

**Consultation Conclusions
on the Accounting and Auditing Provisions
of the Companies Ordinance**

BACKGROUND

1. On 29 March 2007, the Financial Services and the Treasury Bureau (“FSTB”) launched a three-month public consultation on legislative proposals to improve the accounting and auditing provisions in the Companies Ordinance (Chapter 32) (“CO”). The consultation paper on the proposals (“Consultation Paper”) was circulated to relevant professional bodies, chambers of commerce and financial services regulators. It has also been posted on the FSTB’s CO rewrite website.
2. During the consultation period, we organised a consultation forum to seek public views on 4 June 2007. We had also attended a forum organised by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and several meetings of other interested organisations to brief the participants on the proposals and listen to their views. A list of the forums and meetings we attended is at Appendix I.

OUTCOME OF CONSULTATION

3. The consultation ended on 29 June 2007. A total of 32 submissions from 30 deputations were received, including a few that were received after the end of the consultation period. A list of the respondents is at Appendix II. A summary of the respondents’ views is at Appendix III. A compendium of the submissions is also available at the FSTB’s CO Rewrite website¹.
4. We have considered the respondents’ views in consultation with the Joint Government/Hong Kong Institute of Certified Public Accountants Working Group to Review the Accounting and Auditing Provisions of the CO (“Working Group”)² and the Standing Committee on Company Law

¹ Available at http://www.fstb.gov.hk/fsb/co_rewrite/.

² The Working Group was established in March 2002 to undertake a comprehensive review of the accounting and auditing provisions of the CO.

Reform (“SCCLR”)³. The majority of respondents indicate general support for most of the proposals. Nevertheless, there are a few proposals that draw reservation or objection from a substantial number of respondents. The respondents’ concerns and our responses on these proposals are summarised below.

A. *Proposal to extend the right of inspecting a company’s accounting records to managers and company secretaries (Question 1(a))*

Respondents’ views

5. About half of the respondents disagreed with the proposal. Even among those who saw the proposal in a positive light, some had expressed certain reservations or caveats. The main reasons for disagreement or reservation were that:
- (a) the statutory right to inspect accounting records should be restricted to directors only as they have specific duties in relation to keeping of books and preparation of accounts and they are subject to accountability for the powers conferred on them. If other officers were to be allowed to do so, they should have been authorized by the directors to do so first and the extent of their authority should be dictated by the authorization, the terms of their employment or internal procedures or management but not by the law; and
 - (b) the extension of the inspection right to persons other than the directors or someone properly authorized by the directors may lead to leakage of confidential, or in the case of listed companies, price sensitive information.

Our response

6. We agree to withdraw the proposal, taking into account the following considerations:

³ The SCCLR mainly advises the Government on necessary amendments to the CO. Its members include representatives of the Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as individuals from relevant sectors or professions such as accountancy, legal and company secretarial.

- (a) the proposal is taken from the United Kingdom (“UK”) Companies Act and might not be appropriate for the vast majority of small private companies incorporated in Hong Kong which are owner-managed;
- (b) the concern about confidentiality is quite legitimate because directors are the ones charged with the legal responsibility for and the management of the company’s affairs. Extending the right to inspect a company’s accounting records to other employees would raise legitimate concerns about what use such other employees might make of that information; and
- (c) in the UK, company accounts are public records as companies (except the small ones) are required to file accounts. Since there is no such requirement for private companies in Hong Kong, the issue of disclosure of information may be more sensitive in Hong Kong.

B. Proposals regarding first accounting reference period and accounting reference date (Question 2(a) and (b))

Respondents’ views

- 7. While the majority of respondents supported most of the proposals, there were concerns regarding the following aspects:
 - (a) a significant number of respondents (including the HKICPA, the Law Society of Hong Kong, and a few major accounting firms) queried the proposal to restrict the first accounting reference period to a minimum of 6 months after the incorporation of a company; and
 - (b) a majority of respondents (including the HKICPA, the Law Society of Hong Kong, Hong Kong Exchanges and Clearing Limited (“HKEx”), and a few major accounting firms) queried the proposal to impose a 5-year restriction on a company to alter its accounting reference date since the last extension of the accounting period, save for the purpose of aligning the accounting reference date with

that of its holding company. Some argued that the proposal was unnecessary, inflexible or arbitrary and it might cause practical and operational difficulties, particularly at times when flexibility and changes were required.

Our response

8. On paragraph 7(a) above, we agree that there seems no strong reason why a company could not produce its first set of accounts earlier than six months after its incorporation. We are prepared to withdraw the proposal, taking into account the following points:
 - (a) in the case of an Initial Public Offering (“IPO”), if restructuring takes place and a new company is incorporated just before an IPO, the first accounting period of the company would be the period from the date of incorporation to a date immediately before the IPO, which might be less than six months from the date of incorporation; and
 - (b) there is currently no constraint in the CO with regard to the first accounting reference period. If some one incorporates a company and wants to use it for some transactions soon afterwards, he should not be precluded from preparing its first set of accounts within a couple of days of incorporation and then the annual accounts thereafter.

9. As regards paragraph 7(b) above, we agree to revise the proposal so that a company can alter its accounting reference date within five years since the last extension of the accounting reference period, if approved by members in a general meeting⁴. Members’ approval could be an acceptable safeguard against manipulation of results by the management.

⁴ In other circumstances, alteration of the accounting reference date could be done through a directors’ resolution.

C. Proposal to require companies to prepare a more analytical and forward-looking business review (Question 4)

Respondents' views

10. While a slight majority of respondents supported in principle the proposal that companies (except for private companies that are eligible for preparing simplified accounts and simplified directors' reports) should be required to prepare a more analytical and forward-looking business review as part of the directors' report, a significant number of respondents (including the Law Society of Hong Kong, the Hong Kong Bar Association and several major accounting firms) queried the need for such proposal, especially in respect of private companies which were not subject to public filing requirement for their accounts. Some were concerned about the additional burden on directors. Others believed that statements could become too generic to contain any informative value to shareholders. All in all, they argued that the costs of compliance would outweigh any benefit that was to be gained from the disclosure.

Our response

11. We note the above concerns but believe that some respondents who objected to the proposed business review might have overlooked another proposal that would allow many more private companies to prepare simplified accounts and directors' reports (i.e. section 141D of the CO, see Question 17 in Appendix III) and, thereby, will be exempted from the new requirement to prepare a business review. We still consider that the proposal should be taken forward, taking into account the following factors:
- (a) other than public companies, it is expected that only a small number of larger private companies where the shareholders have effectively indicated that they want the directors to prepare full accounts and that more detailed directors' reports would be subject to the new requirement; and
 - (b) companies that have not opted for simplified accounts and directors' reports should not be given an option of dispensing with a more analytical and forward-looking business review. To allow

for cherry-picking across the two sets of obligations would be confusing and undesirable.

D. Proposal to include in the directors' report information on any significant difference in the market value and book value of the company's non-current operating assets (Question 7(a))

Respondents' views

12. A clear majority (including the HKICPA, the Hong Kong Institute of Chartered Secretaries ("HKICS") and several major accounting firms) objected to the proposal, mainly on the ground that vague valuation could be misleading, unreliable or not reflective of the market value. The information might not be relevant to shareholders but it would impose additional burden on the directors. The time and costs involved might outweigh the benefits of such information, particularly if professional valuation was needed.

Our response

13. Having considered the respondents' views, we agree to withdraw the proposal in view of the following:
- (a) the accounting standards do not require information on any significant difference in the market value and book value of the company's non-current operating assets to be put in the financial statements by note or otherwise;
 - (b) the financial statements themselves are produced on a mixed model basis, comprising of valuation, cost, depreciated value, etc. There is no reason why only one element of that should be remedied by law without remedying the others; and
 - (c) Hong Kong's property prices are not predictable and, the market value of properties at the end of the financial year might be different from the value as at the date of the directors' report.

E. Proposal to include the directors' report statement concerning disclosure of information to auditors (Question 8)

Respondents' views

14. About half of the respondents (including the Association of Chartered Certified Accountants, HKICS and several major accounting firms) disagreed with the proposal. They generally found the requirement unnecessary as the current practice of asking directors to sign a letter of representation to the auditors seems to have worked well in most circumstances. Besides, the proposed requirement could be too onerous for those directors who were non-accountants or were not in a position to handle financial reporting directly, and would increase their potential liability substantially.
15. Some other respondents (such as the HKICPA) had also expressed some reservations or proposed other alternatives. For example, the HKICPA proposed the alternative of making each director personally responsible if he was aware that material information had been withheld from the auditors or misrepresented to them.

Our response

16. We agree that there might be problems with the proposed statement by directors as compliance required ascertainment of the state of mind of each director in relation to what relevant audit information each director knew that the auditors had known or not. As an alternative, we propose to make a director criminally liable if he knows of certain information that the auditor considers necessary for the performance of his duties but did not disclose it to the auditor upon his request, unless it was not reasonably practicable for him to do so. This will be in addition to section 134 of the CO which sets out the offence in relation to an officer of a company (including directors) who knowingly or recklessly provides misleading, false or deceptive statements to auditors.

F. Qualifying criteria for a guarantee company to take advantage of the simplified accounting and reporting requirements (i.e. to apply section 141D of the CO) (Question 20)

Respondents' views

17. The respondents generally supported that small guarantee companies should be allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies under section 141D if they were able to meet certain specified qualifying criteria. There were different views on what the qualifying criteria should be. A majority of the respondents agreed that the qualifying criteria applicable to private companies should also apply to guarantee companies. Some respondents preferred a lower threshold while a few respondents considered that all guarantee companies should be able to take advantage of simplified accounting and reporting requirements.

Our response

18. Having considered the respondents' comments and consulted the HKICPA and the Working Group, we consider it inappropriate for large guarantee companies, including those for educational, recreational, charitable or community-related purpose, to opt out of the full reporting requirements, as public interest is often involved. It is also considered that the total assets and number of employees are not suitable criteria to distinguish large guarantee companies from the small ones. We suggest using total annual revenue of not more than HK\$25 million as a bright line rule for guarantee companies. Those guarantee companies with total annual revenue of HK\$25 million or less can take advantage of the simplified accounting and reporting requirements.

OTHER OUTSTANDING MATTERS

The basis on which directors of companies that apply section 141D of the CO should prepare financial statements or consolidated financial statements (Paragraphs 8.12 and 8.13 of the Consultation Paper)

19. At present, section 141D(1)(e)(ii) requires the auditors' report of a company applying section 141D to state "whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs". Paragraphs 8.12 and 8.13 of the Consultation Paper highlight the issue concerning whether the phrase "true and correct" view is appropriate and should be amended, and indicate that the Administration will revisit the issue in the light of the development of the International Financial Reporting Standard ("IFRS") for Small and Medium Enterprises ("SMEs").

20. We have recently reconsidered the issue in consultation with the Working Group. It is noted that the International Auditing and Assurance Standards Board has issued an exposure draft of the IFRS for SMEs that would enable them to give a "true and fair" view of the financial statements prepared in accordance with a specified framework. It is expected that the revised standard will receive general support and become effective in 2009. We propose that those companies applying section 141D should prepare accounts on a "true and fair" basis (instead of the "true and correct" basis currently in force).

CONCLUSION

21. The proposals in the Consultation Paper should be adopted subject to the following modifications:
 - (a) the proposal to extend the right of inspecting a company's accounting records under section 121(3) of the CO beyond directors to other officer of the company (such as managers and secretaries) should be withdrawn (*Question 1(a)*);

- (b) the proposal to require the first accounting reference period of a newly incorporated company to be not less than six months (counting from its incorporation date) should be withdrawn (*Question 2(a)*);
- (c) the proposal to disallow alteration of the accounting reference date within five years since the last extension of the accounting reference period (save for the purpose of aligning the accounting reference date with that of its holding company) should be relaxed so that such alteration would be allowed if it is approved by members of the company by an ordinary resolution (*Question 2(b)*);
- (d) the proposal to require a directors' report to reflect any significant difference in the market value and book value of the company's non-current operating asset should be withdrawn (*Question 7*);
- (e) the proposal to require a directors' report to contain a statement by each director concerning disclosure of information to auditors should be withdrawn. Instead, we propose to make a director criminally liable if he knows of certain information that the auditor considers necessary for the performance of his duties but did not disclose it to the auditor upon his request unless it was not reasonably practicable for him to do so. (*Question 8*);
- (f) a guarantee company with a total annual revenue of not more than HK\$25 million should be allowed to take advantage of the simplified accounting and reporting requirements applicable to private companies under section 141D of the CO (*Question 20*); and
- (g) those companies applying section 141D should prepare accounts on a "true and fair" basis in accordance with the applicable accounting standards (instead of "true and correct" basis currently in force) (*Paragraphs 8.12 and 8.13 of the Consultation Paper*)

WAY FORWARD

22. The Administration will incorporate all the proposals to improve the accounting and auditing provisions into a White Bill to be issued for further public consultation in mid-2009.

**Financial Services and the Treasury Bureau
March 2008**

List of Forums & Meetings Attended

Date	Organising Parties	Nature
8 May 2007	Small and Medium Enterprises Committee, Trade and Industry Department*	Meeting
21 May 2007	Hong Kong Institute of Certified Public Accountants*	Seminar
4 June 2007	Companies Bill Team, Financial Services and the Treasury Bureau	Forum
8 June 2007	The Small and Medium Enterprises Committee, Hong Kong General Chamber of Commerce*	Meeting
21 June 2007	The Federation of Hong Kong Guangdong Community Organisations *	Meeting

- * We were invited by the organising parties to attend the meetings and seminars to further introduce the proposals on the accounting and auditing provisions in the Rewrite of the Companies Ordinance. Comments on the proposals were also received from members of the organising parties through discussions.

List of Respondents

Organisations

1. Arthur Lam & Co. CPA
2. Association of Chartered Certified Accountants, The
3. Association of International Accountants
4. Association of Women Accountants (Hong Kong) Limited
5. British Chamber of Commerce, The
6. Canadian Certified General Accountants Association of Hong Kong
7. Chamber of Hong Kong Listed Companies, The
8. Chartered Institute of Management Accountants – Hong Kong Division, The
9. CLP Holdings Limited
10. CPA Australia
11. Deloitte Touche Tohmatsu
12. Ernest & Young
13. Hong Kong Bar Association
14. Hong Kong Exchange and Clearing Limited
15. Hong Kong General Chamber of Commerce
16. Hong Kong Institute of Certified Public Accountants
17. Hong Kong Institute of Chartered Secretaries
18. Institute of Accountants in Management, The
19. International Management Association
20. KPMG
21. Law Society of Hong Kong, The
22. Mandatory Provident Fund Scheme Authority
23. Society of Chinese Accountants & Auditors, The

Individuals

24. Victor HO
25. Robert KENRICK
26. Selwyn MAR
27. Paul MOK

28. Mandy TAM Heung-man

29. Yea Tann Simon TSAO

30. One respondent has requested his name not to be disclosed

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Summary of Respondents' Views

Question Number	Questions and Respondents' Views
1 (a)	<p>Should the right of inspecting a company's accounting records be extended beyond directors to other officers of the company (such as managers and secretaries)?</p> <p>Views were divided. About half of the respondents supported the proposal and considered that it would enhance the operation of a company. They also opined that company secretaries and other officers should have statutory right of access to the company's accounting records.</p> <p>However, other respondents disagreed with the proposal. They considered that a company's accounting records were price-sensitive and of paramount importance and expressed concerns over its confidentiality. If other officers were allowed to inspect the accounting record, they should have been authorised by the directors to do so first. Moreover, the Government should not over-legislate on internal management of a company. Some respondents also had reservations on the definition of "officers of the company".</p>
1 (b)	<p>Do you agree that the court may, on application by a director, allow a person to inspect a company's accounting records on behalf of the director on such terms and conditions as the court may think fit?</p> <p>The majority of the respondents supported the proposal. They considered that it would provide additional professional support to directors, including the non-executive directors, in discharging their duties. However, a few respondents had reservations over the confidentiality of the accounting records to be inspected by the person instructed by the court.</p>

Question Number	Questions and Respondents' Views
2 (a)	<p>Do you agree that the CO should be amended to require each company to have a fixed accounting reference period? <u>IF YES</u>, do you agree that: <u>For a newly incorporated company:</u> it should be allowed to appoint a day as its accounting reference date through a directors' resolution, provided that the first accounting reference period should be (counting from its incorporation date) as mentioned in paragraph 3.8(a) of the Consultation Paper:</p> <ul style="list-style-type: none"> • not less than six months? • not more than 18 months? <p>(i) if there is no appointed date under (i) above, the accounting reference date should be the last day of the month of its incorporation anniversary as mentioned in paragraph 3.8(a) of the Consultation Paper?</p> <p>(ii) in either case, the subsequent successive accounting reference periods should be 12 months each?</p> <p><u>For any other company:</u></p> <p>(iii) the accounting reference date should be the anniversary of the end-date of the company's most recent accounts laid at its AGM?</p> <p>(iv) the first and subsequent successive accounting reference periods should be 12 months each?</p> <p>The majority of the respondents supported the proposal in general and considered that it would provide assurance to shareholders and investors that the financial reports are prepared in a timely and efficient manner. However, a significant number of respondents queried the need to restrict the first accounting reference period to a minimum of 6 months since its incorporation.</p>
2 (b)	<p>Do you agree that each company should be allowed to alter its accounting reference date through a directors' resolution? <u>IF YES</u>, do you agree that:</p> <p>(i) the accounting reference period should not be extended to more than 18 months?</p> <p>(ii) such alteration should not occur within five years since the last extension of the accounting reference period, save for the purpose of aligning the accounting reference date with that of its holding company?</p> <p>(iii) in the case of a public company, the resolution should be filed with the Registrar of Companies for public information?</p> <p>Most respondents agreed with our proposal that each company should be allowed to alter its accounting reference date through a directors' resolution. However, a majority of respondents queried the proposal to impose a 5-year restriction on a company to alter its accounting reference date since the last extension of the accounting period, save for the</p>

Question Number	Questions and Respondents' Views
	purpose of aligning the accounting reference date with that of its holding company. Some also argued that the proposal was unnecessary, inflexible or arbitrary and it might cause practical and operational difficulties, particularly at times when flexibility and changes were required.
2 (c)	<p data-bbox="454 510 1417 651">Do you agree that the CO should be amended to require each company to have a fixed financial year, i.e. the same as the accounting reference period, except that directors may alter the last day of the financial year by plus or minus seven days?</p> <p data-bbox="454 696 1417 913">The majority of the respondents supported the proposal. They considered that the proposal was flexible and would enhance good corporate governance. However, a few respondents considered that such flexibility would make a company's accounting periods not comparable and might facilitate directors to window dress the financial results and position of the company.</p>
3 (a)	<p data-bbox="454 952 1417 1057">Should a holding company be relieved from the obligation to prepare its own accounts, provided that it has prepared group accounts and has included its own balance sheet as a note to its group accounts?</p> <p data-bbox="454 1102 1417 1281">The majority of respondents agreed with the proposal. They considered that it would help save costs. There was a suggestion that the definition of group accounts, which ought to be prepared in accordance with the Hong Kong Financial Reporting Standards ("HKFRSs"), should be clearly given in the new provisions.</p>
3 (b)	<p data-bbox="454 1323 1417 1429">Do you agree that the conditions under which a subsidiary is not required to prepare group accounts should be refined as proposed in paragraph 3.13 of the Consultation Paper?</p> <p data-bbox="454 1473 1417 1691">The majority of the respondents agreed with the proposal. However, some respondents considered it burdensome for a non-wholly owned holding company to be required to obtain the consent of all its shareholders. In this regard, they suggested that the new provisions should minimise the discrepancies between the legislation and the accounting standards.</p>
4	<p data-bbox="454 1727 1417 1877">Should companies (unless otherwise exempted as proposed in paragraphs 4.6, 7.9 and 7.11) be required to prepare a more analytical and forward-looking business review along the lines of paragraph 4.3 of the Consultation Paper?</p> <p data-bbox="454 1921 1417 2051">Views were divided. While a slight majority of respondents supported in principle the proposal that companies (except for private companies that are eligible for preparing simplified accounts and simplified directors' reports) should be required to prepare a more analytical and</p>

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	<p>forward-looking business review as part of the directors' report, a significant number of respondents queried the need for the proposed requirement, especially in respect of private companies which were not subject to public filing requirement for their accounts. Some were concerned about the additional burden on directors. Others believed that statements could become too generic to have any informative value to shareholders. All in all, they argued that the costs of compliance would outweigh any benefit that was to be gained from the disclosure.</p>
5	<p>Do you have any suggestions on the information that should be included in the financial and non-financial key performance indicators, a generic term which is intended to refer to factors by reference to which a company's business can be measured effectively?</p> <p>Some respondents recommended that the financial key performance indicators ("KPIs") should cover financial information of a company, e.g. assets turnover, liquidity ratio, principal debt covenant performance and so on. They also suggested that non-financial KPIs should include information such as customer feedback, employee satisfaction and development, corporate social responsibilities and so on. However, a few respondents considered that non-financial KPIs should be tailored from one business to another as there was a wide variety of issues in different industries.</p>
6	<p>Do you have any other suggestions on matters that should be covered in the business review?</p> <p>Respondents made a number of recommendations, including information concerning directors' roles and duties, the company's risk management strategies, major market forecasts or competitive trends, to be covered in the business review.</p>
7 (a)	<p>Should directors' reports (unless otherwise exempted) be required to include information on: any significant difference in valuation between the market value of the company's non-current operating assets shown on the balance sheet as consist of interests in land and buildings and its book value to the extent practicable and, if so, what should be the appropriate information sources?</p> <p>A clear majority objected to the proposal, mainly on the ground that vague valuation could be misleading, unreliable or not reflective of the market value. The information might not be relevant to shareholders but it would impose additional burden on the directors. The time and costs involved might outweigh the benefits of such information particularly if professional valuation was needed.</p>

Question Number	Questions and Respondents' Views
7 (b)	<p>Should directors' reports (unless otherwise exempted) be required to include information on: equity linked agreements which subsist at the end of the financial year or which the company has entered into in the financial year, if the issue of shares under such agreements has a potential to dilute existing shareholders' interests?</p> <p>The majority of the respondents agreed that equity linked agreements which might potentially dilute shareholders' interests should be included in the directors' report. They considered that the proposal would help protect the minority shareholders' interests (especially those in unlisted companies) and would enhance corporate governance. Some suggested that the new provisions should specify the minimum information that should be disclosed in the respect of the equity linked agreements.</p>
8	<p>Should directors' reports contain a statement to the effect that, so far as each director knows, there is no relevant audit information of which the auditors are unaware, and that each director has taken all the steps he should have taken to make himself aware of such information and to establish that the auditors are aware of it?</p> <p>About half of the respondents disagreed with the proposal. They generally found the requirement unnecessary as the current practice of asking directors to sign a letter of representation to the auditors seemed to have worked well in most circumstances. Besides, the requirement could be too onerous for directors who were not accountants and did not understand the requirement or were not in a position to handle financial reporting, and would increase their potential liability substantially.</p> <p>Some respondents, while having no objection in principle, had also expressed some reservations or proposed other alternatives. For example, the HKICPA proposed the alternative of making each director personally responsible if they were aware that material information had been withheld from auditors or misrepresented to them.</p>
9 (a)	<p>Do you agree that a separate directors' remuneration report should be prepared by: listed companies incorporated in Hong Kong;</p> <p>The majority of the respondents supported the proposal. They considered that it would improve transparency and corporate governance. However, some respondents opined that there should be a balance between transparency and privacy. They also suggested that the new provisions should clearly state the definition of "remuneration" and the disclosure requirements.</p>

Question Number	Questions and Respondents' Views
9 (b)	<p>Do you agree that a separate directors' remuneration report should be prepared by: unlisted companies incorporated in Hong Kong where holders of not less than 5% of the issued share capital or, in the case of a company not having a share capital, members representing not less than 5% of the total voting rights of all the members so request? <u>IF YES</u>, do you agree that the remuneration report should disclose full details of various types of benefits given to the individual directors by name, including basic salary, fees, housing and other allowances, benefits in kind, pension contributions, bonuses, compensation for loss of office and long-term incentive schemes including share options?</p> <p>Most respondents supported the proposal in principle. However, views on the details of disclosure were divided. Some respondents considered that all shareholders should have the right to require full disclosure of remuneration packages to directors while others suggested that the disclosure could be limited to remuneration bands rather than by name of each individual director.</p>
10	<p>We aim to revise the provisions regarding summary financial reports to make them more user-friendly from the company's as well as the members' viewpoints. Would you support amending the provisions along the lines as suggested in paragraph 5.4 of the Consultation Paper? Do you have any specific suggestions as to the form or contents of the summary financial reports?</p> <p>The majority of respondents agreed with our proposal. They considered that summary financial reports were sufficient for the purposes of most shareholders and would also simplify administrative procedures. However, a few respondents said that shareholders should be able to choose to receive a hard copy of a full set of financial reports free of charge. It was important to strike a balance between the demand for information and the need to provide adequate financial information for shareholders to make informed decisions as to whether they should continue their investments in the companies. They also suggested that the new provisions should be consistent with the Listing Rules.</p>
11	<p>Should auditors be given qualified privileges for statements made in the course of their duties as auditors and in respect of their resignation as auditors under the CO? <u>IF YES</u>, do you agree that the proposed privileges should be extended to persons who publish any document prepared by the auditors in the course of their duties as auditors and in respect of their resignation under the CO?</p> <p>The majority of the respondents supported the proposal. They considered that it would encourage auditors to disclose the true reasons</p>

Question Number	Questions and Respondents' Views
	<p>for their resignation so the public can more accurately appraise the situation and value of the companies concerned. However, a few respondents expressed concerns that the privileges might be abused and considered that the outgoing auditors would have other ways to express their views on the company concerned.</p>
12	<p>Should the auditors' rights to information be enhanced so that they can require "specified persons", as mentioned in footnote 51 of the Consultation Paper to provide them with information, explanations or other assistance as they think necessary for the performance of their duties as auditors? [<i>"specified persons" include officers or employees of the company; any person holding or accountable for any of the company's books, accounts or vouchers; any subsidiary undertaking of the company, which is a body corporate incorporated in Hong Kong; any officer, employee or auditor of such undertaking; any person holding or accountable for any books, accounts or vouchers of such undertaking; plus any person falling within the said categories at a time to which the information required by the auditor relates</i>]</p> <p>The majority of those responding agreed with the proposal that auditors' right should be enhanced. They generally considered that this would provide additional evidence to the auditors to justify their audit opinion and gave additional assurance to shareholders. However some respondents opined that the obligation of providing information to auditors should rest with company directors, but not other officers, especially when failure to do so amounted to an offence.</p> <p>On the other hand, some respondents considered that the existing provisions under section 141(5) of the CO should suffice. If the auditors need assistance from those persons, the requests could be made through the company. Some respondents also considered it inappropriate to compel predecessor auditors and non-HK residents to provide information by law.</p>
13	<p>Where a holding company has a subsidiary undertaking which is not a body corporate incorporated in Hong Kong, should the auditor have the right to require the holding company to obtain from the relevant persons or parties such information, explanations or other assistance as the auditor may reasonably require for the purposes of his duties as auditor?</p> <p>The vast majority of the respondents agreed with our proposal that the auditor should be in the position to do so. They considered that the proposal was consistent with the requirements in the financial reporting standards and the statutes of other comparable jurisdictions. However, there might be practical difficulties in enforcement, especially for overseas subsidiaries. One respondent said that listed companies had already adopted the practice while for unlisted companies, the auditors</p>

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	could qualify their reports without such information.
14	<p data-bbox="454 360 1417 472">Should an outgoing auditor be allowed to give the incoming auditor information that he became aware of in his capacity as auditor without seeking permission of the company?</p> <p data-bbox="454 510 1417 947">The majority of the respondents agreed with the proposal. They considered that the practice was important for incoming auditor to formulate his risk management strategies. It would also help encourage the accounting profession to be more answerable and thus further enhance corporate governance in Hong Kong. A few respondents suggested that notification to the company in advance should be required as a matter of courtesy. Moreover, there should also be limits on the scope of information that could be passed and that qualified privileges should also be granted to auditors. On the other hand, some respondents considered that the current provisions dealing with outgoing auditors were sufficient. Outgoing auditors should be relieved of the duty of confidentiality when they resigned, retired or were removed.</p>
15	<p data-bbox="454 987 1417 1167">Should all outgoing auditors (i.e. auditors who cease to hold office for any reasons) be required to provide a statement of any circumstances connected with his ceasing to hold office that he considers should be brought to the attention of the members or creditors of the company or a statement of no such circumstances?</p> <p data-bbox="454 1205 1417 1641">Most respondents agreed with the proposal. They considered it to be in line with practices common in other jurisdictions or with standards used by other professionals. They opined that there should be clarity on the meaning of "ceasing to hold office" especially when a "causal vacancy" arose under the current section 131(5) of the CO. Moreover, they suggested that the auditors should give the timing and the real substantive reasons for their cessation. The circumstances reported should also be consistent with the guidance provided in the HKICPA's Code of Ethics for Professional Accountants. However, one respondent considered that the proposal was unnecessary as there was already a communication channel established under section 140A(2)(a)(ii) for resigning auditors and section 132(3) for auditors being removed.</p>
16	<p data-bbox="454 1688 1417 1800">Do you agree with the proposed amendments to the auditing provisions as set out in paragraph 6.9 of the Consultation Paper? Paragraph 6.9 proposes that:</p> <p data-bbox="454 1800 1417 1912">(a) requiring auditors to report on any inconsistencies between the audited accounts and financial information contained in other parts of the annual report, such as the directors' report;</p> <p data-bbox="454 1944 1417 2018">(b) requiring auditors to report on the auditable part of the directors' remuneration report if such a report is prepared;</p>

Question Number	Questions and Respondents' Views
	<p data-bbox="454 286 1417 358">(c) clarifying that an auditor's term of appointment ceases when a liquidator is appointed; and</p> <p data-bbox="454 398 1417 504">(d) removing the existing requirement of fixing the auditors' remuneration by a company in a general meeting, and allowing directors to fix the auditors' remuneration.</p> <p data-bbox="454 544 1417 907">Most respondents agreed with the proposed amendments to the auditing provisions as set out in paragraph 6.9(a) & (b). They considered that auditors' confirmation would enhance the reliability of directors' report and the reporting requirement for auditors was in accordance with section 497 of the United Kingdom Companies Act 2006. However, some respondents considered that auditing requirements set out in Hong Kong Standard on Auditing 720 "Other Information in Document Containing Audited Financial Statement" were sufficient. They also expressed concern over the practical application of the requirement as it might involve auditors' subjective judgment and interpretation.</p> <p data-bbox="454 947 1417 1052">All respondents agreed to give clarification that an auditor's term of appointment ceases when a liquidator was appointed as set out in paragraph 6.9(c).</p> <p data-bbox="454 1093 1417 1384">The majority of respondents supported the proposal in paragraph 6.9(d) because the existing requirement no longer reflected the current practice. However, a minority of respondents objected to the proposed amendment as the recommendation was allegedly contradictory to enhancing corporate governance and might jeopardise of the independence of the auditor. They opined that shareholders' right to fix the auditors' remuneration in a general meeting should be reserved to ensure that the auditors acted primarily in the interests of the shareholders.</p>
17 (a)	<p data-bbox="454 1429 1417 1568">Do you agree that the qualifying criteria for exemptions from certain accounting provisions for private companies under section 141D should be relaxed along the lines as suggested in paragraph 7.6 of the Consultation Paper?</p> <p data-bbox="454 1608 1417 1904">All respondents agreed with the proposal. They suggested that the qualifying criteria on "small group" and the international development of International Financial Reporting Standards ("IRFSs") for Small and Medium Enterprises ("SMEs") should be properly considered. However, some of them had reservations on the adoption of the qualifying criteria based on the same size criteria and qualifying conditions in the Hong Kong SME Financial Reporting Framework ("SME-FRF") and SME Financial Reporting Standard ("SME-FRS").</p>

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17 (b)	<p data-bbox="453 286 1417 432">Specifically, do you agree that the size criteria set out in paragraphs 7.3 and 7.6(e) of the Consultation Paper, i.e. (aggregate) total annual revenue, (aggregate) total assets and number of employees are the right criteria? <u>IF YES</u>, do you agree with the proposed thresholds?</p> <p data-bbox="453 472 1417 943">Most respondents agreed with the proposed size criteria and threshold which would benefit more companies. However, some respondents expressed concern about the updating of the size criteria in future. The meaning of “revenue” should also be clarified. Besides, some respondents had reservations on such relaxation if the companies were required under the loan arrangement to submit audited accounts prepared in accordance with HKFRSs and they suggested harmonising the changing SME-FRF criteria and the requirements proposed in the CO. A few respondents also considered that audited simplified accounts might be misleading and might create a risk for investors who sought to acquire SMEs. One respondent opined that companies should be divided according to the extent of the public interest in the company’s affairs rather than their “size”.</p>
18	<p data-bbox="453 987 1417 1167">Should section 141D be amended to require a private company applying the section to prepare a full set of accounts dealing with the state of affairs and profit or loss of the company as required under the SME-FRS and, in the case of a holding company, also to prepare a full set of group accounts?</p> <p data-bbox="453 1207 1417 1503">All respondents agreed with the proposal. Some opined that the on-going harmonisation of the proposed requirements with the SME-FRS criteria should be maintained which would help resolve the inconsistency between the existing requirements and the HKFRSs. Some suggested that SME-FRS be amended to provide clear guidance on the preparation of group accounts and to consider whether to expand the acceptable frameworks under which financial statement may be prepared in the legislation so as to provide a choice for shareholders.</p>
19	<p data-bbox="453 1543 1417 1644">Should “section 141D companies” be required to produce only simplified directors’ reports along the lines of paragraph 7.9 of the Consultation Paper?</p> <p data-bbox="453 1684 1417 2040">All respondents supported the proposal. However, some of them suggested a number of new items to be included in the simplified directors’ report, including the amount recommended by the directors to be paid by way of dividend, negative statements, amounts of fixed assets purchased, the donations paid and a comprehensive statement to disclose other types of conflicts of interests and directors’ interests. Some respondents had reservations on the recommended statement on disclosure of information to auditors. They were concerned that it would only serve to transfer risk exposure directly to individual company directors, thus leaving directors unclear on the steps and extent of the</p>

Question Number	Questions and Respondents' Views
	information that the auditor should know. (Please also see Question 8 above)
20	<p>Do you agree that guarantee companies should be allowed to take advantage of the simplified reporting and disclosure requirements similar to those proposed to be applied to section 141D private companies (including simplified accounts and simplified directors' reports) if they are able to meet certain qualifying criteria?</p> <p><u>IF YES,</u></p> <p>(i) do you agree that the size criteria set out in paragraphs 7.3 and 7.6(e), i.e. (aggregate) total annual revenue, (aggregate) total assets and number of employees, are the right criteria for guarantee companies?</p> <p>(ii) should the thresholds outlined in paragraphs 7.3 and 7.6(e) be applied to guarantee companies or should they be modified?</p> <p>(iii) should any additional information be required from those guarantee companies which take advantage of the simplified reporting and disclosure requirements?</p> <p>Respondents generally supported that small guarantee companies should be allowed to take advantage of the simplified reporting and disclosure requirements applicable to private companies under section 141D if they were able to meet certain specified qualifying criteria. There were different views on what the qualifying criteria should be. A majority of the respondents agreed that the qualifying criteria applicable to private companies should also apply to guarantee companies. Some respondents preferred a lower threshold while a few respondents considered that all guarantee companies should be able to take advantage of simplified accounting and reporting requirements.</p>
21 (a)	<p>Among the three options listed in paragraph 8.2 of the Consultation Paper, which option do you favour? What are the reasons for your choice?</p> <p>There was a strong preference for option (3) as it provided the most efficient and effective way forward in delineating the respective roles of the Tenth Schedule and the accounting standards, while including specific additional disclosures that are deemed necessary for local requirement. It was also the simplest option to avoid overlapping of and retain flexibility for the financial reporting standards to align with the international practices without amending the CO.</p>
21 (b)	<p>If Option (3) is chosen, do you also favour giving statutory recognition to the HKFRSs by requiring companies to state in their accounts as to whether the accounts have been prepared in accordance with applicable accounting standards, and particulars of any material departure from those standards and the reasons?</p>

Question Number	Questions and Respondents' Views
	<p>A majority of the respondents favoured the proposed way of giving statutory recognition to the HKFRSs. A few of them considered that recognition should also be accorded to the International Financial Reporting Standards. However, a few other respondents considered it unnecessary to give statutory backing or recognition to accounting standards as it would encourage a mechanical compliance-driven approach which might restrict the flexibility of the accounting profession to exercise professional judgment. They also opined that the true and fair view requirement under section 123 and section 126 of CO already provided adequate protection.</p>
21 (c)	<p>If you do not favour any of the three options, do you have any other suggestion for dealing with possible conflicts between the Tenth Schedule and accounting standards?</p>
	<p>There was no response to this question.</p>
22 (a)	<p>Do you agree that the Eleventh Schedule in its present form should be repealed while retaining those disclosure requirements concerning section 141D companies with a significant public interest or corporate governance dimension and which are not presently covered by the SME-FRS?</p>
	<p>Almost all respondents supported the proposal as they thought it would avoid any possible conflicts between the Eleventh Schedule of the CO and the SME-FRS.</p>
22 (b)	<p><u>IF YES</u>, do you agree that statutory recognition should be given to the SME-FRS by requiring section 141D companies to state in their accounts as to whether the accounts have been prepared in accordance with applicable accounting standards, and particulars of any material departure from those standards and the reasons?</p>
	<p>The majority of respondents agreed with the proposal of giving statutory recognition to the SME-FRS. A few respondents disagreed. The considerations for and against the proposal were similar to those in Question 21(b).</p>
22 (c)	<p><u>IF NOT</u>, do you have any other suggestion for dealing with possible conflicts between the Eleventh Schedule and the SME-FRS?</p>
	<p>One respondent opined that there was no material conflicts between the Eleventh Schedule and the SME-FRS.</p>