

Hermes Equity Ownership Services

Hermes Equity
Ownership Services Limited
1 Portsoken Street
London E1 8HZ
United Kingdom

Tel: +44 (0)20 7702 0888
Fax: +44 (0)20 7702 9452

www.hermes.co.uk

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

23 October 2009

Anticipated by Fax: +852 2524 0149

Dear Sir/Madame,

Response to the HKEx's Consultation on Acceptance of Mainland Accounting and Auditing Standards and Mainland Auditing Firms for Mainland Incorporated Companies Listed in Hong Kong

I am writing to give Hermes' views on the consultation by the Stock Exchange of Hong Kong ("HKEx") on acceptance of Chinese mainland ("Mainland") accounting and auditing standards and Mainland auditing firms for Mainland incorporated companies listed in Hong Kong.

By way of background, Hermes is one of the largest pension fund managers in the City of London and is wholly owned by the BT Pension Scheme. As part of the work of its Equity Ownership Services ("EOS"), we also respond to consultations on behalf of many other clients from around the world, including the BBC Pension Trust, the Lothian Pension Fund, the National Pension Reserve Fund of Ireland, PNO Media Stichting Pensioenfondsen of the Netherlands, Canada's Public Sector Pensions Investment Board and VicSuper of Australia (only those clients which have expressly given their support to this response are listed here). Hermes EOS has assets under advice of over US\$ 65 billion (as at 31st March 2009).

Hermes takes a close interest in matters of company law and regulation because they set the context for the exercise of our clients' rights as part-owners of the companies in which they invest. We seek to safeguard our clients' current rights and also to enhance the transparency and accountability of companies and their directors to their long-term owners. To minimise risk to our clients we believe that the markets in which they invest should be transparent and efficient and that regulators should ensure that their actions encourage these aims.

Hermes has always been a strong supporter of the principle of a single set of global accounting standards in the world's increasingly integrated capital markets. We have therefore welcomed the Chinese authorities' strong commitment to convergence with the International Financial Reporting Standards ("IFRS") by the adoption of the new China Accounting Standards for Business Enterprises ("CASBE") in 2007, which are considerably in line with the IFRS in many areas. We have seen that the CASBE has contributed to the removal of the market distortions arising from the discrepancy between the previous Chinese accounting standards and IFRS. We believe that the CASBE which incorporates accounting principles familiar to global investors has enhanced international



investors' confidence in the Chinese capital markets and financial reporting since their adoption.

We also note the fact that the China Accounting Standards Committee ("CASC") and the Hong Kong Institute of Certified Public Accountants ("HKICPA") declared their commitment to the convergence of the CASBE with the Hong Kong Financial Reporting Standards ("HKFRS") and therefore convergence in substance with the IFRS as HKFRS are converged with the IFRS on an ongoing basis.

However, we do feel that it is premature at this stage to allow the immediate use of the CASBE rather than the HKFRS or IFRS by Chinese incorporated companies that are listed on the Hong Kong Stock Exchange, given that the convergence of the CASBE and the HKFRS has not been fully completed yet. We note that the CASBE still lacks disclosure requirements for certain sectors, such as banking and insurance. As long as the convergence of the CASBE with the HKFRS is still in progress, we believe strongly that the first priority should be gaining assurance on the convergence rather than the proposal in the consultation which amounts to acceptance of the CASBE. We would suggest that the proposed framework should be reviewed carefully again once the convergence has been completed instead of rushing in adoption of the CASBE at this stage. We do not find any benefit for shareholders/investors, who are the ultimate end-users of financial reporting, from prematurely allowing the proposed framework. Any hasty moves also risk unsettling market confidence and so harming the financial interests of long-term share owners.

Finally, we would like to highlight our concern about a particular clause of the proposed framework which, in our view, threatens the protection of shareholders' interest. In the consultation paper, we have found that neither the Financial Reporting Council ("FRC") nor the HKICPA would have statutory power to impose penalties or fines on audit firms in the mainland of China and that the responsibility for taking appropriate disciplinary action and sanctions against those local audit firms will rest with the Ministry of Finance in China and the China Securities Regulatory Commission. We do not gain any comfort from the consultation papers on the proposed delegation of authority by Hong Kong regulators to their Chinese counterparts to deal responsibly with any possible misconduct by Mainland audit firms. We are concerned that any misconduct by audit firms could cause significant shortcomings in financial reporting, which ultimately could seriously mislead shareholders/investors. We therefore suggest that there must be more concrete sanctions for the Hong Kong regulators in the proposed framework in the event that disciplinary action or sanctions against Mainland audit firms are necessary.

We hope that these comments are useful to you. Please do not hesitate to contact me should you wish to discuss these issues further.

Yours sincerely

June Choi
Manager