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Your ref: CB1/BC/3/04

Clerk to Bills Committee on Companies (Amendment) Bill 2004
(Attn: Ms. Connie Szeto)
Legislative Council Secretariat
3/F, Citibank Tower
3 Garden Road, Hong Kong.

Dear Connie,

Bills Committee on Companies (Amendment) Bill 2004

We refer to the letter of 10 January 2005 from the Secretary for Financial Services and the Treasury to the Bills Committee, presenting the FSTB's paper on "Follow-up Actions Arising from the Discussion At the Meeting on 16 December 2004".

As the FSTB paper has been prepared to address many of the comments made by the HKMC on behalf of the securitisation industry, we believe it would be important for us to respond to the comments made in the paper. Enclosed is a copy of the FSTB paper with annotation in upper case to highlight the comments that we would like to submit for consideration by the Bills Committee.

We hope that the Bills Committee will find our comments useful, and we would request attendance before the Committee to facilitate the deliberation by the Bills Committee.

Yours sincerely,

Hong Kong Mortgage Corporation Limited's comments on the paper provided by the Administration

Bills Committee on Companies (Amendment) Bill 2004

Follow-up Actions Arising from the Discussion At the Meeting on 16 December 2004

PURPOSE

At the Bills Committee meeting held on 16 December 2004, Members requested the Administration to consider and provide information on a number of matters relating to the Companies (Amendment) Bill 2004 (the Bill). We have consulted the Department of Justice and Hong Kong Institute of Certified Public Accountants (HKICPA), and set out the relevant information in the following paragraphs.

EXCLUSION OF SUBSIDIARIES FROM GROUP ACCOUNTS

(a) *To consider proposing Committee Stage amendments (CSAs) to the proposed section 124(2A)(a);*

(b) *To review the proposed section 124(2A)(b) of the Companies Ordinance (CO, Cap. 32) and consider proposing a CSA, if necessary; and*

(c) *To review whether amendments to the existing section 124(2) of the CO are necessary.*

2. We agree to review Clause 4 of the Bill (containing the proposed sections 124(2A)(a) and 124(2A)(b)), alongside the existing section 124(2) of the CO, in the light of the United Kingdom (UK) Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 and the latest changes to International Accounting Standard (IAS) 27. The proposed CSAs will be available for Members' discussion when the Bills Committee proceeds to the clause-by-clause examination of the Bill.

IMPACT OF THE BILL ON THE ASSET-SECURITIZATION MARKET IN HONG KONG

(d) *Administration's assessment on the impact of the Bill on the asset-securitization market in Hong Kong.*

3. We note that, as relayed to us by the Hong Kong Mortgage Corporation Limited (HKMC) and Hong Kong Capital Markets Association (HKCMA), the asset-securitization industry is primarily concerned about the requirement for group accounts to consolidate accounts of special purpose entities (SPEs) established and controlled dominantly by a company for the purpose of asset-securitization. While the need to enhance transparency in financial reporting is in-principle supported, the industry considers that such consolidation would deprive the asset-securitization market of the off-balance-sheet treatment in the presentation of financial statements. As a result, this would discourage *some* securitization transactions which, according to the HKMC and HKCMA, are driven primarily to take benefit of off-balance-sheet treatment. As a result, the asset-securitization industry claims that the Bill might put Hong Kong in a disadvantaged position vis-à-vis other international financial centres.

4. The Administration, in consultation with the HKICPA[1], has considered the above line of argument carefully. In the first place, it is necessary to emphasize that Government attaches great importance to the development of the securitization market, which forms part of our continuing effort to reinforce Hong Kong's position as an international financial centre. Government's specific initiatives in recent years include the streamlining of the company prospectuses requirements, the securitization of revenues from government toll tunnels and bridges, and investor education.

HKMC'S COMMENT: FIRST, THE ADMINISTRATION'S CONSULTATION WITH ONLY THE HKICPA IN DRAWING UP THIS SET OF COMMENTS TO THE BILLS COMMITTEE DEMONSTRATES ITS UNWILLINGNESS TO CONSULT MORE

[1] The HKICPA is empowered, pursuant to section 18A of the Professional Accountants Ordinance (Cap. 50), to issue accounting standards required to be observed, maintained or otherwise applied by any certified public accountants. These accounting standards are referred to as the "Hong Kong Financial Reporting Standards (HKFRSs)" collectively. Hong Kong Accounting Standard (HKAS) 27 "Consolidated and Separate Financial Statements" is one of the HKFRSs, and is equivalent in all material aspects, including the definition of "subsidiary", with IAS 27 "Consolidated and Separate Financial Statements".

EXTENSIVELY THAN BEFORE, INCLUDING E. G. THE HONG KONG CAPITAL MARKETS ASSOCIATION AND THE ASIAN SECURITISATION NETWORK WHICH COMPRISES AROUND 200 PROFESSIONALS FROM INVESTMENT BANKS, ACCOUNTING FIRMS AND LAW FIRMS ETC. WHICH SPECIALISE IN SECURITISATION. SECONDLY, THE SPECIFIC INITIATIVES MENTIONED BY THE GOVERNMENT WITH RESPECT TO THE "STREAMLINING OF THE COMPANY PROSPECTUSES REQUIREMENTS" WERE IN FACT MADE AT THE INSTIGATION OF THE HKMC WHEN IT FIRST SUBMITTED ITS "ROADMAP" FOR SIMPLIFICATION OF THE PROSPECTUS REGIME TO THE SECURITIES AND FUTURES COMMISSION AND THE ADMINISTRATION IN JANUARY 2002. THIRDLY, WHILST SUCH INITIATIVES IMPLEMENTED BY THE GOVERNMENT ARE LAUDABLE SINCE THEY HELP TO CUT DOWN RED TAPE, UNFORTUNATELY THE CURRENT INITIATIVE PROPOSED BY THE ADMINISTRATION COULD HAVE THE EFFECT OF STIFLING THE DEVELOPMENT OF THE SECURITISATION MARKET BY DEPRIVING ORIGINATORS OF THE OFF-BALANCE SHEET ACCOUNTING TREATMENT WHICH IS A MAJOR DRIVER FOR MANY SECURITISATION TRANSACTIONS.

5. However, we are not convinced that the proposed amendments to the definition of "subsidiary" in the CO for the purpose of group accounts would put Hong Kong in a disadvantaged position in the development of the asset-securitization market. To appraise this issue will require putting the nature of the asset-securitization business in a proper context. Asset securitization is a useful financing tool, whereby originators of securitization transactions benefit from lower-cost financing, optimization of the use of the company capital, improved liquidity, a source for long-term matching of funds and the securitized assets, etc. There are a host of factors contributing to the development of asset-securitization market in Hong Kong. The "off-balance-sheet" accounting treatment should not be equated to be the "oxygen" to the asset-securitization market.

HKMC'S COMMENT: THIS IS PRECISELY WHERE THE ADMINISTRATION AND THE SECURITISATION INDUSTRY ARE AT THE OPPOSITE ENDS OF THE SPECTRUM. THE SECURITISATION INDUSTRY REGARDS "OFF-BALANCE SHEET" ACCOUNTING TREATMENT AS A COROLLARY OF SECURITISATION, WHEREAS THE ACCOUNTING PROFESSION REGARDS IT AS AN ATTEMPT TO FRUSTRATE THE PURPOSE OF

ACCOUNTS TO SHOW A "TRUE AND FAIR" VIEW. BUT WHY SHOULD NOT ASSETS SOLD BY THE ORIGINATOR TO THE SPE BE REMOVED FROM THE BALANCE SHEET OF THE ORIGINATOR WHEN THE TITLE, OWNERSHIP AND RISKS ASSOCIATED WITH THOSE ASSETS HAVE BEEN ENTIRELY PASSED TO THE SPE? DOES NOT INSTEAD THIS REPRESENT A BETTER "TRUE AND FAIR VIEW" OF A SECURITISATION TRANSACTION? FINANCIAL REGULATORS LIKE THE HKMA AND AUSTRALIAN PRUDENTIAL REGULATORY AUTHORITY HAVE INDEED TAKEN THE STANCE THAT THE OFF-BALANCE SHEET TREATMENT IS A BETTER REFLECTION OF THE STATE OF AFFAIR AT THE ORIGINATOR COMPANY.

Under this context, our views on the impact of the Bill on the asset-securitization market are elaborated below -

(a) Quality and reliable financial reporting is a key to the underpinning of investors' confidence. Insofar as the financial reporting requirements of companies are concerned, it is imperative for Hong Kong to consistently and constantly upgrade her regime in line with internationally recognized financial reporting standards. This objective is equally, if not more, important in order to sustain the financial integrity of Hong Kong as a healthy international financial centre attracting market liquidity of securities and business transactions of all kinds.

HKMC'S COMMENT: HARMONISATION WITH THE IAS/IFRSs SHOULD NOT BE AN END IN ITSELF. THE EU HAS SHOWN THIS IN THE CASE OF IAS 39 WHERE DUE TO OBJECTIONS FROM A NUMBER OF EUROPEAN COUNTRIES, THE ACCOUNTING STANDARD WAS ADOPTED WITH SPECIFIC CARVE-OUTS TO ADDRESS THE CONCERNS OF CERTAIN SPECIFIC SECTORS. IN THE CASE OF THE EFFECTS OF IAS 27 AND 39 ON SECURITISATION, THE AUSTRALIAN SECURITISATION FORUM, THE AMERICAN SECURITISATION FORUM AND THE EUROPEAN SECURITISATION FORUM HAVE COMMENCED A PROJECT, WITH THE ENDORSEMENT OF THE IASB, TO DEVELOP A NEW MODEL FOR ACCOUNTING FOR SECURITISATION TRANSACTIONS.

Despite its reservations, the asset-securitization industry, together with most respondents consulted by the Bills

Committee, has not disputed that it is important to promote a higher degree of transparency for companies by preventing the use of corporate structures to circumvent disclosure of intra-group transactions. The benchmarks we are adopting are the International Financial Reporting Standards (IFRSs), which are promulgated by the International Accounting Standards Board (IASB)[2]. Aligning our CO's definition of "subsidiary" more closely with that adopted in IAS 27 will improve the transparency and quality of accounts.

HKMC'S COMMENT: THE ADMINISTRATION ARGUES THAT THE RATIONALE FOR THE LEGISLATIVE CHANGE IS TO IMPROVE THE TRANSPARENCY, QUALITY AND INTEGRITY OF THE ACCOUNTS. BUT THEN IT GOES ON TO CONTRADICT ITSELF BY ITS OWN STATEMENT IN LINE 2 OF PARA. 5(D) BELOW, I.E. 'THE CHANGES INTRODUCED BY THE BILL TO FINANCIAL STATEMENTS LIE PRIMARILY WITH THE FORMAT OF THE PRESENTATION, AND NOT WITH THE CONTENT OR AMOUNT OF THE DISCLOSURE IN THE ACCOUNTS." THE HKMC'S ARGUMENT IS THAT IF THE CHANGE IS ONLY IN THE FORMAT BECAUSE THE INFORMATION IS ALREADY SHOWN IN THE FOOTNOTES, WHY TAKE THE TROUBLE TO FORCE THIS CHANGE WHICH IS NOT SUPPORTED BY THE INDUSTRY AND THE HONG KONG MONETARY AUTHORITY? THE HKMC ALSO ARGUES THAT THE CHANGE WOULD ALSO AFFECT THE FINANCIAL RATIOS AND ANALYSTS' PERCEPTION OF THE RISKS RETAINED ON THE ORIGINATOR'S BALANCE SHEET AND COULD LEAD TO INVESTORS SHUNNING A COMPANY WITH "POOR" FINANCIAL RATIOS, NOTWITHSTANDING ANY DISCLOSURE IN THE NOTES TO THE ACCOUNTS, SIMPLY BECAUSE THEY MIGHT NOT WISH TO BOTHER TO DEFEND ITS DECISION TO INVEST IN SUCH COMPANY. THIS IS WHY THE INDUSTRY OBJECTS TO THE PROPOSED CHANGE. THE REGULATOR HKMA ALSO DIFFERS FROM THE HKICPA ON THE IMPACT OF THIS CHANGE.

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[2] The International Accounting Standards Board (IASB) is the most widely recognized accounting standard-setter in the world. The IASB is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world. The IASB publishes its standards in a series of pronouncements called International Financial Reporting Standards (IFRSs). IAS 27 "Consolidated and Separate Financial Statements" is one of these pronouncements. According to the IASB, the IFRSs have achieved wide recognition in over 90 jurisdictions which have implemented these standards by 2005.

(b) We believe that the primary objective of financial reporting is to show the true and fair view of the company's results and state of affairs. We should be mindful that other considerations (for example, market development) should not take precedence over this primary objective in the formulation of financial reporting requirements in law and accounting standards. **The means and the ends would easily be mixed up if a so-called "favourable" accounting method is treated as a key driver to boost a particular sector without much regard to the primary objective that financial reporting serves in the first place.** While the Administration supports the development of the asset-securitization industry, we do not believe that this should be done at the expense of the primary objective that the group accounts should reflect the true and fair view of the results and the state of affairs of a parent company and its subsidiaries as a whole group. This is because allowing off-balance-sheet accounting treatment for certain subsidiaries (such as securitization SPEs) may result in distortion of financial statements of the group as a whole to the extent that they do not show a true and fair view.

HKMC'S COMMENT: THE ADMINISTRATION ACCEPTS HKICPA'S STANCE ON WHAT CONSTITUTES A "TRUE AND FAIR VIEW OF THE RESULTS AND THE STATE OF AFFAIRS OF A PARENT COMPANY AND ITS SUBSIDIARIES AS A GROUP". CERTAIN MEMBERS OF THE ACCOUNTING PROFESSION TOOK THE VIEW THAT THE CONTROL-BASED DEFINITION OF SUBSIDIARY PRESENTS A TRUE AND FAIR VIEW AND THEREFORE THE REST OF THE WORLD SHOULD FOLLOW. THE HKMC'S SUBMISSION IS THAT A "TRUE AND FAIR VIEW" SHOULD DEPICT THE RISKS RETAINED BY THE ORIGINATOR AND NOT THE RISKS THAT HAVE BEEN LAID OFF THROUGH ASSET SECURITISATION.

(c) **At present, non Hong Kong-incorporated companies that are primarily listed in Hong Kong are already required to comply with IFRSs or HKFRSs[3], including IAS 27 or**

[3] This is a requirement stipulated in the Listing Rules which are made by the Stock Exchange of Hong Kong Limited and subject to the approval by the Securities and Futures Commission under the Securities and Futures Ordinance (Cap. 571).

HKAS 27, which use the same approach in defining "subsidiary" as that proposed in the Bill. The Bill will thus contribute towards a higher degree of consistency relating to the format of the accounts of Hong Kong-incorporated companies and non-Hong Kong companies that are primarily listed on the Stock Exchange of Hong Kong. It is only because of the "gap" between the CO and HKFRSs / IFRSs that an interim arrangement has been set up in HKAS 27 whereby **Hong Kong-incorporated companies** shall make **disclosure in the notes to the accounts** in respect of the "subsidiaries" that are excluded from consolidation by virtue of the statutory requirements but would have been required to be consolidated by virtue of the accounting standard requirements. Moreover, we wish to reiterate that there is no question of competitive disadvantage to Hong Kong vis-à-vis the European Union (EU), Singapore and Australia. These jurisdictions have all adopted the proposed "control-based" approach for the definition of "subsidiary" in IAS 27 in their own company laws or statutorily backed accounting standards[4]. In fact, this approach to the definition of "subsidiary" has been reaffirmed by the IASB. In its latest deliberations at the November 2004 Board meeting, the IASB has emphasized that "*the Board's intention is that the consolidation principles it develops would apply to all entities, including SPEs*". The IASB has also reaffirmed that "*consolidation should be based on the notion of control*" and that "*control of an entity is the ability to direct the strategic financing and operating policies of an entity*[5]". Accordingly, **should the Bill be passed, Hong Kong-incorporated companies would be required to present the effects of securitization transactions on exactly the same basis as our counterparts in these jurisdictions.** If we insist on staying with the *status quo*, we will only risk hampering comparison of group accounts of Hong Kong-incorporated companies (including companies in the asset-securitization industry) with those of these jurisdictions.

HKMC'S COMMENT: THE ADMINISTRATION ARGUES THAT

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4 The EU requires all companies listed on the regulated markets in the EU to prepare their group accounts on the basis of IAS 27 starting from 1 January 2005, whereas the definition of "subsidiary" in IAS 27 applies to all companies in Australia and Singapore.

5 A paper – *Consolidation (including special purpose entities)*, issued by the IASB on 23 November 2004 to reflect the decisions up to and including the November 2004 Board meeting.

FOLLOWING THE IAS 27 WOULD ALLOW COMPARABILITY WITH COUNTRIES FOLLOWING IAS 27. BUT IT IS EQUALLY TRUE THAT THIS WOULD MEAN THE COMPARABILITY WOULD FAIL FOR COUNTRIES LIKE US, JAPAN AND KOREA THAT DO NOT FOLLOW IAS 27. THE FACT IS THAT IASs OR IFRSs ARE NOT UNIVERSAL STANDARDS. AS MENTIONED ABOVE, THE IASB HAS ENDORSED A GLOBAL PROJECT, HEADED BY CHAIRS FROM THE AUSTRALIAN, EUROPEAN AND THE AMERICAN SECURITISATION FORUMS, TO DEVELOP A NEW MODEL FOR ACCOUNTING FOR SECURITISATION TRANSACTIONS. THIS ENDORSEMENT IS SURELY AN IMPLICIT RECOGNITION OF THE INADEQUACY OF THE CURRENT IAS/IFRS FRAMEWORK.

(d) It is important not to exaggerate the impact of the Bill on financial statements. **The changes introduced by the Bill to financial statements lie primarily with the format of the presentation, and not with the content or amount of the disclosure in the accounts. This observation was also shared by the HKMC** at the Bills Committee meeting held on 16 December 2004. In our view, consolidation will facilitate users of the financial statements to appraise, for their various own purposes, the financial information of **all** entities under the group's **control**, instead of having some subsidiaries' information incorporated into the balance sheet while some other subsidiaries' (i.e. SPEs') information contained in notes to the group accounts. Consolidation will not represent any distortion to financial analysts because all entities consolidated are subject to the **same** criteria in determining the "parent-subsidiary" relationship. Compared to notes disclosure, consolidation will present a much clearer picture as regards the company's leverage hence facilitating interpretation of the accounts. We are not aware of any repercussions in relation to the interpretation of accounts of asset-securitization companies from the experience in other relevant jurisdictions, which have used the same "control-based" approach to the definition of "subsidiary" in their company laws or statutorily-backed accounting standards.

HKMC'S COMMENT: PLEASE SEE COMMENTS ON PARA. 5(a) ABOVE. ALSO, THE PROPOSED APPROACH OF AN ACROSS-THE-BOARD CONSOLIDATION OF SUBSIDIARIES

BASED ON HKICPA'S "CONTROL" APPROACH PLAINLY IGNORES THE FACT THAT CONTROL OF SUBSIDIARIES IS NOT EQUIVALENT TO RISKS/RESPONSIBILITIES OF THE ORIGINATOR. FURTHERMORE, AS MENTIONED IN FOOTNOTE 5, THE IASB IS CURRENTLY RE-EXAMINING THE CONCEPT OF "CONTROL". WE SHOULD NOT THEREFORE PRE-EMPT THE RESULTS OF THEIR DELIBERATIONS.

6. In short, if there is any impact at all, it may be argued that the Bill may affect some companies which currently consider it expedient or beneficial to remove securitization transactions from the face of the balance sheet. However, this should not have a bearing on **genuine securitization transactions** which indeed are a very useful financing tool. Given that the same information for such SPEs is already provided in the notes to the accounts of securitization companies, we have difficulties in appreciating HKMC's opinion, as set out in its letter dated 22 December 2004 to the Chairman of the Bills Committee, that the Bill would "be extremely detrimental to Hong Kong's ambition to develop itself as a regional centre for securitization business".

HKMC'S COMMENT: THE ARGUMENT HERE GIVES A WRONG IMPRESSION OF WHAT CONSTITUTES "SECURITISATION TRANSACTIONS". BY DEFINITION, SECURITISATION INVOLVES THE ORIGINATOR/SELLER TAKING OFF ITS OWN BOOKS (I.E. OFF-BALANCE SHEET TREATMENT) THE ASSETS SOLD TO AN SPE. WITHOUT OFF-BALANCE-SHEET TREATMENT, THERE WOULD BE NO "GENUINE SECURITISATION TRANSACTIONS" AS ALLEGED ABOVE.

PLEASE REFER TO AN ARTICLE BY IAN GIDDY ON "ASSET SECURITISATION IN ASIA" WHICH IS A USEFUL GUIDE ON THE BASIC ELEMENTS OF SECURITISATION AND ITS ASSOCIATED BENEFITS, AND CAN BE FOUND AT http://pages.stern.nyu.edu/~igiddy/ABS/absasia.pdf

7. We note that the HKMC in the aforementioned letter has made additional comments on the Administration's responses to its earlier comment (see LC Paper No. CB(1)465/04-05(03)). We set out our further responses thereto at **Annex**.

(e) Administration's further response to the following proposals raised by the HKMC -

(i) *Carve-out for securitization SPEs;*
(ii) *Adoption of the UK's "linked-presentation" format for group accounts; and*
(iii) *Deferring the Bill until the IASB has completed the review of whether the "control" model for subsidiaries should also be applied to SPEs.*

(f) *In connection with item (e) above, any other proposals put forward by the Administration to address the concern about the impact of the Bill on the asset-securitization market in Hong Kong.*

A Carve-out?

8. We do not consider a **carve-out** specifically catered for a particular sector, say, the asset-securitization industry, tenable. As advocated by the IASB, the "control-based" approach should apply to any company vis-à-vis any of their subsidiaries, irrespective of the types of transactions at stake. We believe that such a carve-out will not be consistent with the purpose of presenting a "true and fair view" of the group's position in its accounts. Moreover, no carve-out, in relation to the preparation of group accounts, is provided in any jurisdictions that adopt IFRSs.

HKMC'S COMMENT: AS ARGUED BEFORE, THE HKICPA'S CONCEPTION OF "TRUE AND FAIR VIEW" BECOMES THE OVERRIDING CONSIDERATION THAT DRIVES THE PRESENTATION OF ACCOUNTS, WHICH IS MADE TO BECOME AN END IN ITSELF. THIS IS NOTWITHSTANDING THAT THIS PARTICULAR "TRUE AND FAIR VIEW" AS INTERPRETED BY THE HKICPA IS NOT SUPPORTED BY THE AUSTRALIAN AND HONG KONG FINANCIAL REGULATORS.

9. The "carve-out" proposal, if adopted, will create an inequality of treatment of consolidation between securitization companies and other companies adopting either HKFRSs or IFRSs, and will affect adversely the comparison of financial statements across companies.

HKMC'S COMMENT: SYNCHRONISATION OF TREATMENT IS HELD OUT AS THE PRE-EMINENT OBJECTIVE, WITHOUT REGARD TO THE ACTUAL PURPOSE AND JUSTIFICATION OF THE STANDARDS AND STATEMENTS OF ACCOUNTS THEMSELVES.

10. According to the HKICPA, the accounting standards in Hong

Kong have all along been close to the model developed by the IASB. The IFRSs issued by the IASB are much different than the US accounting standards. We are not aware that any other jurisdictions following IFRSs will apply the concept of "Qualifying Special Purpose Entities (QSPEs)" found in the US accounting standards. The US accounting standards provide an exemption for the consolidation of the accounts of SPEs set up for securitization purposes. In fact, **the concept of QSPEs under the US accounting standards has been questioned in the wake of Enron**. Nor would the accounting standards of Japan or Korea, in the HKICPA's view, constitute a suitable benchmark for Hong Kong. In fact, Hong Kong's company law originates from the UK company legislation. Besides, we are aware that the accounting standards setting boards in the US and Japan have announced that they will actively collaborate with the IASB in a bid to converge their accounting standards with IFRSs.

HKMC'S COMMENT: THE FACT IS THAT AFTER THE ENRON CASE, THE US REVIEWED THE ACCOUNTING STANDARDS BUT DECIDED TO RETAIN THE "QUALIFYING SPE" TREATMENT. AS REGARDS THE ALLEGED CONVERGENCE OF THE US AND JAPAN'S ACCOUNTING STANDARDS WITH IAS/IFRSs, THIS IS GENERALLY UNDERSTOOD TO BE A POLITICAL STATEMENT AND NOTHING CONCRETE HAS HAPPENED SO FAR.

"Linked presentation method"?

11. The "linked presentation method" in the UK essentially means reflecting in the balance sheet the securitized loans as a deduction from the gross amount of the item it finances. As advised by the HKICPA, this is a unique concept in the domestic financial reporting standards of UK. The IFRSs have not adopted a similar approach for financial reporting. The HKICPA does not consider it appropriate, for the purpose of presenting the "true and fair view" of the group's results and states of affairs, to deviate from the IFRSs and to permit under accounting standards the linked presentation method which is a concept unique to the UK. In fact, starting from 2005, **all listed companies in the UK** are required to **abandon the "linked presentation method"** when preparing their group accounts.

HKMC'S COMMENT: WE ALSO ACKNOWLEDGED THAT THE LINKED PRESENTATION APPROACH USED TO APPLY TO ALL UK COMPANIES, BUT FROM 1 JAN. 2005 ONLY TO LISTED COMPANIES. THIS SERVES TO ILLUSTRATE THE IMPORTANCE OF THE LINKED PRESENTATION OR THE UK AUTHORITIES

WOULD NOT HAVE HAD THIS “CARVE-OUT” TREATMENT BEFORE, AND RETAIN IT NOW FOR NON-LISTED COMPANIES. AS THE ADMINISTRATION ARGUES IN PARA. 10 ABOVE, HK’S COMPANY LAW ORIGINATES FROM THE UK COMPANY LEGISLATION. IN THAT CASE, WHY DOES THE HKICPA INSIST ON NOT FOLLOWING THE UK PRACTICE IN THIS INSTANCE? SHOULD IT NOT INSTEAD BE CONSIDERING WHY THE UK CHOSE TO KEEP THIS LET-OUT ROUTE?

“Wait and see”?

12. We do not consider it appropriate to withhold the Bill given that the “control-based” definition of “subsidiary” proposed in the Bill has been adopted by the IASB since 1990 and was adopted by many jurisdictions in their company laws or statutorily backed accounting standards in the last decade. As far as we are aware, this definition of “subsidiary” for the purpose of group accounts has been well accepted in these jurisdictions over the years. Given that the IASB has reaffirmed this approach on many occasions before and recently, we see it unnecessary to defer the Bill at the expense of the enhancement of the quality of financial reporting for Hong Kong-incorporated companies.

HKMC’S COMMENT: THERE EXIST OF COURSE OTHER JURISDICTIONS LIKE US, JAPAN AND KOREA THAT DO NOT FOLLOW THE IFRSs. ALSO, WE WOULD REITERATE THAT THE PICTURE PAINTED BY THE ADMINISTRATION THAT THERE IS WIDESPREAD ACCEPTANCE OF THE DEFINITION OF “SUBSIDIARY” IN OTHER IAS JURISDICTIONS IS IN FACT FAR FROM BEING SETTLED.

13. While the IASB is, as a regular practice, reviewing IAS 27, its primary focus is on the further guidance for accountants to identify the ultimate controllers of the SPEs. According to the IASB, in relation to the SPEs, the issues under review will include “*the feasibility of identifying the entity ultimately responsible for policy predetermination; the other indicators that might be useful in identifying those ultimately responsible for policy determination; the circumstances in which an entity involved with an SPE post-policy determination might be responsible for an SPE’s liabilities*[6]”. According to the HKICPA, the subject review is more concerned about the application of the “control-based” approach in practice. Given that jurisdictions including

[6] Same as footnote 5.

the EU, Australia and Singapore have not refrained from applying IAS 27 merely because of the review being conducted by the IASB, we do not consider it justified to delay the Bill.

HKMC'S COMMENT: WE UNDERSTAND THAT VARIOUS SECURITISATION INDUSTRY FORUMS ARE GOING TO PURSUE THIS QUESTION OF "CONTROL-BASED" DEFINITION OF SUBSIDIARY WITH THE IASB. THE CASE IS BY NO MEANS CLOSED, ALTHOUGH THE IASB MIGHT LIKE TO THINK THAT IS THE CASE.

OVERSEAS EXPERIENCE

(g) *To provide information on the provisions for SPEs in the preparation of group accounts in relevant legislation, rules and practices adopted by other jurisdictions, including but not limited to, the UK, the US, Australia and Singapore. Please specify whether carve-outs and off-balance sheet treatment are provided for SPEs in other jurisdictions;*

(h) *To provide relevant information in the US by expanding the comparison table attached at Annex A to the Administration's paper on "Follow-up Actions Arising from the Discussion at the Meeting on 8 November 2004" (LC Paper No. CB(1)453/04-05(16)).*

14. We are in the process of collating the relevant information and will submit it for Members' consideration as and when available.

HKMC'S COMMENT: HKMC SUBMITTED ON 10 JANUARY 2005 A COMMUNICATION TO THE BILLS COMMITTEE WITH INFORMATION ON THE PRACTICE IN SOME RELEVANT OVERSEAS JURISDICTIONS.

PROPOSED "TRUE AND FAIR VIEW OVERRIDE" PROVISIONS

(i) *The Administration is requested to consider how the HKMC's concerns over the proposed "true and fair view override" provisions could be addressed.*

15. The HKMC is concerned that the "true and fair view override" provisions in the proposed sections 123(4), 123(4A), 126(4) and 126(5) are not wide enough to enable the asset-securitization industry to evade consolidation in the event that the IASB "liberalizes" the

treatment for consolidating the accounts of securitization SPEs in future. The HKMC points out that the provisions relating to the **definition** of "subsidiary" in the CO are not within the possible ambit to allow "true and fair view override". The HKMC is of the view that the "true and fair view override" provisions are restrictive in nature. Moreover, the HKMC seems to suggest that giving statutory backing to accounting standards as in Singapore and Australia will provide the flexibility to accommodate any futures changes to IFRSs which have a bearing on the CO requirements.

16. The Administration's intention with regard to the proposed "true and fair view override" provisions is that only the Tenth Schedule and other requirements of the CO as to the matters to be included in company's accounts are subject to this "true and fair view override". To further extend the scope of the "true and fair view override" to any other sections in the CO will unnecessarily allow a larger room for discretion beyond what is strictly required in relation to the form and content of the accounts (i.e. the Tenth Schedule) and other CO requirements as to the matters to be included in a company's accounts or group accounts. In this light, we consider that the current proposal for the "true and fair view override" provisions, which are modelled on the UK Companies Act 1985, is appropriate and prudent.

HKMC'S COMMENT: THE HKMC's SUGGESTION OF A BROADER "TRUE AND FAIR VIEW OVERRIDE" IS TO ENABLE A REGIME MORE RESPONSIVE TO CHANGES IN INTERNATIONAL STANDARDS. THE DISCRETION TO INVOKE THE OVERRIDE IS NOT UNFETTERED, AND WILL CERTAINLY BE EXAMINED IN DEPTH BY THE AUDITORS. THE AUDITORS ARE MOST UNLIKELY TO ENDORSE AN OVERRIDE THAT IS NOT FULLY AND ADEQUATELY JUSTIFIED BY THE COMPANY MANAGEMENT.

17. It should be noted that accounting standards in Hong Kong are not given statutory backing. We agree that this is a much broader subject that may need to be looked into separately, if necessary. Under the existing framework, as far as the Bill is concerned, the definition of "subsidiary" is dealt with under the CO. In case there are future changes to the definition of "subsidiary" in IAS 27 which have a bearing on the definition in the CO, legislative changes can be proposed.

HKMC'S COMMENT: THE ADMINISTRATION SUGGESTS THAT LEGISLATIVE CHANGES CAN BE PROPOSED IN FUTURE,

WHERE NECESSARY. BUT THERE WOULD BE A LAGGING EFFECT TO IMPLEMENT CHANGES TO IAS/IFRSs, AND IT IS PRECISELY THIS COMPLICATED APPROACH IN THE CO THAT ENABLES HONG KONG'S COMPETITORS TO DEPLOY CRITICISM AGAINST HONG KONG'S REGIME AND TRY TO ATTRACT COMPANIES TO MOVE THE SECURITISATION BUSINESS TO THEIR JURSIDICTIONS.

18. The HKMC has rightly pointed out that the "true and fair view override" provisions are not intended to be used easily in practice but only in very exceptional circumstances with strong justifications. This position is similar to that under the UK Companies Act 1985. Moreover, as accounts are subject to audits by auditors who have a statutory duty to state whether in the auditors' opinion the accounts have been properly prepared and whether in their opinion a true and fair view is given, this will provide a safeguard to avoid abuses.

Financial Services and the Treasury Bureau
January 2005

Annex

Companies (Amendment) Bill 2004
Administration's Responses to the Submission
dated 22 December 2004
from the Hong Kong Mortgage Corporation Limited (HKMC)

(1) International Financial Reporting Standards ("IFRSs") are accepted internationally

*Summary of **HKMC's comments**[1] dated 9 December 2004*

- *The proposed amendments will make off-balance-sheet treatment, which is a major driver for some transactions, very difficult to achieve. There is a **continuing controversy over the effects of the IFRSs** on the global securitization industry.*

The **Administration's responses** dated 15 December 2004

- IFRSs are **international standards and have been adopted and implemented in over 90 jurisdictions worldwide**. Notably, the EU requires all companies listed on the regulated markets in the EU to prepare their group accounts on the basis of IAS 27 starting from 2005. The Bill will facilitate comparison and interpretation of accounts of Hong Kong-incorporated companies vis-a-vis those in other major financial markets in the world that adopt IFRSs.

*Summary of **HKMC's further comments**[1] dated 22 December 2004*

- ***Some major jurisdictions still do not subscribe to IFRSs**, e.g. USA, Japan, Korea.*
- *In the EU, the adoption of IFRSs is subject to carve-outs to address the concerns of the industry, e.g. there are two carve-outs for IAS 39.*
- *Consultation in Hong Kong was very limited and did not attempt to address the concerns expressed in the submissions of the HKMC and the securitization industry.*
- *The IASB is currently carrying out a project on Consolidation of Special Purpose Entities.*

The **Administration's further responses**

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[1] For details of the comments, please refer to the original submissions from the HKMC.

- The accounting standards in Hong Kong have all along been close to the model developed by the IASB. The IFRSs issued by the IASB are much different than the US accounting standards. The concept of "QSPEs" in the US accounting standards to permit certain securitization companies to adopt the **off-balance-sheet treatment has in fact been questioned in the wake of Enron.** Nor would the accounting standards of Japan and Korea, in the HKICPA's view, constitute a suitable benchmark for Hong Kong. (See paragraph 10 of the paper.)
- There is no carve-out in EU in relation to the adoption of "control-based" definition in IAS 27. For the carve-outs relating to IAS 39, please refer to the Administration's further responses under item (2) below.
- The Administration has actively engaged relevant stakeholders in the preparation of the Bill. In April 2003, we invited comments on the bill from the Hong Kong General Chamber of Commerce, Chinese General Chamber of Commerce, Hong Kong Mortgage Corporation Limited and Hong Kong Capital Markets Association. We have all along been exchanging views with the industry with a view to appreciating their concerns. Moreover, we have consulted the Legislative Council Panel on Financial Affairs on the Bill in April 2003. Members of the Panel did not object to the legislative proposal. According to the HKICPA, it has also consulted its members and other relevant parties before issuing the relevant financial reporting standards.
- On the IASB's regular review, please see paragraph 13 of the paper and Administration's further responses under item (9) below.

(2) Interaction between IAS 39 and IAS 27

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *If the Bill is passed, Hong Kong originators* ***will not only be subject to the provisions of HKAS 39****, which already greatly restricts the scope of off-balance-sheet treatment, but* ***in addition*** *will have to* ***deal with the effect of HKAS 27****, the combined effect of which will make achieving off-balance-sheet treatment more difficult.*

The **Administration's responses** dated 15 December 2004

- In short, **IAS 39 is about the recognition and measurement of financial asset, not consolidation of accounts.** HKICPA advises that IAS 39 is **not particularly relevant** to the Bill which aligns the

definition of "subsidiary" more closely with that in IAS 27.

*Summary of **HKMC's further comments** dated 22 December 2004*

- *The decision tree for the application of HKAS 39 (the Hong Kong equivalent of IAS 39) clearly sets out the requirement to consider the need to consolidate all "subsidiaries" which would have to be interpreted in accordance with the new definition derived from IAS 27.*

The **Administration's further responses**

- According to the HKICPA, it wishes to reiterate that IAS 39 / HKAS 39 is not particularly relevant, as it primarily deals with, among other things, the criteria by which a financial asset should be de-recognized from the balance sheet when the prescribed conditions in relation to the rights to the cash flows and the transfer of risks and rewards are fulfilled. Even when a company consolidates its subsidiaries, the company can still de-recognize the assets from its group's balance sheet when the prescribed conditions are fulfilled. **According to the HKICPA, the two accounting standards should not be mixed up.**
- The European carve-outs involve primarily a **measurement issue** of when the **fair value option** can or must be applied to certain categories of financial liabilities[2]. **This matter has no bearing on the issue of consolidation,** which is the subject of the Bill**.**

HKMC'S COMMENT: THE EXISTENCE OF THE CARVE-OUTS SERVES TO CORROBORATE ONE POINT. THAT IT IS POSSIBLE FOR A MAJOR PLAYER LIKE THE EUROPEAN COMMISSION TO SECURE CARVE-OUTS FROM THE IAS/IFRSs. IT IS ALSO OPEN FOR A (LESS INFLUENTIAL) PLAYER TO DETERMINE WITHIN ITS OWN JURISDICTION HOW IT IMPLEMENTS THE IFRSs. THIS IS WHAT WE ARE REQUESTING THE BILLS COMMITTEE TO ASK THE ADMINISTRATION AND HKICPA TO CONSIDER.

- The EU has not adopted any carve-out in relation to the

[2] In IAS 39, the full fair value option permits entities to designate irrevocably on initial recognition any financial asset or financial liability as one to be measured at fair value with gains and losses recognized in profit or loss. The IASB's principal reason for introducing this option was to resolve certain practical issues associated with IAS 39's mixed measurement model – in particular, those relating to the measurement of debt instruments that fund portfolios of financial instruments that are held for trading. The European Commission considers that this option may require further revision by the IASB and, on a temporary basis, permits a carve-out. The main category of liabilities excluded from fair valuation is companies fair valuing their own debts.

"control-based" approach for the definition of the "subsidiary" under IAS 27.

(3) "True and fair view override" provisions provide effective means to deal with any future discrepancy between CO and IFRSs

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *The Bills Committee may wish to consider whether the "true and fair view override" provisions should be amended to expressly* ***extend its overriding effect over other sections in the CO****, such as the definitions sections.*

The **Administration's responses** dated 15 December 2004

- In essence, our intention is that only the Tenth Schedule and other requirements of the CO as to the matters to be included in company's accounts are subject to this "true and fair view override". **This is modelled on the position in the UK Companies Act 1985.**
- To further extend the scope of the "true and fair view override" to any other sections in the CO will **unnecessarily allow a larger room for discretion beyond which is strictly required** in relation to form and content of the accounts (i.e. Tenth Schedule) and other CO requirements as to the matters to be included in a company's accounts or group accounts.

Summary of ***HKMC's further comments*** *dated 22 December 2004*

- *If the IAS's definition of subsidiary was amended in a manner which was inconsistent with the entrenched definition of subsidiary in the CO, the company would not be able to make use of the "true and fair view override" provisions.* ***This puts Hong Kong in a disadvantage*** *compared to* Australia and Singapore as they do not entrench the definition of "subsidiary" in their legislation.

The ***Administration's further responses***

- Our intention is that only the Tenth Schedule and other requirements of the CO as to the matters to be included in company's accounts are subject to this "true and fair view override". We consider that **this is an appropriate and prudent proposal.**
- **If further changes are made to the definition of "subsidiary" in IAS 27 which may necessitate amendments to the CO, we will**

consider introducing legislative amendments for this purpose. **We do not consider that this should be regarded as putting Hong Kong in a "disadvantage"** compared to jurisdictions like Australia and Singapore**.** (See paragraphs 15 to 18 of the paper.)

(4) Consolidation of SPEs: presentational issue or one of substance?

*Summary of **HKMC's comments** dated 9 December 2004*

- *The proposed amendment will **make off-balance-sheet arrangement very difficult to achieve**.*

The **Administration's responses** dated 15 December 2004

- The changes introduced by the proposed amendment lie primarily with the format of the presentation, and not with the content or amount of the disclosure. Consolidation will present a clearer picture to users of accounts. Notwithstanding the present reporting CO's requirements, **Hong Kong-incorporated companies are already required under HKAS 27 to disclose the financial information of their subsidiaries in the form of "notes to accounts"**.

*Summary of **HKMC's further comments** dated 22 December 2004*

- ***Consolidation of the assets and liabilities of SPEs into group accounts will distort the key financial ratios** of the consolidating entity which are used by investors and financial analysts to assess the state of affairs of the reporting entity. This would have consequences in the capital markets and for a company's financial covenants which could be breached due to distortion of gearing and other ratios as a result of the inclusion of assets / liabilities of any deemed subsidiary.*

The **Administration's further responses**

- Quality and reliable financial reporting is a key to the underpinning of investors' confidence. We believe that **the primary objective of group accounts is to show the true and fair view of the group's results and state of affairs**. While the Administration supports the development of the asset-securitization industry, we do not believe that this should be done at the expense of this primary objective. This is because **allowing off-balance-sheet accounting treatment**

for certain subsidiaries (such as securitization SPEs) may result in distortion of financial statements of the group as a whole to the extent that they do not show a true and fair view.

- As discussed at the Bills Committee meeting held on 16 December 2004, **the changes proposed by the Bill lie primarily with the format of the presentation, and not with the content or amount of the disclosure.** In our view, consolidation will facilitate users of the financial statements to appraise, for their various own purposes, the financial information of all entities under the group's control, instead of having some subsidiaries' information incorporated into the balance sheet and some other subsidiaries' (i.e. SPEs') information contained in notes to the group accounts. **Consolidation will not represent any distortion to financial analysts because all entities consolidated are subject to the same criteria in determining the "parent-subsidiary" relationship.** (See paragraph 5 of the paper.)

(5) Greater transparency?

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *Some banking regulators have taken the view that IFRSs do not adequately address* ***regulatory capital reporting requirements*** *for banks.*

The **Administration's responses** dated 15 December 2004

- **Financial reporting and financial regulation aim to serve different purposes.** Financial reporting is fundamentally about presenting the financial performance in a true and fair view, while financial regulation is more on the prudential regulation of the entities concerned or the protection of investors/depositors.

Summary of ***HKMC's further comments*** *dated 22 December 2004*

- ***The HKMC supports the aim of greater transparency*** *but argues that consideration should be given to the effect of the amendments on genuine securitisation transactions. The HKMC* ***does not object to adequate disclosure about the effect of securitisation SPEs in company accounts****, but consolidation of such SPEs will affect the key financial ratios of a company and not give a true view of the assets, liabilities and risks for which the company is actually responsible.*

The **Administration's further responses**

- **We welcome the HKMC's support for the principle of enhancing the transparency of financial reporting.** The IASB has reaffirmed that "*consolidation should be based on the notion of control*" and that "*control of an entity is the ability to direct the strategic financing and operating policies of an entity*[3]". If consolidation of any other subsidiaries fulfilling the "control" criteria represents greater transparency, it is logical that consolidation of SPEs falling within the same "control-based" definition of "subsidiary" achieves the same greater transparency rather than giving rise to distortion.
- **Group accounts are intended to show the true and fair view of the results and the state of affairs of the group (including the parent and all its subsidiaries) as a whole.** Therefore, all members of the group fulfilling the "control-based" definition for "subsidiary", alongside the parent company, should be consolidated in the group accounts, regardless of the type of transactions each member may separately engage in.

(6) Adverse Impact on Competitiveness?

<u>*Summary of **HKMC's comments** dated 9 December 2004*</u>

- *Entrenchment of the definition of "subsidiary" in the CO will put Hong Kong in a competitive disadvantage vis-à-vis other countries (like Singapore and Australia) that do not have entrenched definition. Notwithstanding the adoption of IFRSs in **Australia and Singapore,** these jurisdictions **have no intention to amend the definition of "subsidiary" in their legislation**.*

<u>The **Administration's responses** dated 15 December 2004</u>

- Neither Singapore nor Australia amends the company law with regard to the general operation of "subsidiary" because there is no need to do so. The company law there has given statutory backing to the financial reporting standards which follow IAS 27 with respect to the "control-based" definition of "subsidiary" and the treatment of "SPEs" in accounts consolidation.

<u>*Summary of HKMC's further comments dated 22 December 2004*</u>

- ***Australia and Singapore's company legislation requires companies***

[3] A paper – *Consolidation (including special purpose entities)*, issued by the IASB on 23 November 2004 to reflect the decisions up to and including the November 2004 Board meeting.

to prepare their accounts in accordance with accounting standards. *However, Hong Kong will have entrenched a specific definition into the CO which cannot be overcome by the "true and fair view override".* ***In the event of an IFRS change, Hong Kong's legislation will lag behind*** *and the industry cannot react as quickly as in Australia and Singapore to implement changes to accounting standards.*

The **Administration's further responses**

- The Bill does not seek to change the existing framework whereby the definition of "subsidiary" is dealt with under the CO. In case there are future changes to the definition of "subsidiary" in IAS 27 which have a bearing on the definition in the CO, **legislative changes can be proposed**.
- **We however do not agree that this will put Hong Kong in a disadvantaged position. We cannot see how this will create any adverse impact on the competitiveness of the industry in Hong Kong.** (see paragraph 17 of the paper.)

(7) Carve-out option

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *Our preferred option is for the legislation to* ***expressly provide a carve-out*** *from the definition of "subsidiary" for asset securitization SPEs similar to the concept of the QSPEs available under US accounting rules.* ***Notwithstanding concern about the abuse of SPEs following a number of financial scandals (e.g. Enron)****, there are apparently as yet no plans to phase out the concept of QSPEs under the Financial Accounting Standards Board in the US.*

The **Administration's responses** dated 15 December 2004

- We are not aware that other jurisdictions following IFRSs will apply the concept of **QSPEs** in their own local accounting standards, as the concept **has been questioned in the post-Enron era.** In fact, the **IASB stresses that there "*should be no specific exceptions from consolidation on the basis of transaction types (such as for certain types of securitization)*[4]"**. Given IASB's confirmation, we do not see the need to propose a carve-out, in a way that is not recognized by

[4] A paper - *Consolidation (including special purpose entities)*, issued by IASB on 31 May 2004 to reflect the decisions up to and including the May 2004 Board meeting.

the IASB and any jurisdictions that have adopted IFRSs.

Summary of ***HKMC's further comments*** *dated 22 December 2004*

- *There are a number of jurisdictions (e.g. the US, Korea, Japan) which have legislation or accounting standards which specifically provide special treatment to securitisation activities.*

The **Administration's further responses**

- The primary objective of financial reporting is to show the "true and fair view" of a company's results and state of affairs. The means and the ends will easily be mixed up if a so-called "favourable" accounting method is treated as a key driver to boost a particular sector without much regard to the primary objective that financial reporting serves in the first place. We believe that **such a carve-out will not be consistent with the purpose of presenting a "true and fair view" of the group's position in its accounts.** Moreover, no carve-out, in relation to the preparation of group accounts, is provided in any jurisdictions that adopt IFRSs.
- The "carve-out" proposal, if adopted, will **create an inequality of treatment of consolidation between securitization companies and other companies** adopting either HKFRSs or IFRSs, and will affect adversely the comparison of financial statements across companies. (See paragraphs 8 to 10 of the paper.)

(8) "Linked-presentation"

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *The HKICPA should consider possible amendments to HKFRSs which will* ***enable asset securitization SPEs to use the UK's "linked presentation" format*** *for their accounts which can disclose the effect of securitization transactions on the originator's balance sheet.*

The **Administration's responses** dated 15 December 2004

- **All listed companies in the UK have been prohibited to use the linked presentation method in their group accounts starting from 1 January 2005.** The HKICPA does not consider it appropriate to deviate from the international norm and to permit under accounting standards the linked presentation method which is a falling-away concept even in the UK.

Summary of ***HKMC's further comments*** *dated 22 December 2004*

- *Notwithstanding adoption of IFRSs in the UK from 1 January 2005,* ***non-listed companies*** *will still have the option to use the "linked presentation method" for off-balance-sheet presentation.*

The **Administration's further responses**

- **Listed companies in the UK are prohibited from using the "linked presentation method"** starting from 2005. Unlisted companies may also opt to adopt the IAS 27's consolidation requirements in preparing group accounts. As far as we are aware, no any other jurisdictions adopting the IFRSs allow the use of "linked presentation method" in preparing group accounts. The HKICPA does not consider it appropriate, **for the purpose of presenting the "true and fair view" of the group's results and state of affairs**, to deviate from the IFRSs and to permit under accounting standards the linked presentation method. (See paragraph 11 of the paper.)

(9) "Wait and see"

Summary of ***HKMC's comments*** *dated 9 December 2004*

- *We submit that it will not be objectionable for a* ***short deferral*** *of the amendments.*

The **Administration's responses** dated 15 December 2004

- We **do not consider it appropriate to withhold the Bill** given that the "control-based" definition of "subsidiary" proposed in the Bill has been adopted by IASB since 1990 and was adopted by many jurisdictions in their company laws / accounting standards in the last decade. (See paragraph 12 of the paper.)

Summary of ***HKMC's further comments*** *dated 22 December 2004*

- *The IASB is currently carrying out a project on Consolidation (including special purpose entities). There is* ***no urgent need for the Bill*** *and there is no harm to wait until the exposure draft is published.*

The **Administration's further responses**

- While the IASB is, as a regular practice, reviewing IAS 27, its primary focus is on the further guidance for accountants to identify the ultimate controllers of the SPEs. According to the HKICPA, the subject review is more concerned about the application of the "control-based" approach in practice. Given that jurisdictions including the **EU, Australia and Singapore have not refrained from applying IAS 27 merely because of the review being conducted by the IASB**, we do not consider it justified to delay the Bill. (See paragraphs 12 to 13 of the paper.)