

Hon Mandy Tam's Submission
on the Consultation Paper Regarding
Accounting and Auditing Provisions of the Rewrite of
The Companies Ordinance

Introduction

The commercial sector and the accounting profession have been advocating the rewrite of the Companies Ordinance since the 1990s. It is appreciated that a public consultation has been launched by the government so that our society can express its views on this important issue which affects the foundation of Hong Kong's economy and its status as an international financial centre.

This submission aims at proposing some principles and points to note relevant to the rewrite of the ordinance. It also elaborates the rationale behind each principle proposed.

Major Proposals

1. Standard Setting

Certain disclosure requirements and technical accounting standards are currently stated in both the Companies Ordinance and Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) or in the Listing Rules of the Hong Kong Exchanges and Clearing Limited (HKEx). Such overlapping in both legislation and regulations may be contradictory or lead to confusion. Hence, it is proposed that the new Companies Ordinance excludes some requirements and technical standards which have already been included in the HKFRSs or the Listing Rules.

Such confusions may arise when there are amendments in some accounting standards and Listing Rules which may appear more frequently than do amendments in the related legislation. The time lag between the amendments may lead to two sets of regulatory measures which could be contradictory.

Furthermore, in the long term, the setting of disclosure requirements and accounting standards should be left to the HKICPA and the HKEx. Alternatively, we can consider establishing an independent body responsible for setting accounting standards which includes representatives from the government, accounting professional bodies, HKEx, Securities and Futures Commission and other independent members from the accounting profession.

2. Segmentation of Corporations and Transformation of Audit into a Statutory Review

The government suggests in the consultation paper that corporations should be segmented into large corporations and SMEs according to size with thresholds of turnover, assets and employees, and that two sets of different financial reporting standards be imposed on the two types of corporations. However, this manner of segmentation may cause difficulties to both enterprises and accountants.

Experience in some overseas countries, including the United Kingdom, has suggested that the definition of SMEs may vary frequently every three or four years when taking account of recommendations of EC Directives. Such variation is prompted by the effects of inflation, deflation and economic cycles. For those corporations with a size near to the category margins, such a variation of definition may lead to a change of disclosure requirements imposed on them and cause difficulties.

It is suggested that corporations be segmented according to the level of their relativity to the public interest. Under such a benchmark, corporations may be segmented into two categories: (1) self-owned companies or limited interest companies; and (2) public interest companies.

Self-owned companies are defined as companies in which not less than 75% of the shares are controlled by the directors, officers and the related parties. Such companies are less related to public interest and a moderate level of assurance of their financial statements is acceptable by the limited user groups. Therefore, it is proposed that the audit requirements imposed on such companies be replaced by statutory review requirements, which provide a moderate level of assurance to financial statements. The standards of such a report may be set according to the review engagement standards adopted universally.

Public interest companies are defined as follows: (a) listed companies; (b) companies with less than 75% of shares controlled by its directors, officers and related parties; (c) charitable agencies; (d) banks and financial institutes, (e) insurance companies, (f) investment brokers etc. Financial reports of a higher level of assurance should be imposed on such companies.

The audit requirements may, therefore, be kept for these companies and tightening of some requirements may also be considered.

3. Non-compliance of the Ordinance

Currently, companies, including shareholders, are penalized instead of the directors when there is non-compliance of the Ordinance. The new legislation should ensure that the responsibility for non-compliance rests with the directors.

The Consultation Paper also proposes that the inspection right of non-compliance may be opened to "other officers" such as managers and secretaries. However, such a proposal should be considered very carefully. Firstly, the proposal does not clearly define the term "other officers", including that of "managers". Secondly, if we open the right of inspection to "other officers", such individuals may get access to confidential commercial information, such as payroll, to which they are not entitled

4. Progress of Rewrite of Ordinance

It is understood that the current proposal to rewrite the Companies Ordinance is mainly based on the last rewritten Companies Act of the United Kingdom. If so, the progress of the rewrite should be accelerated as the United Kingdom is now further rewriting the Companies Act. We are lagging far behind; the gap between the global standard and ours will become increasingly wide if we do not speed up our progress.

5. Replacement of the Concept of True and Correct View

The term "True and Correct" view under Section 141D of the Company Ordinance is misleading. The word "Correct" has been replaced by "Fair" since the 1948 Companies Act in the UK, recognizing that it is not possible to certify the "correctness" of accounts as some figures can only be fairly assessed. Depreciation, goodwill, inventory and deferred tax etc, can only be "fairly" estimated, not arithmetically precise and accurate. To keep using this outdated view for audited financial statements (regardless of company size) could give a bad impression to, or mislead, account users. Moreover, the term "True and Correct" is rarely found in international auditing text books today.

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