



# 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@hkicpa.org.hk](mailto:commentletters@hkicpa.org.hk) >. Click [here](#) for past issues.

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*Financial Reporting, Auditing and Ethics by:*  
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*Specialist Practices, Business Members and Advocacy by:*  
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## Financial Reporting, Auditing and Ethics

### New!

#### 1. Financial Reporting Forum – Developments in Proposed IFRS on Revenue Recognition and Leases

Tatsumi Yamada, the IASB member, is visiting Hong Kong to attend a Financial Reporting Forum – Developments in proposed IFRS on Revenue Recognition and Leases held by the Institute on 2 September 2010 to talk about the latest development in accounting for revenue recognition and leases.

To secure seats, please register early by completing the [registration form](#).

#### 2. Re-run HKFRS for Private Entities Workshops

The Institute will re-run two HKFRS for Private Entities Workshops in September and October 2010. This education initiative for the HKFRS for Private Entities Workshops will take place over three days. Each day will be broken down into a number of sessions. Each session will include plenary instruction followed by group break-out exercises and group feedbacks. The agenda of the workshops is based largely on the IASB training materials with practical guidance on application of all sections of the standard.

Click [here](#) for enrolment details.

### Members' Handbook

#### 3. Handbook Updates No. 89 & 90

- (i) **Update No. 89** contains consequential amendments to HKFRSs which were previously set out in the appendix to the standards as they were not yet effective. The Institute has taken this opportunity to incorporate amendments applicable on 1 January 2010 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

- (ii) **Update No. 90** relates to editorial changes to clarified auditing standards made by IAASB and withdrawal of practice notes.

In April 2010, the International Federation of Accountants published the 2010 edition of the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* (2010 Handbook) and made editorial and formatting changes in finalizing the 2010 Handbook. As part of the convergence with the International Standards on Quality Control and Auditing, the changes have been made to the Hong Kong Standards on Quality Control and Auditing.

PN 1001 *IT Environments – Stand-Alone Personal Computers*, PN 1002 *IT Environments – On-Line Computer Systems*, PN 1003 *IT Environments – Database Systems* and PN 1009 *Computer-Assisted Audit Techniques* are withdrawn as the corresponding International Auditing Practice Statements 1001, 1002, 1003 and 1009 had been withdrawn.

### Financial Reporting

#### 4. FRSC Minutes

This **FRSC minutes** on 1 June 2010 covers:

- Accounting Application Issues
- Consultation Paper on Companies Ordinance Rewrite relating to Accounts and Audit
- National Standard Setters proposed involvement in the IASB Conceptual Framework Projects
- Consideration of IASB Consultation Documents

## 5. Invitation to Comment on IASB ED of *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*

The Institute has issued an **Invitation to Comment** on IASB ED of *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*, with comments requested by 20 August 2010.

The proposal contains further enhancements to a disclosure proposal on Level 3 fair value measurements that formed part of the IASB's ED *Fair Value Measurement* published in May 2009.

In the ED, the IASB proposed a three-level fair value hierarchy that categorizes observable and non-observable market data used as inputs for fair value measurements. According to that hierarchy, Level 3 inputs are "unobservable inputs" used for the fair value measurement of assets or liabilities for which market data are not available.

In response to comments received, the IASB proposes to enhance its original proposal by requiring the measurement uncertainty analysis disclosure to reflect the interdependencies between unobservable inputs used to measure fair value in Level 3. Users of financial statements commented that this information would allow them to assess the effect that the use of different unobservable inputs would have had on the fair value measurement.

The FASB is publishing the proposals in the ED *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. Both boards will consider the comments received on the exposure drafts jointly as they continue their discussions about fair value measurement.

## 6. Institute Comments on IASB EDs

### (i) IASB ED on *Financial Instruments: Amortized Cost and Impairment*

The Institute made a **submission** to IASB ED on *Financial Instruments: Amortized Cost and Impairment* and generally supports

the direction proposed by the IASB to include forward looking credit expectations within the impairment model. However, the Institute has significant concerns with some conceptual and practical implementation aspects of the expected cash flow model as proposed in the ED:

- The proposal of presenting impairments (including expected losses) together with effective interest on the income statement is not consistent with the business models of most banking entities.
- An impairment loss under the proposed approach actually includes both the actual incurred loss and future expected credit losses.
- It is highly impractical and subjective to require management to estimate future credit losses over the expected life of the relevant financial asset or portfolio of financial assets and across a whole range of possible outcomes.
- The probability-weighted possible outcome model is quite difficult to understand and implement for small portfolios and individual loans and result in numbers which are difficult to explain and verify.
- It is impractical to estimate amortized cost and expected losses for open portfolios as required in the ED.
- The Institute does not agree with the ED's proposal to recognize expected losses on trade receivables upfront as a deduction against revenue as it is believed that this adds little value to users of financial statements as such receivables are usually short term in nature and they are not held to generate interest revenue.

- A very long implementation period will be required and given the high subjectivity and low reliability of the likely results, it is unlikely that the benefits will outweigh the costs.

(ii) IASB ED on *Fair Value Option for Financial Liabilities*

The Institute made a **submission** to IASB ED on *Fair Value Option for Financial Liabilities* and generally supports the IASB's aims to remove the impact of changes in "own credit" risk on a liability from profit and loss. It is agreed that recognition of changes in own credit risk for a liability carried at fair value in the profit or loss leads to counter-intuitive accounting and does not provide decision-useful information.

Although the Institute agrees that fair value changes due to changes in an entity's own credit risk from re-measurement of financial liabilities designated under the fair value option should not affect profit or loss, and accepts the recognition of these gains/losses in other comprehensive income (OCI) as a pragmatic solution to this issue, the Institute is concerned that the proposal is another requirement to classify items into OCI without a clear and conceptual meaning of what is OCI and what it should be used for. Therefore, the Institute strongly recommends that the IASB's project on *Financial Statement Presentation* should consider the purpose of OCI, establish a principle for recognition of gains and losses therein and consider the appropriateness of recycling between profit or loss and OCI.

(iii) IASB ED on *Conceptual Framework for Financial Reporting: The Reporting Entity*

The Institute's **submission** is supportive of the ED's proposed description of a reporting entity which attempts to cover a broad range of financial information. It is noted that it will include what normally would not be regarded as general purpose financial statements. If the intention is to make it as wide as possible, it is believed it could be perhaps described more simply as "a

separately identifiable unit of economic activities whose financial information provides useful information to its proposed intended users".

Although the Institute agrees that a reporting entity need not necessarily be a legal entity, the Institute believes using a legal entity as starting reference point is useful in explaining the concept of a reporting entity as the existence of a legal entity normally triggers a reporting requirement either under the law of its place of incorporation or under accounting standards.

Moreover, it is noted the ED describes how to determine a reporting entity and also touches on "control" in determining the circumscribed area. It is believed this complicates the issue and believe that the meaning of "control" could be developed and expanded elsewhere in detailed accounting standards which provide guidance on "how" and "what" information on the reporting entity should be presented.

It is noted that IAS 27 *Consolidated and Separate Financial Statements* exempts a parent entity from preparing consolidated financial statements in specified circumstances (IAS 27.10). This exemption is inconsistent with the proposal in the ED that parent-only financial statements should only be presented together with consolidated financial statements. Also, it is believed that this would create inconsistency with regulatory requirements in jurisdictions that require the preparation of financial statements for the parent alone. It is considered that the question of the type of financial statements published by a parent entity (i.e. whether consolidated or parent-only) should be primarily a matter for local company legislation to mandate. IFRS may mandate additional disclosures beyond those required by legislation and should focus primarily only with the content of those different types of financial statements.

Given the project on the conceptual framework is of critical importance, it is agreed that this project should not be delayed until the standards on consolidation have been issued. However, it is important to ensure that those standards that are issued at the standards level in the future must not introduce any fundamental new concepts as they should first be debated at the conceptual level.

## Audit & Assurance

### 7. AASC Minutes

This [AASC minutes](#) on 22 June 2010 mainly covers:

- Clarified HKSA 505 *External Confirmations*
- Revisions to HKSA 210 *Agreeing the Terms of Audit Engagement*
- Revised HKSIR 400 *Comfort Letters and Due Dilligence Meetings on Financial and Non-financial Information*
- Annual Auditing Update Conference 2010
- Matters arising from the Companies Ordinance Rewrite Consultation
- Accounting Application Issue

### 8. Invitation to Comment on IAASB ED on Proposed ISA 315 (Revised) and ISA 610 (Revised)

The Institute has issued an [Invitation to Comment](#) on IAASB ED on Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and ISA 610 (Revised), *Using the Work of Internal Auditors*, with comments requested by 15 October 2010.

The IAASB's objective in revising ISA 315 and ISA 610 is to enhance the performance of external auditors by:

- enabling them to better consider and leverage, as appropriate, the knowledge

and findings of an entity's internal audit function in making risk assessments in the external audit, and

- strengthening the framework for the evaluation and, where appropriate, use of the work of internal auditors in obtaining audit evidence.

The IAASB believes that the proposed revision will enhance the quality of audits internationally.

## Ethics

### 9. Highlight on the Revised Code of Ethics for Professional Accountants

The Institute issued the Revised Code of Ethics for Professional Accountants (Revised Code) in June 2010, which will be effective from 1 January 2011. The Revised Code is based on the Code of Ethics for Professional Accountants (IESBA Code) issued by the IESBA in July 2009.

Core changes are described below:

- New and consistent drafting conventions have been adopted throughout the IESBA Code issued in July 2009.
- There is an enhanced explanation of the "conceptual framework approach". This includes a requirement to apply safeguards, when necessary, to eliminate threats or reduce them to an 'acceptable level'.
- The IESBA Code issued in July 2009 includes a revised description of the "threats", together with modified examples of circumstances which create threats.
- Reviews of financial statements are subject to the same independence requirements as audits of financial statements.
- The existing Section 290 (Independence) has been split into two sections (i) Section 290, dealing with audit and review engagements; and (ii) Section 291, dealing with other assurance engagements.

Also, key revisions are made to Section 290 (Independence – Audit and Review Engagements) and are summarized as follows:

- (a) extends certain independence requirements to all public interest entities.
- (b) introduces additional guidance on what firms are required to document as to their conclusions regarding compliance with independence requirements.
- (c) introduces new requirements and application guidance addressing situations where, as a result of a merger or acquisition, an entity becomes a related entity of an audit client.
- (d) introduces a new term "Key Audit Partner" to whom, notably in the case of Public Interest Entities, certain requirements will apply.
- (e) introduces a new section dealing with 'Management Responsibilities'.
- (f) contains new provisions relating to threats that are created by certain tax services.
- (g) enhances discussion of nature of Corporate Finance Services, the threats created, factors to consider and potential safeguards.
- (h) includes (and extends) certain specific requirements in relation to public interest entities.
- (i) introduces a new prohibition on contingent fees for a non-audit assurance service to an audit client if certain specified conditions are met.
- (j) introduces a requirement that a Key Audit Partner shall not be evaluated on or compensated based on that partner's success in selling non-assurance services to the partner's audit client.

(k) introduces a new requirement where the total fees from the audit client exceed 15% of the total fees of the firm for two consecutive years.

(l) contains new modified independence requirements relating to certain audit and review reports that include a restriction on use and distribution.

#### Key local addition

The Revised Code has also been enhanced to include an additional paragraph 240.7A, which reflects the legal requirement in Hong Kong and additional guidance on the application of the Prevention of Bribery Ordinance.

Members should note that under the Prevention of Bribery Ordinance, there are provisions governing acceptance of any payment by someone who is in an agent-principal relationship with another person. For example, if an agent receives payment from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the payment in order to avoid the risk of contravening the Prevention of Bribery Ordinance.

The same principle applies to someone who is paying another person who is in an agent-principal relationship with some other person: the payer should ensure that the agent has obtained permission from his principal for receiving the payment.

Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Members should consult their own legal advisors as and when necessary.

In order to support implementation of the IESBA Code, the IESBA staff has prepared some adoption and implementation materials in the "Resources" section of its website. Click [here](#) for details.

The Institute will hold re-run seminars on 7 September, 5 October and 2 November to discuss the key changes in the code. To secure your seats, please register early by completing the [registration form](#) and returning it to the Institute.

## 10. Ethics Committee Minutes

This EC minutes on [6 May](#) and [26 May](#) 2010 covers:

- Report from the HKICPA representative on IFAC Small and Medium Practice Committee-Mr. Albert Au
- The proposed revised HKICPA Code of Ethics for Professional Accountants
- Revised Statement 1.500 Continuing Professional Development

## International Meetings

### 11. International Accounting Standards Board

The IASB met on 19-23 July 2010, and discussed the following topics:

- Amortized cost and impairment
- Annual improvements
- Consolidation
- Conceptual framework-measurement
- Derecognition
- Financial instruments - liabilities
- Financial Instruments with characteristics of equity
- Hedge accounting
- IAS 29 *Financial Reporting in Hyperinflationary Economics* – Reporting in accordance with IFRSs after a period of severe hyperinflation

- IFRS Advisory Council: Update from last meeting
- IFRS Interpretations Committee update
- Income taxes
- Insurance contracts
- Leases
- Rate-regulated activities

Click to view the IASB Update on the meeting on [19-23 July](#). The IASB next meets in August 2010.

### 12. IFRS Interpretations Committee

The IFRS Interpretations Committee met on 8-9 July 2010, and discussed the following topics:

- Accounting for production stripping costs
- Vesting and non-vesting conditions
- Put options written over non-controlling interests
- IFRS Interpretations Committee agenda decisions
- IFRS Interpretations Committee tentative agenda decisions
- Issues considered for *Annual Improvements*
- IFRS Interpretations Committee work in progress

Click to view the IFRIC Update on the meeting on [8-9 July](#). The IFRS Interpretations Committee next meets in September 2010.

### 13. International Auditing and Assurance Standards Board

The IAASB next meets in September 2010. Click [here](#) for the next meeting's details and previous meeting summary.

## 14. International Ethics Standards Board for Accountants

The IESBA next meets in November 2010. Click [here](#) for the next meeting's details and previous meeting summary.

### Useful Resources

## 15. Publications

The following are publications on various topics:

- (i) Update on IASB's modified work plan:
  - [IFRS in focus](#) by Deloitte
- (ii) IASB project on fair value measurement:
  - [Comprehensive project summary](#) by IASB
- (iii) HKFRS for Private Entities:
  - [HKFRSs/IFRSs update](#) by BDO
- (iv) G20 Toronto summit:
  - [Briefing sheet](#) by KPMG
- (v) Proposed changes to impairment models for financial assets:
  - [IFRS outlook](#) by Ernst & Young
- (vi) Committee of European Securities Regulators enforcement decisions:
  - [Eighth extract from European Enforcers Co-ordination Sessions' database of enforcement decisions](#) by Committee of European Securities Regulators
- (vii) IFRS update:
  - [Executive guide to IFRS](#) by PwC

### Comment Due Dates

**20 August 2010:** IVSC ED *Proposed New International Valuation Standards*

**20 August 2010:** IASB ED of *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*

**23 August 2010:** IASB ED of Proposed Amendments to IAS 19 – *Defined Benefit Plans*

**31 August 2010:** IAASB ED on Proposed ISAE 3420 *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*

**13 September 2010:** IASB ED of *Presentation of Items of Other Comprehensive Income (Proposed amendments to IAS 1)*

**17 September 2010:** IASB Request for Comment on FASB *Financial Instruments* ED

**8 October 2010:** IASB ED of *Revenue from Contracts with Customers*

**15 October 2010:** IAASB ED on Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and ISA 610 (Revised), *Using the Work of Internal Auditors*



## Specialist Practices, Business Members and Advocacy

### Corporate Finance

#### 16. Institute Submits Views on Statutory Price Sensitive Information Disclosure Requirements

As reported in [TechWatch no. 90](#), the government released a consultation paper on the proposed statutory codification of certain requirements for listed companies to disclose price sensitive information (PSI). The Institute issued a [submission](#) commenting on various proposals.

While the Institute supports, in principle, measures to encourage more timely disclosure of PSI, there are concerns about the proposed PSI framework since decisions as to whether certain information would be likely to be seen by investors as price sensitive, in any given circumstances, may be quite subjective and judgmental in nature. The Institute, therefore, emphasizes the need for more specific guidance to be issued and for the existence of effective ongoing channels of communication between listed companies and regulators.

The Institute considers that the safe harbour provisions, which are a key part of the PSI framework, setting out the circumstances in which disclosure may be delayed or withheld, should be extended. They need to accommodate situations where the companies or directors who have considered a particular situation and have, in good faith, come to the conclusion that certain information is not price sensitive, even though subsequently, with the benefit of hindsight (which will be available to the market misconduct tribunal (MMT)), that the judgment may turn out to be incorrect.

It is believed that the aim of the proposed legislative framework should be to help companies and directors to understand their disclosure obligations and encourage them to comply, rather than seek to impose the most

stringent penalties, which could ultimately act as a disincentive to suitable candidates to take up directorships. Under the circumstances, the Institute suggests that there is scope for removing some of the harsher proposed penalties or reducing their severity, and that any remedial action taken by the regulators and the MMT, where breaches are alleged, should adopt the principle of proportionality. It is also suggested that a fairly cautious approach should be adopted in implementing a statutory PSI disclosure regime for the first time in Hong Kong. Once the market has become accustomed to the way in which the framework operates and the expectations of all interested parties, if considered desirable, further changes can be considered in future.

### Insolvency & Corporate Restructuring

#### 17. Consultation Conclusions on Corporate Rescue Procedures

On 9 July 2010, the government published the [conclusions](#) drawn from the public consultation on the review of the legislative proposals to introduce a corporate rescue procedure. The objective is to provide a statutory "grace period" for companies with long-term viability, which may be facing short-term financial difficulties, so that they can restructure their business or debts, or seek a capital injection and so be turned around. Many of the submissions welcomed the introduction of a statutory corporate rescue procedure, and a majority of the submissions indicated support for many of the legislative proposals. See [TechWatch no. 89](#) for the Institute's submission.

A full summary of the proposals to be adopted is set out under paragraph 126 on pages 30 – 34 of the [conclusions paper](#), including:

- The initial moratorium period will be set at 45 working days.
- All registered certified public accountants and practising solicitors will be eligible to take up appointment as a provisional supervisor.

- The scope of personal liability of provisional supervisor will be extended to cover specified debts and liabilities under certain conditions.
- Phased payments of outstanding employees' entitlements will be provided for.
- Insolvent trading provisions will be introduced.
- "Headcount test" will be abolished in the voting at meetings of creditors.

## Taxation

### 18. Minutes of Annual Meeting with IRD

The minutes of the 2010 annual meeting between the Inland Revenue Department and the Institute cover DIPN 21, taxation on financial instruments, and other important tax issues. Click [here](#) to read.

## Legislation & Other Initiatives

### 19. Companies (Amendment) Ordinance 2010 and Business Registration (Amendment) Ordinance 2010

The above ordinances were published in the gazette on 16 July 2010.

The **Companies (Amendment) Ordinance 2010**, will allow applicants for company registration to file their registration forms and company documents electronically, upon the implementation of Phase II of the Integrated Companies Registry Information System (ICRIS II), which is expected to come on stream in phases in 2011.

Other amendments made to the Companies Ordinance (CO) include:

- Strengthening the company name registration system to enhance enforcement against possible abuses by "shadow companies" (i.e., companies incorporated in Hong Kong with names very similar to existing and established trademarks or

trade names, which often pose as representatives of the owners of such trademarks or trade names to produce counterfeit products.

- Allowing Hong Kong companies to use electronic means (including their websites) to communicate with shareholders.
- Removing the limitations in the CO that compel the use of paper documents of title and paper instruments of transfer in relation to shares and debentures.
- Expanding the scope of statutory derivative actions to cover "multiple" derivative actions, so that a member of a related company of a specified corporation can commence or intervene in proceedings on behalf of the corporation.

The **Business Registration (Amendment) Ordinance 2010** will enable the Companies Registry to provide a one-stop company and business registration service upon the implementation of ICRIS II. Any person who submits an application for company registration will be deemed to have applied for business registration at the same time.

### 20. Combating Money Laundering/ Terrorism Financing

Members may wish to note that the following report has been published by the financial action task force (FATF):

- **Global money laundering & terrorist financing threat assessment:** This report provides an assessment of the global systemic ML/TF threats. The document is aimed at raising the level of understanding of these threats and their negative impact, and helping governments to take decisive action to minimize the harm that they can cause.

For more background information on the current law in Hong Kong relating to anti-money laundering, see the Institute's **Legal Bulletin 1**, "Requirements on anti-money laundering, anti-terrorist financing and related matters".

## Useful Resources

### 21. Library Resources

**Featured titles** and **new books** of high reference value for members are now available.

In addition, members can **login** to the **e-Library** and access e-journals and e-books on a wide range of business subjects.

### 22. Other Publications

The following articles/publications on topical issues may be of interest to members:

- (i) Publications to raise public awareness of the new investor protection measures by Securities and Futures Commission:
  - **How to read product key facts statements**
  - **Unlisted structured investment products - post-sale cooling-off arrangement**
- (ii) Publications in July 2010 by Hong Kong Exchanges and Clearing Limited:
  - a number of **listing decisions**
  - two **guidance letters** on IPO matters
  - revised **FAQ Series 4** (items 1C, 3C, 3D, & 7A)
  - **presentation materials** on new rules for mineral companies
  - **presentation materials** on streamlining on circular and listing document requirements
  - **presentation materials** on amendments to connected transaction rules
  - **revised presentation materials** on enhancing corporate governance and market quality (charts)
- (iii) Articles on corporate governance by Deloitte:
  - **Corporate governance trends and updates – looking back as we move forward**
  - **The ever-changing structure of executive compensation**
  - **Asia Pacific economic outlook: China, Japan, India, Philippines**
- (iv) Tax apportionment of profits under import processing arrangement:
  - **Hong Kong tax alert** by Ernst & Young
- (v) Taxation of shipping industry in China, Singapore and Hong Kong:
  - **Transportation & logistics: your gateway to industry information** by PwC
- (vi) Business ethics:
  - **2010 update of the OECD guidelines for multinational enterprises** by OECD