



Exposure Draft (ED) of a Proposed Preface to Hong Kong Financial Reporting Standards and Accounting Guidelines

Comments to be received by 15 July 2003

**Issued by the Financial Accounting Standards Committee
Hong Kong Society of Accountants**

This exposure draft is issued by the HKSA Financial Accounting Standards Committee for comment only and does not necessarily represent the final views of the FASC or the Council of the HKSA.

This exposure draft is based on the IASB Preface to International Financial Reporting Standards. The FASC invites comments from any interested party and would like to hear from both those who agree and those who do not. Comments should be supported by specific reasoning and should preferably be submitted in written form. This proposed Preface may be modified as a result of comments received.

*Comments may be sent by mail or fax to:
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fax number (852) 2865 6776, or by e-mail to commentletters@hksa.org.hk,
to be received by
15 July 2003.*

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

Invitation to Comment

The Hong Kong Society of Accountants (HKSA) Financial Accounting Standards Committee (FASC) invites comment on the exposure draft of a proposed Preface to Hong Kong Financial Reporting Standards and Accounting Guidelines (“HK Preface”) from HKSA members and from a broad range of other interested individuals and organisations.

Background

This Exposure Draft proposes to revise the Foreword to Statements of Standard Accounting Practice (SSAP), Interpretations and Accounting Guidelines issued in September 1978 (reviewed March 1984 and amended December 1991 and June 2000) (“the Foreword”) to attain convergence with the Preface to International Financial Reporting Standards (IASB Preface) issued by the International Accounting Standards Board (IASB).

In 2001, the Council of the HKSA adopted the policy of converging SSAPs with International Financial Reporting Standards (IFRSs). This Exposure Draft proposes to set out the Council’s objectives, procedures and due process in respect of setting accounting standards following the adoption of the convergence policy.

This Exposure Draft also proposes to explain the scope and authority of Hong Kong Financial Reporting Standards (HKFRSs), which, for the purposes of the proposed HK Preface, includes SSAPs. The proposals take into account various developments in the past few years, including revisions to the Framework for the Preparation and Presentation of Financial Statements and SSAP 1, Presentation of Financial Statements. Unlike the Foreword, this Exposure Draft does not propose to include provisions concerning the link between compliance with SSAPs and presentation of a true and fair view as this matter is dealt with in SSAP 1.

In addition, the Exposure Draft proposes to include a provision on compliance with a basis or standard of accounting other than HKFRSs (see below). This provision, once finalised, would give effect to the HKSA Council’s specification of professional standards applicable under the Professional Accountants Ordinance and, accordingly, would permit the HKSA to initiate disciplinary action against a HKSA member for an alleged breach of non-HKSA standards.

Proposals

The following highlights the significant new proposals in the Exposure Draft:

- To recognise the Council’s objective of achieving convergence of HKFRSs with IFRSs.
- To recognise that close coordination of the HKSA’s due process with the IASB’s due process is important for the success of achieving convergence of the two sets of Standards.
- To make clear that the ‘benchmark treatment’ and the ‘allowed alternative treatment’ in HKFRSs are of equal standing.
- To make clear that paragraphs in bold typeface in HKFRSs indicate main principles but paragraphs in bold typeface and plain typeface have equal authority.
- To require a member of the HKSA who assumes responsibilities in respect of financial statements prepared on a basis or standard of accounting other than HKFRSs to observe that other basis or standard of accounting and to justify departures.

Preface to Hong Kong Financial Reporting Standards and Accounting Guidelines

This Preface is issued to set out the objectives and due process of the Council of the Hong Kong Society of Accountants (HKSA) (hereafter referred to as the “Council”) in respect of setting Hong Kong Financial Reporting Standards (HKFRSs) and to explain the scope, authority and timing of application of HKFRSs. For the purpose of this Preface, the term “Hong Kong Financial Reporting Standards” includes all Statements of Standard Accounting Practice (SSAPs) approved by Council and currently in issue. It also sets out the relationship between HKFRSs and International Financial Reporting Standards (IFRSs) and the scope and authority of Accounting Guidelines and Accounting Bulletins. The Preface was approved in [] 2002 and supersedes the Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines issued in September 1978 (reviewed March 1984 and amended December 1991 and June 2000).

1. Pursuant to section 18A of the Professional Accountants Ordinance (Chapter 50), Council may, in relation to the practice of accountancy, issue or specify any standards of accounting practices required to be observed, maintained or otherwise applied by members of the HKSA. Approval of HKFRSs and related documents, such as the *Framework for the Preparation and Presentation of Financial Statements (Framework)*, exposure drafts, and other discussion documents, is the responsibility of Council.
2. Council has delegated the accounting standards setting function to the Financial Accounting Standards Committee (FASC). The FASC has a mandate from Council to achieve convergence with the IFRSs issued by the International Accounting Standards Board (IASB). Within this remit, Council permits the FASC to work in whatever way it considers most effective and efficient and this may include forming advisory sub-committees or other forms of specialist advisory groups to give advice in preparing new and revised HKFRSs.
3. The Urgent Issues and Interpretations Sub-Committee (UII) is a sub-committee formed under the auspices of the FASC. The role of the UII is to prepare interpretations of HKFRSs for consideration by the FASC and, in the context of the *Framework*, to provide timely guidance on financial reporting issues not specifically addressed in HKFRSs.
4. The HKSA’s Standard-Setting Steering Board (SSSB) is responsible for reviewing and advising on the HKSA’s overall strategy, policies and processes for setting accounting standards. One of the SSSB’s main objectives is to give advice to the FASC on priorities and on major standard-setting projects.

Objectives of Council

5. In 2001, Council adopted the policy of achieving convergence of HKFRSs with IFRSs. Council’s objectives in this respect are:
 - (a) to develop, in the public interest, a single set of high quality, understandable

and enforceable accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the capital markets and other users of the information to make economic decisions;

- (b) to promote the use and rigorous application of those standards;
- (c) to promote and support compliance with those standards by members of the HKSA whether as preparers or auditors of financial information; and
- (d) to bring about convergence of accounting standards with IFRSs.

Scope and authority of HKFRSs

6. Council achieves its objectives primarily by developing and publishing HKFRSs and promoting the use of those standards in general purpose financial statements and other financial reporting. Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. In developing HKFRSs, Council takes into consideration the need to achieve convergence of HKFRSs with IFRSs and the need to achieve consistency with the legal framework.
7. HKFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. They may also set out such requirements for transactions and events that arise mainly in specific industries. HKFRSs are based on the *Framework*, which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the *Framework* is to facilitate the consistent and logical formulation of HKFRSs. The *Framework* also provides a basis for the use of judgement in resolving accounting issues.
8. HKFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organised in corporate or in other forms. They include organisations such as mutual insurance companies and other mutual cooperative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants. Although HKFRSs are not designed to apply to not-for-profit activities in the private sector, public sector or government, entities with such activities may find them appropriate.
9. HKFRSs apply to all general purpose financial statements. Such financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity that is useful to those users in making economic decisions.
10. A complete set of financial statements includes a balance sheet, an income statement, a statement showing either all changes in equity or changes in equity other than those arising from capital transactions with owners and distributions to owners, a cash flow statement, and accounting policies and explanatory notes. In the interest of timeliness and cost considerations and to avoid repeating information previously reported, an

entity may provide less information in its interim financial statements than in its annual financial statements. SSAP 25 *Interim Financial Reporting* prescribes the minimum content of complete or condensed financial statements for an interim period. The term ‘financial statements’ includes a complete set of financial statements prepared for an interim or annual period, and condensed financial statements for an interim period.

11. In some cases, HKFRSs permit different treatments for given transactions and events. Usually, one treatment is identified as the ‘benchmark treatment’ and the other as the ‘allowed alternative treatment’. The financial statements of an entity may appropriately be described as being prepared in accordance with HKFRSs whether they use the benchmark treatment or the allowed alternative treatment.
12. Council’s objective is to require like transactions and events to be accounted for and reported in a like way and unlike transactions and events to be accounted for and reported differently, both within an entity over time and among entities. Consequently, Council intends to minimise choices in accounting treatment. Also, Council has reconsidered, and will continue to reconsider, those transactions and events for which HKFRSs permit a choice of accounting treatment, with the objective of reducing the number of those choices.
13. Statements approved by Council include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual standard should be read in the context of the objective stated in that standard and this Preface.
14. Interpretations of HKFRSs are to give authoritative guidance on issues that are likely to receive divergent or unacceptable treatment, in the absence of such guidance.
15. SSAP 1 *Presentation of Financial Statements* includes the following requirement:

“An enterprise whose financial statements comply with Statements of Standard Accounting Practice should disclose that fact. Financial statements should not be described as complying with Statements of Standard Accounting Practice unless they comply with all the requirements of each applicable Statement and each applicable Interpretation.”

This requirement extends to HKFRSs currently in issue.

16. Any limitation of the scope of a HKFRS is made clear in the standard.

**Obligation for members of the HKSA
to observe HKFRSs or justify departures**

17. Council is committed to promoting and supporting compliance with HKFRSs by members of the HKSA whether as preparers or auditors of financial information.
18. Council therefore expects members of the HKSA who assume responsibilities in respect of financial statements to observe HKFRSs.

19. Where this responsibility is evidenced by the association of members' names with such financial statements in the capacity of directors or other officers, the onus will be on them to ensure that the existence and purpose of HKFRSs are fully understood by non-member fellow directors and other officers. Members of the HKSA should also use their best endeavours to ensure that HKFRSs are observed and that significant departures found to be necessary are adequately disclosed and explained in the financial statements.
20. Where members of the HKSA act as auditors or reporting accountants, they should be in a position to justify significant departures, to the extent that their concurrence with the departures is stated or implied. They are not, however, required to refer in their report to departures with which they concur, provided that adequate disclosure has been made in the notes to the financial statements.
21. Council may enquire into apparent failures by members of the HKSA to observe HKFRSs or to ensure adequate disclosure of significant departures there from.

Due process

22. HKFRSs and Interpretations of HKFRSs are developed through a due process that involves members and member practices of the HKSA, listed companies in Hong Kong, the stock exchange, regulatory and legal authorities, academics and other interested individuals and organisations.
23. The FASC consults the SSSB on major projects, agenda decisions and work priorities. Due process for projects normally, but not necessarily, involves the following steps:
 - (a) the staff are asked to identify and review all the issues associated with an exposure draft or a draft interpretation issued by the IASB for possible adoption in Hong Kong or any other topics and to consider the application of the *Framework* to the issues, if needed;
 - (b) study of pronouncements of the IASB and other standard setting bodies and accepted industry practices about the issues;
 - (c) consulting the SSSB about the advisability of adding the topic to the FASC or UII's agenda;
 - (d) formation of an advisory group to give advice to the FASC on the project;
 - (e) publishing for public comment a discussion document;
 - (f) publishing for public comment an exposure draft or a draft interpretation;
 - (g) publishing within an exposure draft a basis for conclusions;
 - (h) consideration of all comments received within the comment period on discussion documents, exposure drafts and draft interpretations and, when appropriate, preparing a comment letter to the IASB;
 - (i) following publication of the finalised IFRS or Interpretation of IFRS, consideration of the changes made, if any, by the IASB;

- (j) approval of a standard or an Interpretation by Council; and
- (k) publishing within a standard a basis for conclusions, if appropriate, explaining how the conclusions were reached and to give background information that may help users of HKFRSs to apply them in practice.

Coordination with International Due Process

- 24. Council understands that close co-ordination between the FASC's and IASB's due processes is important to the success of achieving convergence of HKFRSs with IFRSs.
- 25. In its due process statements, the IASB states that it is exploring ways in which it can integrate its due process more closely with national due process (such as that operated in Hong Kong by the FASC).
- 26. In particular, the IASB states that it is exploring the following procedures for projects that have international implications:
 - IASB and national standard setters would co-ordinate their work plans so that when IASB starts a project, national standard setters would also add it to their own work plans so that they can play a full part in developing an international consensus. Similarly, where national standard setters start projects, IASB would consider whether it needs to develop a new IFRS or revise its existing IFRSs. Over a reasonable period, IASB and national standard setters should aim to review all standards where significant differences currently exist, giving priority to the areas where the differences are greatest;
 - National standard setters would not be required to vote for IASB's preferred solution in their national standards, since each country remains free to adopt IASC standards with amendments or to adopt other standards. However, the existence of an international consensus is clearly one factor that members of national standard setters would consider when they decide how to vote on national standards;
 - IASB would continue to publish its own Exposure Drafts and other documents for public comment;
 - National standard setters would publish their own exposure documents at approximately the same time as IASB Exposure Drafts and would seek specific comments on any significant divergences between the two exposure documents. In some instances, national standard setters may include in their exposure documents specific comments on issues of particular relevance to their country or include more detailed guidance than is included in the corresponding IASB document; and
 - National standard setters would follow their own full due process, which they would, ideally, choose to integrate with IASB's due process. This integration would avoid unnecessary delays in completing standards and would also minimise the likelihood of unnecessary differences between the standards that result.

Council supports the integration of its standard setting process with that of the IASB as outlined above by adopting these procedures.

Timing of application of HKFRSs

27. HKFRSs apply from a date specified in the document. New or revised HKFRSs set out transitional provisions to be applied on their initial application.
28. Council has no general policy of exempting transactions occurring before a specific date from the requirements of new HKFRSs. When financial statements are used to monitor compliance with contracts and agreements, a new HKFRS may have consequences that were not foreseen when the contract or agreement was finalised. For example, covenants contained in banking and loan agreements may impose limits on measures shown in a borrower's financial statements. Council believes the fact that financial reporting requirements evolve and change over time is well understood and would be known to the parties when they entered into the agreement. It is up to the parties to determine whether the agreement should be insulated from the effects of a future HKFRS, or, if not, the manner in which it might be renegotiated to reflect changes in reporting rather than changes in the underlying financial condition.
29. Exposure drafts are issued for comment and their proposals are subject to revision. Until the effective date of a HKFRS, the requirements of any HKFRS that would be affected by proposals in an exposure draft remain in force.

Relationship with IFRSs

30. Although Council has a policy to achieve convergence of HKFRSs with IFRSs, Council may consider it appropriate to include additional disclosure requirements in a HKFRS or, in some exceptional cases, to deviate from an IFRS. Each HKFRS issued by Council contains information about the extent of compliance with the equivalent IFRS. In most cases, compliance with a HKFRS automatically ensures compliance with the relevant IFRS. However, where the requirements of a HKFRS and an IFRS differ, the HKFRS should be followed by entities reporting within the area of application of the HKFRSs.
31. The following sets out the views of Council in relation to IFRSs that have been issued and are in force:
 - (a) Where the HKFRS agrees with or goes further than the IFRS that deals with the same topic: -

Compliance with the HKFRS ensures compliance with IFRS.
 - (b) Where an IFRS is effective but Council has not issued a HKFRS that deals with the same topic:-

The IFRS is not obligatory in Hong Kong unless some other consideration is applicable (e.g. there is a requirement under the regulations of a stock exchange to comply with all IFRSs).
 - (c) Where an IFRS goes further than a HKFRS issued by Council that deals with the same topic: -

Compliance with the HKFRS is required. Non-compliance with the IFRS should be noted only if there are other considerations, e.g. a stock exchange requirement, as mentioned in (b) above.

Scope and application of Accounting Guidelines

32. Accounting Guidelines are those guidelines that have been approved for issue by Council.
33. Accounting Guidelines have effect as guidance statements and indicators of best practice. They are persuasive in intent. Unlike HKFRSs, Accounting Guidelines are not mandatory on members of the HKSA but are consistent with the purpose of HKFRSs in that they help define accounting practice in the particular area or sector to which they refer. Therefore, they should normally be followed and members of the HKSA should be prepared to explain departures if called upon to do so.

Scope and application of Accounting Bulletins

34. Accounting Bulletins are informative publications issued by the FASC on subjects of topical interest and are intended to assist members of the HKSA or to stimulate debate on important accounting issues. They do not require the approval of Council and they do not have the same authority as either HKFRSs or Accounting Guidelines.

Compliance with a basis or standard of accounting other than HKFRSs

35. Where a member of the HKSA assumes responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, the member should observe that other basis or standard of accounting. Accordingly, paragraphs 19 to 21 of this Preface shall apply, as if the references to HKFRSs in those paragraphs are to the other basis or standard of accounting, to members of the HKSA who assume responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, as they apply to members of the HKSA who assume responsibility in respect of financial statements prepared under HKFRSs.