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

23 October 2009

Dear Sir,

**Consultation Paper on Acceptance of Mainland Accounting and Auditing Standards and Mainland Audit Firms for Mainland Incorporated Companies Listed in Hong Kong issued in August 2009**

We refer to the subject consultation paper and would like to express our full support to the proposed changes. With the convergence of Mainland and Hong Kong accounting and auditing standards, we support that a framework be explored and developed to give companies from the Mainland and Hong Kong the choice to prepare financial statements under the accounting standards of the home jurisdiction and engage auditors in the home jurisdiction for listing in Hong Kong and the Mainland respectively. The implementation of the proposals, including the parallel scheme to be operated in the Mainland, can enhance the effectiveness and efficiency for listing in China capital markets and thus maintaining the attractiveness of Hong Kong and the Mainland as fund raising platforms.

Investor confidence is a key factor for the acceptance and success of the proposed framework. We consider a transparent regulatory system for audit firms, a clear mechanism for investors to pursue their rights and an agreed way to tackle application issues are crucial to maintain investor confidence in China capital markets. We, therefore, would like to set out our detailed comment regarding each of these below. In addition, since the proposal recommends a two-way mutual recognition, we have considered our comment below from both Hong Kong and Mainland markets perspective.

Unless otherwise stated, terms used herein shall have the same meanings as those defined in the paper.

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## REGULATORY SYSTEM ON AUDIT FIRMS

Currently, in Hong Kong or the Mainland, auditors of different listed companies are subject to monitoring and oversight by the same regulatory bodies. The proposed framework suggests reliance on the mutual co-operation between the relevant regulatory authorities of the Mainland and Hong Kong to regulate the endorsed audit firms from the other side. That is, under the proposed framework, the detailed monitoring and oversight of Mainland audit firms who act as reporting accountants or auditors of companies listed in Hong Kong will essentially be carried out by MOF and CSRC instead of the relevant authorities in Hong Kong. Although it is not detailed in the paper, presumably on a reciprocal basis, the detailed monitoring and oversight of Hong Kong audit firms who act as reporting accountants or auditors of companies listed in the Mainland will essentially be carried out by HKICPA instead of the relevant authorities in the Mainland. This represents a significant change from the current practice.

In Mainland or Hong Kong markets, when an investor makes an investment decision, he would like to enjoy the same level of protection in the respective market no matter who is the auditor of the listed company. To ensure this can be achieved and to ease any possible concerns that Mainland and Hong Kong investing community may have on the proposed changes, we regard transparency of the mutual co-operative system under the proposed framework as essential. Steps should be taken to let the investing public of the two markets fully understand and appreciate the mechanics of the mutual co-operative system, in particular, a detailed analysis of the following regarding both markets should be published prior to the implementation of the proposals.

- (a) acceptance criteria for endorsing audit firms;
- (b) practice review systems;
- (c) investigation procedures;
- (d) extent of information sharing; and
- (e) sanction structures.

## INVESTORS RIGHTS

Investors in a market would like to enjoy the same level of protection regardless of who the auditor of the listed company is.

### Legal systems

The current legal systems in the Mainland and Hong Kong are different. Hong Kong adopts a common law system whereas the Mainland adopts the continental approach. Due to this difference, investors in Hong Kong and the Mainland may not be familiar with the respective

legal systems of the other side. It is not clear from the paper on whether this has been considered and how the detailed mechanics for pursuing rights can work. In finalising the consultation paper, we consider this should be addressed.

Professional indemnity insurance coverage

In Hong Kong, auditors practising as corporate practices must have a minimum professional indemnity insurance coverage. The minimum requirements are set out in the Corporate Practices (Professional Indemnity) Rules issued by the HKICPA.

It is not clear whether the endorsed Mainland audit firms would need to have the same insurance coverage in place before auditing a Hong Kong listed company.

Reciprocally, when the parallel system is introduced in the Mainland, it is also not clear whether the Hong Kong audit firms should make a similar contribution to the “professional risk fund” (职业风险基金) as required by MOF before it can audit a Mainland listed company.

We would expect the above to be resolved before implementation of the proposed changes.

**APPLICATION ISSUES**

Provision of high quality financial information will rely on whether standards are being interpreted in the same way and whether preparers and practitioners have enough knowledge on listing related rules and regulation.

Convergence of Mainland accounting, auditing and ethical standards with those in Hong Kong

Convergence of Mainland accounting, auditing and ethical standards with those in Hong Kong is one of the basic pre-conditions for adopting the proposed framework. We consider a detailed comparison of these standards, in particular on the application aspects, should be prepared and published to ensure investors of both markets are informed of the practical details of the convergence and thus enhance their confidence in financial information provided by listed issuers in both markets.

Knowledge on capital market related standards, rules and regulation

Apart from the above accounting, auditing and ethical standards, both the Mainland and Hong Kong have their unique sets of standards, rules and regulation that govern capital markets work. For example, HKICPA has issued the Standard on Investment Circular Reporting

Engagements 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" and Standard on Investment Circular Reporting Engagements 400 "Comfort Letters and Due Diligence Meetings on Financial and Non-financial Information", and SFC has issued Codes on Takeovers and Mergers and Share Repurchases. In the Mainland, for example, CSRC requires "Letter on variance between CSRC filing proof and final proof of prospectus" (封卷稿无差异说明), and an opinion on internal control (内部控制鉴证报告).

We consider the knowledge of Mainland and Hong Kong audit firms in these areas, in particular local practice and interpretation, should be regarded as pre-conditions for endorsing such firms to carry out work for Hong Kong and Mainland listed companies respectively. Moreover, we consider measures should be put in place to uplift the respective audit firms' knowledge in these areas. For example, by having joint audits with the audit firms of the listing jurisdiction or providing continuing training.

## **IMPLEMENTATION ISSUES FOR LISTING RULES IN HONG KONG**

### Commencement date of the proposed rules

In assessing whether 1 January 2010 is an appropriate commencement date for the proposed rules, we consider the Exchange should address all comments received from the consultation properly and should provide enough time for the market to be ready for the proposed changes.

### Implementation of the proposed rules

It is proposed that the new rules should apply to annual accounting periods beginning on or after 1 January 2010. It is not clear how this should be applied in initial public offering or circular situations where financial information set out in an accountant's report covers more than one financial period. We urge the Exchange to clarify this.

### Draft rule amendments

Please refer to the appendix attached to this letter for our comments on the draft rule amendments set out in Appendix 6 to the paper.

## **FUTURE REVISIONS AND IMPROVEMENTS**

We noted from the paper that any amendments to the proposed framework may be made only with the agreement by the relevant regulatory authorities of the Mainland and that of Hong

Kong. We consider it is also important to issue public consultation paper before adopting any proposed revisions and improvements in order to increase their acceptability by the market.

**OTHER MATTERS - REGULATION OVER PREPARERS OF FINANCIAL INFORMATION**

Preparers of financial information play an important role in providing high quality information. The paper has not dealt with how preparers of financial information can be regulated under the proposed framework. We urge the Exchange to address this in finalising the consultation paper.

We hope the above are helpful. If you want to discuss any matters further, please do not hesitate to contact our China and Hong Kong Assurance Leader, Ernest Ip, on .

Yours faithfully,

Encl.

**Comments on draft rule amendments set out in Appendix 6 to the paper**

Our comments on the detailed rule amendments are as follows:

- For Main Board 4.05, paragraph 1(ii) of Appendix 15, paragraphs 4(3) and 7 of Appendix 16; and GEM 7.04, 18.08, 18.50B(3) and 18.80, our suggestions are:  
"...segmental information required by one of the following accounting standards which is adopted by the issuer for the preparation of its annual financial statements:  
(a) Hong Kong Financial Reporting Standards (HKFRS); or  
(b) International Financial Reporting Standards (IFRS); or  
(c) China Accounting Standards for Business Enterprises (CASBE)."
  
- For Main Board 19A.31 and GEM 25.25, our suggestions are:  
"The annual accounts must be audited by a person, firm or company who must be a practising accountant of good standing. Such person, firm or company must also be independent of the PRC issuer to the same extent as that required of an auditor under the Companies Ordinance and in accordance with the statements on independence issued by the Hong Kong Institute of Certified Public Accountants or the International Federation of Accountants and, ..."
  
- For Main Board 19A.33 and GEM 25.26, our suggestions are:  
"The report of the auditors must be annexed to all copies of the annual accounts required to be sent by the PRC issuer and indicate whether in the opinion of the auditors the accounts give a true and fair view or present fairly in all material respects:..."
  
- For Main Board 19A.35 and GEM 25.29, our suggestions are:  
"If the PRC issuer is not required to draw up its accounts so as to give a true and fair view or to present fairly in all material respects but is required to draw them up to an equivalent standard, the Exchange may allow its accounts to be drawn up to that standard. ..."  
Given the amendment set out in Main Board 19A.33 and GEM 25.26 above, please revisit the necessity of this rule.

Also, we would like to suggest the following changes to Main Board paragraph 40(1) of Appendix 16 and Gem 18.55:

- Main Board paragraph 40(1) of Appendix 16: "..., the minimum information in respect of the balance sheet and the income statement as set in paragraphs 4(1) and (2). .... "
- GEM 18.55(8): "the information set out in rule 18.50B(1) and (2)"