

COMMENTS ON CONSULTATION PAPER ON A PROPOSED FRAMEWORK FOR DIFFERENTIAL REPORTING

INTRODUCTION

In my opinion, the overall consultation paper on the above-mentioned topic is interesting and essential to all directors, auditors and all users of audited financial statements. However, more consideration of the following points is worthy to research and to contemplate before any final decision to be considered and to be necessary.

VALIDITY OF ARGUMENTS

- 1) The expectation of differential reporting to certain or to specific directors or/and users of financial statements need further reservation. First, it is the law or court expectation that require the relevant accounting bodies in various jurisdictions to develop differential reporting other than practitioners themselves and we are waiting relevant academic papers on the proper reasoning and arguments of the need of the differential reporting under their specific criteria. In my opinion, information is insufficient to readers to judge the relevance and reliability of these authorities;
- 2) I consider the SWIH of specific criteria of exemption of small entities require further research. The paper did not mention about what population of entities are included and excluded from the exemption. Besides, it is subjective to say the financial statements users are unable to follow qualitative characteristics of financial reporting and is lacking of objectivity to consider the feeling of directors, auditors and the pool of survey of relevant audited financial statements users such as courts people like liquidators, police units, the inland revenue and users of financial statement analysis such as investors. In my opinion, proper stratification of groups of entities with quantitative method to research the relevant needs of differential reporting is necessary. For instance, inactive associates, joint ventures, subsidiaries may be fit and properly to comply with differential reporting. But, it may not be true as users of financial statements are unable to get full information about the overseas entities under common managements or controls;
- 3) In respect to the benefits and costs of differential reporting, we need to consider the definition of costs and benefits. For example, costs represent cost to directors and auditors and benefits represent benefits to specific entities'

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shareholders than other users of financial statements or intentional directors who think of fraud or collusion or auditors who consider audit fee is more material than true and fair view, based on compliance of GAAPs or exemption of disclosures;

- 4) In addition, we are unable to examine the relationship of shareholders or users of audited financial statements and directors and/or auditors after the introduction of differential reporting in Hong Kong. Forgoing interests of minority shareholders, excessive directors remuneration or poor corporate governance entities may be the increasing tendency to deteriorate the quality of exemption groups of entities meeting the criteria of differential reporting. We are unable to ascertain the final outcomes to these groups of shareholders and to auditors. It all matters about agency theory in financial accounting. We are waiting more information to get to the conclusion.
- 5) Furthermore, expectation gaps of auditors and stakeholders are still puzzling and needs more evidence and findings from Hong Kong directors, licensed auditors and from Companies Reform parties, The Government of HKSAR. In Hong Kong, we still expect auditors to be diligent and high quality and are able to comply with laws and regulations such as true and fair view. In my opinion, true and fair view mean auditors should not produce negligent misstatements in financial reporting and audit work. Other engagements are irrelevant than statutory regulations;
- 6) In my ideas, the relationship of true and fair view and full compliance of SSAPs in Hong Kong is still requiring proper efforts;
- 7) The relationship of statutory responsibilities of auditors and entities under exemption of differential reporting is still unknown;
- 8) We need to further understand the implication of GEMs in Hong Kong under the potential exemption of differential reporting and its implication to efficiency of stock markets. Also, we need to cross-check the potential exemption of differential reporting and the changing expectation of laws and regulations about securities industries;
- 9) I consider the full exemption under full exemption is acceptable. I cannot accept the paragraphs under partial exemption, as potential implication may be material;

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- 10) For exemption, banker or investors are unable to get information about the existence of impairment of assets, how much provisions and contingencies etc. These involve the degree of disclosures in the notes to the audited accounts.

HOW TO STRENGTH THE ASSUMPTIONS

- 1) We need to know the reasoning of why differential reporting does not apply to the disclosure of accounting policies;
- 2) In nowadays financial reporting in Hong Kong, auditors require to show the results, net assets and compliance of material SSAPs of entities only. This implies that the expectation from shareholders is properly considered. It is a gray area to comment the relationship of compliance of SSAPs and its full disclosures in audited accounts as evidence. It is still subjective to say materiality is applicable by auditors and directors in normal statutory audits.

WHAT WEAKEN THE ASSUMPTIONS

- 1) More details about benefit and cost analysis of differential financial reporting. For example, more quantitative analysis is considered important such as statistics, calculus and matrix;
- 2) Critically evaluate the benefit and cost and its criteria and the relationship to auditors' duties, directors' duties and expectation of stockholders.

CONCLUSION

In my opinion, the overall contents about the framework for differential reporting are adequate and readers are easy to digest the content at ease.

AUTHOR

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