30th October 2002

Deputy Director, Accounting
Hong Kong Society of Accountants

Dear Sirs

Consultation Paper on a Proposed Framework for Differential Reporting

We refer to the Consultation Paper on Proposed Framework for Differential Reporting ("the Paper") issued by the Hong Kong Society of Accountants on 21 August 2002 and would like to advise that while the Association supports the criteria of cost-benefit, there is mixed views on whether there should be differential reporting in Hong Kong.

For those who disagree on adopting differential reporting , they are of the view that cost and benefit is one of the significant criteria, a balance has to be reached between cost (provided by the reporting entity) and benefit (to users of financial information which include creditors and shareholders). Differential reporting is not international standard and a more effective approach to implement cost-effective criteria in financial reporting is by adopting the principle of materiality which will apply universally to all enterprises. Materiality has already be defined in the HKSA Foreward & Framework: "information is material if its omission or misstatement could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements." If the concept of materiality is ingrained in the HKSSAP, differential reporting will become a non-issue.

For those who support that there is a need for differential reporting in Hong Kong, they have the following comments on the proposed framework:

1. With regard to the separation of owners and governing body, we should also take into account the interest of the other stakeholders, such as banks and other creditors.

2. Access to differential reporting should be restricted solely to small entities. As explained under (1) above, larger companies generally have more stakeholders whose interest should also be taken into consideration.

3. Consolidated financial statements should be required for groups. If the consolidated size of a group reaches the threshold, the group (at the consolidated level) should not be entitled to differential reporting treatment.

4. The public accountability criteria detailed in paragraphs 24 and 25 are appropriate.

5. With regard to the size criteria, while the two criteria on total revenues and assets look reasonable, the threshold of 50 employees looks high. We consider 30 may be more appropriate. In addition, we should be grateful for clarification as to whether this criterion is limited to staff employed in Hong Kong SAR or whether it includes those outside Hong Kong SAR as well (e.g. in the mainland of China).

6. We have reservations about the following proposed exemptions, as they would impair the assessment of the credit standing of the borrower:

- SSAP 20: Related party disclosures
- SSAP 1: Presentation of financial statements
- SSAP 2: Net profit or loss for the period, fundamental errors and changes in accounting policies
- SSAP 9: Events after the balance sheet
- SSAP 13: Accounting for investment properties
- SSAP 14: Leases
- SSAP 17: Property, plant and equipment
- SSAP 18: Revenue
- SSAP 22: Inventories
- SSAP 23: Construction contracts
- SSAP 28: Provisions, contingent liabilities and contingent assets
- SSAP 31: Impairment of assets

Of the above, those causing most concern are SSAP 20, 1, 22, 23 and 28 for the following reasons:-

SSAP 20: Related party disclosures (on the condition of the unanimous written agreement of the shareholders)

Related party transactions can have a very material impact on the financial standing of a company. The disclosure of related party transactions mainly relies on the integrity of the management/share holders of a company as it is difficult for the auditors to identify these transactions.

SSAP 1: Presentation of financial statements: Qualifying entities are not required to disclose the information required by paragraph 56.

The proposed exemption from disclosing the amount of assets/liabilities expected to be recovered/settled after more than 12 months would have a material impact. Such exemption would conflict to a degree with the Companies Ordinance which requires separate disclosure of fixed assets, current assets and other assets which are neither fixed nor current. This may result in a more detailed disclosure of assets than liabilities.

SSAP 22: Inventories: Qualifying entities are not required to sub-classify inventory (into categories such as raw materials, work in progress and finished goods) as required under paragraphs 30(b). Qualifying entities are not required to disclose the information required under paragraph 30 (c), (d) and (e).

Such exemptions would have a material impact as:

a. The composition of raw materials, work in progress and finished goods and the change in the composition from year to year can indicate slow-moving stock.
b. Inventories should be measured at the lower of cost and net realizable value. If the net realisable value is lower than the cost, the book value of inventories will be overstated. Inventories are usually a material item on balance sheets.
c. The reversal of write-down is usually non-recurrent and may have a material impact on the year's performance. The disclosure of the information can improve the assessment of the operating performance.
d. The disclosure of the circumstances or events can help determine whether the reversal is appropriate.

SSAP 23: Construction contracts: Qualifying entities are not required to disclose the information required by paragraphs 38(a), 39 and 41.

Such exemption would have a material impact as all information contained therein is important for assessing construction contracts.

SSAP 28: Provisions, contingent liabilities and contingent assets: Qualifying entities are not required to disclose the information required by paragraphs 84, 85, 89, 91 and 92.

Such exemption would have a material impact as the disclosure of the amount, nature and expected timing of inflow/outflow of economic benefits for each class of provision is important in assessing such provisions.

Yours faithfully
Eva Wong
Secretary