

**Bills Committee on  
Companies (Amendment) Bill 2004**

**Impact of the Bill on the Asset-Securitization Market in Hong Kong**

**Purpose**

At the Bills Committee meeting held on 13 January 2005, Members discussed, among other things, the impact of the Bill on the asset-securitization industry of Hong Kong. To facilitate further discussion on the matter, the Administration has been invited to -

- (a) comment on the submission of Hong Kong Institute of Certified Public Accountants (HKICPA) dated 12 January 2005;
- (b) comment on the submissions received by the Bills Committee from local academics, viz.
  - (i) Dr. Ben-Hsien Bao and Mr. Kam-por Yuen for and on behalf of Professor Ferdinand A. Gul of the Hong Kong Polytechnic University;
  - (ii) Dr. Maurice Tse and Dr. Frederik Pretorius of the University of Hong Kong;
  - (iii) Professor Kalok Chan of the Hong Kong University of Science and Technology;
  - (iv) Professor Raymond So of the Chinese University of Hong Kong;
- (c) comment on the submissions received from other stakeholders, viz.
  - (i) Hong Kong Mortgage Corporation Limited (HKMC) (dated 10 and 11 January 2005);
  - (ii) ACI–The Financial Markets Association of Hong Kong;

- (iii) Heller Ehrman White & McAuliffe LLP; and
- (d) provide further information on the overseas experience in relation to carve-out and off-balance sheet treatment for a special purpose entity (SPE) under a securitization transaction.

This paper sets out the Administration's responses thereto.

### **Administration's Comments on Submissions**

2. A constant theme of the submissions received by the Bills Committee involves the issue of whether the Bill would discourage certain securitization transactions which are driven by off-balance-sheet treatment. We have paid careful attention to the views of all relevant stakeholders, including the accounting profession (as represented by the HKICPA), the securitization industry (for example, the HKMC, Hong Kong Capital Markets Association (HKCMA), ACI-The Financial Markets Association of Hong Kong) and the local academics. We note the concerns as set out in the series of submission of HKMC, HKCMA, and some other stakeholders that certain securitization transactions may be discouraged if the off-balance-sheet treatment is disallowed.

3. In response to the submissions mentioned in paragraph 1, the Administration's paper entitled "Follow-up Actions Arising from the Discussion at the Meeting on 16 December 2004" (LC Paper No. CB(1)668/04-05(03)) has indeed set out the Administration's view on the matter in considerable detail. This notwithstanding, we would like to draw the Bills Committee's attention to the key considerations which guide us through the formulation of the Bill and we think are imperative in the overall assessment. These are set out in the following paragraphs.

#### ***(a) The Nature of Group Accounts***

4. Group accounts are aimed to present the results and the state of affairs of the group as a whole which consists of the parent company **and** its subsidiaries. HKMC and Professor Kalok Chan seem to question the need for the group accounts to consolidate the SPE when the

title, ownership, and risks associated with the securitized assets have been entirely passed from a company to its SPE. As pointed out by the HKICPA, the Bill will **not** have an “*effect on securitization where the originators of the (securitized) receivables have made a clean sale of their receivables to a party over which they have **no control** (emphasis added)*”. The HKICPA also advises that as per its observations “*many, if not most, banks (major participants in the securitization market) that have transferred their receivables to third parties without recourse for securitization purposes **have been able to remove these items from their balance sheets even when using the ‘control-based’ definition of subsidiary** (emphasis added)*”.

5. Therefore, the crux of the matter lies with whether the parent company continues to **retain control** over the SPE. Even though the title, ownership and risks may have been substantially transferred from the parent company to the SPE, the parent company may still retain the control<sup>1</sup> over the operating and financial policy of the SPE hence the need for consolidation of the SPE as part of the **group**. If the parent company retains no control at all under a “clean sale” situation, the “control-based” definition of subsidiary, as Professor Ferdinand Gul, Dr. Maurice Tse and Dr. Frederik Pretorius point out, will have no impact on the asset securitization arrangement as the asset will be rightly removed from the balance sheet.

*(b) The Impact on the Ratios of Securitization Companies*

6. The HKMC opines that consolidation of the accounts of securitization SPEs might “distort” financial ratios of an originator engaged in securitization transactions, thereby affecting the credit rating of the originator. We have difficulties in accepting this line of argument, as it implies that information disclosed in notes to group accounts would be ignored in credit rating assessments. This argument also misses the point that ratios should not be and, we believe, are not viewed in isolation. In this regard, we share Professor Ferdinand Gul’s view that “*we should not allow firms to remove liabilities off the balance sheet simply to improve some important accounting ratios on paper to ‘gain’ more*

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<sup>1</sup> Control may still exist even though a SPE may operate in a predetermined way (i.e. operate on “autopilot”) whereby the financial and operating policies of the SPE are predefined and limited by the parent company at the inception of the SPE.

*business. Sophisticated investors will check the relevant footnotes to recalculate these ratios anyway. **Off-balance-sheet financing and reporting stands for poor corporate governance and less corporate transparency** (emphasis added)*".

7. Notwithstanding that Professor Kalok Chan is concerned about any inevitable impact, if perceived adversely, on the financial ratios, he refers to the accounting theory that "*accounting rules do not and should not affect the rationale for undertaking transactions*". We would also like to point out that the means and the ends would easily be mixed up if a so-called "favourable" accounting method is attempted to be used as a key driver to boost a particular sector but unfortunately results in distortion of financial statements of the group as a whole to the extent that they do not show a true and fair view.

(c) ***Carve-out Derogates from the Purpose of the Bill***

8. We note one of Professor Raymond So's observations that it is a common practice for financial institutions to "*set up **subsidiaries in the form of SPE***" so that they "*can **circumvent** the reporting of many financial activities* (emphasis added)". This exactly highlights the importance of the Bill which is aimed to enhance the financial disclosure of company, and therefore, its corporate governance. To address the risk of having the primary objective of financial reporting being circumvented, the Bill introduces the "dominant influence" test to require consolidation as and when the parent company has the right to give directions with respect to the operating and financial policies of its **subsidiaries**. We are of the view that the proposed carve-out would lead to inconsistent approach in the preparation of group accounts thereby derogating from the purpose of the Bill. We have not found any good reasons as to why SPEs in the asset-securitization industry alone should not be subject to the same approach in determining parent-subsidiary relationship. No other jurisdictions following IFRSs have adopted a carve-out to facilitate their securitization industry to circumvent the reporting of financial activities.

9. We have to emphasize that the duty to prepare group accounts giving a "true and fair view" of the group's state of affairs and

profit or loss under sections 124(1) and 126(1) of the Companies Ordinance (Cap. 32, CO) rests primarily on directors. Moreover, the auditors of a company have a statutory duty under section 141(3) of the CO to state whether **in the auditor's opinion** group accounts are prepared in accordance with the Ordinance and give the "true and fair view". In this light, independent auditors remain the first line of defence against the failure in this respect.

10. Thus, we should give careful and due consideration to the auditing / accounting profession's view over this matter. As pointed out clearly by the HKICPA in its submission dated 12 January 2005, the profession takes the view that "*if a 'carve-out' is granted under the proposed legislation, the financial statements prepared by those entities, including the HKMC, that have unconsolidated SPEs because of the 'carve-out' granted by law will not give a true and fair view as required under Hong Kong Financial Reporting Standards (emphasis added)*". HKICPA also reiterates that "*such a 'carve-out' would result in two similar entities presenting very different results and financial positions depending on whether or not they meet the conditions of the carve-out and thereby hindering the comparability of financial statements*".

11. We therefore do not agree with HKMC's assertion that "*the Administration accepts the HKICPA's stance on what constitute 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.....*" It should be pointed out that the auditing / accounting profession is indeed vested with the statutory **duty** to give its independent and professional opinion on whether a true and fair view is given in group accounts. Moreover, the standard adopted by the HKICPA, and some other 90 jurisdictions globally, is based on those issued by the International Accounting Standards Board (IASB), which is the most widely recognized accounting standard setter in the world. The accounting standard in question is certainly not a matter agreed by "*certain members of the accounting profession*" as HKMC claims, but a consensus reaffirmed on many occasions at both the levels of the IASB and HKICPA. We share Professor Kalok Chan's view that "*in order for*

*Hong Kong to become a major player in international settings, it is important that it should converge to international accounting standards like those set by the IASB.”*

### **Views of Other Organizations**

12. We are also pleased that the Bill in the present form has received very favourable support from various sectors/bodies including the Securities and Futures Commission, the Stock Exchange of Hong Kong Limited, the Standing Committee on Company Law Reform, the Association of International Accountants, and the Hong Kong Institute of Companies Secretaries.

### **International Comparison**

13. We have expanded the comparison table attached to the Administration’s paper entitled “Follow-up Actions Arising from the Discussion at the Meeting on 8 November 2004” (LC Paper No. CB(1)453/04-05(16)). The revised table at **Annex** recapitulates the information available to us in the process of collating the relevant information through Hong Kong Economic and Trade Offices. The HKICPA has also provided the Administration with the information gathered from their counterparts overseas.

**Financial Services and the Treasury Bureau  
February 2005**

**A Comparison Table between Provisions in relation to Group Accounts  
in the Hong Kong Companies Ordinance (CO) / Companies (Amendment) Bill 2004 vis-à-vis  
International Financial Reporting Standards (IFRSs), Hong Kong Financial Reporting Standards (HKFRSs),  
and Company Laws and Relevant Standards in the United Kingdom (UK), Australia, Singapore, the United States (US), Japan and Korea<sup>1</sup>**

## (A) Definitions

	IFRSs / HKFRSs	Hong Kong (CO)	Hong Kong (Companies (Amendment) Bill 2004)	UK Companies Act 1985 <sup>2</sup>	Australia (Corporations Act 2001, Australian Accounting Standard AASB 127)	Singapore (Companies Act, Financial Reporting Standard FRS 27)	US (Relevant Laws are set out in Footnote 3)
<b>Determination of a “Parent-Subsidiary” Relationship</b>	<p>A subsidiary is “an entity that is <b>controlled</b> by another entity (known as the parent)”.</p> <p><i>[Para. 4 of IAS 27 / HKAS 27]</i></p> <p>“Control” is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the <b>voting power</b> of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.</p> <p>Control also exists when the parent owns half or less of the voting power of a subsidiary when there is –</p> <p>(a) power over more than half of the <b>voting rights</b> by virtue of an agreement with other investors; or</p> <p>(b) power to <b>govern the</b></p>	<p>A company shall be deemed to be a subsidiary of another company, if that other company-</p> <p>(i) controls the <b>composition of the board of directors</b> of the first-mentioned company; or</p> <p>(ii) controls more than half of the <b>voting power</b> of the first-mentioned company; or</p> <p>(iii) holds more than half of the <b>issued share capital</b> of the first-mentioned company.</p> <p><i>[S. 2(4)(a)]</i></p>	<p>An undertaking is a parent undertaking in relation to a subsidiary undertaking if –</p> <p>(a) the subsidiary undertaking is a body corporate and is a subsidiary of the parent undertaking by virtue of section 2(4), (5), (6) and (7) of the Ordinance;</p> <p>(b) the subsidiary undertaking is not a body corporate and the parent undertaking -</p> <p>(i) holds a majority of the <b>voting rights</b> in the subsidiary undertaking; or</p> <p>(ii) is a member of the subsidiary undertaking and has the right to <b>appoint or remove a majority of its board of directors</b>; or</p> <p>(iii) is a member of the subsidiary undertaking and controls alone, pursuant to an</p>	<p>An undertaking is a parent undertaking in relation to a subsidiary undertaking if –</p> <p>(a) it holds a majority of the <b>voting rights</b> in the undertaking, or</p> <p>(b) it is a member of the undertaking and has the right to <b>appoint or remove a majority of its board of directors</b>, or</p> <p>(c) it has the <b>right to exercise a dominant influence</b> over the undertaking, or</p> <p>(d) it is a member of the undertaking and controls alone a majority of the <b>voting rights</b> in the undertaking.</p> <p>An undertaking is also a parent undertaking in relation to a subsidiary undertaking if –</p> <p>(a) it has the power to exercise, or actually exercises, a dominant</p>	<p>Since s. 296(1) of Corporations Act 2001 requires that the financial report of a company must comply with the accounting standards, Australia’s financial reporting standard AASB 127 (which is based on IAS 27) is relevant in determining the definition of “subsidiary” and “parent”.</p> <p><i>[S. 296]</i></p> <p>The definition of “control” under AASB 127 is same as IFRS/ HKFRS.</p>	<p>A corporation shall be deemed to be a subsidiary of another corporation, if that other corporation –</p> <p>(i) controls the <b>composition of the board of directors</b> of the first-mentioned corporation; or</p> <p>(ii) controls more than half of the <b>voting power</b> of the first-mentioned corporation; or</p> <p>(iii) holds more than half of the <b>issued share capital</b> of the first-mentioned corporation.</p> <p><i>[S. 5(1)]</i></p> <p>Since s. 201(3A) of the Companies Act requires that group accounts shall comply with the Accounting Standards, FRS 27 (which is based on IAS 27) is relevant in determining “control”. The definition of “control” under FRS 27 is same as IAS 27/ HKAS 27.</p>	<p>A “parent” of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.</p> <p>A “subsidiary” of a specified person is an affiliate <b>controlled</b> by such person directly, or indirectly through one or more intermediaries.</p> <p><i>[Reg. S-X, 17 CFR § 210.1-02]</i></p> <p>The term “control” means the possession, direct or indirect, of <b>the power to direct or cause the direction of the management and policies</b> of a person, whether through the ownership of voting shares, by contract, or otherwise.</p> <p><i>[Reg. S-X, 17 CFR § 210.1-02]</i></p>

<sup>1</sup> The information contained in this table is based on the best available information in published literature as well as from the relevant official contacts and accountancy bodies of the respective jurisdictions. We consider that there may not be a useful direct comparison between the regimes set out in this comparison table with the legislative provisions in Japan and Korea, as the two jurisdictions follow the civil law systems. Moreover, although we are unable to obtain authoritative information about Japan and Korea through official contacts, some information about the position in the two places have been obtained through the HKICPA’s counterparts and other published literature. They are set out separately after the comparison table.

<sup>2</sup> The relevant provisions under UK Companies Act 1985 have been amended by the Companies Act 1989 and the Companies Act 1985 (International Accounting Standards and other Accounting Amendments) Regulations 2004.

<sup>3</sup> The information contained in the table regarding U.S. law has been drawn from, or is otherwise based upon, a review of (i) the Model Business Corporation Act, as revised (“MBCA”), and (ii) the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and regulations promulgated under, or in connection with, both such acts, including Regulation S-X (“Reg. S-X”).

	IFRSs / HKFRSs	Hong Kong (CO)	Hong Kong (Companies (Amendment) Bill 2004)	UK Companies Act 1985 <sup>2</sup>	Australia (Corporations Act 2001, Australian Accounting Standard AASB 127)	Singapore (Companies Act, Financial Reporting Standard FRS 27)	US (Relevant Laws are set out in Footnote 3)
	<p><b>financial and operating policies</b> of the entity under a statute or an agreement; or</p> <p>(c) power to appoint or remove the majority of the members of the <b>board of directors</b> or equivalent governing body and control of the entity is by that board or body; or</p> <p>(d) power to cast the majority of <b>votes</b> at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.</p> <p><i>[Para. 13 of IAS 27 / HKAS 27]</i></p>		<p>agreement with other shareholders or members, a <b>majority of the voting rights</b> in the subsidiary undertaking; or</p> <p>(c) the parent undertaking has the <b>right to exercise a dominant influence</b> over the subsidiary undertaking.</p> <p><i>[S. 2(1) of the 23<sup>rd</sup> Schedule]</i></p>	<p>influence or control over it, or</p> <p>(b) it and the subsidiary undertaking are managed on a unified basis.</p> <p><i>[S. 258(2), (4)]</i></p>			
<b>Scope of “undertaking”</b>	<p>An “entity” includes an unincorporated entity such as a partnership.</p> <p><i>[Para. 4 of IAS 27 / HKAS 27]</i></p>	<p>The existing definition of CO pre-supposes that only a “company” can be deemed to be a subsidiary of another company. The expression “company” includes any body corporate or corporation.</p> <p><i>[S. 2(4), (8) of CO]</i></p>	<p>“Undertaking” includes a body corporate or corporation; a partnership; an unincorporated body carrying on a trade or business, whether for profit or not.</p> <p><i>[S.1(1) of the 23<sup>rd</sup> Schedule]</i></p>	<p>“Undertaking” means a body corporate or partnership; or an unincorporated association carrying on a trade or business, with or without a view to profit.</p> <p><i>[S. 259(1)]</i></p>	<p>Same as IAS 27 / HKAS 27.</p>	<p>The Companies Act is based on the concept of “company” but its Accounting Standard “FRS 27” uses the same concept of “entity” as in IAS 27.</p> <p><i>[S. 5 &amp; 201(3A) of Companies Act; para. 4 of FRS 27 ]</i></p>	<p>An “entity” includes domestic and foreign business corporation; domestic and foreign nonprofit corporation; estate; trust; domestic and foreign unincorporated entity; and state, United States, and foreign government.</p> <p><i>[MBCA § 1.40]</i></p>
<b>Applications of the provisions to parent undertakings which are incorporated or registered or formed locally and those not</b>	<p>Not applicable.</p>	<p>“Company” means a company formed and registered under the CO or an existing company. “Hong Kong incorporated companies” are required to prepare group accounts under the CO.</p> <p><i>[S. 2(1)]</i></p>	<p>No change to the present position.</p>	<p>“Company” means a company formed and registered under the Act or an existing company. “UK incorporated companies” are required to prepare group accounts under the Act.</p> <p><i>[S. 735(1)]</i></p>	<p>All disclosing entities incorporated or formed in Australia, public companies, large proprietary companies, and registered schemes shall prepare financial reports.</p> <p><i>[S. 292(1)]</i></p>	<p>“Company” means a company incorporated pursuant to the Companies Act or pursuant to any corresponding previous written law. “Singapore incorporated companies” are required to prepare group accounts under the Act. <i>[S. 4(1)]</i></p>	<p>A “corporation,” “domestic corporation” or “domestic business corporation” means a corporation for profit, which is not a foreign corporation, incorporated under or subject to the provisions of this act.</p> <p><i>[MBCA § 1.40]</i></p>

	IFRSs / HKFRSs	Hong Kong (CO)	Hong Kong (Companies (Amendment) Bill 2004)	UK Companies Act 1985 <sup>2</sup>	Australia (Corporations Act 2001, Australian Accounting Standard AASB 127)	Singapore (Companies Act, Financial Reporting Standard FRS 27)	US (Relevant Laws are set out in Footnote 3)
<b>Application of the provisions to subsidiary undertakings which are incorporated or registered or formed locally and those not</b>	The undertaking's place of incorporation, formation, and registration is <b>not relevant</b> in determining whether it is a subsidiary undertaking.	Same as IFRSs/HKFRSs.	Same as IFRSs/HKFRSs.	Same as IFRSs/HKFRSs.	Same as IFRSs/HKFRSs.	Same as IFRSs/HKFRSs.	An "entity" includes domestic and foreign business corporation; domestic and foreign nonprofit corporation; estate; trust; domestic and foreign unincorporated entity; and state, United States, and foreign government.  [MBCA § 1.40]

**(B) Preparation of Group Accounts and the “True and Fair View” Provision**

	<b>IFRSs / HKFRSs</b>	<b>Hong Kong (CO)</b>	<b>Hong Kong (Companies (Amendment) Bill 2004)</b>	<b>UK (Companies Act 1985)</b>	<b>Australia (Corporations Act 2001)</b>	<b>Singapore (Companies Act)</b>	<b>US (Relevant Laws are set out in Footnote 3)</b>
<b>Preparation of group accounts</b>	<p>A parent shall present <b>consolidated financial statements</b> in which it consolidates its investments in subsidiaries in accordance with IAS 27 / HKAS 27.</p> <p><i>[Para. 9 of IAS 27 / HKAS 27]</i></p>	<p>Where at the end of its financial year a company has subsidiaries, <b>group accounts</b> dealing with the state of affairs and profit or loss of the company and the subsidiaries shall be laid before the company in general meeting when the company’s own balance sheet and profit and loss account are so laid.</p> <p><i>[S. 124(1)]</i></p>	<p>No change to the present position.</p>	<p>If at the end of a financial year a company is a parent company, individual accounts and <b>group accounts</b> for the year shall be prepared. The group accounts shall deal with the state of affairs and profit or loss of the parent company and its subsidiary undertakings.</p> <p><i>[S. 227(1), 227A(1)]</i></p>	<p>The financial statements for the year are:</p> <p>(a) the financial statements in relation to the entity reported on that are required by the accounting standards; and</p> <p>(b) if required by the accounting standards — the financial statements in relation to the <b>consolidated entity</b> that are required by the accounting standards.</p> <p><i>[S. 295(2)]</i></p>	<p>For a company that is a parent company, at the end of its financial year <b>consolidated accounts</b> dealing with the profit or loss and the state of affairs of the company and its subsidiaries must be laid before the company at its annual general meeting.</p> <p><i>[S. 201(3A)]</i></p>	<p>A corporation shall furnish its shareholders annual financial statements, which <b>may be consolidated or combined</b> statements of the corporation and one or more of its subsidiaries.</p> <p><i>[MBCA § 16.20]</i></p> <p>There is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one entity directly or indirectly has a controlling financial interest in another entity.</p> <p><i>[Reg. S-X, 17 CFR § 210.3A-02]</i></p> <p>Among the factors that the registrant should consider in determining the most meaningful presentation are: whether the corporation has a majority ownership of the subsidiary; whether the two entities have different fiscal periods; whether the subsidiary is (or might become) subject to divestiture under the Bank Holding Company Act; and whether the subsidiary is a foreign entity.</p> <p><i>[Reg. S-X, 17 CFR § 210.3A-02]</i></p>
<b>“True and fair view”</b>	<p>Financial statements shall give a <b>true and fair view</b> of the financial position and performance of an entity. The application of IFRSs / HKFRSs, with additional disclosure when necessary, is presumed to result in financial statements that give a true and fair view.</p> <p><i>[Para. 13 of IAS 1 / HKAS</i></p>	<p>The group accounts laid before a company shall give a <b>true and fair view</b> of the state of affairs and profit or loss of the company and the subsidiaries dealt with thereby as a whole, so far as concerns members of the company.</p> <p><i>[S. 126(1)]</i></p>	<p>No change to the present position.</p>	<p>The accounts must give a <b>true and fair view</b> of the state of affairs and the profit or loss of the undertakings included in the consolidation as a whole, so far as concerns members of the company.</p> <p><i>[S. 227A(2)]</i></p>	<p>The consolidated financial statements must give a <b>true and fair view</b> of the financial position and performance of the consolidated entity.</p> <p><i>[S. 297]</i></p>	<p>The consolidated accounts shall give a <b>true and fair view</b> of the accounts, so far as it concerns members of the parent company.</p> <p><i>[S. 201(3A)]</i></p>	<p>It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange... to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.</p> <p><i>[Securities Exchange Act of 1934 Rule</i></p>

	IFRSs / HKFRSs	Hong Kong (CO)	Hong Kong (Companies (Amendment) Bill 2004)	UK (Companies Act 1985)	Australia (Corporations Act 2001)	Singapore (Companies Act)	US (Relevant Laws are set out in Footnote 3)
	1]						10b-5, 16 FR 7928] Financial statements should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. [Reg. S-X, 17 CFR § 210.4-01]
<b>“True and fair view override” and the corresponding disclosure requirement</b>	<p>If management concludes that <b>compliance with a requirement in accounting standards would be so misleading</b> that it would conflict with the objective of financial statements, the entity shall <b>depart from that requirement</b> if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.</p> <p>When an entity departs from the requirements of accounting standards, it shall disclose –</p> <p>(a) that management has concluded that the financial statement gives a true and fair view of the entity’s financial position and performance;</p> <p>(b) that it has complied with applicable accounting standards, except that it has departed from a particular requirement to give a true and fair view;</p> <p>(c) the title of the accounting standard from which the entity has departed, <b>the</b></p>	No express “true and fair view override” provisions.	<p>Where compliance with the relevant requirements as to the matters to be included in a company’s group accounts or in a statement annexed to the group accounts would <b>not be sufficient to give a true and fair view</b> of the state of affairs or the profit or loss of the company and its subsidiaries, <b>additional information</b> as may be necessary to give a true and fair view thereof <b>shall be given</b> in the group accounts or statement.</p> <p>Where compliance with the relevant provisions is <b>inconsistent</b> with the requirement to give a true and fair view of the state of affairs or the profit or loss of a parent company and its subsidiaries, the directors <b>shall depart from those provisions</b> to the extent as may be necessary, with the <b>reasons for and particulars and effects of such departure</b> to be given in a statement annexed to the company’s group accounts.</p> <p>[Proposed s. 126(4), (5)]</p>	<p>Where compliance with the relevant provisions as to the matters to be included in a company’s group accounts would <b>not be sufficient to give a true and fair view</b>, the necessary <b>additional information must be given</b> in the accounts or in a note to them.</p> <p>If in special circumstances where compliance with the relevant provisions is <b>inconsistent</b> with the requirement to give a true and fair view, the directors <b>must depart</b> from that provision to the extent necessary to give a true and fair view. <b>Particulars of any such departure, the reasons for it and its effects</b> must be given in a note to the accounts.</p> <p>[S. 227A(4), (5), (6)]</p>	<p>If the financial statements and notes prepared in compliance with the accounting standards <b>would not give a true and fair view</b>, <b>additional information must be included</b> in the notes to the financial statements.</p> <p>[S. 297]</p>	<p>Where consolidated accounts prepared in accordance with any requirement of the Accounting Standards <b>would not give a true and fair view</b> of any matter required, the consolidated accounts <b>need not comply</b> with that requirement to the extent that this is necessary for them to give a true and fair view of the matter.</p> <p>In the event of any non-compliance with a requirement of the Accounting Standards, there shall be included in the consolidated accounts, among other things,</p> <p>(a) <b>particulars of the departure, the reason therefor and its effects</b>, if any; and</p> <p>(b) such <b>further information</b> and explanations as will give a true and fair view of that matter.</p> <p>[S. 201(14A), (14B)]</p>	No such concept under U.S. law.

	<b>IFRSs / HKFRSs</b>	<b>Hong Kong (CO)</b>	<b>Hong Kong (Companies (Amendment) Bill 2004)</b>	<b>UK (Companies Act 1985)</b>	<b>Australia (Corporations Act 2001)</b>	<b>Singapore (Companies Act)</b>	<b>US (Relevant Laws are set out in Footnote 3)</b>
	<p><b>nature of departure</b> (including the treatment that the accounting standard would require, the reason why the treatment would be so misleading) <b>and the treatment adopted;</b></p> <p>(d) the financial impact of the departure on the financial statements that would have been reported from complying with the requirement.</p> <p><i>[Para. 17 and 18 of IAS 1 / HKAS 1]</i></p>						
<b>Guidelines for “True and fair view override” provisions</b>	No such guidelines.	Does not apply	No plan for such guidelines.	No such guidelines.	No such guidelines.	No such guidelines	Does not apply.

(C) *The treatment to securitization industry*

	IFRSs / HKFRSs	Hong Kong (CO)	Hong Kong (Companies (Amendment) Bill 2004)	UK (Companies Act 1985)	Australia (Corporations Act 2001)	Singapore (Companies Act)	US (Relevant Laws are set out in Footnote 3)
<b>Off-balance-sheet treatment allowed?</b>	<p>Under both IAS 27 and HKAS 27, so long as the special purpose entity (SPE) fulfills the “control-based” definition of a parent-subsidary relationship, accounts of the SPE should be consolidated.</p> <p>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 Hong Kong CO but would have been required to be consolidated by virtue of the accounting standard requirements.</p>	<p>So long as the SPE fulfills the definition of a parent-subsidary relationship in section 2(4) of the CO, accounts of the SPE shall be consolidated.</p>	<p>So long as the SPE fulfills the definition of a parent-subsidary relationship in section 2(4) of the CO or s. 2(1) of the 23<sup>rd</sup> Schedule, as the case may be, accounts of the SPE shall be consolidated.</p>	<p>So long as the SPE fulfills the definition of a parent-subsidary relationship in section 258 of the Act, accounts of the SPE shall be consolidated.</p>	<p>So long as the SPE fulfills the “control-based” definition of a parent-subsidary relationship (see above), accounts of the SPE shall be consolidated.</p>	<p>So long as the SPE fulfills the “control-based” definition of a parent-subsidary relationship (see above), accounts of the SPE shall be consolidated.</p>	<p>Under US accounting standard FASB 140, securitization companies meeting the very restrictive criteria of “sale accounting” and “qualifying special purpose entity (QSPE)” would be allowed to use off-balance-sheet treatment to account for securitization transactions.</p>
<b>Carve-out?</b>	<p>No specific carve-out for securitization industry.</p>	<p>No specific carve-out for securitization industry.</p>	<p>No specific carve-out for securitization industry.</p>	<p>“Linked presentation” method is only available to a “quasi-subsidary”, as defined under UK Accounting Standard FRS 5. The UK DTI advises that, in the light of the Companies Act 1985 (International Accounting Standards and other Accounting Amendments) Regulation 2004, the present scope of “quasi-subsidary” has become heavily circumscribed. Hence, in the present regime, many previous quasi-subsidaries, which might use linked presentation before, would need to be consolidated now pursuant to the Companies Act requirement. As UK standards are being converged to IFRS over time, the UK DTI advises that the “linked presentation” method is expected to be withdrawn sooner or later. Indeed, all listed companies in the UK have already been disallowed to use the linked presentation method starting from January 2005.</p>	<p>No specific carve-out for securitization industry.</p>	<p>No specific carve-out for securitization industry.</p>	<p>Securitization companies in the US may use QSPEs as a means to avoid consolidation.</p>

## **Further Information**

The HKICPA has also provided the Administration with the following information gathered from their counterparts overseas -

### **Japan**

2. We have been advised that under Japan's Regulations for Presentation and Disclosure of Financial Statements and Enforcement Regulations of the Commercial Code that a subsidiary is defined as "an entity that is controlled a parent" and that the definition of "control" is based on the principles set out in IAS 27. The basic principle with regard to financial statements is to give a "fair presentation in conformity with generally accepted accounting principles". There is no such a concept as the "true and fair view override" in Japanese accounting standards and law.

3. Separately, the IASB and the Accounting Standards Board of Japan jointly announced in January 2005 their agreement to launch a joint project to reduce differences between IFRSs and Japanese accounting standards. This is an indication of Japan moving towards the IFRSs.

### **Korea**

4. We have been advised that the main criteria for consolidation in Korea hinges on the ownership percentage of the subsidiary held by the parent company. It has been suggested that consolidation is required when a parent holds over 50% ownership stake of the subsidiary; or holds over 30% ownership stake of the subsidiary and is the largest shareholder. The other criteria include the power to appoint or remove the majority of the board of directors; and the right to exercise a majority of voting rights. We are also told that there is no such a concept as the "true and fair view override" in Korea.

5. The information contained in HKMC's submission to the Bills Committee dated 10 January 2005 may also provide Members with references to the overseas situation.