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30 September, 2008.

Mr. Steve Ong,
Deputy Director, Standard Setting Department,
Hong Kong Institute of Certified Public Accountants,
37th Floor, Wu Chung House,
213 Queen's Road East,
Wanchai,
Hong Kong.

Dear Mr. Ong,

**HKICPA CONSULTATION PAPER ON
FINANCIAL REPORTING BY PRIVATE COMPANIES**

I enclose my view and comments on the above subject for the consideration by the relevant committee.

Yours faithfully,



LAU Kai Hing

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BY:.....

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Views to the two consultation documents on Financial Reporting by Private Companies and Exposure Draft of Proposed Amendments to SME-FRF and Proposed Sections of SME-FRS

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Professional accountant in practice

Consultation Paper on Financial Reporting by Private Companies

1. *Do you agree that relief from applying full HKFRSs should be permitted for private companies?*

Agree.

Reasons:

- a) Private companies do not involve significant public interest.
- b) Under the current Companies Ordinance, private companies do not require to file their financial statements.
- c) Stakeholders do not acquire financial statements from public records. They would only obtain from the Entity.
- d) Financiers, e.g. bankers, would **not** solely depend on financial statements to grant credit. The audited financial statements are only historical status a few months ago.

2. *Do you agree that the SME-FRS is an appropriate reporting option for small private companies and groups ?*

Agree.

Reasons:

- a) The name SME-FRS could be changed to meet the current needs in the society. The proposed new names could be: e.g. i) Private Entity Financial Reporting System (PE-FRS)
- b) There should be open-minded consideration for private companies and **not** trying to make different accounting standards by stressing on 'small' 'medium' and 'large' sizes.

c) The present laws do not allow private companies with subsidiary to prepare financial statements under the present SME-FRS. During the consultation and the process of re-write of the Companies Ordinance, recommendation by HKICPA should be made to the relevant authorities on such significant issues such as 'size test' on single company and on group that would be relevant to the current situations of Hong Kong.

3. *Do you agree that large private companies should be provided with an option to choose a simpler reporting framework than HKFRSs ?*

Agree BUT there should **not** be different accounting standards for "small and medium sized" and "large private companies:

Reasons:

- a) There are views that the setting of IFRS is of the intention that the FRS is to be applied to 'listed companies' which would be of public interest. However, HKICPA determines full adoption without given careful and sufficient consideration to the significant **adverse** effect to most of the entities and to its ability in the changes in the laws of Hong Kong to cope with the changes in accountings standards and the financial reporting standards after adoption. Now, it would be a good opportunity to rectify such situation. Careful and more in depth review is required to put them into effect.
- b) Considerations should also be made in the proposed changes to financial reporting standards that private companies should be allowed more freedom to provide additional disclosure based on their own needs. HKICPA carries regulating functions, membership service functions, training and other functions. It should consider balancing effects to the listed companies which affects investors and general public and to entrepreneurs, especially small and medium size entities which constitutes more than 80% of the companies of Hong Kong. The ability and the supply of the accounting professionals, technicians and staff in adopting the accounting standards in servicing the community of Hong Kong should also be considered.

- c) Consideration should be made as to whether to take the approach for 'large private companies to choose a simpler reporting framework than HKFRS, thus creating a three-tier accounting systems. Or, to allow more disclosures based on SME-FRS, which could be modified to meet the current developments and changes in economic conditions.

4. *Do you agree with the view of Council that the SME-FRF & SME-FRS does not meet the reporting needs of the users of the financial statements of large private companies; and the SME-FRF & FRS should not be expanded to meet those needs ?*

Disagree.

Reasons:

- a) If the Council takes the view that in adopting the SME-FRF & FRS, there should not be disclosures more than those stated under the current SME-FRF & FRS. Then, it would result in the thinking as stated in the question.
- b) If the Council could adopt open-minded view, considerations could be made to the current SME-FRF & FRS (propose to rename '**Private Entity FRS (PE-FRS)**') by making it be available to private entities and allowing more flexibility for private entities in disclosing more information in the PE-FRS. This include: individual entity should be allowed adopting some of the standards in HKFRS if they consider that such action would result in more information disclose of financial information of their own entity, but the PE-FRS would not be expanded to make them compulsory. Those 'large private entities, if choose not adopting the full HKFRS, could choose more disclosures which they consider could give a more fair representation of their financial status.
- c) The other private entities would not suffer the need to make more than necessary disclosures to accommodate the 'wishes' of the 'large private entities'.

5. *Do you agree that the Institute should adopt or develop a large private company financial reporting framework? There are 3 options mentioned in paragraph 37 of the Consultation Paper, set out as follows:*

- (1) HKFRS with reduced disclosures;*
- (2) IRFS for SMEs; and*
- (3) IFRS for SMEs with addition simplifications.*

Which of the above options do you think is appropriate for developing large private company financial reporting framework?

Disagree to this proposal.

Reasons :

- a) There would be different sizes of 'large private company'. If a different set of standards is set and the size test is set low, it would result in some defined as 'large private entity' be overburdened with more than necessary disclosures. The issue of creating a new set of standards for 'large private entity' would create another problem of the same argument.
- b) The 'size test' would not be fairly applied to all entities. Entities under different line of industry would be different. For example, a property company when holding larger premises would be considered 'large private entity', but in fact the operation is simple.
- c) The draft IFRS for PEs has stated the adoption could be determined by a county according to its situation. Hong Kong, being a city that is different from many other countries, would not be necessary to adopt their standards in full. Hong Kong can have our own standards, including adopting part of IFRS standards that would be appropriate for our needs.
- d) Basically manufacturing companies are operating in China. The size of operation and the applicable laws are quite different. It would be difficult to set standards meeting the various situations.

6. *Please identify whether you use financial statements as a preparer, auditor and/or user and the effect on you in all of these cases of the proposed introduction of a large private company framework.*

I am auditor.

REQUESTS:

The HKICPA Council should make statistics on the members and students serving the accountancy sector in the following areas:

- i) Number of members serving the listed companies and their subsidiaries.
- ii) Number of students serving the listed companies and their subsidiaries.
- iii) Number of members serving the 'large private entities' and their subsidiaries, including those entities under regulated industries, NGO's that are no listed.
- iv) Number of students serving the 'large private entities' and their subsidiaries, including those entities under regulated industries, NGO's that are not listed
- v) Number of members in public practice
- vi) Number of students working in member firms/companies in public practice.
- vii) Number of members in retirement/semi-retirement
- viii) Number of members serving the SMEs
- ix) Number of students serving the SMEs.
- x) What are the ratios of members serving as preparers for SMEs ?

Would the HKICPA advise what are their conclusions on the survey in manpower supply in the accountancy sector, given that not many the students would be able to act as preparer of the financial statements.

OPINION

The creation of more sets of FRS would create more trouble to the accounting sector, in terms of operation and trailing.

Exposure Draft of Proposed Amendments to Small and Medium-Sized Entity Financial Reporting Framework (SME-FRS) and Proposed Sections of Small and Medium-Sized Entity Financial Reporting Standard (SME-FRS).

1. *Do you agree that the SME-FRF and SME-FRS should be amended to cover groups? If not, why not?*

Agree,

BUT

- a) The quantity amounts in the size test should be increased
- b) The SMEs should be given options of **not** choosing to prepare consolidated financial statement for groups if certain criteria are met, e.g. more than 75% of the members agreed. This has to be in line with the awaiting amendments to Companies Ordinance.

Reasons:

- a) If there are impairment losses during the year, they should be included in the results of the year and the investment value in the balance sheet should reflect the fair value, I.e. the equity method is automatically adopted.
- b) If there are any commitments or contingent liabilities, it should have been stated in the financial statements under the current accounting standards.

2. *Do you agree that the size criteria set out in paragraph 24 of the SME-FRF appropriately identify a "small group" in Hong Kong? If not, why not?*

Disagree.

Reasons:

If the framework is to be re-considered as classifying into 'listed entities' and 'private entities, the size criteria would not be necessary.

However, if the proposed three-tier FRS standards is insisted, the current SME-FRF and SME-FRS could be reviewed with such modification necessary, but could be based on '**double**' the current size criteria at least for "small group" in setting the FRSs.

3. *Do you agree that at the company level, investments in associates and interest in jointly controlled entities should be accounted for using the cost method? If not, why not? Do you agree that when an investor / a venturer presents consolidated financial statements, investments in associates and interests in jointly controlled entity should be accounted for using the equity method?*

Agree to use the cost method.

Do **not** agree to use the Equity method.

Reasons:

- a) If there are impairment losses during the year, they should be included in the results of the year and the investment value in the balance sheet should reflect the fair value, I.e. the equity method is automatically adopted.
- b) If there are any commitments or contingent liabilities, it should have been stated in the financial statements under the current accounting standards.
- c) The entity can choose to disclose the equity value in the notes to the financial statements which could serve the purpose of disclosing the equity value in the financial statements.

4. *Should a complete set of financial statements prepared under the SME-FRS be required to include a cash flow statement? If not, why not?*

No.

Reasons:

- a) If the direct method is adopted, it may serve the purposes of explaining the cash flows for the year. However, not many companies would be able to produce cash flow statements using direct method. Even prepared, the cost of preparation would out-weight the benefits to the shareholders and would not be of much use to other users.
- b) If the indirect method is adopted, the users might not understand what it means. If only professional accountants are able to understand it, it would result in being accused by the shareholders as one of the means of HKICPA setting these requirements in order to create a way for accountants/auditors to benefit in income without use to the users. But the preparers, auditors do not benefit from it as they have to spend unnecessary time and effort on these 'no real use' statements. The image of accountancy profession is tainted.
- c) The cash flows statements would not be producing significant information to the users **but** only with higher preparation charges to the Entity.
5. *If a cash flow statement is required, do you agree that either the direct method or indirect method can be used for reporting cash flows from operating activities, as set out in paragraph 22.7 of the SME-FRS? If not, why not?*

Agree either method can be used.

BUT

Why make it compulsory to prepare such statement without real use to the users, but causing the reporting company to pay for such statements. The costs to the Entity would taint the image of accountancy profession.

6. *Are there any disclosure requirements included in sections 18 to 22 of the SME-FRS that you consider are too onerous for SMEs and therefore should be excluded? If so, what are they and why?*

Section 19

- a) Under 19.1, a parent should present consolidated financial statements

SMEs should be allowed not requiring presenting consolidated financial statements should the required percentage of shareholders elect. The percentage should be the same with that of applying the awaiting amended Section 141D of the Companies Ordinance

- b) Under 19.2(b), ..a partially-owned subsidiary of another entity and has the consent of **ALL** its other members for not presenting consolidated financial statements.

The “**all**” requirements should be changed to be the same requirement in the **overall** percentage as applying the awaiting amended Section 141D of the Companies Ordinance.

- c) Under 19.5(a), combine the financial statements of the parent and its subsidiaries **line by line** by adding together like items of assets,

In some countries, such as China, there are regulator defined accounting terms and format which cannot be changed. The treatment of tax would be different also. It would be illogical making it **mandatory** in accounting standards to make it “**line by line**” adding. Flexibility should be allowed for adding those items of **similar nature**.

- d) Under 19.9 Uniform accounting policies, the accounting policies on certain items, such as “Depreciation on fixed assets (property, plant and equipment)” there are defined depreciation rate with fixed residual value deduction. This accounting policies should not be compulsorily applying in Hong Kong entities. Even the requirement to making adjustments in preparing consolidated financial statements should **NOT** be required, so far the accounting policies are properly stated.

Section 20

- a) The comments as stated in **c) and d) under Section 19 above** also **apply** to Associates under this Section 20
- b) Under 20.10 on accounting policies under equity method, the Entity should not be required to make adjustments in the financial statements so far such accounting policies are stated.

Section 21

- a) The comments as stated in **c) and d) under Section 19 above** and **b) under Section 20 above**, should also **apply** to Jointly Controlled Entities under this Section 21

Section 22

- a) Cash Flow Statements should **NOT** be compulsory. The entity should be allowed to prepare Cash Flow Statements should it so chooses.

Reasons:

The reasons have been stated in 4 above.



LAU Kai Hing