



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, by email to < commentletters@hkicpa.org.hk >. Click [here](#) for past issues.

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Financial Reporting, Auditing and Ethics

New!

1. New Technical Training and Support Programme

The New Technical Training and Support Programme covering the period from April to June 2011 features a number of important and popular accounting and auditing topics, which include:

- HKAS 12 *Income Taxes* and latest updates
- PN 740 *Auditor's letter on Continuing Connected Transactions under the Hong Kong Listing Rules* (Re-run)
- New and revised Accounting Standards/Guidance 2010/2011 (Re-run)
- HKSA 600 (Clarified) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*
- AB 4 *Guidance on the Determination of Realized Profits and Losses in the Context of Distributions Under the Hong Kong Companies Ordinance*
- HKFRS 9 *Financial Instruments* and latest updates
- Training for Audit Staff Workshop
- Audit Practice Manual Application Workshop
- The Revised Code of Ethics
- HKFRS for Private Entities Workshop

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

Members' Handbook

2. Handbook Update No. 105

Update No. 105 contains minor editorial amendments to Illustrations 1, 5 and 6 in Appendix 1 of HKSA 810 *Engagements to Report on Summary Financial Statements* to better reflect the reporting requirements in Hong Kong. The revised Illustrations are effective upon issue.

Financial Reporting

3. FRSC Minutes

This **FRSC minutes** on 8 February 2011 covers:

- Update on Companies Ordinance Rewrite
- IFRS Foundation Paper for Public Consultation - Status of Trustee's Strategy
- IVSC ED of Real Property and Business Valuation
- IASB Outreach Meetings on Hedge Accounting and Impairment

4. Invitation to Comment on IVSC ED of Technical Information Paper 1 The Discounted Cash Flow Method – Real Property and Business Valuations

The Institute has issued an **Invitation to Comment** on the International Valuation Standards Council ("IVSC") ED of *Technical Information Paper 1 The Discounted Cash Flow Method – Real Property and Business Valuations*, with comments requested by **13 April 2011**.

In order to assist valuation professionals in identifying best practice, the International Valuation Professional Board is preparing a series of Technical Information Papers ("TIPs"). TIPs do not form part of IVS and are published separately. Although the TIPs are designed to promote consistency of practice and support the application of the principles in the IVS, they are not intended to be mandatory.

It is proposed that this exposure draft will replace the current GN9 *Discounted Cash Flow Analysis for Market Valuations and Investment Analyses* (Revised 2007). GN9 predominantly focused on the valuation of real property assets. This exposure draft provides practical guidance for the application of the discounted cash flow approach for the valuation of businesses as well as real estate assets.

5. Institute Comments on Consultation Documents

- (i) IFRS Foundation Paper for Public Consultation – Status of Trustee's Strategy Review

The Institute made a **submission** to IFRS Foundation on four strategic fronts – the Foundation's mission, governance, the standard-setting process, and financing, which are important to the achievement of the Foundation's ultimate objective of developing a single high-quality globally accepted set of accounting standards.

The Institute made the following comments:

- The IASB may consider the principles-based framework for public interest which has been recently been exposed in an International Federation of Accountants consultation in order to add clarity and consistency to the understanding of "public interest".
- The Institute is concerned about the notion of financial stability being an objective for IFRSs because political or economic agenda of governments and regulators should not take precedence over the needs of users of general purpose financial statements.
- It would seem more logical for the IFRS Trustees and the IASB to be accountable to jurisdictions that have or are in the process of adopting IFRSs rather than specific bodies, some of which are from jurisdictions that have not adopted IFRSs. If the Monitoring Board is to be seen to represent

jurisdictions, further transparency over the appointment procedure for members of the Monitoring Board should be introduced.

- It is believed that the completion of the review of the conceptual framework should be given priority and that fundamental changes to existing standards should not be made until they can be guided by and debated within the conceptual framework.
- The IFRS Foundation may wish to consider whether it would be appropriate to introduce a higher percentage supporting vote for new or revised standards to be issued. Furthermore, it is believed that it is important that IASB members do not use their status of being independent from specific interest groups as a justification for taking technical positions and making changes which do not have broad support. The Institute considers different accounting solutions can be of equally high quality, and the one that is most acceptable to the public at large is usually the one that should be retained.
- There are occasions that the standards separately proposed by the IASB and FASB do not result in converged financial reporting standards. The Institute considers that IASB and FASB should resolve the differences in financial reporting standards and seek more cooperation such that a single set of global accounting standards can become a reality.
- The Institute observes that the concept of income recognition under IFRS is increasingly unrelated to the concept of realization, which makes the performance statement less and less useful for directors as a basis for determining the level of dividends to be proposed and for investors to make assessments as to the company's dividend trends and policy. It is

concerned that it is increasingly becoming necessary to supplement IFRS performance information on such key pieces of decision-useful information with reconciliations or alternative measures of "profit" for distribution purposes.

(ii) IASB ED of *Hedge Accounting*

The Institute made a **submission** to IASB ED of *Hedge Accounting* and the Institute supports the IASB's decision to undertake a comprehensive review of the hedge accounting requirements to develop a principles-based approach that provides more meaningful information. The Institute agrees with the direction of the proposed objective to reflect, in the financial reporting, the extent and effects of the entity's risk management activities. It is believed that this approach has the benefit of being consistent with the role of the business model in the classification of financial instruments.

The proposals remove a number of the restrictions to hedge accounting in IAS 39 *Financial Instruments: Recognition and Measurement*. There are important improvements relating to the removal of the effectiveness test based on bright-lines (80% to 125%), the possibility to designate derivatives, risk components and net positions as hedged items, and the possibilities to apply hedge accounting to components of non-financial items. These proposals make the hedge accounting less rigid and enable an entity to align its hedge accounting closer to its risk management objectives.

However, the Board should address the following key application issues in order for the proposals in the ED to be operational:

- Further guidance should be provided on how to link the accounting to the objective of the risk management strategy and how comprehensive the documentation of the risk management

strategy is required to make the proposal operational.

- The Institute has concerns with the current wording in the ED that would require a hedging relationship to produce an unbiased result, as this is overly restrictive and the requirement to minimize expected hedge ineffectiveness could be inconsistent with an entity's risk management strategy.
- The ED is unclear as to the criteria that must be applied in order to decide whether there is a need to rebalance the hedge.
- The IASB should further considered (i) restriction of eligible hedged items to risks that could affect profit or loss prohibits hedge accounting for equity securities classified as fair value through other comprehensive income; (ii) restriction to the eligibility of specific components such as inflation and credit risk is considered to be inconsistent with the proposed objective of the hedge accounting of representing the effect of an entity's risk management activities if these components can be separately identifiable and reliably measurable; (iii) to extend the eligible hedging instruments to non-financial items.
- Based on the observation at the IASB outreach meetings in Hong Kong, it was noted that the interpretation of some of the requirements in the exposure draft, such as the hedge effectiveness requirements and situations which would require rebalancing, is not consistent between the constituents and the staff of the IASB, it is concerned that diversity in practice may result were the exposure draft to proceed without suitable clarifications. The Institute recommends that IASB to review the current wordings in the exposure draft to ensure they reflect what the IASB intends.

Audit & Assurance

6. AASC Minutes

The AASC minutes on **21 December 2010** and **15 February 2011** mainly covers:

- IFAC ED on "A Public Interest Framework for the Accountancy Profession"
- Issuance of PN 820 *The Audit of Licensed Corporations and Associated Entities of Intermediaries*
- Update on HKSIR projects
- Comparison between Hong Kong and International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements as at 31 December 2010
- Update on Hong Kong Interpretation 5 *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that contains a Repayment on Demand Clause*
- HKEx proposal on requesting auditors to respond to questions at an annual general meeting
- Bank confirmation specimen in HKSA (Clarified) 505 *External Confirmations*
- Reporting to Hong Kong Leisure and Cultural Services Department
- To discuss the requirements of paragraph 10(e) of HKSA 210 (Clarified) *Agreeing the Terms of Audit Engagements*
- Auditing and Assurance Technical Bulletin 1 *Assistance Options to New Applicants and Sponsors in connection with Internal Controls over Financial Reporting*
- To discuss issuing a Chinese Standard Bank Confirmation Request Form
- Update on Companies Ordinance Re-Write

- To discuss certain issues on HKSA 600 (Clarified) *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*

7. Institute Comments on IFAC ED

The Institute made a **submission** to IFAC ED of *Policy Paper #4, A Public Interest Framework for the Accountancy Profession* and the Institute supports the work of the IFAC to develop a principle-based public interest framework which should be evaluated against the proposed three criteria that the Institute considers appropriate:

- Consideration of costs and benefits for society as a whole;
- Adherence to democratic principles and processes; and
- Respect for cultural and ethical diversity.

It is noted that many other standard setters and professional bodies also have a mission to serve and consider public interest and in the course of their activities have to strike a balance between the public interest and the interests of the professions they serve. The adoption of international standards by more and more countries requires the standard setting body to be cognizant of the wider impact of their standards on human behaviour, economies and financial stability. The Institute believes the proposed Framework and the criteria are relevant to other professional and regulatory bodies.

In addition, the Institute has the following additional comments on the Policy Position Paper:

- The Institute understands that the IFRS Foundation is also currently considering its objectives and strategy and considers it would be helpful for the two international standard setting bodies for the accountancy profession to reach a common view on the definition of "public interest" and therefore the Institute would suggest that the IFAC may wish to co-ordinate its efforts with the

IFRS Foundation in further developing the framework.

- The Institute is of the view that further elaborations and guidance would be useful in relation to page 6 of the Position Paper which mentioned as an example of responsibilities that professional accountants have to society the reduction of economic uncertainty in the marketplace and throughout the financial infrastructure.

International Meetings

8. International Accounting Standards Board

The IASB met on 1-2 March, 14-18 March, 21-23 March, and 29 March 2011, and discussed the following topics:

- Disclosure – Cross-cutting issues
- Effective dates – post-employment benefits and other comprehensive income
- Effective dates and transition methods
- Fair value measurement – effective dates
- Financial instruments: hedge accounting
- Financial instruments: impairment
- Financial statement presentation
- IFRS 5 *Noncurrent Assets Held for Sale and Discontinued Operations* - Discontinued Operations
- Insurance contracts
- Leases
- Revenue recognition
- Sweep issues – forthcoming IFRS 12 *Disclosure of Interests in Other Entities*

Click to view the IASB Update on the meetings on [1-2 March](#), [14-18 March](#), [21-23 March](#) and [29 March](#). The IASB next meets in April 2011.

9. IFRS Interpretations Committee

The IFRS Interpretations Committee met on 10-11 March 2011, and discussed the following topics:

- Accounting for stripping costs in the production phase of a surface mine
- Contingent pricing of property, plant and equipment and intangible assets
- Put options written over non-controlling interests
- IFRS Interpretations Committee agenda decisions
- Post-implementation review
- IFRS Interpretations Committee work in progress

Click to view the IFRIC Update on the meeting on [10-11 March](#). The IFRS Interpretations Committee next meets in May 2011.

10. International Auditing and Assurance Standards Board

The IAASB next meets in June 2011. Click [here](#) for the next meeting's details and previous meeting summary.

11. International Ethics Standards Board for Accountants

The IESBA next meets in June 2011. Click [here](#) for the next meeting's details and previous meeting summary.

Useful Resources

12. Publications

The following are publications on various topics:

- (i) Implementing the clarified ISAs:
 - [Findings](#) by the IAASB

- (ii) Share-based payments:
 - [Guide](#) by PwC
- (iii) Service concession arrangements:
 - [Guide](#) by Deloitte
- (iv) Year-end statements preparation:
 - [Update](#) by BDO
- (v) International convergence:
 - [Speech](#) by IASB
- (vi) Guide to using ISA in the audits of SME:
 - [Core concepts](#) by IFAC
 - [Practical guidance](#) by IFAC

Comment Due Dates

13 April 2011: IVSC ED of *Technical Information 1 The Discounted Cash Flow Method – Real Property and Business Valuations*

21 April 2011: IAASB ED on Proposed ISRE 2400 (Revised) *Engagements to Review Historical Financial Statements*

3 May 2011: IAASB DP on *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications*

20 May 2011: IAASB ED on Proposed ISAE 3410 *Assurance Engagements on Greenhouse Gas Statements*

Specialist Practices, Business Members and Advocacy

Professional Accountants in Business – IFAC Publications

13. Business Leaders Give Views on Improving the Business Reporting Supply Chain

IFAC recently published the report, [Integrating the Business Reporting Supply Chain](#), based on its interviews with 25 prominent business leaders, including two from Hong Kong, representing preparers, directors, auditors, standard setters, regulators, and investors. The interviews focus on what should be done to effectively improve governance, the financial reporting process, audit, and the usefulness of business reports in the aftermath of the financial crisis. Click to see the [press release](#).

14. Updated Sustainability Framework

The updated IFAC [Sustainability Framework](#) consolidates the important aspects of embedding sustainability into the DNA of an organization and can be applied to entities of all sizes and complexities. This edition focuses on the integration of sustainability factors from three perspectives--business strategy, operational, and reporting--and highlights the important roles that professional accountants play in facilitating the sustainable development of their organizations.

15. Global Survey on Risk Management and Internal Control

The IFAC PAIB Committee recently released the results of its survey on risk management and internal control. According to the survey, further international alignment of risk management and internal control guidelines is needed. Click to see the [results, analysis and proposed next steps](#).

Corporate Finance

16. SFC Findings Reveal Deficiencies in Work of Some IPO Sponsors

The SFC conducted an inspection on 17 licensed sponsors of different sizes, focusing primarily on their work undertaken in initial listing applications, to assess the level of their compliance with existing regulatory requirements. The findings reveal certain deficiencies in the work performed by some sponsors and some inadequacies in their internal systems and controls, including:

- Unsatisfactory due diligence on listing applicant's business
- Questionable disclosure to the stock exchange during the listing application process
- Failure to maintain proper documentation of due diligence
- Inadequate internal systems and controls over sponsor work

Details of the findings are discussed in a [report](#) released on 29 March 2011.

The SFC has indicated that it will continue its efforts in overseeing the work of sponsors through inspections and enforcement action. It will also review the existing requirements relating to the work of sponsors, with a view to enhancing the regulatory regime for better investor protection and market quality.

17. Institute's Views on SFC and HKEx Consultation Papers

(i) Streamlining property valuation requirements

As reported in [TechWatch no. 98](#), the SFC and HKEx issued a joint consultation paper on proposals to streamline the listing rule requirements for property valuation disclosure.

In the [submission](#), while the Institute agrees, in principal, that the proposals will remove unnecessarily onerous property valuation requirements, it considers that, in order to avoid any confusion or uncertainty, guidelines should be provided to facilitate understanding of the revised disclosure obligations.

As regards the proposed materiality guidance, the Institute suggests that more specific, possibly quantitative, benchmarks should be adopted in the tests of materiality, rather than basing it on subjective judgment, as currently drafted, which could result in inconsistencies in implementation.

The Institute considers that the information expected to be disclosed about a material property is still potentially quite onerous. It suggests that the proposed disclosure guidance be looked at again and that specific information referred in the guidance be limited to factual information about the particular property interests and, possibly, some readily available market data or statistics.

(ii) Ex-entitlement trading and shareholder approval

The Institute's [submission](#) supports HKEx's proposals that shares should be traded ex-entitlement only after shareholder approval. In addition, the record date should be set at least three business days after the date of shareholder approval, so as to provide a window of at least one trading day after the general meeting (under the current T+2 settlement system) for shareholders to sell their cum-entitlement shares in the market, if they do not want to take up the entitlement. The Institute further considers that this principle should be applied consistently to all conditional entitlements to avoid market confusion.

(iii) Proposed changes to the requirements for listing of debt issues issued to professional investors

As reported in [TechWatch no. 99](#), HKEx consulted the market on a number of proposed changes to the requirements for listing of debt securities issued to professional investors only.

In the [submission](#), while the Institute appreciates that there is less need for detailed and comprehensive disclosure requirements for listing documents aimed at professional investors, it is of the view that the proposal to replace the requirement for detailed information with a requirement for a document to contain the "information that the investors to whom securities are being offered would customarily expect" could create uncertainty. It is not clear how this rule could be enforced in practice and, in the event of investors suffering a substantial loss on particular listed debt securities, the proposed test could potentially become contentious.

The Institute considers that the definition of "professional investor" is of fundamental importance in this area of the listing rules. It suggests that a more structured set of criteria be developed for this purpose, rather than simply cross-referring to the definition in another source, namely, Schedule 1 of the Securities and Futures Ordinance.

Corporate Governance

18. Institute Submits Views on HKEx's Consultation on Review of the Code on Corporate Governance Practices

As reported in [TechWatch no.99](#), HKEx conducted a consultation on proposed changes to the Code on Corporate Governance Practices and associated listing rules.

While the Institute's [submission](#) expresses general support for the underlying principles of the consultation proposals, which aim to strengthen transparency and standards of corporate governance, the Institute has comments to make on a number of the specific proposals including the need for further practical guidance in several areas. In addition, the

Institute suggests that the parts of the code on internal controls, which were not covered in the consultation, should also be reviewed in the near future. The submission also suggests that additional provisions or recommended best practices be introduced into the code to cover environmental and sustainability reporting, as well as the need for issuers to have a professional accountant amongst the senior management, or on the board, as an executive or non-executive director.

Insolvency & Corporate Restructuring

19. Invitation to Comment on ED of Professional Ethics in Liquidation and Insolvency

The Institute has issued an [Invitation to Comment](#) on an exposure draft of section 500 *Professional Ethics in Liquidation and Insolvency* of the Institute's Code of Ethics for Professional Accountants ("the Code"), with comments requested by **31 May 2011**.

The proposed new section 500 will update and replace the existing section 432 *Integrity, objectivity and independence in insolvency* of the Code.

The structure of the proposed section 500 adopts a principles-based approach. It sets out the five fundamental principles to which insolvency practitioners should adhere, the threats to compliance with the fundamental principles and the more common types of threat that insolvency practitioners may face in their work, together with examples of specific situations that may occur. Several examples in the existing section 432 are retained in section 500, as they continue to be relevant.

As the revised section 500 applies to a specialist area of practice, it is proposed to introduce a new and distinct part, "Part E Insolvency Practitioners", into the Code, which will reiterate some of the fundamental principles from the main body, of the Code. This will avoid the need to cross-refer frequently to other parts of the Code. It should facilitate and encourage all insolvency practitioners, including those who are not members of Institute, to make reference to

this part, which, in turn, should help to support high standards of conduct in the field of insolvency.

Taxation

20. Useful Links from the IRD

The following are useful links from the IRD:

- **DIPN 14** has been revised to reflect the changes made to the definition of the term "owner" in relation to the common parts of land and/or buildings
- **Inland Revenue (Amendment) Ordinance 2011**, which enhances the qualifying debt instrument scheme (see related [tax info and FAQ](#)) has been gazetted
- Legislative Council questions have been asked and responded to by the government on **enhancing Hong Kong enterprises' competitiveness, depreciation allowances on machinery or plant and taxation issues faced by Hong Kong enterprises**
- Hong Kong has signed double taxation agreements with **Portugal** and **Spain**

Legislation & Other Initiatives

21. Companies Registry Update

(i) In relation to the formal launch of the electronic incorporation and the one-stop company and business registration service on 18 March 2011, the Companies Registry ("CR")'s website has been updated, as follows:

- **CR External Circular No.2/2011**
 "Launch of Electronic Company Incorporation and a One-stop Electronic Incorporation and Business Registration Service"
- **CR External Circular No.3/2011**
 "Commemorative Records of Registration"

- A **press release** on "Electronic Incorporation Service launched"
- A new subsection **Electronic Services at the e-Registry** has been created, where three samples of model memoranda and articles of association, facilitating electronic incorporation of private companies limited by shares, can be downloaded
- The following revised/new information pamphlets:

Revised

- **Incorporation of a Local Limited Company**
- **Change of Name of a Local Limited Company**
- **Incorporation or Change of Name of a Local Limited Company - Points to Note**

New

- **One-stop Electronic Company Incorporation and Business Registration Service**

- A new **Electronic Company Incorporation and Business Registration** topic under **Frequently Asked Questions** section
 - Details of the **launching ceremony** and the **roving exhibition** on the CR's electronic incorporation service
 - Contents of the **Electronic Submission of Information** section and the **Integrated Companies Registry Information System** section have been updated
- (ii) CR has issued **CR External Circular No. 4/2011** to alert the public to the problem of shadow companies and provides information on steps being taken by the CR to address the problem.

22. Seminars on Anti-money Laundering/ Combating Terrorist Financing ("AML/CFT")

The Narcotics Division, Hong Kong SAR Government and the Institute jointly organized two AML/CFT seminars for Institute members in March (one each in English and Chinese), which explained the role of accountants in preventing money laundering/terrorist financing. To read the presentation slides on the topics covered at the seminars, please click the links next to each topic.

- AML/CFT – aligning with international standards ([English](#), [Chinese](#))
- Suspicious transaction reporting: legal obligations and protection, statistics and case examples ([English](#), [Chinese](#))
- New developments on the United Nations (Anti-Terrorism Measures) Ordinance ([English](#), [Chinese](#))
- Experience sharing session ([English](#) only) (Chinese slides unavailable)

For further background information on the current AML/CFT law and requirements in Hong Kong, see the Institute's [legal bulletin 1](#), "Requirements on anti-money laundering, anti-terrorist financing and related matters".

23. Latest Notices on AML/CFT

Members may wish to note the following notices and publications in relation to combating money laundering/terrorist financing:

- [Circulars from the office of the commissioner of insurance \(linked to AML-related gazette notices\)](#)
- [US executive order 13224](#): Changes to the list relating to "Blocking property and prohibiting transactions with persons who commit, threaten to commit or support terrorism"

- [Financial Action Task Force \("FATF"\) public statement](#): Draws attention of its members (Hong Kong has been a member since 1990) to the risks of transactions involving Iran and Democratic People's Republic of Korea
- [Improving global AML/CFT compliance: update on-going process](#): Draws the attention of FATF members to jurisdictions with deficiencies that pose money laundering/terrorist financing risks in the international financial system
- [Review of the FATF standards](#): Following a [public consultation](#) by FATF on the first phase of its review of the FATF standards, a compilation of the responses is available below:
 - Financial sector - [Part 1/Part 2](#)
 - [Designated non-financial business and professions](#)
 - [Non-government organizations and individuals](#)

Useful Resources

24. 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.

25. Other Publications

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

- (i) In March 2011, HKEx published:
 - a number of listing decisions in relation to:
 - acceptance of Japanese Generally Accepted Accounting Principles for preparing accountants' report for a listing document and subsequent

financial reports, subject to certain conditions (**LD3-2011**)

- France as an acceptable jurisdiction of an issuer's incorporation (**LD4-2011**)
- classification of share repurchase by listed subsidiary (**LD5-2011**)
- prior shareholder mandate for notifiable transactions (**LD6-2011**)
- restriction on disposal after change in control (**LD7-2011**)
- an **updated listing decision** on mainland valuers' qualification (LD102-1)
- an **update** on HKEx's preparations for renminbi products
- **HKEx Fact Book 2010**, which presents a review of the securities and derivatives markets in 2010, as well as clearing and settlement information
- one **guidance letter** on disclosure requirements for IPO cases – Formal Notice (GL24-11)
- **report** on IPO applications, delisting and suspensions (as at 28 February 2011)

(ii) In March 2011, SFC published:

- **Report** of the survey on hedge fund activities of SFC-licensed managers/advisers
- March 2011 issue of **InvestEd Intelligence** – this issue reminds investors to get prepared before trading listed renminbi securities, discusses equity-linked investment, and explains why a company's share price may fall after it announces capital reorganization

(iii) Articles on corporate governance by Deloitte:

- **Audit committee brief – The tech-savvy audit committee**
- **Shareholder activism: reinforcing practices**
- **Asia pacific economic outlook: China, India, Indonesia, Singapore**

(iv) **Ten to-dos for audit committees in 2011** by KPMG

(v) **Corporate governance in the wake of the financial crisis** by UNCTAD