



STANDARDS & TECHNICAL

NEWS AT A GLANCE

TechWatch is a publication designed to alert members to topics and issues that impact on CPAs and their working environment. We welcome your comments and feedback. Comments and suggestions on TechWatch should be addressed to Stephen Chan, Executive Director by [email](#).

ISSUE 40 • December 2005/January 2006

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TechWatch is prepared by the Hong Kong Institute of CPAs and is intended for general guidance only. Professional advice should be taken before applying the content of this publication to your particular circumstances. While the Institute endeavours to ensure that the information in this publication is correct, no responsibility for loss to any person acting or refraining from action as a result of using any such information can be accepted by the Institute.

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Spotlight

1. Handbook Update No. 24

Update 24 encloses two new Practice Notes:

- PN 730 *Guidance for Auditors Regarding Preliminary Announcements of Annual Results*
- PN 900 *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard*

Further details are set out in the “Audit & Assurance” section below.

CPD & Events

2. Technical Update Evening (TUE)

The **new TUE programme** covering the period from January to April 2006 features a number of important auditing, financial reporting and ethics topics:

- 601 (26 Jan) Practice Notes relating to Audit of Listed Issuers
- 602 (7 Feb) Business Combinations: New Accounting Guideline on Merger Accounting and other recent developments
- 603 (21 Feb) New Code of Ethics – Issues relevant to Auditors and CPAs in Public Practice
- 604 (14 Mar) Introduction to Financial Instruments
- 605 (21 Mar) New Code of Ethics – Issues relevant to Professional Accountants in Business
- 606 (11 Apr) Issues in Preparing Financial Statements
- 607 (25 Apr) Improving Audit Documentation

To secure your seats, please register early by completing the **registration form** and returning it to the Institute.

3. Professional Development Activities February 2006

The Institute is committed to provide an all rounded CPD programme to suit the varying needs of members. Highlights for February 2006 are:

- **Executive Program for Accountants on Information Technology Risk Management** (11 Feb to 2 Apr)
- **SIR 400 - Comfort Letters and Due Diligence Meetings on Financial and Non-Financial Information** (10 Feb)
- **Process Improvement - How to do it effectively** (15 Feb)
- **Tax Planning & Investigation in One Lesson – Part II** (17 Feb)
- **How to Prepare and Conduct a Case for Clients before the Board of Review** (27 Feb)

View the full programme [here](#). Act fast to secure a seat.

4. **New CPD Requirements Effective From 1 December 2005**

Members are reminded that the new CPD requirements detailed in **Statement 1.500** (August 2005) have become effective from 1 December 2005. Go to the Institute's webpage under **Mandatory CPD Requirements** for more information.

Financial Reporting

5. **FRSC Meeting Summary – 7 December 2005**

This **FRSC meeting summary** covers:

- The appropriate treatment for an owner used property in Hong Kong
- IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*
- First time adoption of Hong Kong Financial Reporting Standards (consolidation of consequential amendments)
- Consolidation – de facto control
- CEO/CFO Luncheon
- Proposed dates of the meetings in year 2006

Audit & Assurance

6. **Reminder To Auditors Applying Hong Kong Standards On Auditing**

All auditors are reminded that they should apply Hong Kong Standards on Auditing (HKSA) to all audits of financial statements for periods beginning on or after 15 December 2004, i.e., starting with December 2005 year-end audits.

All HKSA issued to date are effective for audits of historical financial information for periods beginning on or after 15 December 2004 except for HKSA 220 *Quality Control for Audits of Historical Financial Information*, which is effective for audits of historical financial information for periods beginning on or after 15 June 2005.

HKSA replace all Statements of Auditing Standards (SASs), other than the following, which are still applicable until they are replaced:

- SAS 230 *Documentation*
- SAS 510 *Principal auditors and other auditors*
- SAS 600 *Auditors' report on financial statements*

HKSA issued by the Institute adopt the equivalent International Standards on Auditing (ISAs) and are a completely new set of standards that may require significant changes to the conduct of audits. The new risk and fraud standards, for example, require auditors to conduct more wide-ranging and in-depth procedures than the previous standards. They also require auditors to undertake more work on evaluating the design and implementation of controls and to carry out additional procedures relating to the possibility of management override of controls. Senior audit personnel are required to have greater involvement in the direction of the audit including strategic audit planning. Furthermore, the new standards also require more documentation of the work performed. Click [here](#) to view a Comparison Table of HKSA and ISAs.

7. Institute Issues New Audit Guidance

(i) Guidance on SME-FRS Audit

The Institute has issued **Practice Note (PN) 900** *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard*.

This PN applies to the audit of financial statements prepared in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS), including companies applying section 141D of the Companies Ordinance, that cover a period beginning on or after 1 January 2005. It gives guidance on the applicability of Hong Kong Standards on Auditing to the audit of financial statements prepared in accordance with the SME-FRS. The existing PN 600.2 *Audit Approach to Companies Applying Section 141D of the Companies Ordinance* continues to apply to the audit of companies applying section 141D that cover a period beginning before 1 January 2005 (except where a company chooses to early adopt the SME-FRS, in which case PN 900 will apply).

The Appendix to PN 900 contains an example unqualified auditors' report on the financial statements prepared in accordance with the SME-FRS.

(ii) Guidance on agreement with preliminary announcements of annual results of listed issuers

The Institute has issued **PN 730** *Guidance for Auditors Regarding Preliminary Announcements of Annual Results*, which is prepared in consultation with the Stock Exchange of Hong Kong and the Securities & Futures Commission to provide guidance for auditors on their responsibilities with regard to preliminary announcements of annual results of listed issuers. The directors of a listed issuer are required by the Main Board Listing Rule 13.49(2) and GEM Listing Rule 18.49 to publish a preliminary announcement of the annual results, which shall have been agreed with its auditors before it is published.

The Listing Rule requirements for a listed issuer to obtain its auditors' agreement with the preliminary announcement of its annual results have become effective for annual results announcements for accounting periods commencing on or after 1 July 2004, i.e., first applicable to June 2005 year end announcements.

In applying PN 730, it should be noted that whilst PN 730 allows draft financial statements to form the basis of the preliminary announcements, it expects the draft financial statements to be in very final form and the audit to be more or less completed subject only to minor outstanding matters.

8. Institute Invites Comments On IAASB ED On Related Parties

The Institute has issued an **Invitation to Comment** on the IAASB Exposure Draft of ISA 550 (Revised) on Related Parties, with comments requested by **10 April 2006**.

The IAASB is seeking comments on the proposed standard that will:

- extend current practice by requiring the auditor to obtain an understanding of the nature and business rationale of an entity's related party relationships and transactions sufficient to identify, assess and respond to the risks of material misstatement resulting from them; and
- place greater emphasis on the difficult task for the auditor of attempting to identify related party relationships and transactions not identified or disclosed by management.

9. **Revised Example Report On Annual Return On Employees' Compensation Gross Premium**

Following the enactment of the Professional Accountants (Amendment) Ordinance 2004 and the adoption of Hong Kong Standard on Assurance Engagements (HKSAE) 3000 *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, the Commissioner of Insurance has issued, in consultation with the Institute, a revised **Example Report** by the auditors on Annual Return on Employees' Compensation Gross Premium. The revised Example Report is based on HKSAE 3000.

10. **New Example Report On The Calculation Of The Fund Expense Ratio Under MPF**

Reference is made to the following sections of the Code on Disclosure for MPF Investment Funds issued by the Mandatory Provident Fund Schemes Authority (MPFA) in June 2004:

- Section G2.7 requires that Fund Expense Ratio (FER) of both constituent funds and Approved Pooled Investment Funds (APIFs) should be first calculated for any financial period that commences after 31 December 2004.
- Section E4.2 requires that approved trustees and operators of APIFs should ensure that the calculation of the FER is checked by the auditor of the financial statements of the relevant scheme or APIF. Calculations and source data should be documented and retained by approved trustees or operators of APIFs for inspection by the Authority.

It has been agreed between the Institute and the MPFA that the requirement under section E4.2 would be an agreed-upon procedures engagement in accordance with HKSRS 4400 *Engagements To Perform Agreed-upon Procedures Regarding Financial Information* issued by the Institute. An example report by the auditors on the requirement of section E4.2 of the Code is under development by the Institute in consultation with MPFA.

11. **AASC Meeting Summary – 29 November 2005**

This **AASC meeting summary** covers:

- Draft Discussion Paper on *Understanding the Types of Reports prepared by Auditors and Accountants In Hong Kong*
- Proposed HKSA 230 *Audit Documentation*
- Proposed Practice Note *Guidance for Auditors Regarding Preliminary Announcements of Annual Results*
- Proposed example report on the calculation of Fund Expense Ratio pursuant to the Code on Disclosure for MPF Investment Funds
- Example Disclosure Note on Regulatory Reserve for Banks
- HKAS 27 Convergence Issue and Audit Reporting

Ethics

12. **Ethics Committee Meeting Summary – 8 November 2005**

This **Ethics Committee meeting summary** covers discussion of the proposed Code of Ethics for Professional Accountants that is modelled on the IFAC Code of Ethics for Professional Accountants issued in June 2005.

Banking

13. HKMA Issues Consultation Papers On New Capital Adequacy Standards

The Hong Kong Monetary Authority (HKMA) issued, on 23 December 2005, a batch of five **Consultation Papers on New Capital Adequacy Standards in Hong Kong** for consultation until end of January 2006, covering the following subjects:

- Determination of capital base
- Scope of application of the capital rules
- Market risk capital adequacy regime
- Recognition of external credit assessment institutions
- Treatment of netting arrangements under the revised capital adequacy framework.

This is the fifth batch of consultation papers issued by the HKMA on the implementation of the New Basel Capital Adequacy Standards (“Basel II”) in Hong Kong. The new capital adequacy standards based on Basel II is expected to take effect from 1 January 2007 upon their finalisation.

The HKMA has also issued a **circular** providing an update on its progress in developing the Capital Rules and Disclosure Rules for the implementation of Basel II in Hong Kong.

Taxation

14. Institute Submits Budget Proposals 2006/07 To Financial Secretary

The Institute recently submitted proposals for the 2006/07 budget to the Financial Secretary (“FS”) and the Institute’s president and Taxation Committee chair, Paul Chan, explained the proposals to the media at a **briefing** held on 12 January 2006. The theme of this year’s submission is “Clarity, Consistency, Certainty, Opportunity”.

Against the background of an increasing level of uncertainty amongst tax practitioners and their clients over the interpretation of certain fundamental areas of tax law and administration, the submission calls for a return to the basic principles of clarity, consistency and certainty, through legislative amendments, where necessary. “Opportunity” refers to, e.g., proposals for tax incentives to enhance the Hong Kong’s competitiveness as an international financial centre.

A number of the key issues reiterate and follow up on concerns raised in the Institute’s 2005/06 budget proposals that have not been addressed. Areas covered include:

1. Fundamentals – restoring predictability and certainty to Hong Kong’s taxation system by reviewing and, where necessary, amending certain specific areas of the Inland Revenue Ordinance. These include clarifying issues relating to the source of profits and of employment income; addressing the adverse tax implications arising from a broad application of the decision in *CIR v. Secan Ltd. and Ranon Ltd.*; and reducing the time limits for concluding and reopening tax cases.
2. Broadening the tax base – given the structural problems inherent in Hong Kong’s very narrow tax base, and the mismatch between operating expenditure and revenue, which is likely to worsen in the future, with, e.g., an ageing population and growing costs of providing health care, it is proposed that the government should also focus on broadening the tax

base in Hong Kong. The submission recommends some important design features of a goods and services tax.

3. Alleviating pressure on the middle-income group – the submission recommends several measures aimed at alleviating the financial pressure on middle-income earners, including reviewing the progressive rates of salaries tax, with a view to adjusting them downwards; extending the period for which the deduction for mortgage interest can be claimed by homeowners and reviewing the ceiling on the amount of interest claimable; and increasing the ceiling of the deduction for self-education expenses from HK\$40,000 to HK\$60,000.
4. Incentives – the introduction of incentives to enhance Hong Kong's competitiveness as a location for regional and group offices, and as an international financial centre. Proposals include group relief and loss carry-back, and a profits tax exemption for management and consultancy fees charged by regional offices to their overseas associates. The overall rates of profits and salaries tax should also be reduced at the earliest opportunity, in line with the international trend to reduce reliance on direct taxation and to keep Hong Kong competitive.
5. Community – including measures to promote and improve environmental awareness and protection; provide some assistance to the unemployed; and to encourage charitable donations.
6. "User pays" principle – the "user pays" principle should be followed, as far as possible, but subject to greater accountability by the government for costs of delivering public services and a willingness to explore ways of delivering of them more efficiently.

A summary of the main proposals is set out at section A1.4 of the [submission](#).

15. Institute Comments On The Revenue (Profits Tax Exemption For Offshore Funds) Bill 2005

As reported in [TechWatch No. 38](#), the Institute made a submission on the Revenue (Profits Tax Exemption for Offshore Funds) Bill ("the Bill") in October 2005. The objective of the Bill is to amend the Inland Revenue Ordinance to implement the proposal, announced in the 2003/04 Budget, to exempt offshore funds from profits tax.

More recently, the Bills Committee has invited the Institute to comment on the Administration's proposed Committee Stage Amendments ("CSAs") to the Bill. The Institute's [submission](#) notes that a number of additional improvements have been made to the Bill by the CSAs, although not all of the concerns expressed in the Institute's previous submissions on the Bill have been addressed. In particular, the Institute would also have liked the legislation to be more supportive of the local funds industry. Nevertheless, the submission states that, on balance, with the improvements so far introduced, the legislation should be workable and should be allowed to proceed. At the same time, it is hoped that the Administration will in due course consider the need for further legislative amendments to address some or all of outstanding concerns.

Corporate Finance

16. Submission To The SFC On Possible Reforms To The Prospectus Regime

As reported in [TechWatch No. 36](#), the SFC issued a [consultation paper](#) in August 2005 inviting comments on possible reforms designed to modernise the regime governing the public offering of shares and debentures, currently set out in Parts II and XII of the Companies Ordinance. The overriding purpose of the possible reform initiatives, as stated in the consultation paper, is to encourage capital raising and issuance of securities and investments in Hong Kong by adjusting

and refining the legal framework to facilitate offers, while ensuring satisfactory standards of investor protection.

The Institute's detailed comments on the proposals discussed in the consultation paper, and on related matters that impact upon the proposals, are set out in the [submission](#).

In general, the Institute does not have any objection, in principle, to the proposals that are introduced to provide a unified offering regime for all regulated investments, i.e., consolidating all securities laws into a single piece of legislation, although the Institute has some doubt as to whether, in practice, such proposals will reduce complexity and lower compliance costs.

Whilst the Institute would not have any strong objection to prohibiting the issue of written pre-initial public offering (IPO) research reports by connected analysts, as this could help to create a more level-playing field, it considers that there should continue to be some facility to allow the marketing of IPOs privately to institutional investors, investment professionals, etc.

The Institute, however, has serious reservations about the proposal to extend the civil liability regime without progress having been made on much-needed liability reform in Hong Kong. It also questions the appropriateness of placing too much emphasis on the responsibility of any single party, such as sponsors. The Institute is of the view that a detailed study and comparison with the regulatory regimes, civil and criminal, of other major financial markets (e.g., UK, US, Australia, etc.) should first be carried out and the information made available to market participants for further consideration. It also points out that Hong Kong should not create a liability regime that is out of step with international practice.

The Institute also disagrees with the proposals that extend the right to claim compensation for losses resulting from untrue statements in the prospectus to secondary market purchasers, and removing the need to prove that the investor relied on the prospectus.

International Meetings

17. International Accounting Standards Board Meeting

The International Accounting Standards Board met in London on 13 to 16 December 2005 and discussed the following topics:

- Conceptual Framework
- Insurance contracts
- Short-term convergence: income tax
- Fair value measurement
- Puttable instruments at fair value
- Accounting standards for small and medium-sized entities
- Update on IFRIC activities
- Joint ventures
- Technical plan

Click [here](#) to view the December 2005 IASB Update of the Board Decisions on IFRS.

18. International Financial Reporting Interpretations Committee Meeting

The International Financial Reporting Interpretations Committee met in London on 1 December 2005 and discussed the following topics:

- D16 *Scope of IFRS 2* - Proposal for a final Interpretation
- Interim Financial Reporting and Impairment of Goodwill and of Investments in Equity Instruments - Proposal for a draft Interpretation
- Tentative agenda decisions

Click [here](#) to view the December 2005 IFRIC Update of the newsletter of the IFRIC.

19. International Auditing & Assurance Standards Board Meeting

The IAASB met on 5 to 9 December 2005 in Cape Town and discussed topics on:

- Using the Work of an Expert
- Communications with Those Charged with Governance
- Related Parties
- The Audit of Group Financial Statements
- Materiality
- Due Process

Click [here](#) to obtain more information.

The IAASB's next meeting will be held in Hong Kong from 6 to 10 March 2006. Further details will be announced later on how we will make use of the presence of the IAASB board members and secretariat in Hong Kong.

Members of the Institute who wish to attend the IAASB's meeting from 6 to 10 March, as observers, are to register with the IAASB in accordance with the IAASB Guidelines. Click [here](#) for further details.

20. International Ethics Standards Board For Accountants Meeting

The IESB's next meeting will be held in New York from 20 to 22 February 2006.

International Newsbytes

21. New Trustees Appointed To The IASC Foundation

The IASC Foundation has announced the appointment of new Trustees, including:

- as Chairman of Trustees, Tommaso Padoa-Schioppa, a founding member of the Executive Board of the European Central Bank;
- as members, Marvin Cheung, retired Chairman of KPMG Hong Kong, and Liu Zhongli, President, Chinese Institute of Certified Public Accountants.

The Trustees have also reappointed Sir David Tweedie as Chairman of the IASB. The media release can be found [here](#).

Your Questions/Staff Answers

Please note that the staff answers only address general issues and provide general guidance. The staff answers do not constitute professional or legal advice. You need to base your accounting policies or any of your actions on Frameworks, Standards and other documents approved by the Council of the Institute, after taking account of your specific circumstances.

Q. I am a practising accountant and have recently been asked by a new client to accept nomination as its auditors. If the existing auditor of my new client does not reply to my request for professional clearance, what should I do? Can I accept the engagement?

A. The requirements regarding obtaining professional clearance is set out in Section 440 "Changes in a Professional Appointment" of the **Code of Ethics for Professional Accountants**. Paragraph 440.26 states that if the member does not receive within a reasonable time a reply to his communication to the existing auditor and he has no reason to believe that there are any unusual circumstances surrounding the proposed change, he should endeavour to get into touch with the existing auditor by some other means. If he is unable to do so, or is unable to obtain a satisfactory outcome in this way, he should send a further letter, preferably by recorded delivery service, stating that unless he receives a reply within a specified time, he will assume that there are no matters of which he should be aware before deciding whether to accept.

Q. HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors requires changes in accounting policies (except where a standard contains a transitional provision) and corrections of errors to apply the change or correction retrospectively, unless retrospective restatement is 'impracticable'. What does 'impracticable' mean?

A. **HKAS 8**, paragraph 5, defines 'impracticable' and HKAS 8, paragraphs 50-53 and BC25-BC27, further explain its meaning. Impracticable does **not** mean that an estimate of restated amounts is required. Impracticable does **not** mean that the restatement requires some work.

Retrospective restatement is impracticable if:

- the necessary data was not collected in a prior period and it is not practicable to collect that data now because, for example, records have not been kept and cannot be recreated;
- assumptions about management's intent is required and the intention at the time was not recorded in some way. For example, if there is no record about management's plans whether to hold a financial asset to maturity or to hold it for possible sale, then it is not practicable to measure the instrument at that prior date as it cannot be classified;
- it is not possible to distinguish information that would have been available at the past date from information that is available today. For example, assume that you need to estimate the fair value of a specialised piece of equipment on a date 3 years before the balance sheet date. If you had been calculating the fair value three years ago, you would have collected information at that time to assist in the valuation. If similar 'back-dated' information cannot be collected today, you cannot estimate the fair value of that piece of equipment at that date.

Comment Due Dates

DATE	SUBJECT
10 February 2006	IAASB Exposure Draft – Improving the Clarity of IAASB Standards
10 April 2006	IAASB Exposure Draft of ISA 550 (Revised) on Related Parties
12 April 2006	IASB Discussion Paper on Management Commentary
28 April 2006	IASB Discussion Paper on Measurement Bases for Financial Accounting – Measurement on Initial Recognition

Please send comments to commentletters@hkipa.org.hk