



# 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 Ms. Patricia McBride, Director, Standard Setting by [email](#).

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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 29**

**Update 29** contains instructions to remove all SSAPs, SSAP Interpretations and Industry Accounting Guidelines from the Members' Handbook and encloses the following:

- Revised HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (consolidation of consequential amendments)
- Hong Kong (IFRIC) Interpretation 8 *Scope of HKFRS 2*
- Hong Kong (IFRIC) Interpretation 9 *Reassessment of Embedded Derivatives*

Further details are set out in the "Financial Reporting" section below.

## **CPD & Events**

### 2. **Professional Development Activities May To July 2006**

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

#### Technical Update Evening (TUE)

The **new TUE programme** covering the period from May to July 2006 features a number of important auditing and financial reporting topics:

- 610 (9 May) Improving Audit Documentation (re-run)
- 612 (16 May) Issues in Preparing Financial Statements (re-run)
- 613 (23 May) Proposed changes to HKAS 1
- 614 (6 June) New Standards on Pro Forma Financial Information
- 615 (27 June) Discussion Paper on "Requests for Special Purpose Reports"
- 616 (11 July) Commonly asked financial reporting questions

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

#### IFRS Training

- **Hong Kong Financial Reporting Standards Overview** (20 May)
- **Financial Reporting Standards Forum – The 2005 Experience** (3 June)

#### Corporate Governance

- **Corporate Governance Update** (9 May)
- **Corporate Governance for Public Bodies and Not-For-Profit Organisations – The Good and The Bad** (8 June)

#### Finance

- **Understanding Stock Options** (15 June)

### Legal

- **Listing Documentation – Legal Issues** (13 May)
- **The Regulatory Regime for Offering of Investments under the Securities and Futures Ordinance and the Companies Ordinance** (22 June)

### PRC

- **國內民事訴訟和仲裁實務** (19 May)
- **Mergers and Acquisition in China - 2005** (5 June)
- **中國會計準則大變革** (6 June)

### Taxation

- **International Corporate Structuring – An Overview of the Basics** (26 June)

### Others

- **Privacy Guidelines: Monitoring & Personal Data Privacy at Work** (15 May)
- **Investment Psychology for Accounting Professionals** (9 June)
- **First Step to Risk Management Process: Risk Assessment – A Suggested Approach** (19 June)

### Soft Skills & Language

- **Influencing and Assertiveness Skills** (20 May)
- **Presentation by Building a Storyline** (3 June)
- **The Gentle Art of Self Defense: Verbal Judo for Accountants** (10 June)

View the full programme [here](#) and enroll before they are full.

## **Financial Reporting**

### **3. Revised HKFRS 1 First-time Adoption Of Hong Kong Financial Reporting Standards**

The Institute issues **revised HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards**. The revised standard consolidates all the amendments consequential on the issue of the following new standards and interpretations and amendments to standards issued in 2004 and 2005:

- HK(IFRIC)-Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* and HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*
- HKFRS 6 *Exploration for and Evaluation of Mineral Resources*
- Amendment to HKAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures*
- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – Transitional and Initial Recognition of Financial Assets and Financial Liabilities*
- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions*
- Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKFRS 6 *Exploration for and Evaluation of Mineral Resources*
- HKFRS 7 *Financial Instruments: Disclosures*

#### 4. New Hong Kong (IFRIC) Interpretations

(i) Hong Kong (IFRIC) Interpretation 8 *Scope of HKFRS 2*

The Institute issues **HK(IFRIC)-Int 8 *Scope of HKFRS 2*** with effect for annual periods beginning on or after 1 May 2006 (with earlier application encouraged).

HK(IFRIC)-Int 8, which is converged with the equivalent International Financial Reporting Interpretations Committee (“IFRIC”) interpretation, clarifies that HKFRS 2 *Share-based Payment* applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. It also explains that, if the identifiable consideration given appears to be less than the fair value of the equity instruments granted or liability incurred, this situation typically indicates that other consideration has been or will be received and HKFRS 2 therefore applies.

(ii) Hong Kong (IFRIC) Interpretation 9 *Reassessment of Embedded Derivatives*

The Institute issues **HK(IFRIC)-Int 9 *Reassessment of Embedded Derivatives*** with effect for annual periods beginning on or after 1 June 2006 (with earlier application encouraged).

HK(IFRIC)-Int 9, which is converged with the equivalent IFRIC Interpretation, addresses the issue of whether the treatment of an embedded derivative has to be reassessed subsequently if certain events occur. It concludes that reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

#### 5. Removal Of All SSAPs, SSAP Interpretations And Industry Accounting Guidelines From The Members’ Handbook

Statements of Standard Accounting Practice (“SSAPs”), SSAP Interpretations (“SSAP-Ints”) and Industry Accounting Guidelines (“IAGs”) are all replaced by new Hong Kong Financial Reporting Standards (“HKFRSs”), Hong Kong Accounting Standards (“HKASs”) and HK(SIC) Interpretations (“HK(SIC)-Ints”) with effect from accounting periods beginning on or after 1 January 2005. Accordingly, the Institute has removed all SSAPs, SSAP-Ints and IAGs from Volume II of the Members’ Handbook and posted them onto the archive section of the e-Handbook for members’ reference. An entity which has not yet reported on any periods prior to 1 January 2005 can continue to use SSAPs, SSAP-Ints and IAGs as they are applicable for earlier periods, and such entities are not required to early adopt the HKFRSs, HKASs and HK(SIC)-Ints.

#### 6. Institute Comments On IFRIC Interpretation D18

IFRIC Interpretation D18 *Interim Financial Reporting and Impairment* proposes that impairments recognised in an interim period for goodwill and investments in equity instruments classified as available for sale should not be reversed in subsequent interim periods or in the annual financial statements. This proposal helps clarify the interaction between the requirements of IAS 34 *Interim Financial Reporting* and the recognition of impairment losses on goodwill in IAS 36 *Impairment of Assets* and certain financial assets in IAS 39 *Financial Instruments: Recognition and Measurement*. However, the effect of this proposal is that the frequency of an entity’s reporting may affect its annual profit result.

Under the Institute’s due process for setting accounting standards, the Institute made a **submission** to the IASB on IFRIC Interpretation D18. The Institute accepts that the amendments to IAS 36 and IAS 39, which prohibit reversals of impairment losses in certain situations, have led to a need for clarification of the approach to be taken in the preparation of interim reports. However, the Institute does not support the conclusion reached in IFRIC Interpretation D18 as it is

of the view that the fundamental principle in IAS 34, that interim reports are prepared on a year-to-date basis, whereby the frequency of an entity's reporting shall not affect the measurement of its annual results, should be adhered to.

## 7. Institute Comments On IASB Discussion Paper On Management Commentary

The discussion paper is a first step in the possible development by the International Accounting Standards Board ("IASB") of a standard or guidance covering Management Commentary (MC). The discussion paper proposes that MC should supplement and complement financial statement information, provide an analysis of the entity through the eyes of management, and have an orientation to the future. The discussion paper seeks views as to whether such information should be provided within the financial statements or as an adjunction to the financial statements.

Under the Institute's due process for setting accounting standards, the Institute made a **submission** to the IASB on the discussion paper. In general, the Institute appreciates the initiative of the IASB in taking up a project on MC. However, given the IASB's limited resources, the Institute does not consider development of requirements for MC should be a priority for the IASB. The Institute is of the view that the IASB's priority should be to resolve issues and problems relating to the application of International Financial Reporting Standards (IFRSs) to general-purpose financial statements. In view of the nature of MC, the Institute considers that the project could be driven or undertaken by a body such as IFAC, rather than the IASB.

As far as the proposals for MC are concerned, the Institute is generally supportive of them. However, the Institute would have concerns if auditors are required to audit or verify the information to be included in the MC in order to enable them to form an opinion on compliance with IFRSs. The Institute considers that it would be better if the proposals are to be issued by a respected international body as a non-mandatory best practice guide. Relevant regulatory authorities within each jurisdiction could then determine the way(s) to enforce this guide if considered appropriate.

## 8. FRSC Meeting Summary – 8 March 2006

This **FRSC meeting summary** covers:

- HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (consolidation of consequential amendments)
- IFRIC Interpretation D18 *Interim Financial Reporting and Impairment*
- IFRIC Interpretation 9 *Reassessment of Embedded Derivatives*
- Interest-free inter-company loans at fair value
- Disclosure of directors' share option as remuneration
- IASB staff request for information from users about fair value accounting
- Meaning of "available for public use"

## Audit & Assurance

## 9. Institute Invites Comments On IAASB ED On The Audit Of Group Financial Statements

The Institute has issued an **Invitation to Comment** on the International Auditing and Assurance Standards Board ("IAASB") exposure draft ("ED") of ISA 600 (Revised and Redrafted) *The Audit of Group Financial Statements*, with comments requested by **7 July 2006**.



In summary, following earlier consultations, the IAASB has modified the proposals and reissued the ED. The primary issues revolve around the extent to which the group auditor needs to be involved in the audits of components that are audited by other auditors, whether these auditors are independent of the group auditor (unrelated) or belong to the group auditor's national or international firm or network of firms (related auditors). Therefore, in addition to inviting comments on the application of the clarity drafting conventions, the IAASB is seeking comments on the following two specific matters:

- (i) Previous proposals distinguished between the work that the group auditor needed to do, depending upon whether other auditors were related or not. While this may be a relevant factor, the strength of relationships varies. The IAASB considers that the distinction is not itself a sufficient basis for determining the group auditor's work and has proposed eliminating the distinction in the ISA. As a result of this, substantial changes have been made to some of the proposed requirements. Respondents are asked to indicate whether they are in agreement with the proposal and the effect that it has on the procedures that the group auditor performs in relation to the work of other auditors.
- (ii) The proposed ISA is drafted on the basis that a group auditor takes sole responsibility for the audit opinion on the group financial statements. This requires that the group auditor obtain sufficient appropriate audit evidence on which to base such an opinion. Given that current group audit practices vary, the IAASB considers it necessary to be reasonably specific about the steps to be taken, and the work effort required, by the group auditor to acquire such evidence when other auditors are involved. Respondents are asked whether this approach is justified.

## 10. **Institute Invites Comment On Discussion Paper: Requests For Special Purpose Reports**

The Institute has issued an [Invitation to Comment](#) on the ED of Discussion Paper *Requests for Special Purpose Reports*, with comments requested by **31 October 2006**.

In summary, as part of the Institute's programme of converging with pronouncements issued by the International Federation of Accountants ("IFAC") in recent years, the Institute has issued and revised a number of professional standards. Amongst these, the Institute has issued a number of standards on different reporting engagements typically undertaken by accountants in public practice in Hong Kong, namely, assurance engagements and other types of engagements such as agreed upon procedures engagements and compilation engagements. These standards set out key principles, required procedures and the appropriate form a report should take when the engagement falls within the scope of those standards.

This discussion paper is prepared by the Auditing and Assurance Standards Committee ("AASC") of the Institute to help clarify the principal types of special purpose engagements and the form and content of the related reports. This paper also sets out some of the practical issues that may arise when undertaking such engagements and guidance on how to address them.

## 11. **Audits Of Insurance Brokers – Professional Indemnity Insurance**

The Commissioner of Insurance informed the Institute that it has come to their attention that the professional indemnity insurance ("PII") cover for some insurance brokers was not adequate, as the level of the PII cover was not determined in accordance with the minimum requirements for insurance brokers. According to the requirements, an insurance broker is required to maintain a PII policy with a minimum limit of indemnity determined with reference to its insurance brokerage income relating to 12 months immediately preceding the date of commencement of the PII cover. In this connection, the Commissioner of Insurance has issued letters to the two approved bodies of insurance brokers, requesting them to be vigilant in monitoring the situation and to obtain their members' annual written confirmation on compliance with the relevant requirements.

Auditors of insurance brokers are therefore required to note the above issue and to follow the Institute's Practice Note 810.1 *Insurance Brokers – Compliance with the minimum requirements specified by the Insurance Authority under sections 69(2) and 70(2) of the Insurance Companies Ordinance* in carrying out their audits of insurance brokers, as appropriate.

## 12. **AASC Meeting Summary – 28 February 2006**

This **AASC meeting summary** covers:

- Meeting schedule for the rest of 2006
- Term of Reference and Proposed Work Plan for 2006
- IAASB March 2006 Meeting in Hong Kong – 6 to 10 March 2006
- Invitations to Comment on IAASB ED of Improving the Clarity of IAASB Standards
- Progress report on the draft Discussion Paper *Requests For Special Purpose Reports*
- Professional pronouncements under the Accountants' Report Project
- Issues arising from entities preparing accounts under the Building Management Ordinance and Education Ordinance
- Assistance to sponsors in reporting on internal controls

### **Ethics**

## 13. **Ethics Committee Meeting Summary – 14 February 2006**

This **meeting summary** covers the Ethics Committee's discussion of the agenda items of the International Ethics Standards Board for Accountants ("IESBA")'s February 2006 meeting, which was attended by the chairman of the Ethics Committee as the Institute's representative. Further details of the IESBA meeting are set out in the "International Meetings" section below.

### **Banking**

## 14. **HKMA Issues Disclosure Rules Consultation Paper**

The Hong Kong Monetary Authority ("HKMA") has recently issued **Disclosure Rules Consultation Paper**, with comments requested by **24 May 2006**. The proposed Disclosure Rules seek to set out the minimum disclosure standards that the HKMA expects of authorized institutions ("AIs") under the Banking Ordinance for the purpose of implementing the requirements of the new Capital Adequacy Framework (often referred to as "Basel II"). The new section 60A of the Banking Ordinance, amended by the Banking (Amendment) Ordinance 2005, empowers the HKMA to set rules prescribing information relating to financial affairs to be disclosed to the general public by AIs.

The proposed Disclosure Rules will take the form of subsidiary legislation and are intended to come into effect on 1 January 2007. They will replace the existing disclosure requirements currently set out in the following modules of the HKMA's Supervisory Policy Manual:

- FD-1 Financial Disclosure by Locally Incorporated AIs;
- FD-2 Interim Financial Disclosure by Locally Incorporated AIs; and
- FD-3 Financial Disclosure by Overseas Incorporated AIs.



## **Taxation**

### **15. Budget Legislation Introduced Into Legislative Council**

The Revenue Bill 2006, which seeks to amend the Inland Revenue Ordinance (Cap. 112) to implement two proposals relating to salaries tax and personal assessment, announced in the 2006-07 Budget (as reported in [TechWatch No. 42](#)), was introduced into the Legislative Council on 26 April 2006.

The proposed legislation will lower the marginal rates of the second, third and top salaries tax bands by 1% each, to 7%, 13% and 19% respectively, from 2006/07, while the 2% marginal rate applicable to the first HK\$30,000 of assessable income, the tax allowances, and the standard rate of salaries tax, currently 16%, will remain unchanged. This revision of the marginal rates is expected to cost the government \$1.5 billion in a full year.

The second proposal incorporated into the bill is the extension to the period for which relief can be claimed, under salaries tax, for home loan mortgage interest, by a further three years, to ten years in total. The ceiling for the deduction remains at HK\$100,000 per annum. This measure will cost the government HK\$1.2 billion in 2006/07.

### **16. Taxation Interest Group Holds Lively Discussion Forum On Board Of Review Procedures**

The Taxation Interest Group (“TIG”) held a lively and well-attended discussion forum on Board of Review Procedures on 6 April 2006. The forum was chaired by Ms. Deborah Annells, the TIG convenor, and the speakers were Professor Andrew Halkyard of the Law Faculty, University of Hong Kong and Deputy Chairman of the Board of Review (“BoR”), and Mr. Trevor Wong, Director, Tax Appeals of Ernst & Young.

Mr. Wong presented a practitioner’s view on the BoR procedures, covering a range of issues, including the possible reasons for going to the BoR, evaluation of the chance of success of a case beforehand, the notice of appeal, grounds of appeal, and preparation for the hearing. Mr. Wong stressed that all the grounds of appeal should be contained in the notice of appeal. Taxpayers who intend to introduce new grounds in the hearing in support of their appeal against assessment would need to obtain leave from the BoR, while the Inland Revenue Department (“IRD”) may introduce new arguments in defending its assessment at the hearing.

Professor Halkyard clarified some of the specific aspects in the BoR procedures. While the taxpayer appellant may opt for the language of the proceedings, the choice should be made carefully taking into account the language used in most of the documents involved. For example, if most of the relevant documents are in English, English may be the most appropriate language to be used in the proceedings, but the witnesses may give evidence in their chosen language or dialect. It is important to clarify with the IRD in advance as to the points that are in dispute, whether they involve matters of fact or law. The onus of proof that an assessment is excessive or incorrect is on the taxpayer.

During the Q & A session, Professor Halkyard suggested that while the BoR was not legally bound by its previous decisions, it could be helpful for taxpayers to quote previous decisions of the BoR that were relevant to the case in question.

In response to the questions raised by Ms. Deborah Annells towards the end of the discussion forum, some participants indicated that they would be more confident in handling BoR cases after participating in the discussion forum. Those who had previously handled BoR cases were generally satisfied with the performance of the BoR.

## **Corporate Finance**

### **17. Submission To HKEx On Growth Enterprise Market**

As reported in [TechWatch No. 41](#), Hong Kong Exchanges and Clearing Limited (“HKEx”) published a [Discussion Paper on the Growth Enterprise Market](#) (“GEM”) in January 2006 inviting comments on enhancing the further development of the GEM and ensuring that the objectives and functions of the GEM appropriately align with the expectations and needs of the various market stakeholders.

In general, the Institute considers that there is a need for a growth company market in Hong Kong to provide a channel/platform for emerging companies and small and medium-sized enterprises, amongst others, to raise capital for their business development and expansion. It is further suggested that, rather than designating the second market as growth company market, which could foster the impression that its focus is limited to emerging companies, consideration should be given to widening the scope of the second market to position it as an alternative board for companies with good business prospects, but which may not meet the criteria for listing on the Main Board.

The Institute does not see anything fundamentally wrong, in principle, with the existing GEM market that could not be addressed by maintaining (i) the quality of listings, and (ii) an effective, although not necessarily more stringent, regulatory regime, with proper enforcement against blatant misconduct by managements, professional advisers and sponsors, as appropriate. At the same time, the Institute considers that active marketing and promotion of the GEM could also be stepped up to help build up and maintain its image.

The Institute’s detailed comments on the key discussion questions raised in the discussion paper are set out in the [submission](#).

## **Corporate Governance**

### **18. Submission To IFAC On Proposed Guidance For A Code Of Corporate Conduct**

The International Federation of Accountants (“IFAC”) issued an exposure draft: [Guidance for the Development of a Code of Corporate Conduct](#) in January 2006. The proposed guidance is designed to draw greater attention to the need for corporate codes of conduct and to provide practical guidance on the scope and implementation of such codes. Its focus is to help professional accountants in profit, not-for-profit and government organisations address issues relating to the development, monitoring, reinforcement and reporting of a code of corporate conduct.

The proposed guidance identifies a three-stage approach to the development and implementation of codes of conduct according to the objectives of management: managing for compliance, managing stakeholder relations and creating a values-based organisation. To assist in the development of codes of corporate conduct, it also includes information on presentation and content, organisational and management challenges.

In its [submission](#), the Institute pointed out that this was a worthwhile, although fairly ambitious and challenging project, given the diversity of companies and the sectors in which they operate. The submission offered suggestions in relation to the organisation and structure of the proposed guidance, as well as commenting on a number of detailed points.

## **International Meetings**

### **19. International Accounting Standards Board Meetings**

The IASB met in London on 28 – 31 March 2006 and discussed the following topics:

- Financial statement presentation
- Financial instruments puttable at fair value
- Joint ventures
- Short-term convergence: borrowing costs
- Business Combinations II
- Insurance
- Accounting standards for small and medium-sized entities
- Revenue recognition
- Conceptual Framework
- Amendments to IAS 37
- Consolidations (including special purpose entities)
- Agenda proposal: Amendments to IFRS 1
- Leases
- Update on IFRIC activities
- Technical plan

The IASB met in London on 24 – 26 April 2006 and discussed the following topics:

- Financial instruments
- Revenue recognition
- Business Combinations II
- Conceptual Framework
- Insurance
- Financial instruments puttable at fair value
- Consolidations
- Liabilities and equity

The IASB also met with the Financial Accounting Standards Board in a joint meeting on 27 and 28 April 2006, where they discussed:

- Financial instruments
- Revenue recognition
- Business Combinations II
- Conceptual Framework
- Leases

See the [March 2006 IASB Update](#) and the [April 2006 IASB Update](#) of the Board Decisions on IFRS for further details. The IASB next meets on 22 – 26 May 2006.

## 20. International Auditing And Assurance Standards Board Meeting

The next IAASB meeting will be held in New York from 22 – 26 May 2006. The agenda has been posted on the IAASB website. The topics that will be discussed are:

- Materiality and Misstatements
- Communications with Those Charged with Governance
- Modifications to the Opinion in the Independent Auditor’s Report
- Emphasis of Matter and Other Matters Paragraphs in the Independent Auditor’s Report
- Independent Auditor’s Report on Other Historical Financial Information
- Clarity and ISA Objectives

Click [here](#) for further details.

## 21. International Ethics Standards Board For Accountants Meeting

The IESBA met in New York on 20 – 22 February 2006 and discussed the following topics:

- Revised definition of network firm
- Revisions to the independence section
- Ethics guidance for professional accountants in business when encountering fraud or illegal acts.

Click [here](#) for the meeting summary and minutes of the meeting and [here](#) for the audio recording of the IESBA meeting. The IESBA next meets on 13 – 14 June 2006.

### **Comment Due Dates**

DATE	SUBJECT
19 May 2006	<a href="#">IASB Exposure Draft</a> of Proposed Amendments to IFRS 2 <i>Share-based Payment – Vesting Conditions and Cancellations</i>
3 July 2006	<a href="#">IASB Exposure Draft</a> of Proposed Amendments to IAS 1 <i>Presentation of Financial Statements</i>
7 July 2006	<a href="#">IASB Exposure Draft</a> of ISA 600 (Revised and Redrafted) <i>The Audit of Group Financial Statements</i>
31 October 2006	<a href="#">HKICPA Exposure Draft</a> of Discussion Paper: <i>Requests for Special Purpose Reports</i>
<b>Please send comments to <a href="mailto:commentletters@hkicpa.org.hk">commentletters@hkicpa.org.hk</a></b>	