

“TRUE AND FAIR VIEW”

OPINION

1. I am asked to advise as to whether financial statements prepared by companies which are obliged to comply with the provisions as to accounts contained in the Hong Kong Companies Ordinance, that is to say Hong Kong incorporated companies, will comply with such provisions if the financial statements are prepared in accordance with International Accounting Standards (“IAS”) or UK GAAP, US GAAP or other recognised financial accounting frameworks rather than in accordance with Hong Kong GAAP. I am also asked whether my conclusions on that issue would change if the accounts, albeit prepared in accordance with IAS or other recognised financial accounting frameworks, rather than in accordance with Hong Kong GAAP, included a statement showing the financial effect of any material differences between Hong Kong GAAP and the framework actually adopted. I think that as a matter of general principle accounts prepared in respect of Hong Kong incorporated companies will not satisfy the “true and fair view” requirement if they deviate materially from Hong Kong GAAP albeit that they conform, for example, to IAS and that this conclusion is not materially affected by a statement such as is currently proposed. I think the appropriate course is for accounts of Hong Kong incorporated companies to be prepared in conformity with Hong Kong GAAP. I see no objection to accounts so prepared including a statement showing the financial effect of any material differences which would have been reflected had the accounts been prepared in accordance with IAS or some other regulatory framework.
2. Section 123 and 126 of the Companies Ordinance require both individual company

and group accounts of Hong Kong incorporated companies to give a true and fair view and to comply with the requirements of the Tenth Schedule to the Ordinance. The expression “true and fair view” is not defined by the Ordinance. In England, the Companies Act 1989 for the first time gave statutory recognition to the existence of accounting standards. It also required disclosure of whether accounts have been prepared in accordance with applicable accounting standards and particulars of any material departure from those standards and the reasons for such departure. No such provisions have been adopted in Hong Kong. I think the position in Hong Kong is the same as it was in England before the enactment of the UK Act of 1989. The position in England before 1989 was considered in a joint Opinion by Leonard Hoffmann QC (now Lord Hoffmann) and Mary Arden (now Arden LJ) in 1983. That Joint Opinion was supplemented by a later Opinion (in 1984) by Mary Arden. In 1993 Mary Arden wrote a further Opinion explaining the impact of the changes introduced by the UK Act of 1989. I agree with the analysis and conclusions reached in all such Opinions. Those Opinions have been widely disseminated in England and are the subject of no material criticism.

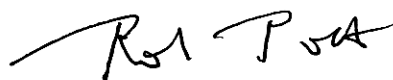
3. In those Opinions the view was expressed that “true and fair view” is a legal concept. As such its interpretation in relation to any particular set of accounts is a matter to be decided by the Courts. However, the Courts would in turn look for guidance to the normal practices of professional accountants. They would treat compliance with accepted accounting principles as prima facie evidence that the accounts in question gave a true and fair view. Equally, they would regard evidence of deviation from accepted accounting principles as prima facie evidence that they did not give a true and fair view. The presumption will be strengthened or weakened by the extent to which an accounting standard is accepted and applied in practice. The application of

the concept of true and fair view involves judgment and questions of degree. There can be more than one true and fair view of the same financial position and there can sometimes be room for differences over the method used to give a true and fair view. Finally, the concept of true and fair view is a dynamic concept. The meaning remains the same over time, but the contents could be expected to change.

4. It is self evident that Mr Hoffmann and Mary Arden, as they then were, when speaking in terms of accepted accounting principles, equated that notion with UK GAAP. This is because their Opinions related to companies required to produce accounts by the UK Companies Act. I think the same principle applies in Hong Kong. By accepted accounting principles is meant Hong Kong GAAP because it is Hong Kong GAAP which encapsulates the generally accepted accounting standards and principles applicable to accounts of Hong Kong companies, whether listed or unlisted, produced in conformity with the Hong Kong Companies Ordinance. The Hong Kong Accounting Standards are produced after lengthy processes of consultation. Members of the Hong Kong Society of Accountants are expected to observe those accounting standards. It is only in exceptional circumstances that such standards should be departed from and then only to ensure that the accounts do give a true and fair view which would not be achieved by compliance with the standards. The education and examination systems are geared to Hong Kong GAAP. The Society is a member of the International Accounting Standards Committee and has a general policy of revising and editing the local standards using IAS as a basis. It supports the aim of harmonising international financial accounting. However, where the requirements of a Hong Kong Accounting Standard and an IAS differ, it is my view that the Hong Kong Accounting Standard should be followed by Hong Kong incorporated companies reporting under the Companies Ordinance save in exceptional cases where

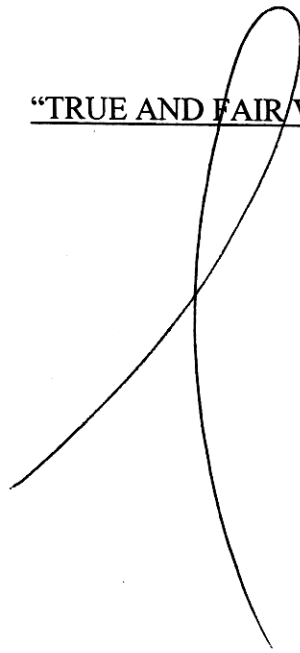
the application of the Standards would not produce a true and fair view. I note that the link between Hong Kong Accounting Standards and UK GAAP and US GAAP is not as strong as the link with IAS. My conclusion that Hong Kong Accounting Standards should be complied with is even stronger in this context. It follows that it is my conclusion that accounts prepared in accordance with IAS or other recognised financial reporting frameworks will not, prima facie, satisfy the true and fair view requirement where the accounts deviate in a material respect from the requirements of Hong Kong Accounting Standards. I do not think the fact that some non-Hong Kong incorporated companies listed on the Stock Exchange of Hong Kong may prepare their accounts otherwise than in accordance with Hong Kong GAAP results in IAS or other non-Hong Kong GAAP accounting frameworks being generally accepted accounting principles in Hong Kong for Hong Kong incorporated companies. Hypothetically, a position might come into existence in the future where a majority of the overseas incorporated companies listed on the Stock Exchange of Hong Kong prepared their accounts in accordance with IAS. If that were to be the position then it might be inferred that members of the Hong Kong Society of Accountants would, at some point, become familiar with the application of IAS. When considering whether accounts give a true and fair view a court will look for guidance to the normal practices of professional accountants. Such practices require judgment and involve questions of degree. If the view of accounting firms auditing listed companies is that IAS gives a true and fair view for overseas companies listed on the Stock Exchange of Hong Kong then a court could consider that this was a factor to be taken into account when determining the weight given to deviation from the HK GAAP but compliance with IAS for a Hong Kong incorporated listed company when determining whether the accounts of such a listed company gave a true and fair view.

5. I do not think the above conclusions are displaced, as matters now stand, by preparing accounts which deviate materially from Hong Kong Accounting Standards and including a statement showing the financial effect of the material deviation. The fact remains that the accounts do deviate in a material respect from Hong Kong GAAP. If it is desired to disclose what the position would have been had the accounts been prepared in accordance with IAS or some other framework I think the practice to be adopted should be to comply with Hong Kong GAAP and then to disclose what the position would have been had the accounts been prepared under the alternative regime.
6. I think the announcement made on 1 April 2001 by the Stock Exchange of Hong Kong is flawed insofar as that announcement might be regarded as applicable not merely to companies incorporated outside Hong Kong but also to Hong Kong incorporated companies. The Exchange can no doubt amend its Exchange Listing Rules but it cannot dispense Hong Kong incorporated companies from their obligations under the Companies Ordinance. It has no power to permit such companies "to adopt" IAS or US GAAP in any case where material discrepancies or differences arise by reason of the adoption of such frameworks as distinct from the continued application of Hong Kong GAAP.
7. I have nothing to add on the information currently available.



Erskine Chambers
Lincoln's Inn
16 October 2001

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