CPA
Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through email co_rewrite@fstb.gov.hk

21 December 2011

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

Dear Sirs,

Companies Bill Consultation Paper on the qualifying criteria for private companies to prepare simplified financial and directors' reports

The Hong Kong Institute of Certified Public Accountants (The Institute) is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. The Institute is committed to acting in the public interest and upholding the highest standards of financial reporting and welcomes the opportunity to provide you with comments on the captioned consultation paper.

The Institute supports the policy intention of the Companies Bill Team to save compliance costs for private companies while at the same time maintaining an appropriate level of transparency of companies' business through financial reporting.

The Institute has the following comments on each of the options as stated in the consultation paper:

Option 1: Large private companies/groups should not be allowed to adopt simplified reporting (i.e. no change to the proposal in the Companies Bill)

The Institute supports this option whereby large private companies/groups should not be allowed to adopt simplified reporting. Our key rationale is that when the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF&FRS) was issued in 2005 in order to provide relief for smaller Hong Kong companies from the burden of the more complex financial reporting requirements in the full Hong Kong Financial Reporting Standards (HKFRSs), SME-FRF&FRS was developed based primarily on cost-and-benefit considerations and therefore is a historical cost accounting framework. In principle, a historical cost accounting framework does not reflect, with the expected degree of transparency and consistency, the state of affairs of large sizeable companies or groups of companies with more complex business and accounting environments.

However, we consider it appropriate that the size criteria for the use of SME-FRF&FRS should be increased to more currently relevant levels, taking into account inflation and the fact that many Hong Kong owned groups have labour-intensive manufacturing operations in the Mainland. Having sought the Bills Team's endorsement for increasing the limits in the proposed Schedule to the Companies Bill, on 6 December 2011 we issued a consultation paper which proposes doubling the current limits to HK$100m

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈三十七樓
Tel 電話 (852) 2287 7228
Fax 傳真 (852) 2865 6776
(852) 2865 6603
Web 網址 : www.hkicpa.org.hk
E-mail 電郵 : hkicpa@hkicpa.org.hk

assets, HK$100m revenue and 100 employees, while maintaining the "two out of three" approach. We consider that this will provide relief to most SMEs in Hong Kong while still ensuring that only entities for which the simplified reporting framework was designed are eligible to use that framework. Our consultation paper can be accessed at http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/ed-pdf-2011/nov/cp-sizecr.pdf.

You will also be aware that in 2010 the Institute issued HKFRS for Private Entities as a reporting option with the intent to relieving larger private companies/groups of the requirements to apply full HKFRSs. HKFRS for Private Entities is based on the International Financial Reporting Standard for Small and Medium-sized Entities issued by the International Accounting Standards Board. We believe that HKFRS for Private Entities is more suitable for use by private companies/groups with larger size and sophistication, being based on full HKFRSs while allowing a degree of relief from some of the more detailed accounting and disclosure requirements of full HKFRSs.

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

The Institute does not support option 2 which proposes to allow adoption of SME-FRF&FRS by any private company/group regardless of size provided consent is given by 75% of shareholders with no member objecting.

We have considered this proposal carefully and set out in a position paper that has been approved by the Institute Council why it is not in the public interest. Please refer to the attached **Annex** for the position paper.

In addition, we note that paragraph 15 of your consultation paper states that under the current section 141D of the Companies Ordinance a private company with members' approval, irrespective of its size, is already allowed to prepare simplified reports. The consultation paper further elaborates that there is a case for allowing large private companies/groups with members' approval to adopt simplified reporting as it does not appear that the current regime has created problems. We do not agree with such reasoning. Currently companies that have a parent company registered under the Ordinance and/or one or more subsidiaries, are not eligible to use section 141D to take advantage of simplified reporting. Section 141D is currently only allowed for a single company. We consider that this indicates that size criteria are implicitly taken into account in assessing the applicability of Section 141D as carrying out large scale and complex businesses in Hong Kong using a single company structure would not be common.

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

The Institute is also not supportive of option 3 which proposes that large private companies/groups can opt to use SME-FRF&FRS if members holding at least 75% of the voting rights so resolve and no other members object subject to their size not exceeding a higher threshold of any two of HK$300/500 million assets, HK$300/500 million revenue and 100 employees. Our concerns expressed above in response to option 2 also apply to this proposal. We believe that full HKFRS or HKFRS for Private

Entities is more suitable for use by private companies/groups of these sizes. Furthermore, as set out in the Institute's abovementioned Consultation Paper dated 6 December 2011, and based on comparisons with other jurisdictions, we consider that doubling the current limits of SME-FRF&FRS to HK$100m assets, HK$100m revenue and 100 employees, while maintaining the "two out of three" approach, is a more appropriate indicator of the maximum size of entity that this particular historical cost accounting framework was developed for.

We hope our comments are useful for your consideration.

If you have any questions on our comments, please do not hesitate to contact me at chris@hkicpa.org.hk.

Yours faithfully,

Chris Joy

Chris Joy
Executive Director

CJ/AW/jn

Encl.