

24 October 2014

BY HAND AND BY EMAIL

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

Attn: Corporate Communications Department

Dear Sirs,

Consultation Paper on Review of Listing Rules on Disclosure of Financial Information with reference to the New Companies Ordinance and Hong Kong Financial Reporting Standards and Proposed Minor/Housekeeping Rule Amendments

Ernst & Young is pleased to respond in this letter to the request of Hong Kong Exchanges and Clearing Limited ("HKEx") for comments regarding the proposals set out in the captioned consultation paper.

We support HKEx's initiatives to make consequential changes to the financial disclosure requirements under the Listing Rules to align with the provisions in the new Companies Ordinance and to streamline the relevant Listing Rules to remove duplications with Hong Kong Financial Reporting Standards ("HKFRS").

We would like to share with you the following observations and comments on the proposed rule amendments relating to disclosure of financial information set out in the consultation paper:

Financial disclosure requirements for companies adopting other GAAPs

We are generally supportive of HKEx's proposal to streamline detailed financial disclosure requirements in Chapter 4 and Appendix 16 of the Listing Rules (and the GEM equivalents) in order to remove the disclosure requirements already in HKFRS. HKFRS follows International Financial Reporting Standards ("IFRS").

However, there are instances where HKEx allows the use of generally accepted accounting principles ("GAAPs") other than HKFRS or IFRS by overseas listing applicants/listed issuers seeking/maintaining a dual primary listing in Hong Kong. The financial disclosures under other GAAPs may not include specific items required under HKFRS/IFRS. The consultation paper does not include any discussion on HKEx's view in this regard.

Names of directors of all subsidiaries

It is stated in paragraph 52(b) of the consultation paper that the scope of the new Companies Ordinance has been expanded to introduce, among other things, the requirement to include in the directors' report the names of all the directors in the group. As stated in paragraph 57 of the consultation paper, HKEx proposes to include this requirement in the revised Appendix 16 to the Listing Rules (and the GEM equivalent) such that the names of persons who are or were directors of the issuer as well as those who are or were directors of any of its subsidiaries included in the issuer's consolidated financial statements have to be disclosed.

For large corporate groups with a large number of subsidiaries, the number of names of directors of all subsidiaries may be of excessive length.

In this regard, we note that the Companies Registry has made some practical suggestions (see extracts below) in its frequently asked questions relating to Part 9 "Accounts and Audit" of the new Companies Ordinance: http://www.cr.gov.hk/en/companies_ordinance/faq_account-audit.htm#13

"Q13. For large corporate groups with a large number of subsidiary undertakings, are there any practical measures that a holding company can adopt to comply with the requirement to disclose directors' names on a consolidated basis in the directors' report of the holding company under section 390(3)?

Answer: The names of directors of all subsidiary undertakings included in the annual consolidated financial statements may be disclosed on a consolidated basis, without further setting out specifically the directorship of each individual subsidiary undertaking. If the number of names of directors of all subsidiary undertakings is, in the opinion of the directors of the holding company, of excessive length, disclosure of the names of directors of subsidiary undertakings may be made by way of inclusion by reference, provided that the information on the relevant directors' names is clearly contained in the directors' report by making a list of such names readily available to the reader. This may include, for example, by providing a link to the relevant website(s) which contains a full list of the names.

The above does not affect the requirement to disclose the names of the directors of the holding company and other particulars required under section 390, such information must be contained fully in the directors' report."

We suggest that HKEx should adopt similar measures by including a note to the relevant requirement in Appendix 16.

Update on accounting/auditing terms

We note in paragraph 76 of the consultation paper that HKEx is taking the opportunity to amend the Listing Rules to update accounting terms used with current financial reporting standards. We are supportive of the proposed update to enhance clarity for all issuers. We suggest HKEx to also consider updating the following auditing terms:

Paragraph 45(7) of Appendix 16 (and the GEM equivalent) requires that, where the auditors' report on a listed issuer's annual financial statements is likely to be qualified or modified (whether or not it is also likely to be qualified), the listed issuer shall include details of the qualification or modification in its annual results announcement.

Hong Kong Standard on Auditing ("HKSA") 705 "Modifications to the Opinion in the Independent Auditor's Report" deals with modifications to the opinion in auditors' reports. HKSA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with emphasis of matter ("EOM") which is not an audit qualification. Following changes made to the auditing standards previously, the terms "qualified" and "modified" have become more clearly defined. Pursuant to HKSA 705, there are three types of modifications to the auditors' report: qualified opinion, adverse opinion and disclaimer of opinion. EOM is separately dealt with in HKSA 706 and is no longer categorised as a modification to the opinion in the auditors' report as such. Pursuant to HKSA 706, an EOM paragraph is a paragraph included in the auditors' report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditors' judgment, is of such importance that it is fundamental to users' understanding of the financial statements. The auditors shall indicate that the auditors' opinion is not modified in respect of the matter emphasized. The clause in brackets in the above rule seems to suggest that HKEx expects issuers to include details of any EOM in annual results announcements. If that has all along been the intention of HKEx, we suggest that this point be made clear in the Listing Rules.

Under Rule 14.86 of the Listing Rules (and the GEM equivalent), HKEx will not accept a written shareholders' approval for a major transaction if the reporting accountants give a qualified opinion in the accountants' report. If HKEx's intention is to include adverse opinion and disclaimer of opinion, we suggest that the word "qualified" be changed to "modified" in the above rule. We also suggest HKEx to check other parts of the Listing Rules to ensure a consistent update across the board.

Proposed wording of rule amendments

We have the following observations after reading the proposed rule amendments in Appendices I, II and III to the consultation paper:

Schedule 4 to the new Companies Ordinance - Accounting Disclosures

We note on page 63 of the consultation paper that HKEx proposes to include the following disclosure requirement in paragraph 28 of Appendix 16 to the Listing Rules (and the GEM equivalent):

"A listed issuer (whether or not it is incorporated in Hong Kong) shall include disclosures required under the following provisions of the Companies Ordinance and subsidiary legislations:-

(1) in financial statements

...

(b) Schedule 4 - Accounting Disclosures; ..."

The above proposed rule amendment means that all issuers will have to make disclosures required under the entire Schedule 4 to the new Companies Ordinance. We doubt whether Section 4 of Part 1 of Schedule 4 should be included based on the analysis set out below.

It is stated in paragraph 45 of the consultation paper that:

"In relation to paragraph 41(d) above, Schedule 4 Part 1 Section 4 "Compliance with applicable accounting standards" of the New Ordinance requires that the financial statements must state whether they have been prepared in accordance with the applicable accounting standards and, if they have not been so prepared, must state the particulars of, and the reasons for, any material departure from those standards. Although this is a new requirement under the New Ordinance, it is consistent with existing practice due to similar requirements to disclose a statement of compliance contained in paragraph 16 of HKAS 1 "Presentation of Financial Statements" and paragraph 5 of Main Board Rules Appendix 16."

Schedule 4 Part 1 Section 4 of the new Companies Ordinance refers to section 380:

"The financial statements for a financial year must state-

- (a) whether they have been prepared in accordance with the applicable accounting standards within the meaning of section 380; and
- (b) if they have not been so prepared, the particulars of, and the reasons for, any material departure from those standards."

Section 380 "General requirements for financial statements" of the new Companies Ordinance contains the following provisions:

"(4) The financial statements for a financial year must also comply with-

- (a) any other requirements of this Ordinance in relation to the financial statements; and
- (b) the accounting standards applicable to the financial statements.

...

(8) In this section-

- (a) **accounting standards** means statements of standard accounting practice issued or specified by a body prescribed by the Regulation; and
- (b) a reference to accounting standards applicable to any financial statements is a reference to accounting standards as are, in accordance with their terms, relevant to the company's circumstances and to the financial statements."

Paragraph 20 of the consultation paper states that the new Companies Ordinance gives statutory backing to HKFRS issued or specified by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and quotes paragraph 7.3 of the consultation document, "Subsidiary Legislation for

Implementation of the New Companies Ordinance - Phase One", issued by Financial Services and the Treasury Bureau and the Companies Registry in September 2012:

"... the reporting standards issued by the HKICPA will be given indirect statutory recognition through section 380(4)(b) and 380(8) of the new CO, which stipulates that the financial statements of a company must comply with the applicable statements of standard accounting practices ... issued or specified by a body prescribed by subsidiary legislation (i.e. the HKICPA)."

In fact, Schedule 4 Part 1 Section 4 of the new Companies Ordinance in effect requires that the financial statements must state whether they have been prepared in accordance with HKFRS and, if they have not been so prepared, must state the particulars of, and the reasons for, any material departure from HKFRS.

Paragraph 5 of Appendix 16 to the Listing Rules states that:

"In the accounting policies section a listed issuer shall state which body of accounting standards have been followed in the preparation of its financial statements. Where applicable, a listed issuer should include a statement by the directors as to the reasons for any significant departure from an accounting standard that forms part of this body of accounting standards."

Paragraph 2.1 of Appendix 16 to the Listing Rules allows the choice of HKFRS, IFRS or China Accounting Standards for Business Enterprises ("CAS"). Paragraph 5 of Appendix 16 above appears to mean that a listed issuer shall state whether it has followed HKFRS, IFRS or CAS in preparing its financial statements and, if any of the accounting policies adopted departs from the relevant accounting standards (be it HKFRS, IFRS or CAS), the directors should explain the reasons.

Whilst Appendix 16 to the Listing Rules allows the use of HKFRS, IFRS or CAS, Schedule 4 Part 1 Section 4 of the new Companies Ordinance only in effect allows the use of HKFRS. The proposed rule amendment to paragraph 28 of Appendix 16 to require compliance with the entire Schedule 4 (including Part 1 Section 4) may mean that an issuer adopting IFRS or CAS will have to state the particulars of, and the reasons for, material departure from HKFRS, if any. We are not sure whether this is the intention of HKEx when drafting the rule amendment.

Aligning old and current accounting terms

We note that HKEx proposes to insert definitions for old accounting terms ("balance sheet", "income statement" and "profit and loss account") such that they will have the same meaning as the respective updated accounting terms used in the financial reporting standards. This approach seems to have been adopted rather than amending each and every old accounting term found in the Listing Rules. However, we note some inconsistencies. For example, whilst old accounting terms continue to be used in rules in Chapter 4 of the Listing Rules such as rules 4.04 and 4.06 (and the GEM equivalents), HKEx proposes individual updates to the same terms in rule 4.05 and Appendix 16 (and the GEM equivalents). We suggest HKEx to use a single approach to improve clarity of the Listing Rules - either defining old terms or amending each and every old term.

Rule 4.10 of the Listing Rules

The first part of rule 4.10 (and the GEM equivalent) which deals with disclosure requirements in accountants' reports reads as follows:

"The information to be disclosed in respect of rules 4.04 to 4.09 must be in accordance with best practice which is at least that required to be disclosed in respect of those specific matters in the accounts of a company under the Companies Ordinance and HKFRS, IFRS or CASBE in the case of a PRC issuer that has adopted CASBE for the preparation of its annual financial statements ..."

The term "Companies Ordinance" now means the new Companies Ordinance. The new Companies Ordinance gives statutory backing to HKFRS and stipulates that the financial statements of a company must comply with the applicable accounting standards issued or specified by a body prescribed by subsidiary legislation (i.e., the HKICPA). Financial statements prepared in compliance with the new Companies Ordinance will therefore comply with the disclosure requirements of HKFRS.

Is it the intention of HKEx to require all accountants' reports to comply with the disclosure requirements of HKFRS regardless of the financial reporting standards adopted for preparation of the accountants' reports?

Revision of financial statements

We support HKEx's proposal to impose an explicit requirement for an issuer to publish an announcement as soon as practicable after the directors decide to revise published financial statements. We note on page 32 of the consultation paper that HKEx refers to the revision of financial statements when explaining the proposal. The corresponding proposed wording of the rule on page 135 of the consultation paper is as follows:

"any revision of interim reports or annual reports, the reason leading to the revision of published financial reports, and the financial impacts, if any"

The proposed wording refers to "financial reports" rather than "financial statements". "Financial reports" has a wider scope and could include documents such as the directors' report. There may be a situation where the directors propose a revision to the directors' report which will not involve a corresponding revision to the financial statements. If the intended trigger of the proposed announcement requirement is the revision of financial statements (with or without consequential changes to directors' reports or other parts of the financial reports), then we suggest HKEx to revisit the wording of the proposed rule amendment above.

Furthermore, we note on page 145 of the consultation paper that the same wording is proposed to be used for the amendment of the GEM Listing Rules. It appears that the scope of the proposed rule does not cover any revision of published quarterly financial statements for GEM issuers.

Implementation date of financial disclosure proposals

It is stated in paragraph 18 of the consultation paper that Part 9 "Accounts and Audit" of the new Companies Ordinance comes into effect for the first financial reporting year beginning on or after 3 March 2014, the commencement date of the new Companies Ordinance. However, it appears that there is no explicit statement in the consultation paper as to whether HKEx would implement the proposed rule amendments relating to disclosure of financial information on the same time frame to ensure a level playing field among Hong Kong incorporated issuers and overseas issuers.

Minor update on accounting related references

Question 7 in Frequently Asked Questions ("FAQ") Series 5 "Rule Amendments relating to GEM Review" first issued by HKEx on 2 May 2008 clarifies the calculation of the "positive operating cash flow" under GEM Rule 11.12A(1) and refers to an illustrative figure in Hong Kong Accounting Standard ("HKAS") 7:

"The figure we normally use to assess compliance can be illustrated by reference to the figure '3,740' of HK Accounting Standard 7 on page 15."

Following subsequent revisions of HKAS 7, the page number referred to in the above FAQ has been changed to page 17.

Should you have any questions on the above comments, please do not hesitate to contact our

Yours faithfully,



Certified Public Accountants
Hong Kong