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By email: co_rewrite@fstb.gov.hk

Mr. Arsene Yiu
Assistant Secretary for Financial Services and the Treasury
Companies Bill Team
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
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Dear Mr. Yiu

Companies Bill - Consultation Paper on the Qualifying Criteria for Private Companies to Prepare Simplified Financial and Directors' Reports (Consultation Paper)

Thank you for your email dated 7 December 2011, inviting our comments on the above Consultation Paper. We would like to set out our comments below for the consideration of the Financial Services and the Treasury Bureau.

Option 1

We welcome the proposal to align the size criteria between the Companies Bill and the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).

We recommend adopting Option 1.

Options 2 and 3

We are not supportive of Options 2 and 3 for reasons set out below.

The SME-FRF's intent is to provide relief for smaller Hong Kong companies

- The SME-FRF was developed for SMEs as an alternative to the full Hong Kong Financial Reporting Standards (HKFRS) (e.g. listed entities are required to comply) and has considerably simpler accounting requirements which are capable of being managed by book-keepers or accounting technicians. We understand that it was originally developed to cater to the needs of very small companies.

- We have taken the view that large and very large companies/groups with more complex accounts and activities should have the financial and fiscal discipline and resources to prepare accounts that show a true and fair view and that qualified accountants should be involved in their preparation. The existing exemption for large private companies/groups to prepare accounts in accordance with HKFRS for Private Entities (HKFRS for PE) satisfies this need while also providing relief from compliance with full HKFRS.

Auditor's report

- For simplified financial reporting under the SME-FRF, there is no requirement for auditors to state whether the accounts give a true and fair view of the company's financial position and financial performance. Instead, the auditor's report will state whether the accounts have been properly prepared in compliance with the applicable standards (i.e. not a full scope audit as it is not a true and fair view audit opinion).

- We believe for large and very large companies/groups, the public interest is best served by requiring, at a minimum, accounts prepared under HKFRS for PE or full HKFRS with the requirement for the auditor to perform a full scope audit. Even though not all stakeholders such as general creditors, suppliers and employees may have the statutory right to receive accounts and audit reports, it is important that a degree of fiscal discipline should be required from such companies.

Banks as users of financial statements

- From a bank's perspective as a user of financial statements, relaxing the reporting requirements will reduce the transparency of the state of affairs of larger companies with more complex activities. The review of the customer's financial statements is a core part of the bank's lending approval process. Some of the key performance indicators are not required to be disclosed under SME-FRF simplified financial reporting. For example, there is no requirement to present a cash flow statement, investments are generally carried at cost or net realisable value (fair value disclosure is not required for unlisted investments), and there is no guidance on derivatives or hedge accounting except for forward contracts.

- If larger companies adopt simplified financial reporting under the relaxed criteria, banks may still require those companies to furnish accounts prepared under HKFRS for PE with full scope audits. This means companies, even if they qualify for simplified financial reporting, may have to nevertheless prepare accounts under HKFRS for PE to meet with the banks' internal requirements. In the absence of a legal requirement to prepare accounts that show a true and fair view, access to credit by large companies could potentially become more difficult.

Comparison with other jurisdictions

- We note that the SME-FRF's proposed size criteria as outlined in HKICPA's Consultation Paper on Eligibility for the Use of Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard are less stringent than Singapore, the United Kingdom and the People's Republic of China. These jurisdictions have different accounting and reporting requirements for large and small companies.

In addition, Options 2 and 3 are not preferred because the view of the major shareholders may not be representative of those other stakeholders such as potential investors, lenders, other creditors and employees and minority shareholders may have limited protection in practice.

We hope you would find our above comments useful. Should you require any further information, please do not hesitate to contact us.

Yours sincerely

Ronie Mak
Secretary