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COMMISSIONER OF INLAND REVENUE,
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Miss Winnie C W CHEUNG
Senior Director,
Professional & Technical Development
Hong Kong Society of Accountants
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89 Queensway, Hong Kong

Fax No. 2865 6603

Dear Miss CHEUNG,

Consultation Paper on a Proposed Framework for Differential Reporting

I refer to my letter of 5 November 2002 and attach our comments on the above consultation paper for your consideration.

Yours sincerely,

(TAM Kuen-chong)
for Commissioner of Inland Revenue

Hong Kong Society of Accountants Consultation Paper on a Proposed Framework for Differential Accounting

Comments of Inland Revenue Department

Financial accounts of a commercial entity provide the basis for the Inland Revenue Department (the Revenue) to determine the entity's assessable profits/losses for tax purposes. They are of vital importance in the Revenue's examination and review of the entity's tax affairs. It would thus be appreciated that the Revenue has a keen interest in seeing that an entity's financial accounts are properly prepared in that sufficient information is disclosed for a clear and full understanding of the operation of the entity. In this regard, the Revenue notes that the consultation paper proposes certain information that is relevant to the review of an entity's affairs to be exempt from disclosure under the proposed framework. To name a few examples: the exemption from disclosure under paragraph 35b of *SSAP 18 Revenue* and paragraph 38 of *SSAP 23 Construction Contracts*.

Under the proposed framework, a large entity or group would also be qualified for differential reporting provided that it does not have public accountability and there is no separation of owners and its governing body. This raises the concern that large but closely held enterprises can avail themselves of the framework and disclose a minimum of information in their financial statements. It may be argued that the Revenue can always seek additional information from the taxpayers in tax returns or under its statutory power. The reality is that non-disclosure or a relaxed disclosure requirement renders irregularities more difficult to detect and crucial tax issues gone unnoticed. Further, a reduction in disclosure in the financial statements might inevitably lead to increased enquiries by the Revenue and thus delay in the finalization of assessments. As a consequence, the services of the Revenue might be compromised.

The Revenue is aware that at present, depending on their own circumstances, certain entities have already been exempt from a number of requirements under various SSAPs. For instance, an entity whose securities are not traded publicly need not comply with the requirements under *SSAP 5 Earning Per Share, SSAP 25 Interim Financial Reporting* and *SSAP 26 Segment Reporting.* And there is no need for an entity with annual turnover or gross income of less than $20 million to prepare cash flow statements as required under *SSAP 15*. It is noted that these four SSAPs are among the seven granted full exemption under the proposed framework.

Furthermore, section 141D of the Companies Ordinance allows private companies, with certain exceptions, to be exempt from a number of requirements in relation to the preparation and presentation of their accounts where all the shareholders of the companies concerned agree in writing to the application of the section. A number of SSAPs are not applicable to an entity invoking s.141D, including *SSAP 20 Related Party Disclosures*. Incidentally *SSAP 20* is another of the seven SSAPs for which full exemption is granted under the proposed framework.

A company that is either a holding company or subsidiary company is not allowed to invoke s.141D (s.141D(3)(a)) and is therefore still required to comply with *SSAP 20*. The proposed framework would, however, have the effect of extending the exemption from related party disclosures to group companies so long as they are qualifying entities. The Revenue has great reservation in respect of this move. The Revenue considers that where a group of companies are involved, it is of utmost importance that information on related party transactions should be disclosed.

All in all, given the existing channels for small entities to seek exemption from certain reporting requirements, the Revenue does not see that there is a real need for differential reporting. If, however, a framework for differential reporting must be implemented, the Revenue prefers the integrated approach as this helps users of financial statements focus on the areas where a differentiated basis has been applied. This is on the basis that the concerns aired by the Revenue in the preceding paragraphs could be addressed, if considered necessary.

Inland Revenue Department
November 2002