



18 April 2008

BY HAND AND BY FAX

FAX NO.: 2524 0149

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

Attn: Corporate Communications Department

Dear Sirs,

Re: Combined Consultation Paper on Proposed Changes to the Listing Rules

Ernst & Young is pleased to respond to the request of Hong Kong Exchanges and Clearing Limited (the "Stock Exchange") for comments from the market regarding a number of substantive policy issues as well as some minor amendments to the Main Board Listing Rules and the Growth Enterprise Market Listing Rules.

We have focused our discussions on those policy issues and minor rule amendments in the captioned Consultation Paper which are more relevant to our role as auditors and reporting accountants, in particular, policy issue 3 relating to qualified accountants and policy issue 16 relating to the disclosure of information in takeovers. Our comments are based on our partners' practical experiences derived from their listed company engagements. Please refer to the attached executive summary and the appendix to this letter for our comments.

We would be pleased to discuss our comments with you at your convenience. For this purpose, please do not hesitate to contact Ms Cecilia Ng, Technical Director (tel: [redacted]), who would be pleased to assist you in this regard.

Yours faithfully,

EXECUTIVE SUMMARY

Policy issue 3: Qualified accountants

Stock Exchange's proposal

The Stock Exchange proposes to remove the requirement for a qualified accountant from both the Main Board Listing Rules and the Growth Enterprise Market Listing Rules.

Our summary response

We do not agree with the proposal to remove the requirement for a listed issuer to employ a qualified accountant. We consider that the Stock Exchange should keep the requirement for the employment of a qualified accountant but amend the rules to provide greater flexibility to listed issuers so far as the required accounting qualifications are concerned. We suggest that the existing eligibility requirement be modified so that accountants with appropriate accounting qualifications may qualify for such a position. We also suggest that the Stock Exchange may consider expanding the oversight role of the audit committee as set out in the Code Provisions of the Code on Corporate Governance Practices in the Listing Rules so that the audit committee will be responsible for the oversight of the employment of the qualified accountant, which is similar to the committee's existing role in the oversight of the appointment/removal of auditors, with a view to monitoring the effective functioning of the role of the qualified accountant.

Please refer to the appendix for our detailed comments.

Policy issue 16: Disclosure of information in takeovers

Stock Exchange's proposal

The Stock Exchange proposes to codify its current practice of granting waivers to listed issuers from strict compliance with the rules concerning the publication of prescribed information on overseas listed target companies in takeover situations such as hostile takeovers. The Stock Exchange proposes to allow listed issuers to publish an initial circular including material public information of the target company before shareholders vote on the acquisition; and then to publish a supplemental circular later when the listed issuer is able to exercise control over the target company or gain access to the target company's books and records, whichever is earlier.

Our summary response

We agree in principle with the concept of requiring the publication of a supplemental circular in takeover situations where the listed issuer has difficulty in obtaining non-public information of the offeree company which is listed overseas. We also consider that the Stock Exchange should extend the scope of the new rules to include all acquisition situations including those where the target company is listed in Hong Kong.

EXECUTIVE SUMMARY

We also suggest that the Stock Exchange should dispense with the need to prepare an accountants' report (with a "true and fair view" opinion) on a target company which is listed on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange. In this regard, we suggest that the Stock Exchange should make reference to the rules adopted in the United Kingdom which allow listed issuers to dispense with the need to provide an accountants' report with a "true and fair view" opinion for acquisitions of listed companies (whether listed locally or overseas). We consider that the Stock Exchange should accept disclosure of the published audited financial statements of the target company (which is listed on an overseas exchange recognised by the Stock Exchange) for the past three financial years together with, if available, the interim/quarterly report published subsequent to the latest financial year end. If the target company will become a subsidiary of the listed issuer and material adjustments need to be made to the financial statements of the target company to achieve consistency with the listed issuer's accounting policies, the initial circular or supplemental circular should include a reconciliation statement together with a report from the auditors or reporting accountants of the listed issuer.

Please refer to the appendix for our detailed comments.

Minor rule amendment: Clarification regarding continuing connected transactions

Stock Exchange's proposal

The Stock Exchange proposes to clarify the rules regarding continuing connected transactions to make it clear that non-exempt continuing connected transactions which are not subject to independent shareholders' approval are also subject to the requirements in respect of a written agreement and an annual cap.

Our summary response

We agree with the proposal. We also suggest that the Stock Exchange should consider making a further minor rule amendment to clarify the exact categories of continuing connected transactions which are subject to the requirements of an annual review by auditors, as the existing wording of the relevant rules is not very explicit in this regard.

Please refer to the appendix for our detailed comments.

Policy issue 3: Qualified accountants

Further detailed comments

Qualified accountant as a member of senior management

In light of the importance of corporate governance and the increased complexity of financial accounting, we believe that qualified professional accountants continue to play a key role in maintaining effective financial reporting procedures and internal controls of listed issuers as well as ensuring compliance with the Listing Rules with regard to financial reporting and other accounting-related issues. A qualified accountant has a particularly important role for companies in Mainland China where corporate and accounting practices are undergoing rapid changes, and the need for a qualified accountant who understands the often complex accounting and internal control requirements will be important. Given the importance of their role, qualified accountants would be expected to be members of the senior management of listed issuers in order to ensure the effective functioning of their role.

We do not agree with certain of the Stock Exchange's analyses in arriving at the conclusion that it would be appropriate to remove the requirement for a qualified accountant from the Listing Rules. We do not see sufficient relevance of the additional checks and balances mentioned in the Consultation Paper, such as the investigative power of the new Financial Reporting Council, the assessment by new listing sponsors, the oversight role of audit committees and the independent advice from external auditors, to justify the proposed removal of the requirement for full-time qualified accountants, given that the qualified accountant plays an important role in the day-to-day management of the listed issuer. We appreciate that the Stock Exchange may wish to provide greater flexibility to listed issuers to determine themselves how to meet the listed issuer's specific needs to maintain effective internal controls for proper financial reporting; and that the Stock Exchange expects listed issuers to employ accountants with appropriate qualifications and experience. However, we consider that this would be best served by maintaining the existing requirements instead of leaving it to the decision of the listed issuers. This will also ensure that listed issuers/listing applicants (especially smaller closely-owned companies) will be clear as to the importance of employing a qualified accountant, which otherwise might not be the case, should the rules be relaxed in this regard. Furthermore, the Stock Exchange has recently proposed introducing mandatory quarterly reporting and accelerating financial reporting deadlines for Main Board issuers. By proposing the removal of the mandatory requirement for a qualified accountant, it appears that the Stock Exchange is conveying a confusing message to the market when qualified accountants are expected to play a key role in assisting listed issuers to fulfil the proposed requirements in respect of periodic financial reporting.

Therefore, we consider that the Stock Exchange should keep the existing rules which require that a listed issuer must employ a qualified accountant at all times on a full time basis and that the qualified accountant must be a member of senior management.

Furthermore, we consider that the Stock Exchange may consider expanding the oversight role of the audit committee as set out in the Code Provisions of the Code on Corporate Governance Practices (the "CG Code") in the Listing Rules so that the audit committee will be responsible for the oversight of the employment of the qualified accountant, which is similar to the committee's existing role in the oversight of

the appointment/removal of auditors as required by the CG Code, with a view to monitoring the effective functioning of the role of the qualified accountant as envisaged by the Listing Rules. We suggest that the Stock Exchange may include another Code Provision in the CG Code so that audit committee will be responsible for reviewing the qualifications and experience of the qualified accountant and making recommendation to the board on the employment and dismissal of the qualified accountant, and to approve the remuneration and terms of engagement, and any questions of resignation or dismissal of the qualified accountant. The Stock Exchange may make appropriate transitional provisions so that the audit committee shall ratify the employment of qualified accountants for existing listed issuers when the new Listing Rules come into effect. If the board has taken a different view from that of the audit committee, the corporate governance report of the listed issuer as required under the Listing Rules must include a statement from the audit committee explaining its recommendation and the reason(s) why the board has taken a different view from that of the audit committee regarding selection, employment, resignation or dismissal of the qualified accountant.

Eligibility

The existing rules also set out the eligibility of a qualified accountant and require that such individual must be a certified public accountant registered with the Hong Kong Institute of Certified Public Accountants (the "HKICPA") or a similar body of accountants recognised by the HKICPA for the purpose of granting exemptions from the examination requirement for membership of the HKICPA.

The Stock Exchange mentions in the Consultation Paper that criticisms over the existing rules regarding qualified accountants include discrimination against accountants with alternative accounting qualifications and the difficulty for Mainland companies to identify and retain a suitably qualified accountant who is a member of the HKICPA. The existing requirement is somewhat rigid and depends to a large extent on the HKICPA's policies regarding membership admission and recognition of overseas accounting bodies. This may result in members of certain well-established accounting bodies not being eligible to act as qualified accountants for listed issuers.

The Stock Exchange also mentions in the Consultation Paper that over the past several years an increasing number of countries and jurisdictions have adopted or are in the process of adopting International Financial Reporting Standards (the "IFRSs") as their national accounting standards. The Hong Kong Financial Reporting Standards became fully converged with IFRSs as from 1 January 2005 and the website of the International Accounting Standards Board indicates that nearly 100 countries require, permit the use of or have a policy of convergence with the IFRSs. These countries include the world's major stock markets in Europe, the United Kingdom (the "UK"), Australia and the United States. The Stock Exchange also notes that, as accounting bodies in many jurisdictions including Hong Kong have adopted or are converging with the IFRSs, the Stock Exchange's previous premise that only accountants with a specified qualification, such as membership to the HKICPA, are likely to have the necessary knowledge and skill has become much less distinct. Given the global trend to converge with the IFRSs and the Stock Exchange's initiative to attract more overseas companies to list in Hong Kong, we suggest that the Stock Exchange should consider amending the eligibility requirements for qualified accountants so that accountants with appropriate accounting qualifications may qualify for such a position.

Policy issue 16: Disclosure of information in takeoversFurther detailed comments***Requirements under the existing rules***

Where a listed issuer acquires a company through an acquisition constituting a very substantial acquisition ("VSA"), a reverse takeover or a major transaction under Chapter 14 of the Main Board Listing Rules or Chapter 19 of the Growth Enterprise Market ("GEM") Listing Rules (the "GEM Listing Rules"), the listed issuer is currently required to include in its circular to shareholders certain prescribed information on the acquisition target so that shareholders may vote on an informed basis. Such prescribed information includes an accountants' report prepared in accordance with Chapter 4 of the Main Board Listing Rules and Chapter 7 of the GEM Listing Rules. Our experience shows that the difficulties faced by listed issuers are often largely related to the preparation of accountants' reports in full compliance with Chapter 4 of the Main Board Listing Rules and Chapter 7 of the GEM Listing Rules.

Pursuant to rule 4.01(3) of the Main Board Listing Rules and rule 7.01(3) of the GEM Listing Rules, accountants' reports are required to be included in a circular issued in connection with a reverse takeover, a VSA or a major transaction unless the company being acquired is itself a listed company on the Main Board or GEM. Although the wording in the current Chapter 14 of the Main Board Listing Rules and Chapter 19 of the GEM Listing Rules is not very explicit in this regard, it is implied that if the acquisition target is a company listed in Hong Kong (either on the Main Board or GEM), there is no need to include an accountants' report in the circular under the rules (and therefore there is no need to apply for a waiver from the Stock Exchange). Prior to the rule changes which came into effect on 31 March 2004, there was a provision in the old Chapter 14 of the Main Board Listing Rules stating that "the circular must contain... an accountants' report on the business, company or companies being acquired... unless it is a listed company which is being acquired, in which case the inclusion of the last published balance sheet and of three years' profits... taken from the published accounts of the company to be acquired, will suffice". Such an explicit provision was deleted from Chapter 14 of the Main Board Listing Rules with effect from 31 March 2004. The old Chapter 19 of the GEM Listing Rules also contained a provision stating that "if the business, company or companies being acquired is or are listed on the Main Board or on GEM, the published financial statements for the last 3 years may be included in the circular instead of the accountants' report and the Exchange will require that the last announcement of interim results also be included". Again, such an explicit provision was deleted from Chapter 19 of the GEM Listing Rules with effect from 31 March 2004. We could not locate any explanation for such amendments in the Stock Exchange's Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues issued in January 2002 and the relevant consultation conclusions issued in January 2003. The Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues also did not set out the exact wording of any proposed new rules; neither did the relevant consultation conclusions.

Pursuant to the existing Chapter 4 and Chapter 14 of the Main Board Listing Rules and Chapter 7 and Chapter 19 of the GEM Listing Rules, accountants' reports are required to be included in a circular issued in connection with a reverse takeover, a VSA or a major transaction if the company being acquired is a company listed overseas.

Furthermore, pursuant to rule 4.06(1)(a) of the Main Board Listing Rules and rule 7.05(1)(a) of the GEM Listing Rules, the accountants' report in a circular in connection with a reverse takeover, a VSA or a major transaction on the acquisition of a business, company or companies must include "the results, for the relevant period, of the business which, or of the company... in whose share capital an interest, has been acquired, agreed to be acquired or is proposed to be acquired since the date to which the latest published audited accounts of the issuer have been made up; provided always that where any company in question has not or will not become a subsidiary of the issuer, the Exchange may be prepared to relax this requirement". Therefore, it appears that, subject to the Stock Exchange granting a waiver, listed issuers may not be required to prepare an accountants' report for an acquisition target if the target will not become a subsidiary of the listed issuer.

Proposed codification of waivers and the implication for accountants' reports

We note that the Stock Exchange acknowledges that some listed issuers have faced difficulties in complying with the full disclosure requirements applicable to circulars where the offeree company is listed overseas and there is no or limited access to non-public information on the offeree company (such as in the case of a hostile takeover), or there are legal restrictions in providing non-public information to the listed issuers. The Stock Exchange mentioned in the Consultation Paper that it had previously granted waivers in such circumstances and allowed listed issuers to publish an initial circular including material public information of the offeree company which was issued before shareholders voted on the acquisition; and then to publish a supplemental circular later when the listed issuer is able to exercise control over the offeree company or gain access to the offeree company's books and records, whichever is earlier. Under the proposed new rules, the material public information of the offeree company to be included in the initial circular will include, among other things, the published audited financial statements of the offeree company (which were audited by overseas auditors) in lieu of an accountants' report, together with a qualitative explanation of the principal differences, if any, between the offeree company's accounting standards and those of the listed issuer which may have a material impact on the financial statements of the offeree company. The Stock Exchange proposes to codify such waivers and to set out in the proposed new rules the circumstances under which a supplemental circular is allowed. The proposed new rules require that the supplemental circular contains all the prescribed information under the Listing Rules which has not been previously disclosed in the initial circular.

Our experience shows that the difficulties faced by listed issuers in gaining access to non-public information of the offeree company largely relate to financial information, in particular, the access required for the audit of the offeree company's historical financial statements for the purpose of issuing an accountants' report. Although it is not explicitly stated in the proposed wording of the new rules set out in Appendix 16 to the Consultation Paper, it appears that the supplemental circular will have to contain an accountants' report as required by Chapter 4 of the Main Board Listing Rules or Chapter 7 of the GEM Listing Rules if the initial circular does not contain such a report. As stated in the proposed wording of the new rules set out in Appendix 16 to the Consultation Paper, other financial information which might also be affected by the unavailability of information of the offeree company includes the statement of sufficiency of working capital of the enlarged group and the statement of indebtedness of the enlarged group.

Suggested dispensation for an accountants' report in certain cases

We suggest that the Stock Exchange should dispense with the need to prepare an accountants' report (with a "true and fair view" opinion) on a target company which is listed on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange. Instead of an accountants' report, the Stock Exchange should accept disclosure of the published audited financial statements of the listed target company for the past three financial years together with, if available, the interim/quarterly report published subsequent to the latest financial year end. If the target company will become a subsidiary of the listed issuer and material adjustments will need to be made to the financial statements of the target company to achieve consistency with the listed issuer's accounting policies, the initial circular or supplemental circular should include a reconciliation statement together with a report from the auditors or reporting accountants of the listed issuer. Such report may be issued by a firm of accountants which is not qualified under rule 4.03 of the Main Board Listing Rules or 7.02 of the GEM Listing Rules (i.e., certified public accountants who are qualified under the Professional Accountants Ordinance for appointment as auditors of a company and satisfy the relevant independence requirements) but which is acceptable to the Stock Exchange (i.e., normally a firm having an international name and reputation and being a member of a recognised body of accountants).

As there would no longer be a need to prepare an accountants' report in the first place, any disadvantages or problems brought about by the required inclusion of an accountants' report in a supplemental circular will be avoided. We would like to set out the principal reasons for our suggestions below:

1. There may not be any material adjustment that needs to be made to the financial statements of a target company, which is listed on an overseas stock exchange recognised for this purpose by the Stock Exchange, to achieve consistency with the listed issuer's accounting policies. The insistence on an accountants' report of the target company may only serve to increase the listed issuer's costs instead of providing additional value to shareholders. Even when material adjustments are required, a reconciliation statement together with a report from the auditors or reporting accountants of the listed issuer will in substance provide the same information to shareholders as an accountants' report.
2. The supplemental circular as suggested by the Stock Exchange is likely to be issued after the acquisition is completed, and any additional information included in the supplemental circular will be of no value to shareholders so far as the voting decision is concerned. The additional information will therefore be mainly for information purposes, after the acquisition has been completed. The additional costs involved in the preparation of accountants' reports may often be significant. Such significant costs will not be worthwhile to the listed issuer and thus its shareholders when the benefits conferred by such additional information are limited in situations involving the acquisition of a target company which is listed on an overseas stock exchange recognised by the Stock Exchange.
3. There may be practical difficulties in furnishing a full accountants' report (with a "true and fair view" opinion) in a supplemental circular in certain situations. In takeover situations, the board of directors as well as certain other members of senior management of the offeree company may resign upon completion of the takeover. The new board of directors of the offeree company will normally comprise nominees from the listed issuer. Since none of the new board members was involved in the past management of the offeree company and the preparation of the historical financial

statements of the offeree company, the new board may have difficulties in providing the necessary approval on these past financial statements, which would be needed by the reporting accountants for the purpose of expressing an audit opinion in the accountants' report in respect of the results and financial position of the offeree company for the past three years. For offeree companies listed on an overseas stock exchange recognised by the Stock Exchange, it appears to be unnecessarily onerous to the new board members as the auditing and disclosure standards deployed in the preparation of the published historical financial statements of such offeree companies are expected to be already of a standard which is sufficient in terms of investor protection in Hong Kong.

The inclusion of financial information such as the working capital statement and the indebtedness statement of the enlarged group in the supplemental circular normally does not pose as many difficulties as in the case of the preparation of an accountants' report because no audit opinion is required for such statements. The working capital statement involves the review of forecast information for which the listed issuer is normally able to provide representation and the preparation of the indebtedness statement is relatively more straight-forward.

Scope of the proposed new rules

Reverse takeovers

The existing rule 14.69 of the Main Board Listing Rules and rule 19.69 of the GEM Listing Rules apply to VSAs as well as reverse takeovers. The proposed wording of the new rule 14.67A as set out in Appendix 16 to the Consultation Paper does not cover reverse takeovers. A takeover may be made by way of a cash offer or a securities exchange offer. A takeover offer made by a listed issuer by way of a securities exchange offer may result in a change in control of the listed issuer and therefore may constitute a reverse takeover for the listed issuer under the Listing Rules. There is no explanation in the Consultation Paper as to why reverse takeovers are not included in the proposed new rules, e.g., whether the Stock Exchange wishes to take a tougher stance on the contents of listing documents in connection with reverse takeovers as the Stock Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant; and/or whether the Stock Exchange may be of the view that acquisitions of listed companies (be it listed in Hong Kong or overseas) should not technically fall under the definition of reverse takeovers (i.e., as a means to circumvent the requirements for new applicants set out in Chapter 8 of the Main Board Listing Rules or Chapter 11 of the GEM Listing Rules) and therefore such transaction should fall to be treated as VSAs.

Non-hostile takeovers

We agree that the proposed new rules should extend to non-hostile takeovers where there is insufficient access to non-public information of the offeree company. In friendly takeovers, listed issuers may still face difficulties in complying with the full disclosure requirements applicable to circulars as in hostile takeovers. In these situations, the listed issuer must explain in the initial circular why there is insufficient access to non-public information of the offeree company.

Other situations

The proposed new rules only refer to acquisitions of overseas listed companies by way of a takeover offer. The proposal does not mention the Stock Exchange's position (a) in respect of acquisitions of Hong Kong listed companies; and (b) in respect of other methods of acquisition of listed companies (other than by way of takeover offer). Listed issuers may face the same difficulties in complying with the full disclosure requirements applicable to circulars in these situations. We suggest that the scope of the proposed new rules be extended to cover these situations as elaborated below.

It is unclear from the Consultation Paper what the Stock Exchange's position will be when considering waiver applications in other situations in future e.g., how the Stock Exchange will approach acquisitions of companies listed in overseas exchanges not recognised for the purpose of the proposed rules. We suggest that the Stock Exchange should include a general rule requiring the listed issuer to consult the Stock Exchange at an early stage so that the Stock Exchange can determine to what extent the disclosure requirements should apply and consider any waiver application, if necessary.

Hong Kong listed offeree companies

Pursuant to the existing wording of rule 4.01(3) of the Main Board Listing Rules and rule 7.01(3) of the GEM Listing Rules, there should be no need to include an accountants' report in the circular if the acquisition target is a company listed in Hong Kong (either on the Main Board or GEM). However, the possible difficulties relating to the access of sufficient information for the purpose of, among other things, compiling the working capital statement and the indebtedness statement of the enlarged group before the listed issuer can exercise control over the offeree company may still exist in some situations, especially when the takeover is a hostile offer. As such, we consider that the proposed new rules should extend to takeovers of companies listed in Hong Kong where there is insufficient access to non-public information of the offeree company.

Acquisitions other than by way of takeover offer

Whilst difficulties in obtaining sufficient information to enable full compliance with the circular disclosure requirements may be more common in acquisitions of listed companies by way of a takeover offer (such as a hostile takeover), the same difficulties may arise in acquisitions other than by way of takeover offer.

We consider that the detailed wording of the proposed new rules should be amended so that a more generic term, "acquisition", is used instead of "takeover offer". Again, the listed issuer must explain in the initial circular why there is insufficient access to non-public information of the target company.

Proposed timing for the issue of the supplemental circular

There is no explanation of the rationale for setting the proposed 45-day deadline for publishing the supplemental circular. Such a deadline may not be achievable if an accountants' report is required where the businesses of the target company cover many geographical locations and/or the scale of operations of the target company is very large. In the event that the Stock Exchange does not adopt the suggested dispensation of the accountants' report requirement in any new rules to be released later, we

suggest that the Stock Exchange should amend the proposed rules so that a longer deadline, say 60 days, is imposed in situations where the supplemental circular will include an accountants' report; and that the Stock Exchange should also include a general rule requiring the listed issuer to consult the Stock Exchange at an early stage if it is anticipated that such a deadline is not feasible so that the Stock Exchange can consider any waiver application, if necessary.

References to overseas regulations

Whilst the Stock Exchange usually sets out rules/practices in overseas markets when discussing certain other policy issues in the Consultation Paper, we note that it did not set out the equivalent rules in other markets in respect of this particular policy issue.

The rules set out in the United Kingdom Listing Authority listing rules (the "UK Listing Rules") contained in the FSA Handbook published by the Financial Services Authority in the UK may be a useful reference.

Set out below is a summary of the relevant rules in the UK Listing Rules about the three-year financial information table of an acquisition target which is listed in the UK or overseas:

- LR 13.5 of the UK Listing Rules sets out the requirements for financial information in circulars in respect of class 1 transactions (the equivalent of major transactions or above in Hong Kong).
- LR 13.5.21 provides that a three-year financial information table of the target must be accompanied by an accountants' opinion (stating whether the financial information table gives a true and fair view of the financial matters set out in it) unless, amongst others, LR 13.5.27 or LR 13.5.28 applies.
- LR 13.5.27 sets out the requirements for accountants' opinion in respect of acquisitions of publicly traded companies. LR 13.5.27(1) sets out the circumstances to which the rule applies, i.e., if the target is (a) admitted to trading on a recognised investment exchange in the UK; or (b) a company whose securities are listed on an overseas investment exchange or admitted to trading on an overseas regulated market; and a material adjustment needs to be made to the target's financial statements to achieve consistency with the listed company's accounting policies. LR 13.5.27(2) provides that a listed company must include the following in the class 1 circular: (a) a reconciliation of financial information on the target, for all periods covered by the financial information table, on the basis of the listed company's accounting policies; (b) an accountants' opinion that sets out: (i) whether the reconciliation of financial information in the financial information table has been properly compiled on the basis stated; and (ii) whether the adjustments are appropriate for the purpose of presenting the financial information (as adjusted) on a basis consistent in all material respects with the listed company's accounting policies.
- LR 13.5.28 provides that an accountants' opinion is not required if the target is (1) admitted to trading on a recognised investment exchange in the UK; or (2) a company whose securities are listed on an overseas investment exchange or admitted to trading on an overseas regulated market; and no material adjustment needs to be made to the target's financial statements to achieve consistency with the listed company's accounting policies.

The UK Listing Rules do not require the reporting accountants to express any audit opinion ("true and fair view" opinion) on the financial statements of an acquisition target which is listed in the UK or overseas. The Hong Kong Listing Rules require the reporting accountants to express an audit opinion ("true and fair view" opinion) on the financial statements of an acquisition target which is listed in places other than in Hong Kong.

- Set out below is a summary of the relevant rules in the UK Listing Rules about the requirement for a supplemental circular in takeover situations:
- LR 13.4.3(1) states that if a class 1 circular relates to a takeover offer which is recommended by the offeree's board and the listed company has had access to due diligence information on the offeree at the time the class 1 circular is published, the listed company must prepare and publish the working capital statement on the basis that the acquisition has taken place.
 - LR 13.4.3(2) states that if a class 1 circular relates to a takeover offer which has not been recommended by the offeree's board or the listed company has not had access to due diligence information on the offeree at the time the class 1 circular is published, then the listed company must comply with LR 13.4.3(3) to (6).
 - LR 13.4.3(3) requires that the listed company must prepare and publish the working capital statement on the listed company on the basis that the acquisition has not taken place. The working capital statement prepared on the basis that the acquisition has taken place must be updated and published and sent to shareholders within 28 days of the offer becoming or being declared wholly unconditional. The circular must state that the statements on a combined basis will be made available as soon as possible.
 - LR 13.4.3(4) provides that other information on the offeree required by LR 13 Annex 1R R should be disclosed in the class 1 circular on the basis of information published or made available by the offeree and of which the listed company is aware and is free to disclose. Such other information includes risk factors, trend information, litigation, significant changes and material contracts.
 - LR 13.4.3(5) states that if the takeover offer becomes unconditional, any change or addition to the information disclosed which is material in relation to the listed company should be disclosed in a circular published (in the absence of exceptional circumstances) within 28 days after the offer becoming or being declared wholly unconditional.
 - LR 13.4.3(6) states that if the takeover offer has been recommended but the listed company does not have access to due diligence information on the offeree, the listed company must disclose in the class 1 circular why access has not been given to that information.

Our suggested approach

We suggest that the Stock Exchange should dispense with the need to prepare an accountants' report (with a "true and fair view" opinion) on a target company which is listed on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange. Instead of an accountants' report, the Stock Exchange should accept disclosure of the published audited financial statements of the listed target company for the past three financial years together with, if available, the interim/quarterly report published subsequent to the latest financial year end. If the target company will become a subsidiary of the listed issuer and material adjustments need to be made to the financial statements of the target company to achieve consistency with the listed issuer's accounting policies, the initial circular or supplemental circular should include a reconciliation statement together with a report from the auditors or reporting accountants of the listed issuer. Such report may be issued by a firm of accountants which is not qualified under rule 4.03 of the Main Board Listing Rules or 7.02 of the GEM Listing Rules (i.e., certified public accountants who are qualified under the Professional Accountants Ordinance for appointment as auditors of a company and satisfy the relevant independence requirements) but which is acceptable to the Stock Exchange (i.e., normally a firm having an international name and reputation and being a member of a recognised body of accountants). Furthermore, we consider that the Stock Exchange should extend the scope of the new rules to include all acquisition situations (not just by way of a "takeover offer") and to situations where the target company is listed in Hong Kong.

Our suggested revisions to the scope and changes to parts of the text of the proposed new Main Board Listing Rules are as follows – with equivalent amendments to be made to the GEM Listing Rules:

1. Rule 14.67(4)(a)(i) and rule 14.69(4)(a)(i) of the Main Board Listing Rules should be amended to include an exception to the requirement for preparing an accountants' report where the company being acquired is listed on the Main Board or GEM or on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange and to include a cross-reference to the rules applicable in such circumstances.
2. Rule 4.01(3) should be amended to include an additional exception to the requirement for preparing an accountants' report where the company being acquired is listed on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange.
3. Rule 14.67A(1) should be added to the following effect, with appropriate cross-reference to the rules applicable to VSAs and reverse takeovers so that rule 14.67A will apply to major transactions as well as VSAs and reverse takeovers:

"If the company being acquired is listed on the Main Board or GEM or on another regulated, regularly operating, open stock exchange recognised for this purpose by the Stock Exchange, the published audited financial statements for the last three financial years may be included in the circular in lieu of an accountants' report. The Exchange may also require that the circular includes the announcement of interim results (or quarterly results, if applicable) or interim report (or quarterly report, if applicable) published subsequent to the latest financial year end."

4. Rule 14.67A(2) should be added to the following effect:

"In respect of acquisitions described in rule 14.67A(1), the directors of the listed issuer must confirm in the circular whether any material adjustment needs to be made to the financial statements of the company being acquired to achieve consistency with the listed issuer's accounting policies if the company being acquired will become a subsidiary of the listed issuer. If material adjustment needs to be made in this regard, the circular must include:

- (a) a reconciliation of the financial information on the company being acquired, for all periods covered by the financial information as required in rule 14.67A(1), on the basis of the listed issuer's accounting policies; and
- (b) a report from the auditors or reporting accountants stating in their opinion:
 - (i) whether the reconciliation of financial information has been properly compiled on the basis stated; and
 - (ii) whether the adjustments are appropriate for the purpose of presenting the financial information (as adjusted) on a basis consistent in all material respects with the listed issuer's accounting policies.

Such an opinion may be issued by a firm of accountants which is acceptable to the Stock Exchange pursuant to rule 4.03."

5. The proposed rule 14.67A(1) as set out in Appendix 16 to the Consultation Paper should be re-numbered as rule 14.67B(1) and be amended to the following effect (see amendments underlined to signify suggested changes/insertions or marked with "^" to signify suggested deletions), with appropriate cross-reference to the rules applicable to VSAs and reverse takeovers so that rule 14.67B will apply to major transactions as well as VSAs and reverse takeovers:

"Where ^ the listed issuer does not have access or only limited access to the non-public information on the company being acquired that would be required for the purpose of complying with the disclosure requirements in respect to such company and the enlarged group under rules 14.66 and 14.67 ^ or 14.69 (as the case may be), then the listed issuer may defer complying with certain of the disclosure requirements in the manner set out in paragraphs (2) and (3) below, provided that the following conditions are satisfied:

- (a) the unavailability of non-public information is caused by a lack of co-operation of the board of directors of the company being acquired (such as in the case of a hostile takeover) and/or legal restrictions on providing non-public information to the listed issuer;
- (b) the company being acquired is listed on the Main Board or GEM or on another regulated, regularly operating, open stock exchange recognised for this purpose by the Exchange; and
- (c) the company being acquired will become a subsidiary of the listed issuer."

6. The proposed rule 14.67A(2) as set out in Appendix 16 to the Consultation Paper should be re-numbered as rule 14.67B(2) and be amended to the following effect (see amendments underlined to signify suggested changes/insertions or marked with "^" to signify suggested deletions):

"Subject to the conditions in paragraph (1)(a), (b) and (c) being satisfied, the listed issuer may defer complying with the disclosure requirements for certain non-public information relating to the company being acquired and/or the enlarged group. In such circumstances, the listed issuer must despatch an initial circular in partial compliance with rules 14.66, 14.67 and 14.67A or rule 14.69 (as the case may be) within the time frame stipulated in rules 14.41 and 14.42 or rules 14.51 or 14.52. The initial circular shall include, as a minimum, the following:

- (a) material public information (and other available information of which the listed issuer is aware and is free to disclose) of the company being acquired to enable shareholders to make an informed voting decision with respect to the proposed acquisition ^. This would include:
 - (i) where the reconciliation statement and/or report as required under rule 14.67A(2) are not available, a qualitative explanation of the principal differences, if any, between the accounting standards/policies adopted by the company being acquired and those of the listed issuer which may have a material impact on the financial statements of the company being acquired; and
 - (ii) other information of the company being acquired in the public domain or made available by such company and which the listed issuer is aware and free to disclose."

The proposed rule 14.67A(2)(b) as set out in Appendix 16 to the Consultation Paper should be re-numbered as rule 14.67B(2)(b) and no amendment is suggested to the proposed wording. We agree that, where information for the enlarged group is not available at the time of issue of the initial circular, the initial circular shall include information regarding the listed issuer (such as the statement of indebtedness, the statement of sufficiency of working capital, material contracts and documents for inspection etc.).

The proposed rule 14.67A(2)(c) as set out in Appendix 16 to the Consultation Paper should be re-numbered as rule 14.67B(2)(c) and the term "offeree company" contained therein should be amended to "company being acquired". We agree that the initial circular shall include the reasons why access to books and records of the company being acquired has not been granted to the listed issuer.

7. The proposed rule 14.67A(3) as set out in Appendix 16 to the Consultation Paper should be re-numbered as rule 14.67B(3). The term "offeree company" contained therein should be amended to "company being acquired" and all rule references contained therein should also include the suggested rule 14.67A. Subject to the adoption of the suggested dispensation of the accountants' report requirement, we agree that the listed issuer would then despatch a supplemental circular at a later date which contains (i) all the prescribed information which has not been previously disclosed in the initial circular (e.g., the reconciliation statement and relevant report from the auditors or reporting accountants as set out in the suggested rule 14.67A(2) above, and the indebtedness statement and

the working capital statement of the enlarged group etc.); and (ii) any material changes to the information previously disclosed in the initial circular. Subject to the adoption of the suggested dispensation of the accountants' report requirement, we also agree that the supplemental circular would be despatched to shareholders within 45 days of the earlier of the listed issuer being able to gain access to the books and records of the company being acquired and the listed issuer being able to exercise control over the company being acquired. In the event that the Stock Exchange does not adopt the suggested dispensation of the accountants' report requirement in any new rules to be released later, we suggest that the Stock Exchange should amend the proposed rules so that a longer deadline, say 60 days, is imposed in situations where the supplemental circular will include an accountants' report; subject to a general rule (see suggested rule 14.67C below) requiring the listed issuer to consult the Stock Exchange at an early stage if it is anticipated that such a deadline is not feasible.

8. Rule 14.67C should be added to the following effect:

"If the listed issuer has experienced or anticipates difficulties in complying with the requirements as set out in rules 14.66, 14.67, 14.67A, 14.67B or 14.69 (as the case may be) in full, it is essential that the listed issuer consult the Exchange at an early stage so that the Exchange can determine to what extent the requirements should apply and consider any waiver application, if necessary."

Minor rule amendment: Clarification regarding continuing connected transactions

Further detailed comments

The Stock Exchange proposes to clarify the rules regarding continuing connected transactions ("CCTs") to make it clear that non-exempt CCTs which are not subject to independent shareholders' approval are also subject to the requirements set out in rules 14A.35(1) to (2), i.e., to be governed by a written agreement of not more than three years and to be subject to a maximum aggregate annual value (cap).

We agree with the proposal. We also suggest that the Stock Exchange should consider making a further minor rule amendment as follows.

There are three broad categories of CCTs, namely, (i) exempt CCTs (i.e., those exempt from reporting, announcement and independent shareholders' requirements); (ii) non-exempt CCTs which are only subject to reporting and announcement requirements (i.e., those which are not subject to independent shareholders' approval requirement); and (iii) non-exempt CCTs which are subject to reporting, announcement and independent shareholders' requirements. Reporting requirements refer to the disclosure of details of the CCTs in the listed issuer's annual report and accounts. Pursuant to rule 14A.38 of the Main Board Listing Rules and rule 20.38 of the GEM Listing Rules, "each year the auditors must provide a letter... confirming that the continuing connected transactions:... have been entered into in accordance with the relevant agreement governing the transactions; and... have not exceeded the cap disclosed in previous announcement(s)". The wording of the rules does not specify the exact categories of CCTs covered by the annual review rules. Only non-exempt CCTs (whether subject to independent shareholders' approval or not) subject to reporting requirements (in annual reports) are required to be governed by a written agreement and a cap. As such, it appears that the auditors are required to review non-exempt CCTs only but not exempt CCTs. We propose that the Stock Exchange should make another minor rule amendment to clarify the exact categories of CCTs which are subject to the requirements of an annual review by auditors as the existing wording of the relevant Listing Rules is not very explicit in this regard.

END

