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Companies Bill Team
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

16 January 2012

Your ref: CBT/14/7/1

Dear Sirs,

COMPANIES BILL - CONSULTATION ON THE QUALIFYING CRITERIA FOR PRIVATE COMPANIES TO PREPARE SIMPLIFIED FINANCIAL AND DIRECTORS' REPORTS (CB Consultation Paper)

We welcome the invitation to provide views on the proposals to amend the qualifying criteria for private companies to prepare simplified financial and directors' reports, as part of the rewrite of the Companies Ordinance.

General comments

We strongly believe that as a major international financial centre it is imperative that Hong Kong should have, and maintain, a robust financial reporting regime. As such, this includes a financial reporting regime for domestic private companies and groups that is comparable to, and no less rigorous, than is found in other international financial centres.

As quoted in the CB Consultation Paper, Singapore and the United Kingdom both have similar financial reporting regimes to that found in the Companies Bill, with different accounting and reporting requirements for large and small private companies. Both jurisdictions use similar threshold criteria to determine the maximum size for a small private company. Private companies exceeding those threshold criteria are not permitted, in any circumstances, to use the relaxed/simplified reporting requirements afforded to qualifying small private companies; not even if there's unanimous members' approval.

Under section 141D of the existing Companies Ordinance a qualifying stand-alone private company of any size could, where there was unanimous shareholder agreement in writing, elect to use the simplified reporting under the HKICPA's Small and Medium-sized Financial Reporting Framework (SME-FRF) and prepare financial statements in accordance with the Small and Medium-sized Financial Reporting Standard (SME-FRS). However, the use of section 141D is

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currently restricted to prevent a company that's a member of a group to use simplified reporting provided by the SME-FRS. In addition, because accounts prepared under this section do not, and cannot, give a true and fair view, directors of qualifying companies choose not to use it.

It is for the above reasons that we recommended in our comment letter of 13 August 2010 that section 141D should be carried forward into the new Ordinance, with two minor changes that would not change its scope, and thus leave the status quo for those qualifying companies to use the SME-FRF&FRS.

On the other hand we do not agree with either widening the scope of section 141D to include groups or companies that are members of a group, or introducing other measures that essentially would mean that private companies or groups above the international consensus of what is meant by 'small' would be able to use simplified financial reporting of the nature of the SME-FRF&FRS. This would not be conducive to international comparability or Hong Hong's reputation.

Overall recommendation

Accordingly, we re-iterate our recommendation from our comment letter of 13 August 2010, namely:

- Section 141D is retained for those stand-alone private companies that fall within its scope, with two amendments:
 - Replace the 100% affirmation by members with a requirement for 'no objection' received from members.
 - Amend the audit opinion requirement to say that the financial statement "has been properly prepared in accordance with ...".
- All other qualifying, non-publicly accountable private companies and groups should be required to use the Hong Kong Financial Reporting Standard for private Entities (HKFRS-PE), as it has the following attributes:
 - (a) it is the reporting standard appropriate to private companies and groups (with significant reductions in disclosures and changes in measurement for simplicity from full HKFRSs);
 - (b) it is internationally accepted;
 - (c) it enables consolidations in Hong Kong and across other territories that have adopted a similar standard;

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- (d) its use gives a true and fair view (that is, it follows the accounting principles behind HKFRSs); and
- (e) it is acceptable to banks and the IRD.

The SME-FRF&FRS are only fit for the purpose for which they were written in 2005, which is a cost basis and is not in compliance with internationally accepted accounting principles.

We note that in Singapore that the equivalent Financial Reporting Standard for Small Entities to the HKFRS-PE (both are derived from the IFRS for SMEs) is used by all qualifying non-publicly accountable small private companies.

Comments on the Options set out in the CB Consultation Paper

Option 1: Large private companies/groups should not be allowed to adopt simplified reporting

This option broadly meets our views that reporting under the SME-FRS is essentially only appropriate for those small companies for which it was originally designed. All other private companies and groups would automatically qualify for the simplified reporting under the HKFRS-PE.

We have some reservations on the quantum of the size criteria for determining what is a small entity and the qualification as private (see below under 'Size criteria and qualifying as private').

Option 2: Allowing large private companies/groups with members' approval adopt simplified reporting

We do not agree with this option.

We have the same reservations as expressed under Option 1 about the quantum of the size criteria for automatic qualification for simplified reporting.

Simplified reporting under the SME-FRF&FRS is not appropriate for large private companies/groups. The requirements of the SME-FRF&FRS are only fit for the purpose of the companies for which they were designed in 2005. As indicated in paragraph 11 of the CB Consultation Paper, reporting under the SME-FRS will not give the degree of transparency that is expected of large companies/groups with more complex accounts.

The proposed member approval threshold of 'at least 75% of the voting rights and no member objecting' seems to cut across a guiding principle in the Companies Ordinance that minorities need

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protection and should not be oppressed. It seems to us that the proposal may facilitate potential abuse of minorities.

Option 3: Allowing large private companies/groups with members' approval adopt simplified reporting, subject to certain size criteria

We do not agree with this option for similar reasons expressed under Option 2. Furthermore, we do not agree that there should be higher thresholds when considering the size criteria for groups (see below under 'Size criteria and qualifying as private').

Summary

To make our point clear, at the time that the original Companies Bill was drafted the simplified reporting afforded under the HKFRS-PE had not been adopted. Now that it is available, we consider this to be the most appropriate reporting regime for most private companies and groups. Nonetheless, the section 141D/SME-FRF&FRS regime still has a place for those particularly small private companies that meet the size criteria, are not a member of a group and the directors and members are unconcerned that the accounts do not give a true and fair view. Widening the scope of section 141D to include groups to allow them to use the SME-FRS is not appropriate, except for those small groups that qualify under the size criteria discussed below.

Size criteria and qualifying as private

Qualification size thresholds

We are unconvinced by the HKICPA's consultation paper that the turnover and total assets thresholds in the size criteria should both be raised to as high as HK\$100m. We disagree with increasing the employee threshold to 100. We do not agree that there should be higher size thresholds for groups, as is suggested in paragraph 18 of the CB Consultation Paper.

Monetary thresholds of HK\$100m (in other currency equivalents) seem much larger than the internationally accepted norm established for small companies. In this respect, and drawing on the information about other jurisdictions in the HKICPA consultation paper, we would prefer that the turnover threshold is set at HK\$50m. Inflation in Hong Kong since 2005, the introduction of the SME-FRF&FRS, has been relatively benign and would not raise that limit to more than HK\$60m.

We note that a large part of the differences between the monetary thresholds in other jurisdictions and Hong Kong has arisen from exchange differences caused by the depreciation of the Hong Kong Dollar against those currencies. This has the apparent effect of inflating the thresholds of the

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other jurisdictions in Hong Kong Dollar terms when in reality there has been no increase in absolute terms.

We note that the total assets threshold under the UK's size criteria for its small company reporting regime is set at approximately 50% of the turnover threshold amount. We believe this is to allow companies with a small asset base but relatively large turnover to qualify as small while disallowing companies with large turnover and asset bases. In Hong Kong terms this would mean a total assets threshold of, say, HK\$25/30m. A concern that is expressed often in Hong Kong is that many companies have a high asset base due to investment property ownership and that a high asset threshold is required. This is perhaps fallacious, since companies only have to qualify under 2 of the 3 criteria and investment property companies may have a high asset base but low turnover and few employees. Nonetheless, for this reason we prefer that the total asset threshold should be the same amount as the turnover threshold.

In respect of the employee number threshold, 100 employees is too large. 50 employees is generally regarded internationally as being a surrogate for a small entity and, as such, we would not wish to see Hong Kong departing from this criterion.

Consequently, our preferred threshold quanta for companies are:

Turnover: HK\$50/60m; Total assets: HK\$50/60m; and Employees: 50.

In paragraph 18 of the CB Consultation Paper it is suggested that the monetary thresholds for turnover and assets for private groups might be 3 or 5 times greater than those for private companies. We do not agree because raising the group thresholds takes the group outside the criteria for determining a small business.

As with other jurisdictions, a reporting entity should qualify for simplified reporting if it meets the same size criteria whether it is organized as a single company or as a group of companies. The legal structure of the reporting entity should not hinder the ability to obtain simplified reporting. However, applying higher thresholds for groups will result in sizeable entities using the SME-FRS for which it is not designed and, in so doing, their financial statements will not provide the transparency about their complexity and state of affairs that is expected or be comparable with their international peers.

Consequently, our preferred threshold quanta for groups are:

Turnover: HK\$50/60m; Total assets: HK\$50/60m; and Employees: 50.

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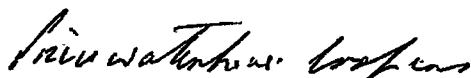
Qualifying as private

A company/group that qualifies as small based on the size criteria, nonetheless, should not qualify for simplified reporting if it is connected with a listed company. For example, either as a member of a group that contains a listed company or as a private holding company that has a listed subsidiary. Under the qualification criteria for the UK's small private company/ group reporting regime, such private companies and private groups cannot qualify as small¹. We consider that this is an important safeguard to the transparency and sufficiency of the information provided by all members of a group that contains one or more listed companies. Those private companies or groups that are connected with a listed company can, nevertheless, use the HKFRS-PE for the form of simplified reporting that is commensurate with their status.

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Should you have any question in relation to this letter, please do not hesitate to contact Paul F Winkelmann or Nigel D Dealy at this office.

Yours faithfully,



PricewaterhouseCoopers

¹ Section 384, UK Companies Act 2006