



TechWatch

News at a glance



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TechWatch updates you on technical developments in financial reporting, auditing, regulation and business. The Institute welcomes your comment, emailed to commentletters@hki CPA.org.hk. Click [here](#) for past issues.

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Spotlight

1. Handbook Update 37 – New HK(IFRIC) Interpretation 11

Update 37 encloses new HK(IFRIC) Interpretation 11 *HKFRS 2 – Group and Treasury Share Transactions*, which is effective for annual periods beginning on or after 1 March 2007.

HK(IFRIC)-Int 11 is converged with the equivalent IFRIC Interpretation. It addresses how to apply HKFRS 2 *Share-based Payment* to share-based payment arrangements involving an entity's own equity instruments or equity instruments of another entity in the same group.

It requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity-instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed for the transaction are obtained. It also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent, should be accounted for as cash-settled or equity-settled in the entity's financial statements.

2. New Technical Update Evening (TUE) Programme

The new **TUE programme** covering the period from February to April 2007 features a number of important financial reporting, ethics and auditing topics, which include:

- 701 (27 February) Proposed New Auditor Independence Requirements
- 702 (13 March) Fair Value Measurements Discussion Paper
- 703 (20 March) Group and Treasury Share Transactions and Service Concession Arrangements – HK(IFRIC) Interpretations 11 and 12

- 704 (17 April) Operating Segments – HKFRS 8
- 705 (24 April) Review of Interim Financial Information Performed by the Independent Auditor of the Entity – HKSRE 2410

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

Financial Reporting

3. FRSC Meeting Summary – 13 December 2006

This **FRSC meeting summary** covers:

- Proposed HKFRS 8 *Operating Segments*
- Proposed HK(IFRIC) Interpretation 11 *HKFRS 2 – Group and Treasury Share Transactions*
- Proposed HK(IFRIC) Interpretation 12 *Service Concession Arrangements*
- IASB Discussion Paper *Fair Value Measurements*
- Draft Policy on providing Interpretations or Rulings on financial reporting issues
- Report from the SME Financial Reporting Framework Sub-Committee
- Referral from the Expert Panel on Securities on accounting treatment of clients' trust monies held in trust or in segregated accounts by licensed corporations
- IASB/FASB round-table discussions on measurement
- Meeting of National Standard Setters

Audit & Assurance

4. Audit Issues Q&As: Audit of Licensed Corporations and Associated Entities of Intermediaries

The [Audit Issues Questions & Answers](#) (“Q&As”) on Audit of Licensed Corporations and Associated Entities of Intermediaries, issued by the Institute’s Expert Panel on Securities in January 2007, are to raise practising members’ awareness of the common audit issues that may be encountered by auditors of licensed corporations and associated entities of intermediaries. They should be read in the light of the Institute’s Practice Note 820 *The Audit of Licensed Corporations and Associated Entities of Intermediaries*.

Topics covered in the Q&As include:

- Some features of the HKSAs issued since the issuance of Practice Note 820 in February 2004; and
- Example unqualified audit report effective for auditor’s reports dated on or after 31 December 2006.

5. Invitation to Comment on IAASB EDs of Proposed ISAs 230, 540, 560, 580, 610 and 720

The Institute has issued an [Invitation to Comment](#) on a number of International Auditing and Assurance Standards Board (“IAASB”) exposure drafts (“EDs”), in two parts:

Part A

ISA 230 (Redrafted) *Audit Documentation*, ISA 560 (Redrafted) *Subsequent Events*, ISA 610 (Redrafted) *The Auditor’s Consideration of the Internal Audit Function* and ISA 720 (Redrafted) *The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*, with comments requested by **16 March 2007**.

Part B

ISA 540 (Revised and Redrafted) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* and ISA 580 (Revised and Redrafted) *Written Representations*, with comments requested by **16 April 2007**.

The Explanatory Memorandum to the EDs provides background information and explanation of the proposed ISAs. In summary, the IAASB’s intentions in developing the revisions to the ISAs are set out below:

- Proposed ISAs 230, 560, 610 and 720 are redrafted to provide clearer requirements and easy to understand application guidance, with no changes proposed to the requirements in the standards.
- Proposed ISA 540, which combines the extant ISA 540 and ISA 545 *Auditing Fair Value Measurements and Disclosures*, is revised to reinforce best practice and cause the auditor to give appropriate attention to areas of accounting judgement, such as assumptions, and to possible bias.
- Proposed ISA 580 is revised to improve the quality and appropriateness of written representations sought by the auditor and, in particular, to deal with concerns about whether auditors may over-rely on representations at the expense of other evidence.

Ethics

6. Invitation to Comment on IESBA ED on Auditor Independence Requirements

The Institute has issued an [Invitation to Comment](#) on the IFAC International Ethics Standards Board for Accountants (“IESBA”) exposure draft (“ED”) on Auditor Independence Requirements, with comments requested by **16 April 2007**.

The ED proposes to update and strengthen the auditor independence requirements contained in the IFAC Code of Ethics for Professional Accountants (“the Code”). The Explanatory Memorandum to the ED provides background information and explanation of the proposed modifications to the Code.

In summary, the significant proposed modifications to the Code include:

- Section 290 of the Code *Independence* will be split into two parts: one covering audit and review engagements and the other on other assurance engagements.
- Some detailed changes to requirements on financial interests in entities which control the audit client.
- An extension of those additional requirements currently applicable to the audits of listed entities to include audits of other entities of significant public interest (“ESPIs”).
- The term ESPIs will be left to member bodies to define, though guidance is given to explain that ESPIs will always include listed entities and, depending upon facts and circumstances, will normally include banks, governments, insurance companies and other regulated financial institutions and may include pension funds, government-agencies, government controlled entities and not-for-profit entities.
- The introduction of a cooling off period for key audit and certain other partners involved in the audit of ESPIs.
- The introduction of a requirement to rotate engagement partners when auditing ESPIs.
- Extension of the new ESPI partner rotation requirements to key audit partners other than the engagement partner.
- Tightening up the provision of non-assurance services in relation to valuation services, recruiting senior management, the provision of corporate finance services and the provision of IT systems.
- Additional guidance on the provision of taxation services which highlights that, in principle, provision of any tax services could create a threat to independence:
 - Tax return preparation is generally not a threat to independence;
 - Tax planning work should be considered to see if it has material effect on the financial statements being audited;
 - Calculation of material tax liabilities for clients who are ESPIs is prohibited; and
 - Restrictions are placed on when auditors can publicly represent their clients in the resolution of tax disputes.

Taxation

7. 2007 Annual Meeting with the Commissioner of Inland Revenue

Representatives of the Institute met the Commissioner of Inland Revenue (“CIR”) and members of her staff (“the IRD”) on 26 January 2007 (as members were previously notified in [TechWatch No. 50](#)). The minutes of the 2007 annual meeting are being prepared and, once they have been agreed, they will be published as a Tax Bulletin. [Tax Bulletins](#) containing the minutes of past years' annual meetings can be accessed at the Institute's website.

At the 2007 annual meeting, upon the Institute's request, it was agreed that information regarding some of the more urgent matters could be released prior to the publication of the Tax Bulletin. On this basis, the following points, which were amongst the issues discussed at the meeting, are for members to note and act upon, as appropriate.

Filing deadlines for the 2006/2007 tax returns

The CIR confirmed that the deadlines for lodging tax returns for the year of assessment 2006/2007 are as follows:

"N" Code – 2 May 2007 (no extension)

Under the Block Extension Scheme:

- "D" Code – 15 August 2007 (no change)
- "M" Code – 15 November 2007 (no change)
- "M" Code current year loss cases – 31 January 2008 (no change)

DIPN 15 (Revised) – Part B: Leasing Arrangements

Depreciation allowance on plant and machinery under contract processing arrangement

The IRD noted that, under a contract processing arrangement, a Hong Kong company may be required to provide plant and machinery ("P&M") to a Mainland enterprise for its use in the Mainland. Where the Hong Kong company is entitled to the concession of granting a 50% depreciation allowance on the P&M, the claim should be made on the basis of a depreciation allowance and not as a capital expenditure deduction under section 16G of the Inland Revenue Ordinance ("IRO").

As regards the eligibility for claiming a depreciation allowance under a contract processing arrangement, the IRD advised tax representatives and taxpayers to take note of paragraph 19 of [Departmental Interpretation and Practice Notes \("DIPN"\) No. 15 \(Revised\)](#) in preparing the 2006/07 tax returns.

Commercial and Industrial Building Allowance

The IRD clarified that, under the IRO, the calculation of commercial and industrial building

allowances ("CBA / IBA") are based on the historical cost of construction and not the fair value of the building. Therefore, HKAS 17, which requires accounting separately for the cost of the land and building elements in proportion to their relative fair values at the inception of a lease, does not have any impact on the calculation of CBA / IBA. The IRD will continue to adopt its existing practice in the calculation of CBA / IBA.

Declaration of due representation in the application for block extension

The IRD wished to remind all tax representatives of the new arrangement introduced last year, that they are required to make a declaration in their applications for block extension confirming that they have obtained written authorisation from their clients appointing them as tax representatives. The authorisation from clients should be in writing and bear the client's signature. Email authorisation will not be accepted. Applications made without confirmation of authorisation from clients will be rejected and will need to be resubmitted once authorisation has been obtained.

International Meetings

8. IASB/FASB Roundtables on Measurement and HKFRSs/IFRSs Forum

IASB/FASB Roundtables

Two IASB/FASB Roundtables were held on 16 and 17 January 2007 in Hong Kong. The Roundtables were hosted by the IASB Chairman (Sir David Tweedie), two IASB Board Members (Messrs. Warren McGregor and Tatsumi Yamada), the IASB Director of Technical Activities (Ms. Elizabeth Hickey) together with a member of the FASB staff (Mr. Kevin McBeth) who works on the joint IASB/FASB project on measurement. The two Roundtables were attended by 20 participants from Hong Kong, the Mainland, Australia, Japan, Singapore, Korea and Malaysia at the invitation of the IASB.

The Roundtables were an initial discussion forum without any key commitments from the IASB. They provided an opportunity to deliberate on the suitable methods of measurement. It was noted that most participants preferred a mixture of measurement basis comprising of historical cost, amortised cost, fair values, present value, replacement cost and others. Most were happy with fair value for investments as long as fair values could be measured reliably.

As the Institute has not yet formulated any official view on the subject, its representative raised his personal view which were echoed by many others, as follows:

- Manage the balance between reliability and relevance. Historical cost based measurements are generally more reliable and easier to develop, although historical cost is not well-designed to cope with accounting for transactions involving leasing, complex financial instruments and share based-payments. In all these examples, items that are apparently valuable may have no historical cost or a historical cost of zero. On the other hand, value based measurements may provide more relevant information but it is more difficult in many cases to develop fair value (the IASB's present discussion paper on Fair Value Measurements is evidence of this). In particular, jurisdictions that are less sophisticated than the UK and the US will have great difficulty in providing fair values for many transactions and events. Even taking the FAS 157 fair value hierarchy approach, fair value measurements become more subjective the more they depend on inputs from lower levels in the fair value hierarchy.
- Concern that users of financial statements give more credibility to aggregates than those aggregates deserve. For example, users of financial statements may assess the size of a company by considering total assets without understanding the impact of our mixed measurement model (and the

options in various standards) on such totals. At the moment, we are where we were 30 years ago with foreign currencies before we learnt to convert currencies to a common base. It is the hope that assets held by different companies might eventually be truly comparable.

- Measurement should not be separated into different stages in their life cycles or segments. There is a need for "cradle to grave" robust measurement concepts that help standard setters, preparers, auditors and users of financial statements to understand how measurement should be applied to all transactions and events. This will help us to determine what capital maintenance concept should apply and the consequential effect on profit and net assets.
- Any measurement methods would eventually have to be subject to assurance procedures – which include external audit, internal audit etc. Some research on the auditability of information prepared on different measurement bases would be useful.
- Finally, to be controversial, what is the IASB's thinking on fair value? We do not hold the commonly expressed view that the IASB is hoping to bring in fair value for all assets through the current fair value measurement project or the first Discussion Paper for this part of the conceptual framework project. However, it does appear that fair value has a number of benefits (such as comparability) and a number of disadvantages (such as day 1 profits on the purchase of inventory). We would like the IASB to complete the Framework project before any further measurement developments within IFRSs.

Some notes (in brief) of the views expressed by some of the participants were:

- Aggregated historical costs are not very meaningful as the amounts represent costs at different times.

- There are problems with fair valuing in some countries as "real" fair values cannot be easily obtained.
- Initial measurement need not be the same as subsequent measurement.
- There should be a clear distinction between financial assets/liabilities and operating assets/liabilities.
- Mixed measurement basis should also take into account cash flows to the entity.
- Deliberations on whether management or economic intent should be taken into account in determining measurement basis, as this can be subject to manipulations.
- Cooperate with valuation or appraisal institutes in various jurisdictions to reduce misunderstandings between auditors, appraisers and standard setters.
- Concern over "valuation" shopping.
- Consider using the value of the asset to the business rather than being skewed too much towards investors' needs.
- Any measurement bases should take into account implementation issues and complexity such that it would not result in auditing in a "vacuum".

HKFRS/IFRS Forum

The HKFRS/IFRS Forum was attended by around 180 Institute members. Messrs. Warren McGregor and Tatsumi Yamada and Ms. Elizabeth Hickey of the IASB were speakers. The key topics addressed were:

- Accounting for leases;
- Financial statement presentation project; and
- IASB work programme.

At the Forum, views on the following subjects were raised with the IASB delegates:

- The complexity and understandability of financial statements prepared under IFRSs.
- The importance of IFRSs on leases and investment properties in this part of the world.
- The urgent need for speedy revisions to the related party standard and income tax standard.
- The need to have a workable standard for SMEs.

9. International Accounting Standards Board

The IASB met in London on 23 – 25 January 2007 and discussed the following topics:

- Business Combinations II
- Financial instruments
- Financial instruments puttable at fair value and obligations arising on liquidation
- Liabilities and Equity
- IFRS 2 *Share-based Payment*
- Insurance
- Financial statement presentation
- Accounting standards for small and medium-sized entities
- IAS 24 *Related Party Disclosures*
- IAS 37 redeliberations
- Fair value measurements
- Intangible assets

- Short-term convergence: income taxes
- Update on IFRIC activities
- Management commentary

Click [here](#) to view the January 2007 IASB Update. The IASB next meets on 19 – 23 February 2007.

10. International Financial Reporting Interpretations Committee

The IFRIC met in London on 11 and 12 January 2007 and discussed the following topics:

- Draft IFRIC Due Process Handbook
- D20 *Customer Loyalty Programmes*
- IAS 18 *Revenue* – Revenue Recognition in respect of Initial Fees
- IAS 19 *Employee Benefits* – Distinction between Curtailments and Negative Past Service Costs
- IAS 21 *The Effects of Changes in Foreign Exchange Rates* – The Hedge of a Net Investment in a Foreign Operation
- IAS 38 *Intangible Assets* – Advertising and Promotional Expenditure and Catalogues
- IAS 41 *Agriculture* – Recognition and Measurement of Biological Assets and Agricultural Produce in accordance with IAS 41
- IFRIC Agenda Decisions
- Tentative Agenda Decisions
- Update on Agenda Committee Business

Click [here](#) to view the January 2007 IFRIC Update. The IFRIC next meets on 8 and 9 March 2007.

11. International Auditing and Assurance Standards Board

The IAASB will meet in New York from 13 – 16 February 2007. Click [here](#) for registration and for the meeting summary of the December 2006 meeting held in London.

12. International Ethics Standards Board for Accountants

The IESBA will meet in New York on 6 and 7 March 2007. Click [here](#) for registration and for the meeting summary of the December 2006 meeting held in London.

For Information

13. Competition Policy Advisory Group Publishes 2005-2006 Annual Report

The Competition Policy Advisory Group (“COMPAG”), chaired by the Financial Secretary, was established in December 1997 to provide a high-level and dedicated forum to review competition-related issues that have substantial policy or systemic implications, and to examine the extent to which more competition should be introduced in the public and private sectors.

COMPAG has recently published its [2005-2006 annual report](#), which outlines the government’s efforts to promote competition in various sectors during the reporting period. As reported in [TechWatch No. 50](#), the government is currently consulting on the future direction of competition policy in Hong Kong. Proposals are contained in a consultation document “[Promoting Competition – Maintaining Our Economic Drive](#)”. The deadline for submissions is 5 February 2007.

14. Standing Committee on Company Law Reform Publishes 2005-2006 Annual Report

The Standing Committee on Company Law Reform (“SCCLR”) was formed in 1984 to advise the Financial Secretary on amendments to the Companies Ordinance and related ordinances.

The SCCLR has recently released its **Twenty-Second Annual Report 2005/2006**, setting out the subject matters considered during the reporting period.

15. Companies Registry News Update

- (i) The statistics for company registrations in 2006 are contained in a [press release](#) issued by the Companies Registry on 30 January 2007.
- (ii) Updated version of the following information pamphlets have been released and posted on the Companies Registry's website:

General Information

- [Information on Presenting Documents to the Companies Registry](#)

Incorporation

- [Incorporation of a Local Limited Company](#) (renamed from "Formation of a Local Limited Company")
- [Change of Name of a Local Limited Company](#)

Registration of Documents

- [Filing of Annual Return by a Local Limited Company](#)
- [Registration of Charges and their Discharge](#)

Search Services

- [How to Obtain Company Information](#)

Money Lender Licence

- [How to apply for a Money Lenders Licence](#)

Comment Due Dates

12 March 2007: [IASB Discussion Paper](#) on *Fair Value Measurements*

16 March 2007: [IAASB Exposure Drafts](#) of ISA 230 (Redrafted) *Audit Documentation*, ISA 560 (Redrafted) *Subsequent Events*, ISA 610 (Redrafted) *The Auditor's Consideration of the Internal Audit Function* and ISA 720 (Redrafted) *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*.

16 April 2007: [IAASB Exposure Drafts](#) of ISA 540 (Revised and Redrafted) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* and ISA 580 (Revised and Redrafted) *Written Representations*.

16 April 2007: [IFAC IESBA Exposure Draft](#) on Auditor Independence Requirements – Section 290 of the Code of Ethics *Independence – Audit and Review Engagements* and section 291 of the Code of Ethics *Independence – Other Assurance Engagements*.

Please send comments to
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