Hong Kong Institute of
Certified Public Accountants
香港會計師公會

14 May 2005

By fax (2810 5385) and by post

Our Ref.: C/CFC, M34736

Securities and Futures Commission
8th Floor, Chater House,
8 Connaught Road Central,
Hong Kong.

Attn.: SFC (Stock Market Listing Rules)
Corporate Finance Division

Dear Sirs,

Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules

We have reviewed the above-referenced consultation paper, which seeks comments on proposed amendments to the Securities and Futures (Stock Market Listing) Rules as part of the process of codifying the more important requirements in the existing Listing Rules into subsidiary legislation under the Securities and Futures Ordinance.

The Institute's comments on the issues raised in the consultation paper are set out in the Appendix to this letter.

We hope that you find our comments to be helpful. If you have any questions on this submission or wish to discuss it further, please contact me at the Institute on 2287 7084.

Yours faithfully,

Peter Tisman
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Appendix

Comments from Hong Kong Institute of CPAs in response to the Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR)

A. Principles in drafting the proposed SMLR

1. *Para. 11(a) and 26 – requirements relate only to disclosure*

The Hong Kong Institute of CPAs supports the principle of giving statutory backing to the more important listing requirements, with the aim of strengthening the current enforcement regime and promoting compliance. We believe this should help to raise the standards of corporate governance in Hong Kong and enhance investor confidence in the quality and integrity of our markets.

Except for disclosure of price-sensitive information, the Institute has no objection to the proposed areas to be codified in the statute, as they are those that are of most concern to minority shareholders and that affect the public interest.

Corporate finance practitioners among our members have expressed concern regarding making disclosure of price-sensitive information a statutory obligation. They consider that decisions as to whether certain information is regarded as price-sensitive, at any given time, often require a judgement call. As decisions of this nature can involve a significant element of subjectivity, it would put practitioners in an invidious position if a judgement made in good faith were, potentially, to render them liable to severe, possibly even criminal, sanction.

It is also noted that the proposed SMLR represent the minimum requirements applicable to all issuers listed on the Main Board and the Growth Enterprise Market (GEM), and that the Stock Exchange of Hong Kong (SEHK) may add to these requirements in the Listing Rules. One example of this, quoted in the consultation paper, is that a requirement to publish half-yearly accounts is intended to be put into the statute, whereas the publication of quarterly accounts will remain a requirement under the GEM Listing Rules (para. 15). We have concerns that imposing different requirements by statute and in the Listing Rules in relation to the same important areas, as in this case, could cause confusion to the market.

Given the various doubts about issues of implementation, to which we have referred in the latter part of this Appendix, corporate finance practitioners are understandably concerned about the proposal to introduce criminal sanctions for breaches of the SMLR. Consideration should be given to deferring the introduction of criminal sanctions, at least until the SMLR have been in place and operating for a period, so that any significant problems of interpretation and enforcement can first be ironed out.

2. *Para. 11(b) – no substantive changes from the present Listing Rules*

Inconsistency between the draft SMLR and the present Listing Rules

It is noted that the new provisions in the draft SMLR are taken from the existing Listing Rules and are intended to be drafted in plain language. The opportunity has also been taken to clarify some interpretive difficulties and reduce duplications (para. 18).

In our view, although the proposed statutory requirements may be intended to be the same in substance as the existing Listing Rules, in practice, the process of redrafting will

tend to increase the likelihood of discrepancies occurring. This situation will be exacerbated if the existing version of the rules remains in force in the form of non-statutory Listing Rules issued by the SEHK. In this connection, neither the consultation paper nor the Financial Services and the Treasury Bureau (FSTB)'s related *Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance to Give Statutory Backing to Major Listing Requirements* make it clear whether or not it is envisaged that two separate sets of rules, covering the same matters, will be in force concurrently.

Furthermore, there may be unintended differences of a material nature between the current Listing Rules and the proposed statutory rules, which could again be confusing to the market. A brief, and by no means exhaustive, examination has identified some examples, set out below, which have not been highlighted as intended substantive changes in Appendix 2 to the consultation paper.

Example 1

The draft SMLR defines "affiliate" to mean "*another corporation which is recorded or required to be recorded in the first mentioned corporation's accounts as being an associate or jointly controlled entity pursuant to the applicable reporting standards*" (Schedule 1). The Listing Rules, on the other hand, define affiliated company as "*a company, which, in accordance with Hong Kong Financial Reporting Standards [HKFRS], is recorded using the equity method of accounting in an entity's financial statements. This includes associated companies and jointly controlled entities as defined in those standards*" (Rule 13.11(2)). Given that, for example, jointly controlled entities may, under HKFRS, be proportionately consolidated rather than accounted for using the equity method, the scope of "affiliated company/affiliate" would appear to be different under the existing Listing Rules and the draft SMLR.

Example 2

This relates to the continuing disclosure requirement of amounts due from and commitments to affiliates. Although both the draft SMLR (para. 14 of Part 2, Schedule 2) and Listing Rules (Rule13.22) require an issuer to include in its interim report and annual report a combined balance sheet of such affiliates, the Listing Rules also provide that, where it is not practicable to prepare the combined balance sheet of affiliated companies, the SEHK may consider accepting, as an alternative, a statement of the indebtedness, contingent liabilities and capital commitment as at the end of the period reported on by affiliated companies. Since the SMLR does not provide for any alternative to inclusion of a combined balance sheet of the affiliates, it is uncertain whether the Listing Rules' provision for an alternative would still be applicable.

In view of the practical difficulties in obtaining financial statements from affiliates on a timely basis in order to prepare a combined balance sheet of such affiliates for inclusion in an issuer's interim and annual report, in particular from overseas affiliates, we consider that provision for an alternative arrangement continues to be necessary.

Example 3

The draft SMLR (para. 2 of Schedule 5) require an issuer to include in its financial statements a statement showing certain information in respect of every subsidiary that materially contributes to the net income of the group. Para. 17(2)(b) of the draft SMLR requires an issuer to disclose details for each of the properties that are material to the group. However, it has not been made clear how materiality is to be defined/interpreted under the draft SMLR. In practice, therefore, the test of materiality may prove to be different from the current Listing Rules, which specifically state that disclosure is required if these items are, <u>in the opinion of the directors</u>, material to the group.

Example 4

As regards preliminary announcements of full-year results, the draft SMLR requires that "*An issuer shall prepare an announcement which complies with the provisions of Schedule 5 relating to preliminary announcement of full-year results, and agree the announcement with the auditors who audit its annual accounts*" (para. 13 of Schedule 4). The existing Listing Rule requirement is that "*The preliminary announcement shall be based on the issuer's financial statements for the financial year which shall have been agreed with the auditors*" (Rule 13.49(2)).

In this regard, the draft SMLR would appear to extend the scope of the Listing Rules, as well as the auditors' role, by requiring the issuer to agree the "announcement" with the auditors rather than simply to base the announcement on the financial statements, which have been agreed with the auditors.

An important question therefore, which needs to be clarified, is whether, in future, there will be two differently-worded sets of rules, covering the same subject matter, which will be administered and enforced by different regulators? If so, in our view, not only this would cause confusion to the market, but it would also impose additional compliance costs on listed issuers, as they will have to ensure that both sets of requirements, i.e. the Listing Rules and the SMLR, are satisfied.

The Institute is firmly of the view that there should be only one set of rules and one form of words in relation to those matters to be covered in the statute.

Secondly, and regardless of whether there will in future be two sets of overlapping rules, we would suggest that any potentially material differences between the current Listing Rules and the proposed SMLR be highlighted and that the implications of the changes be explained.

<u>Two different documents or one combined document?</u>

As indicated above, following the introduction of the revised SMLR, it is not clear whether, for example, the non-statutory Listing Rules will still continue to include those provisions on which the SMLR will have been based or, whether the relevant existing Listing Rule provisions will be replaced by the SMLR and removed altogether from the "red book", except perhaps for a cross-reference to the SMLR; or whether, alternatively, the SMLR will be incorporated into the red book verbatim and separately identified as statutory rules.

We note from the SMLR consultation paper that the Listing Rules may go further than the SMLR, i.e., be more rigorous than the corresponding statutory rule, which implies the continuing existence of the Listing Rules in some form. One possible approach would be for the red book to reproduce the statutory requirements (e.g., in bold print) and to differentiate from them any additional non-statutory requirements imposed by the SEHK.

Generally, the proposed interface between the rules issued by SEHK and the SMLR has not been made clear. This is a concern to members of the Institute and, no doubt, to other interested parties and, as suggested under item 5 below, we believe that the approach of incorporating detailed rules in subsidiary legislation may need to be reconsidered.

3. ***Para. 11(c) – no pre-vetting or approval requirements***

Possible inconsistencies between regulators in the handling of disclosure materials

Para. 21 states that the proposed provisions in the SMLR will not require any pre-vetting or other regulatory approval of materials to be disclosed. However, the current Listing Rules (Rule14.34) stipulate that as soon as the terms of a share transaction, discloseable transaction, major transaction, very substantial disposal or very substantial acquisition (all of which are codified under Schedule 6 of the draft SMLR) have been finalised, the listed issuer must inform the SEHK and send to the SEHK a draft announcement. An announcement requires the SEHK's clearance before it is published.

We are concerned about the potential for inconsistencies to occur in relation to the handling of disclosure materials. Under separate regulations, enforced by two different regulators, there may be situations where, even though an announcement has been cleared with the SEHK, the SFC, which, under the proposals, will not undertake any pre-vetting of documents, may still determine that the company and the relevant directors and officers have breached the statutory rules. In other words, notwithstanding the position of the SEHK on the same matter, the SFC may subsequently take the view that the announcement is not compliant. This could amount to a form of double jeopardy.

Under the circumstances, there needs to be an arrangement/clear and open understanding between the SFC and the SEHK that would enable listed companies and market practitioners to obtain a reasonable level of comfort and certainty in relation to disclosure materials already cleared by the SEHK.

Readiness of local market to accommodate the change in approach

As indicated above, under the current Listing Rules, disclosure materials, such as announcements of notifiable transactions, require the SEHK's clearance before they are published. Following the introduction of the statutory listing requirements, there will not be any pre-vetting of disclosure materials by the SFC. Given the potential for inconsistencies, referred to above, the SEHK may also be inclined to adopt a "hands-off" approach and leave it to the listed issuers, their directors and advisers to ensure compliance with the statutory requirements, particularly in the absence of a clear-cut understanding between the SFC, SEHK and issuers in relation to pre-vetted materials, as suggested above. While doing away with pre-vetting altogether might be a reasonable longer-term objective, we doubt whether, currently, the participants in the Hong Kong marketplace are sufficiently prepared to be able to adapt suddenly to a situation where responsibility is placed entirely on issuers and their advisers without the provision of any assistance.

We would have serious reservations if this were to be allowed to happen by default and without any orderly and well-planned transition. During any transitional period there should be education programmes and additional guidance on matters of interpretation, etc., to help listed company directors/officers and market practitioners to understand better the statutory listing requirements and their own legal responsibilities and liabilities. The adverse consequences of an abrupt change of approach could be damaging to the reputation of Hong Kong's markets.

4. ***Para. 11(d) – SEHK will remain the frontline regulator***

We consider that the proposals for statutory backing cannot be completely divorced from the mechanics of their implementation, including the structure for enforcement, and the Institute has serious reservations about these aspects.

It is noted that the SFC will be responsible for enforcing the statutory listing requirements, whereas the SEHK will remain the frontline regulator of listed companies (para. 24). We are unclear about the practical implementation and the mechanisms for enforcement of the statutory rules, in particular, how the SEHK will continue to be the frontline regulator if it is not the party to enforce the statutory rules.

Enforcement of the statutory rules

The SFC will be responsible for enforcing the statutory listing requirements but, as noted previously, it will not undertake any pre-vetting of disclosure materials. It will have the power to investigate and hold persons liable where they break the statutory rules (paras. 21 and 22).

How in practice will the procedure operate? Will the SFC review all published materials to check if they comply with the statutory requirements, or will it respond only to complaints/allegations, etc? In the case of the latter, how would the SFC be kept informed of possible breaches, i.e., which parties would be expected to alert the SFC and what reporting mechanism/procedure would be adopted?

It is also unclear which party (SFC or SEHK) will be responsible for determining whether a breach of the statutory rules has occurred and the seriousness of any breach. We submit that the process and decision-making proceedings should be seen to be fair and transparent and that the level of fines and other types of sanctions imposed should be relevant and proportionate to the seriousness of the fault involved. We would suggest, therefore, that some assurance should be given that the punishment will be commensurate with the nature of the breach. Even the largest of companies may, for example, sometimes completely innocently overlook a connected transaction and, as regards the timing of the publication of accounts, information required from overseas jurisdictions may on occasions not be released in a timely manner, as a result of commercial disputes, etc., and this may be beyond the control of locally-based officers.

Maintaining and updating post-listing requirements

A further area of uncertainty is how future changes to the SMLR will be initiated. Given the dynamic nature of financial markets, it is essential to establish a mechanism to ensure that the statutory requirements are kept up-to-date on a timely basis, to meet the changing needs and expectations of the market, market participants and investors.

Para. 17 indicates that the SFC will keep the provisions in the SMLR under ongoing review and consult the market and the public when potential changes are identified. However, it appears that the SFC's primary focus will be enforcement. Furthermore, the process of effecting changes to legislative rules will inevitably be slower than changing non-statutory rules.

The SEHK, which will remain in the frontline of market supervision, is likely to be in a better position to understand the market needs as they develop from time to time, through its day-to-day direct contact with listed companies and market practitioners. However, it is not clear what role, if any, the SEHK is intended to have in relation to the future development of the SMLR although, in its own regulatory role, as noted above, the SEHK will be able to introduce provisions that go beyond the minimum requirements of the statutory rules (para. 15). Against this background, we have the following questions:

(i) Will the process of reviewing and updating the statutory requirements be the responsibility of the SFC alone?

(ii) What procedure will be adopted if and when the SEHK sees a need to update or impose additional regulatory requirements in relation to any of the areas covered in the SMLR?

(iii) As it is likely to be easier and quicker to change the Listing Rules than the statute, and the SEHK may add to the requirements imposed in the SMLR, will there be any specific mechanism and procedure to ensure that the two sets of rules remain fundamentally in alignment with one another?

5. Comment on the SFC's approach

We have identified above various potential problem areas, including possible overlaps and differences between the SFC and the SEHK in the handling of disclosure materials, which could result in a form of "double jeopardy" for listed issuers and market practitioners; possible inconsistencies between the draft statutory listing requirements and the current Listing Rules; the ambiguous division between the future roles and responsibilities of the SFC and the SEHK vis-à-vis enforcement, and the interface between the two agencies and issuers and market practitioners. All of these point to potential pitfalls and difficulties with the proposals and their implementation, which lead us to suggest that the SFC's proposed approach of codifying the detailed Listing Rules into provisions in the SMLR may need to be reconsidered.

Furthermore, we believe that incorporating detailed Listing Rules into subsidiary legislation would reduce flexibility and potentially hinder the ability of the framework to adapt, in a timely manner, to changes in the market environment and in public expectations.

We note that one of the options for giving statutory backing to the more important Listing Rule requirements, as suggested in the Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure ("Expert Group Report") published in March 2003, would be "*to have the SFC make subsidiary legislation under the SFO, linking the Listing Rules to certain general requirements which are sufficiently important for investor protection to be set out in the law, but without turning the Rules themselves into subsidiary legislation*" (para. 3.46 of the Expert Group Report). In the Institute's view, the merits of this suggested approach should be further explored.

Notwithstanding the above comments, we have provided comments on areas of the detailed draft SMLR in this Appendix and in particular in Part B of the Appendix.

B. Draft Securities and Futures (Stock Market Listing) Rules

I. Major comments

1. Inconsistencies between the draft SMLR and the present Listing Rules

We have identified a number of apparent inconsistencies between the draft SMLR and the present Listing Rules. Some of the more significant examples are set out in point 2 of Part A of this Appendix. Other examples are set out in this section.

As indicated in Part A, we are concerned that there may be unintended material differences between the current Listing Rules and the proposed statutory rules, which could be confusing to the market. Measures should be taken to ensure that the scope of the draft SMLR is same as the present Listing Rules.

2. Schedule 2 – Disclosure of Price Sensitive Information

(a) Change of Auditors

We would suggest that the SFC may take the opportunity to update para. 20 to reflect the proposals set out in the Institute's Exposure Draft of Professional Ethics Statement 1.207A *Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong*, which has been prepared in conjunction with the SEHK and the SFC.

Including the key proposals of the Professional Ethics Statement 1.207A in the SMLR would reinforce the framework to enhance communication by requiring listed issuers to explain in more detail the circumstances surrounding the change in auditors.

(b) Winding-up and liquidation

Para. 27 of the draft SMLR requires a listed issuer to promptly disclose to the public the occurrence of the relevant event referred to in that paragraph. The Listing Rules (Rule 13.25), on the other hand, require a listed issuer to inform the Stock Exchange on the happening of any of such events, with a note providing that if the directors consider that disclosure of information to the public might prejudice the issuer's business interests, the Stock Exchange may be prepared to give a dispensation from the requirement to make the information public. Since the SMLR requires prompt disclosure to the public, without any provision for dispensation from the requirement, it is uncertain whether the Stock Exchange will still be able to give a dispensation from the requirement.

3. Schedule 3 – Accounts to Conform to Applicable Accounting Standards

Paragraph 1 of Schedule 3 states, "*Where accounts are required to be prepared, audited, or reported upon under these Rules, they shall conform with either HKFRS or IFRS*." We are not clear whether the proposal seeks to give statutory backing to HKFRS (Hong Kong Financial Reporting Standards) and IFRS (International Financial Reporting Standards). We request clarification of the SFC's intention in relation to this point before we can provide our comments on the implications of the proposal, which may be substantial.

4. Schedule 3 – Accountants' Reports and Financial Information

(a) *Reporting framework*

We note that Schedule 3 is built on the existing reporting framework where reporting accountants take responsibility for the historical financial information and include the historical financial information in the accountants' report. This is different from the Institute's proposed reporting framework contained in the Exposure Draft of "*Proposed Standards and Guidance for HKSA* [as the Institute was previously known] *Members in Performing Listing Engagements*" (ED) issued by the Institute in May 2004. We propose to segregate the role of the directors of listing applicants from that of the reporting accountants, such that the directors will be responsible for the preparation of historical financial information for inclusion in investment circulars while the reporting accountants will be responsible for reporting on the historical financial information prepared by the directors. The feedback that the Institute has received indicates general support for the proposed new reporting framework.

The ED was developed by the Institute's Accountants' Report Task Force (ARTF) in consultation with the SFC and the SEHK. A number of meetings and presentations have been held since late 2002 to exchange views on the ARTF's proposals, including the proposed new reporting framework. A copy of the ED was also sent to the SFC when it was issued in May 2004.

It is also noted that in addition to Schedule 3, certain paragraphs in Schedule 6 "Notifiable Transactions" are also drafted on the basis of the existing reporting framework in relation to accountants' reports. They are para. 24(1)(a), in relation to major transaction circulars, para. 25(a)(i), in relation to very substantial disposal circulars, and para. 26(f), in relation to very substantial acquisition circulars. Under these paragraphs, the financial statements/information is to be included in the accountants' report, which implies that the reporting accountants, rather than the directors of listing applicants, take responsibility for the financial statements/information.

We are concerned that the draft SMLR does not support the new reporting framework proposed by the Institute, which is intended to be finalised later this year. While one of the general principles in codifying the more important requirements of the Listing Rules into provisions in the SMLR is that there should be no substantive changes from the present Listing Rules, in practice, there are a number of substantive changes proposed by the SFC which are covered in the same consultation exercise. We request that the draft SMLR be amended so as to accommodate the Institute's proposed new reporting framework.

In addition, we consider that it would facilitate understanding of the new reporting framework if the revised SMLR were to have separate schedules on the preparation of financial information by the directors of listing applicants and on reporting by the reporting accountants.

(b) *Scope*

The scope of Schedule 3 is not well defined. While Schedule 3 adopts the title "Accountants' Reports and Financial Information", certain terms that are not applicable to accountants' reports, such as "accounts", "auditors" and "audited", which should relate to periodic reports, are used in Schedule 3. On the other hand, the terms "reporting accountants" and "accountants' report", which should be defined, are currently not defined.

(c) The term "accounts" in Schedule 3 should be replaced by "financial information".

(d) Our comments below are based on the premise that the relevant provisions are confined to accountants' reports and do not cover periodic reports, which should already have been covered by Schedules 4 and 5.

(i) Opinion to be given by reporting accountants

We consider it inappropriate to state that "*accounts shall not be regarded as duly audited or reported upon unless the auditors or reporting accountants state in their report whether in their opinion the accounts give a true and fair view* …" (para. 6). We would like to point out that reporting accountants do perform engagements that do not require them to express a true and fair view opinion, such as reporting on combined accounts, stub period comparatives, pro forma financial information, etc.

(ii) Reference to previous auditors

Para. 7(a) requires reporting accountants to state in their report whether or not the accounts for the period reported on have been audited by any other accountants and, if so, by whom. This requirement is applicable under the current reporting framework. However, it will not be applicable under the proposed new reporting framework, mentioned above, under which reporting accountants will take on the responsibility of expressing an opinion on the historical financial information for the whole track record period, regardless of whether the historical financial information has previously been audited.

We suggest that para. 7 of the draft SMLR should be dropped. While we do not disagree that such disclosures may provide investors with additional useful information, this information should be disclosed elsewhere in the investment circular instead of in the body of the reporting accountants' report.

5. <u>Schedule 5 – Contents of Periodic Reports and Announcements</u>

(a) Both the draft SMLR (para. 6) and the current Listing Rules (para. 13 of Appendix 16) require an issuer to provide a statement in its annual report, showing the interests and short positions of each of its director, supervisor and chief executive in the shares in or debentures of the issuer, or any of its associated corporation, as at the balance sheet date. The Listing Rules also provide that such compliance may be modified or waived in respect of any associated corporation if, in the opinion of the Exchange, the number of associated companies in respect of which each director and chief executive is taken or deemed to have an interest or short position is such that compliance with this requirement would result in particulars being given that were not material in the context of the group and were of excessive length.

Since the SMLR does not provide for any modification or waiver of such compliance, it is uncertain whether the Listing Rules' provision would still be applicable.

(b) Paras. 46(c), 46(f) and 48(c) require disclosure of notes or supplementary information which is necessary for a reasonable appreciation of the results of the group. It is unclear how the term "necessary" is to be interpreted under the draft SMLR. The test of "necessity" may be different from the current Listing Rules, which specifically state that disclosure is required if the information, <u>in the opinion</u>

of the directors, is necessary/is considered by the directors to be necessary, for a reasonable appreciation of the results of the group.

6. Schedule 5, Part 2 – Banking Companies

The disclosure requirements for banking companies should be updated to bring them in line with the existing HKFRS. Specific disclosure items that need to be updated are set out below. Alternatively, given that Hong Kong Accounting Standard (HKAS) 30 *Disclosures in Financial Statements of Banks and Similar Financial Institutions* applies to banking companies, consideration may be given as to whether this part is still needed.

(a) *Paragraph 33(2)(f), (g) and (h):*

Trading securities, non-trading securities, investment securities, other securities and held-to-maturity securities are the classifications of securities under Statement of Standard Accounting Practice (SSAP) 24 *Investments in Securities.* Since SSAP 24 has now been superseded by HKAS 32 *Financial Instruments: Disclosure and Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement*, the disclosure should be updated to bring it into line with the classifications of financial instruments under the relevant HKAS.

(b) *Paragraph 33(2)(i):*

Disclosure of exceptional items is no longer acceptable under HKFRS and therefore should be removed.

(c) *Paragraph 33(2)(j):*

The term “affiliates” is not a term used in HKFRS.

(d) *Paragraph 33(2)(l):*

Dividend proposed should no longer be recognised in the income statements and should, therefore, be removed.

(e) *Paragraph 33(3)(b) and (d):*

As for item 6(a) above.

(f) *Paragraph 33(4)(b):*

Derivatives are no longer an off-balance sheet exposure, as they are now required to be recognised in the financial statements under HKAS 39.

7. Schedule 5, Part 3 – Financial Conglomerates

The disclosure requirements should be updated to bring them into line with the existing HKFRS. Specific disclosure items that need to be updated are set out below.

(a) *Paragraph 34(2)(d), (h) and (i):*

As for as item 6(a) above.

(b) *Paragraph 34(3)(b),(d),(g)(i)(D)and (h):*

As for item 6(a) above.

(c) *Paragraph 34(4)(b):*

As for item 6(f) above.

8. Proposed substantive changes from the current Stock Exchange Listing Rules

Our comments on the proposed substantive changes set out in Part C of this Appendix should also be taken on board.

II. Other comments

1. Part 3 paragraph 7A – Disclosure obligations of listed corporations

   It is not clear why collective investment schemes, which have been authorised under section 104 of the Securities and Futures Ordinance, should not be required to comply with the provisions of Schedules 2 to 8 of the SMLR.

2. Schedule 1 - Interpretation

   (a) *"associate"*

   In relation to a corporation, it is noted that the draft SMLR defines "associate" as "*…, are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power …*" It is not clear why the draft SMLR refers specifically to a threshold of 30 per cent, whereas the relevant accounting standard (HKAS 28) defines "associate" as an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. If an investor holds, directly or indirectly, 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence.

   Such a difference in the definition of "associate" could be confusing to the market.

   (b) *"audit committee"*

   We should like to point out that, in February 2002, the Institute published *A Guide for Effective Audit Committees*, which updated and superseded *A Guide for the Formation of an Audit Committee*, which was published by the Institute in 1997. Accordingly, we would suggest that reference be made to the more recent guidance on audit committees. In addition, the reference to HKSA in the draft SMLR should be changed to HKICPA.

   As regards the definition, we would suggest it be revised to "*means a committee of the board of directors of an issuer which reviews the effectiveness of the financial reporting process, internal control and risk management systems and oversees the audit process of the issuer's financial statements*".

   (c) "IFRS"

   IFRSs are published by the International Accounting Standards Board and not the International Auditing and Assurance Standards Board of the International Federation of Accountants.

3. Schedule 2 – Disclosure of Price Sensitive Information

   (a) Para. 18 requires prompt disclosure to the public of any change in the status of a director or supervisor. In our view, "any change in the status" is too wide a term as status could refer to information that may not be relevant to the public, e.g., marital status. We consider that the scope of the term "status" should be made clear.

   (b) Para. 18(e) requires disclosure of a director's relationships with any other directors, supervisors or substantial or controlling shareholders of the issuer and any senior manager of the group. We consider that it is more appropriate to follow the wording used in the Listing Rules (Rule 13.51(2)(e)), i.e., relationship with "senior management" rather than with any senior manager of the group.

(c) The term “asset” in para. 28 should be clearly specified, as in the current Listing Rules (Rule 13.25(2)), to be “total asset”, in order to avoid any potential confusion with net asset, net tangible asset, etc.

(d) In para. 33(2)(b), the average closing price of securities is calculated by averaging the price for five business days, instead of five trading days as in the Listing Rules (Rule 13.36(5)(b)). Although it may be very rare and unusual, it is possible that a business day may not be a trading day. We suggest further clarification of “business/trading days” to make it clear that this refers to the days on which the Exchange is open for the trading of securities.

4. Schedule 3 – Accountants’ Reports and Financial Information

(a) It is more appropriate for the heading, above para. 1, be changed to “Accounts to Conform to Applicable Reporting Standards”, as all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards, Statements of Standard Accounting Practice and Interpretations issued by the Hong Kong Institute of Certified Public Accountants are now collectively known as "Hong Kong Financial Reporting Standards".

(b) Para. 1 states: “Where accounts are required to be prepared, audited, or reported upon under these Rules, they shall conform with either HKFRS or IFRS.” This appears to allow listed entities a free choice to adopt either IFRS or HKFRS for financial reporting. However, a legal opinion, which we obtained in 2001 regarding “true and fair”, indicated that accounts prepared in accordance with IFRS might not satisfy the “true and fair” requirement under the Companies Ordinance. We would suggest that listed entities should be alerted to this, in the form of a note or guidance to this provision.

(c) The term “practising accountant of good standing” in paragraph 4 is not defined and its meaning needs to be clarified.

(d) We would like to draw to your attention the fact that “a recognised body of accountants” referred to in paragraph 4(b) is not necessarily a licensing body.

5. Schedule 5 – Contents of Periodic Reports and Announcements

(a) We consider that, to avoid ambiguity, the term “major customers” and “major suppliers” in para. 28 should be further clarified and given the meanings specified in para. 31 of Appendix 16 of the Listing Rules.

C. Proposed substantive changes from the current Stock Exchange Listing Rules

1. Disclosure of directors' dealings during delay in disclosure of price-sensitive information

Corporate finance practitioners among our members have expressed concern about making the disclosure of price-sensitive information a statutory obligation. They consider that decisions on whether particular information is price-sensitive, at any given time, often require a judgement call. Such decisions may involve a significant degree of subjectivity and it would put directors and corporate finance practitioners/advisers in an invidious position if a judgment made in good faith were, potentially, to render them liable to severe, possibly even criminal, sanction.

2. No need to explain differences between HKFRS and IFRS

The Institute supports the proposal not to adopt the current Listing Rule requirement for an issuer adopting IFRS to disclose and explain the differences between IFRS and HKFRS that have significant effect on its financial statements, and to compile a statement of the financial effect.

3. Disclosure of properties by general description

As regards the information to be contained in the general description statement, it is noted that the current draft SMLR requires "*a general description, by categories and groupings if appropriate, of the properties including their locations and uses*." (para. 17(2)(a), Schedule 5) It is not sufficiently clear what information is expected to be disclosed in the general description statement and, in this respect, we would suggest that the SFC should further specify the information to be disclosed therein.

4. References to supervisors for Mainland issuers

The Institute does not have any objection to the statutory rules being drafted to the effect that directors of an issuer would include supervisors of Mainland issuers.

5. Aggregate of related transactions

The Institute does not have any problem in respect of aggregating related transactions, provided that the criteria for aggregation are clearly spelt out.

6. Disclosure of the counterparty and its beneficial owners

We are of the view that disclosing the name of the counterparty to a transaction and its beneficial owners might be of little informative value. Furthermore, in some circumstances, it might be commercially sensitive to disclose identities.

We consider that, rather than the identity, it would be more important to require listed companies to give a clear and concise description of the counterparty, such that the public could easily understand the transaction and the relationships (e.g. business, financial, etc) between the parties.

7. Disclosure of the relevant percentage ratios and the underlying calculations

In our view, there would not be any added benefit in disclosing the relevant percentage ratios and the underlying calculations in announcements for notifiable transactions, as reasonable reliance should be able to be placed on the issuer/financial adviser to have properly categorised a notifiable transaction.

8. Disclosure of profit forecast

While we do not have any objection to the proposal, we consider that the SFC should make clear the requirements for a profit forecast.

9. Disclosure of competing business of proposed directors

The Institute is supportive of the proposal to require disclosure of any competing business(es) of proposed directors. This would improve transparency.

10. In-laws, grandparent, grandchild, uncle, aunt, cousin, nephew and niece as associates

In our view, the proposed "catch-all" is too wide. We do not agree with the presumption that all the parties referred to above are associates of the individual concerned.

11. Aggregate of continuing connected transactions

The Institute does not have any objection to the proposal to aggregate all continuing connected transactions with a single connected party, provided that the criteria for aggregation are clearly spelt out. However, the exception provision requires further clarification/explanation by the SFC.