

The FRC publishes its third enquiry report

(18 September 2009, Hong Kong) Today, the Financial Reporting Council (the “FRC”) publishes its third enquiry report.

The enquiry relates to the consolidated financial statements of Core Healthcare Investment Holdings Limited (“Core Healthcare”) (Stock code: 8250) for the year ended 30 June 2008. Upon receipt of a complaint and following a preliminary review, the FRC appointed a Financial Reporting Review Committee (the “FRRC”) to conduct an enquiry on 17 March 2009. The enquiry was completed on 31 August 2009 and the report on the findings of the enquiry was adopted by the FRC on 3 September 2009.

The FRC has issued a [statement](http://www.frc.org.hk) (www.frc.org.hk) accompanying the enquiry report. The statement provides a brief chronology and the findings of the enquiry.

The issue of the enquiry is the accounting treatment of convertible bonds with anti-dilutive provisions. In the light of the variation in accounting treatments of convertible bonds in the market, the FRC has provided its observation in the appendix to the statement, which includes reference to views of major accounting firms, the FRC’s analyses and suggestion of a reasonable accounting treatment in accordance with the spirit of the current financial reporting standards and the latest development in the review of the relevant financial reporting standards by the international standard setting body.

Mr. M. T. Shum, the Chief Executive Officer of the FRC, said “Our observation is that there is no provision in the current financial reporting standards on the accounting treatments in relation to anti-dilutive clauses in convertible bonds subscription agreement. There is a general consensus in the accountancy profession that anti-dilutive clauses which preserve the relative rights of bondholders before and after the events triggering the adjustment of conversion price do not violate the “fixed-for-fixed” criterion. However, there is no published literature in the accountancy profession on the exemption from the adjustment of conversion price if new shares are issued at a discount of not more than a certain percentage to market value.”

“The FRC considers that it will meet the spirit of the current financial reporting standards if Core Healthcare has classified the equity conversion option of the convertible bonds in question as an equity instrument, provided the issue of materiality has been considered. However, this interpretation involves the extension of the “fixed-for-fixed” criterion beyond its literal meaning and there is considerable professional view in the extension. The FRC will write to the International Financial Reporting Interpretations Committee through the Hong Kong Institute of Certified Public Accountants to ask for more guidance on the application of the existing standard to be issued. It is understood that the International Accounting Standard Board is considering changes in the financial reporting standards which may require all convertible bonds to be classified as financial liabilities in the future. ” Mr. Shum added.

The FRRC comprised 5 members, including Mr. Roderic N. A. Sage as the Chairman, Mr. Chan Ka-ling Edmond, Ms. Chew Sein-mene, Mr. Ding Wai-chuen Raphael and Prof. Low Chee-keong as members.

The [full report](#) and the FRC’s [statement of observation](#) are available on the website of the FRC (www.frc.org.hk).