

Continuing the efforts to improve the level of disclosure in financial reporting of authorized institutions in Hong Kong and to bring it into line with other major international financial centres, the HKMA has issued the 1996 Financial Disclosure Package for authorized institutions on 20th November 1996. This article reports on the new recommendations contained in the 1996 disclosure package.

Introduction

The HKMA has been working closely with the banking industry towards greater transparency in financial reporting by authorized institutions. Over the past two years, following the implementation of the 1994 and 1995 financial disclosure packages¹, Hong Kong's disclosure framework is substantially in line with international best practices.

To bring Hong Kong further in line with international disclosure standards, the 1996 disclosure package, which was issued on 20th November 1996, contains new recommendations in relation to cash flow statements, market risk exposures and refinements to the segmental reporting requirements.

The recommendations in the 1996 disclosure package have been endorsed in principle by the Hong Kong Association of Banks, the Deposit-Taking Companies Association and the Hong Kong Society of Accountants. The Stock Exchange of Hong Kong has also advised all listed banking companies that Appendix 15 of the Listing Rules, which deals with accounts disclosure by banks, will be revised to bring it into line with the 1996 disclosure package.

The 1996 Disclosure Package

The salient features of the 1996 disclosure package are as follows:

- **Cash Flow Statements**

It is recommended that authorized institutions should disclose their cash flow statements in their 1996 accounts. This has taken into account the outcome of the review by the UK Accounting

Standards Board which has re-affirmed the usefulness of cash flow statements, and the voluntary disclosure of cash flow statements by a number of local banks in their 1995 accounts. As regards the format of disclosure, it is recommended that institutions should follow the recommendations set out in the Hong Kong Statement of Standard Accounting Practice (SSAP) 15 issued by the Hong Kong Society of Accountants.

- **Market Risk Exposure**

The question of disclosure of market risk exposure was considered in developing the 1995 disclosure package, but was deferred since the Basle Committee was then still working on the supervisory framework in this area. Now that the Basle Committee has finalised its market risk framework and in the light of the enhanced disclosures in other major financial centres, it is recommended that authorized institutions should start disclosing information about their market risk exposure in the 1996 accounts so that the disclosure standards of Hong Kong will evolve alongside the international framework.

Under the new recommendations, an authorized institution should disclose qualitative information on market risk exposure, which should include –

- (a) a description of the authorized institution's market risk related activities, including types of instrument traded. If derivative

¹ The 1994 and 1995 disclosure packages required authorized institutions to reveal their actual profits as well as more information about the structure of their balance sheets and the quality of their assets. These disclosures provided readers of the accounts with more information to assess the performance and strength of the banks as well as their business strategies.

products are included, an explanation of the use of such instruments; and

- (b) a discussion of the authorized institution's risk management policies, including those for measuring, monitoring and controlling market risks arising from both on- and off-balance sheet activities.

Where, in the opinion of an authorized institution, the market risk arising from its trading book is not material for the institution, a statement to that effect should be made in conjunction with the qualitative information as mentioned above, and no further disclosure is necessary.

Where the market risk arising from the trading book is regarded as material for the authorized institution, in addition to the qualitative information mentioned above, the institution should also provide quantitative information about the amount and volatility of the risk. As a minimum, such information should include the average daily revenue and the standard deviation of such daily revenue, analysed into foreign exchange, interest rate, commodity and equity exposures where material.² An analysis of the frequency distribution of the total daily revenues (in the form of a histogram) should also be provided. As a transitional arrangement for financial statements ending prior to December 1997, an authorized institution is required to disclose information about daily revenue only where such information is already collected and is thus readily available.

Authorized institutions are also encouraged to disclose further quantitative information on a basis that is consistent with the way in which the institution manages its market risk exposures, analysed into foreign

exchange, interest rate, commodity and equity exposures where material. An explanation of the main parameters and assumptions underlying the data provided should be given. The types of information that institutions could provide would include information on the value at risk, an analysis of actual changes in portfolio values, a comparison of risk against performance, a stress analysis based on the hypothetical effect of several changes in market prices, or a gap or duration analysis.

Both the qualitative and quantitative disclosures set out above should encompass market risk arising over the period in respect of both on- and off-balance sheet business included in the relevant market-risk related portfolios.

The disclosure of the above information can be made either as part of the accompanying information to its financial statements or as part of the financial statements themselves.

In addition to the above, further stages of disclosure could be considered later when the local market risk framework has been fully implemented and more overseas experience in such disclosure is available.

- **Segmental Reporting**

The 1995 disclosure package included an optional requirement for authorized institutions to report financial information for the various classes of business (e.g. commercial banking, investment banking, securities business, etc.) which are considered to be significant to the institution. Where an institution chose not to disclose this information in quantitative form in the 1995 accounts, a general description of the main classes of business in which it is engaged was required.

² Revenue in this context would comprise the daily change in value in marked-to-market trading portfolios plus any trading-related net interest income or other revenue.

The experience in 1995 revealed that the descriptive information provided by some authorized institutions has been very general and only a small number of institutions had provided quantitative information. Some institutions have indicated that there might be practical difficulties in providing more detailed breakdowns as it may be difficult to clearly distinguish between the various classes of business.

To enhance disclosure of the business nature of authorized institutions, it is recommended that for the 1996 accounts, authorized institutions should report not only qualitative information, but also quantitative information for the various classes of business which are significant to the institution.

Institutions are encouraged to provide a breakdown of activities rather than simply putting all activities into one broad category. However, recognising that there is no uniform approach in how best to classify the types of business, there is flexibility for each individual institution to decide how they wish to classify their own business for both qualitative and quantitative disclosures.

On qualitative information, an institution should identify its own significant classes of business and give a brief description of the activities of each reported class of business. An institution may decide for itself how to classify its business, which may be based on the internal classification of the institution for management purposes. An institution should aim to provide a breakdown of activities rather

than simply putting all activities into one broad category.

On quantitative information, an institution should provide a breakdown of one or more of the following:

- Total operating income (net of interest expense)
- Profit/loss before provision
- Profit/loss after provision
- Profit/loss before taxation

Such breakdown may be expressed in either absolute or percentage terms, by each class of business reported in the qualitative information. In the former case, the aggregate of such breakdown should reconcile with the figures provided in the audited profit and loss account.

Where consolidated financial statements are presented, the above segmental information need only be provided on the basis of the consolidated financial statements.

Applicability

The 1996 package will be applicable to all licensed banks incorporated in Hong Kong and those RLBs and DTCs with total assets of HK\$1 billion or more or total customer deposits of HK\$300 million or more.

Future Developments

The HKMA will continue its work on refining the disclosure framework currently in place to ensure that financial reporting by banks in Hong Kong keeps pace with local and international developments. ☉

– Prepared by the Banking Development Division