

BY HAND AND BY FAX

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Dear Mr Riley

Consultation on the proposed revisions to the SME-FRF and SME-FRS in respect of the proposal to permit the non-consolidation of subsidiary entities due to "expense and delay" ("the proposal")

Ernst & Young is pleased to comment on the above consultation.

Under the proposal in paragraph 19.1 and 19.1(b):

"One or more subsidiaries may be excluded from consolidation where their inclusion would involve expense and delay out of proportion to the value to members of the company."

"A parent may not exclude a subsidiary from consolidation on the grounds of undue expense and delay out of proportion to the value to members of the company unless the members of the company have been informed in writing about, and do not object to, this exclusion."

It is unclear from the proposal how the concept of "expense and delay out of proportion to the value to members of the Company" ("expense and delay") is expected to be applied. In particular, is it intended that so long as the shareholders do not object, then the expense and delay requirement will be deemed to have been met (i.e. it is for the members to determine how the undue expense and delay requirements will apply to their own circumstances), or is it expected that some form of materiality threshold, through an objective qualitative and /or quantitative assessment, will first be applied by the directors and only then if such threshold is met, will the next step of members' approval be applicable. Without clarification of this point there will likely be inconsistencies in the application of the above proposal by preparers and auditors.

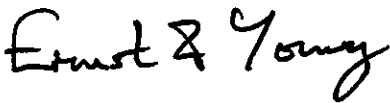
Whilst the absence of specific criteria in the standard to determine "expense and delay" would allow for greater flexibility in the preparation of the financial statements, without this, there is a risk that preparers will be able to decide somewhat arbitrarily whether or not to exclude particular subsidiaries from consolidation, irrespective of their size or nature (so long as the members do not object) – perhaps with the purpose of having a desired effect to the financial statements. This could undermine the credibility of the financial statements. The users of the financial statements may not be limited only to the members of the company and there might be other stakeholders, such as providers of finance. As these other stakeholders

will unlikely have access to financial information related to the excluded subsidiaries or understand the impact on the financial statements from their exclusion from consolidation, the usefulness of the financial statements could be significantly diminished, particularly as only limited information about the excluded subsidiaries is required to be disclosed.

The revised SME-FRS (upon finalization), will already permit that one or more subsidiaries may be excluded from consolidation on the grounds of materiality (paragraph 19.1a) and allow a parent not to present consolidated financial statements if in the financial year it is a wholly owned subsidiary of another entity or, in certain circumstances, if it is a partially owned subsidiary of another entity (paragraph 19.2). The standard will therefore already provide preparers with flexibility when consolidated financial statements are not deemed to be of benefit. However, should the proposal be retained, we believe that further guidance should be included in the standard to assist with the application.

We shall be pleased to further discuss this letter with you at your convenience. For this purpose please do not hesitate to contact Mr Paul Hebditch.

Yours sincerely



Ernst & Young