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THE STOCK EXCHANGE
OF HONG KONG LIMITED
HONG KONG

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31 July 2003

Our Ref. WFP/RCCC/Tech

Subject: **Consultation Paper on the regulation of sponsors and independent financial advisers**

Dear Sirs

We have reviewed the consultation paper (the "Paper"). In general, we agree with the recommendations proposed. There are, however, a few recommendations where we disagree and our comments are set out below.

- (1) Proposal to require sponsor to obtain comfort from the issuer's external auditor or reporting accountants in relation to "non-expert sections" in a listing document

In the proposed Code of Conduct for Sponsors and Independent Financial Advisers (the "Code"), it proposes that regarding the "non-expert sections" contained in a listing document, the sponsor should review the material financial statements of the issuer over the past 3 years to assess the integrity of financial information. Such review would include, among other things, obtaining comfort from the issuer's external auditor or reporting accountants based on agreed upon procedures, where relevant.

In respect of this proposal, we have two comments:

- (a) Why specifically refer to "3 years" financial statements of the issuer?

Under the existing GEM Listing Rules, a new applicant is required to fulfill on active business pursuits period of 24 months (or lowered to 12 months if certain conditions are met) and their accountants' report must include financial information covering 2 financial years immediately preceding the issue of the

listing document (or lowered to 12 months from the commencement of its active business pursuits if certain conditions are met).

In view of the above, the "3 years" financial statements specified in the proposal may not be applicable to new applicants to the GEM Board.

- (b) It is not clear whether the comfort letter provided by the external auditor or reporting accountants based on agreed upon procedures should be published or not.

We would be grateful if it can be clarified in the final rules that the comfort letter should NOT be published.

(2) Proposal to require sponsor to agree the scope of work with the expert in relation to "expert sections" in a listing document

The Code proposes that in relation to the "expert sections" contained in a listing document, the sponsor should agree the scope of work with the expert.

The "expert sections" refer to the sections prepared by a third party expert or professional. For example, accountants report issued by reporting accountants and valuation report issued by property valuer would be regarded as expert sections.

According to the existing practice, the reporting accountants have a contractual relationship with the listing applicant only. If the reporting accountants have to agree the scope of work with the sponsor as proposed, the engagement letter for the listing work should be signed with both the listing applicant and sponsor. Therefore, we urge the Stock Exchange of Hong Kong or the Securities and Futures Commission to work with the Hong Kong Society of Accountants to develop or amend the reporting framework for listing engagements to address this issue.

(3) Proposal to require sponsor to carry out due diligence work

The Paper clarifies the due diligence obligation of the sponsors. However, this is not supported by the availability of "due diligence defence" under either the Securities and Futures Ordinance (the "SFO") or the Hong Kong Companies Ordinance (the "HKCO").

As mentioned in paragraph 140 of the Paper, in United States, "due diligence defence" is available to the underwriters under section 11 and 12 of the Securities Act of 1933. Moreover, we understand that, in United Kingdom, "due diligence defence" is available to the sponsors under section 151 of the Financial Services Act.

We suggest that the Securities and Futures Commission consider the incorporation of "due diligence defence" in the SFO or the HKCO.

We hope the above comments are helpful. If you have any questions, please do not hesitate to contact Paul F. Winkelmann on 2289 2900 or Rebecca Chan on 2289 1287.

Yours faithfully

Price Waterhouse Coopers

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