite the fact that the project of harmonization with International Financial Reporting Standards (IFRS) was launched a few years ago, 1 January 2005 marks a new era and a significant breakthrough for financial reporting in Hong Kong. For all the accounting periods starting on or after that date, companies are required to adopt Hong Kong Financial Reporting Standards (HKFRS) which basically have fully converged with IFRS. While such convergence is considered substantially beneficial to improving disclosure, transparency and accounting quality, how these new accounting standards affect company performance and financial position remains a question to be answered. Upon the request of the Professional Accountants in Business Committee (PAIBC) of the Hong Kong Institute of Certified Public Accountants (HKICPA), we have carried out a pilot study to examine the impact of the new HKFRS on the financial reporting of HSI Constituent Stocks.

Our preliminary review targets the annual reports of HSI Constituent Stocks. As of 31 July 2007, the HSI Constituents consist of 39 companies that spread over four major industry groups including Commerce & Industry, Finance, Properties and Utilities. Our final sample consists of 31 companies for the analysis of profitability impact and 32 companies for the analysis of equity impact. We define the year of adoption as the year when the major block of HKFRS was adopted. As a result, three companies (Cheung Kong (0001), Esprit Hldgs (0330) and HKEx (0388)) are identified as the Major Early Adopters of the new standards while the majority followed the compulsory requirement of adopting HKFRS on 1

January 2005. Also, five companies ((Henderson Land (0012), Hutchison (0013), New World Dev (0017), Sino Land (0083), Hang Lung Prop (0101)) have been identified as Partial Early Adopters that adopted some of the standards for the accounting periods starting before 2005.

To avoid the complexity brought by the early adopters and to enhance the comparability of our cross-sectional analysis, we have focused our Review on the 2005 Pool that has its year of adoption as 2005. At both company and industry group levels, this Review involves the investigation of the impact on profitability and opening equity as a result of fully adopting HKFRS. Such impact is further separated into different standards so as to identify the main forces that drive the most significant changes. In sum, our review and analysis find the following:

- The 31 constituent companies have, on average, reported an increase of 53.63% in net income, while the median increase is 2.59%. All industry groups experience profit increases, and the largest impact is reported by Commerce & Industry, followed by Properties, Finance, and Utilities. The magnitude of profitability change varies substantially among the 31 companies reporting profitability change.
- Sixteen standards affect profit. The top five standards according to the number of companies affected are: HKAS32&39 (Financial Instruments), HKFRS2 (Share-based Payment), HKAS40 (Investment Property) & Int21 (Income Taxes - Recovery of Revalued

Non-Depreciable Assets), HKAS17 (Leases), and HKFRS3 (Business Combination) & HKAS36 (Impairment of Assets). On average, HKFRS2 and HKAS17 bring a negative impact, while the others result in profit increases. While there is a certain level of comparability among companies within the same industry in terms of the direction of profitability change, the magnitude varies substantially, especially in HKAS32&39 and HKAS40&Int21.

- On average, the new standards decrease opening equity by 2.00%, which is not too different from the median decrease of 0.92%. All industry groups report a decrease in opening equity except Finance. The Utilities group is affected the most, followed by Commerce & Industry, Properties, and Finance. Compared with the impact on profitability, the impact on opening equity varies less among the 32 companies reporting equity adjustment.
- Although 14 standards affect opening equity, the following five standards contribute the most: HKAS32&39 (Financial Instruments), HKAS40 & Int 21 (Investment Property & Income Taxes - Recovery of Revalued Non-Depreciable Assets), HKAS17 (Leases), HKAS16 (Property, Plant and Equipment), and HKFRS3&HKAS36 (Business Combination & Impairment of Assets). All of these standards reduce opening equity except HKAS32&39 and HKFRS3&HKAS36. There is a certain level of comparability

among companies within the same industry in terms of the direction of changes caused by the top five standards. However, in terms of the magnitude of change, less comparability exists especially in adopting HKAS32&39, HKAS17 and HKAS40&Int21.

To provide a more comprehensive picture of HKFRS adoption, we supplement the main analysis with the impact on the two groups of early adoption, namely Major Early Adopters and Partial Early Adopters. Two out of the three Major Early Adopters experience a decrease in net income and an increase in beginning equity. As for the Partial Early Adopters, the majority have their net income increased substantially while their beginning equity decreases slightly. In addition, we examine the extent to which companies refer to the new HKFRS in their performance analysis by going through the Chairman's statements in the annual reports. We find no indication of companies referring to HKFRS in their information releases or performance analyse. We also compare the length of financial statements for the year of adoption. Due to the additional disclosure required by the first-time adoption of HKFRS, the financial report sections (including both financial statements and notes) of the annual reports are mostly longer when compared to the previous year. Finally, we attempt to search for reasons to explain the variation in profitability change, and do not find any discernible relationship between the magnitude of profit change and company characteristics such as size, debt level, and profitability level.

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