Professional and Technical News at a glance

HKSA TechWatch

Hong Kong Society of Accountants 香港會計師公會

Issue No. 6 *June 2002*

This is the Sixth Issue of TechWatch, a publication designed to alert members to topics and issues that impact on accountants and their working environment. We welcome your comments and feedback. Comments and suggestions on TechWatch should be addressed to Ms. Winnie Cheung, Senior Director, Professional & Technical Development, Hong Kong Society of Accountants (email:<commentletters@hksa.org.hk>).

This issue (and all back issues) is available online at the Society's website <http://www.hksa.org.hk/professional> under "TechWatch (Members only)".

If you would prefer to receive future issues electronically via email or in hard copy format, you may register or alter your option online at the Members Only section of HKSA web page under "Personal Profile - Publications Preferences". If you have any questions, please contact Karen Moy, Administrative Officer, Professional & Technical Department at <karen_moy@hksa.org.hk> or tel: 2287 7089.

Headlines Of This Issue

Accounting & Financial Reporting

IASB Issues An Exposure Draft Of Proposed Improvements To The International Accounting Standards

The International Accounting Standards Board (IASB) has published for public comment an exposure draft to revise 12 of its 34 active standards. The IASB invites comments on the proposals contained in the exposure draft by 16 September 2002. A copy of the exposure draft has been posted on the IASB website at <http://www.iasb.org.uk>.

The following standards are covered by the "Improvements" ED:

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Balance Sheet Date
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 24	Related Party Disclosures
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Accounting for Investments in Associates
IAS 33	Earnings Per Share
IAS 40	Investment Property

Under the HKSA's due process for setting accounting standards, the HKSA's Financial Accounting Standards Committee (FASC) has approved an Invitation to Comment on the IASB's exposure draft. The Invitation to Comment will be posted on the HKSA's website at <http://www.hksa.org.hk/professional/> and will be distributed before the end of June to members and other commentators by email or post in the way described on pages 8 & 9 of the May 2002 edition of The Hong Kong Accountant.

FASC Issues Draft Interpretation 19, Intangible Assets - Website Costs

The Financial Accounting Standards Committee (FASC) has published Draft Interpretation 19, Intangible Assets - Website Costs. Comments on this Draft Interpretation are requested by 15 July 2002.

The Draft Interpretation is in all material respects verbatim with the equivalent SIC Interpretation 32, Intangible Assets - Website Costs. SIC-32 deals with the issues of:

- ✔ whether a website is an internally generated intangible asset that should be subject to the requirements of the accounting standard on intangible assets; and
- ✔ the appropriate accounting treatment of such website costs.

The paper version of the Draft Interpretation was released on 6 June 2002. A copy of the Draft Interpretation and the FASC's invitation to comment have also been posted on the HKSA website at <http://www.hksa.org.hk/professional>.

FASC Meeting - 15 May 2002

The FASC met on 15 May 2002 and discussed the following items:

- ✔ Business Combinations
- ✔ Land Use Rights Certificates issued in the People's Republic of China
- ✔ Improvements to IAS and Hong Kong SSAPs
- ✔ Proposed Framework for Differential Reporting

A copy of the meeting summary is attached to this issue of TechWatch. The meeting summary may also be viewed at the HKSA website at: <http://www.hksa.org.hk/professional>.

Audit & Assurance

ED Of Proposed SAS 730 "The Examination Of Prospective Financial Information"

The Auditing and Assurance Standards Committee (AASC) has published an Exposure Draft (ED) of proposed SAS 730 "The examination of prospective financial information" for consultation. Comments on the ED are requested by 31 July 2002.

The ED, which is based on the ISA of the same title, establishes standards and provides guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimate and hypothetical assumptions.

The ED and the AASC's invitation to comment have been posted on the HKSA's website at <http://www.hksa.org.hk/professional/ed-sas730.pdf>.

Revised PN 840 "The Audit Of Solicitors' Accounts Under The Solicitors' Accounts Rules And The Accountant's Report Rules"

PN 840 has been revised, after consultation with The Law Society, to take account of the following new and revised Solicitors' Accounts Rules:

Rule 7A - Authority required for drawing money from client account

Rule 9A - Duty to remedy breaches

Rule 10 - Obligation to keep accounts

Rule 10A- Reconciliations.

The revised PN will be issued with Members' Handbook Updated 4/02 and be available on the HKSA's website <http://www.hksa.org.hk/professional/> (under "Professional Pronouncements" and "Volume - III-B"). The Solicitors' Accounts Rules may be found at The Law Society's website <http://www.hklawsoc.org.hk/pub/professionalguide/volume2/default.asp?cap=15>.

Revised Standard Bank Confirmation Request Form

After consultation with the Hong Kong Association of Banks (HKAB), the Standard Bank Confirmation Request Form (Form) has been revised by deleting the requirements for banks to confirm the list of authorised signatories and to send duplicate copies of the first bank statements after the close of business on the balance confirmation date. The review of the Form by the AASC was prompted by a referral from the HKAB.

The revised Form will be issued with Members' Handbook Update 4/02 and be available on the HKSA's website <http://www.hksa.org.hk/professional/> (under "Professional Pronouncements" and "Volume - III-A").

"Areas Of Focus In Relation To The Audits Of Securities Dealers" Prepared By The SFC

The SFC has prepared a List that highlights a number of focus areas in relation to the audits of securities dealers:

- Circularisation of clients' accounts
- Statutory reporting requirements
- Other financial issues.

A copy of the List is attached in the Appendices of this TechWatch for members' information.

IAASB's First Meeting In June 2002

As mentioned in the April 2002 issue of TechWatch, to ensure increased transparency and efficiency in the auditing standards-setting process, the IFAC Board has approved the establishment of the International Auditing and Assurance Standards Board (IAASB), replacing the International Auditing Practices Committee.

IAASB's meetings are open to the public. Its first meeting was held in Mexico City on 10 - 14 June 2002. The Agenda and Background Papers of IAASB's meetings are available at the IAASB's website <http://www.ifac.org/IAASB/> approximately six weeks before the meeting. Highlights of the agenda of the first IAASB's meeting are:

- Final guidance on auditing fair value measurements and disclosures
- Revisions to ISA 220 "Quality Control for Audit Work"
- Discussion paper on "Moderate Assurance Framework"
- Discussion paper on "Audit Risk Project".

In the light of the HKSA's policy to converge Hong Kong SASs/SAEs with the international auditing and assurance standards issued by the IAASB, the AASC will endeavour to issue exposure drafts of Hong Kong SASs/SAEs concurrently with exposure drafts issued by the IAASB.

Legislation & Government Initiatives

Society Comments On Proposal To Abolish Corporate Directors

Currently, under section 154A of the Companies Ordinance (Section 154A), all public companies and the subsidiaries of listed companies must have natural persons as their directors. However, the vast majority of private companies formed and registered in Hong Kong may choose to have corporate directors.

In response to a limited consultation by the Registrar of Companies on the issue of corporate directors and their possible abolition, the Society expressed the view that there would be both advantages and disadvantages from abolishing corporate directors. We suggested that consideration be given to introducing measures to prevent the formation of impenetrable corporate structures that make it extremely difficult to identify any natural persons responsible for directing the operations of certain companies, because they have corporate directors that are themselves controlled by corporate directors, and so on.

Specifically the Society proposed that section 154A of the Companies Ordinance be amended to require that a corporate director must have natural persons as its own directors. The position could then be reviewed again once this measure has been in operation for some time, and its effect can be assessed, as well as in the light of further developments that may take place internationally.

A copy of the submission may be accessed at the Society's website at <http://www.hksa.org.hk/professional/> under "HKSA Submissions".

Business Registration Certificate Levy Increased

Members may recall that in the April 2002 issue of TechWatch (issue No.4), we referred to a proposal to increase the Business Registration Certificate (BRC) levy for the Protection of Wages Insolvency Fund (PWIF).

Pursuant to the Business Registration Ordinance (Amendment of Schedule 2) Order 2002, the levy for the PWIF has now been increased from $250 to $600 per annum with effect from 16 May 2002. Despite the one year waiver of the business registration fee announced in the 2002-03 Budget, an operating business is still required to apply for registration, and the relevant BRC levy for the Fund is still payable on registration of business or issue of a further BRC.

The Protection of Wages on Insolvency Ordinance provides for ex-gratia payments to be made from the PWIF to employees who are owed wages, wages in lieu of notice or severance payment by employers who have become insolvent. According to a Government spokesman, since the Asian financial crisis in 1997, the PWIF has been operating annual deficits. The levy increase of $350, which was supported by both the PWIF Board and the Labour Advisory Board, is considered to be necessary therefore to ensure that the Fund can continue to provide prompt financial relief to employees in insolvency cases.

Corporate Governance

Society To Launch Best Corporate Governance Disclosure Awards 2002

Plans are under way to launch the 2002 Best Corporate Governance Disclosure Awards as part of the Society's on-going efforts to promote better corporate governance in Hong Kong. This will be the third time that the Awards have been held and we are hoping to generate another positive response to this year's competition.

The objective of the Awards is to encourage and promote good corporate governance disclosure practices in Hong Kong, and to give recognition to those companies/organisations that demonstrate the best corporate governance practices.

Panels of reviewers and judges will examine entrants' latest annual reports for financial years ending on or before 31 March 2002 to assess the extent and quality of corporate governance-related disclosures, and the underlying practices that these reveal. As in 2001 and 2000, the competition will be open to companies listed on the Main Board of Stock Exchange and the Growth Enterprise Market, as well as to public sector / not-for-profit organisations. The details of this year's Award competition are being finalised by the Society's Corporate Governance Committee and will be announced publicly in due course.

We hope that members who work in companies / organisations that are eligible to enter the Awards will show their support for the competition by encouraging their company or organisation to participate in the 2002 Best Corporate Governance Disclosure Awards. Members who wish to obtain further details about the Awards should contact Ms. Mary Lam, Assistant Director (Business and Practice) at the Society.

Society Submits Views on Corporate Governance For Authorised Insurers

The Commissioner of Insurance (C of I) invited the Society to comment on a draft guidance on corporate governance for authorised insurers. In the regulated industries sector, guidance on corporate governance for the banks in Hong Kong, issued by the Hong Kong Monetary Authority, is already in effect. The C of I recognises that a high standard of corporate governance is also important in the development of a more stable and healthy insurance market in Hong Kong and is therefore proposing to issue guidance setting out minimum expected standards of corporate governance for the insurance sector.

The Society expressed overall support for the C of I's initiative. We believe that the regulated sector should be setting a good example for others to follow, and given that the financial services sector is one of the principal targets of investment in Hong Kong, it is even more important that Hong Kong should be seen to be adopting international best practice.

As regards the detailed provisions of the draft guidance, the Society made a number of specific suggestions. These covered various areas, such as the composition and meetings of the board of directors and specialised committees, in particular the involvement of independent non-executive directors, as well as matters relating to internal controls, the promulgation of codes of ethical conduct and, more generally, the need to maximise transparency. The Society's submission can be viewed at <http://www.hksa.org.hk/professional/> under "HKSA Submissions".

Financial Management

IFAC Initiative On Accountants In Business

International Federation of Accountants (IFAC), the global accountancy body, currently comprises 156 national professional accountancy organisations in 114 countries and represents 2.4 million accountants worldwide. In view of the fact that more than 50% of the accountants that IFAC represents are now employed in business and industry, a special working group has been established to determine how IFAC, along with its Financial and Management Accounting Committee, can best support member bodies in meeting the needs of this constituency.

The IFAC Working Group's remit is to identify the needs and expectations of accountants in business in relation to the work of IFAC and potential activities that would add value to their membership.

The Society's Vice President and Chairman of the Financial Management Committee (FMC) Chairman, Mr. Edward Chow, has been invited to join the IFAC Working Group as the Society's representative. The FMC, comprising primarily professional accountants working in the corporate sector in Hong Kong, will thus be able to provide input into the programme of the IFAC Working Group.

The IFAC Working Group will hold its first meeting in New York in mid-June 2002. In preparation for this the FMC held a meeting earlier this month to discuss key issues to be reflected to Working Group. The Committee is also hoping to organise a forum on accountants in business later in the year to solicit views more widely.

We will report on significant developments in relation to this IFAC initiative, either through future issues of TechWatch or other appropriate channels. In the meanwhile, if any members have any views on this subject that they would like to pass to the FMC, please write to Mr. Peter Tisman, Deputy Director (Business and Practice) at the Society.

Comment Key Dates

Date	Subject
15 July 2002	Exposure Draft of Proposed SSAP on Financial Instruments and Implementation Guidance
15 July 2002	Draft Interpretation 19, Intangible Assets - Website Costs
31 July 2002	Exposure Draft of proposed SAS 730 "The Examination of Prospective Financial Information"
31 August 2002	Hong Kong Invitation to Comment on the IASB's Exposure Draft Improvements to International Accounting Standards
16 September 2002	IASB's Exposure Draft Improvements to International Accounting Standards. A copy of the exposure draft has been posted on the IASB website at <http://www.iasb.org.uk>
Please send comments to <commentletters@hksa.org.hk>	

Members Ask

Treatment of Revaluation Reserve of an Associate or Jointly Controlled Entity

Q: Under SSAP 13.17, revaluation surpluses and deficits on investment property are treated as movements in an investment property revaluation reserve, unless the total of this reserve is insufficient to cover a deficit on a portfolio basis, in which case the amount by which the deficit exceeds the total amount in the investment property revaluation reserve should be charged to the profit and loss account.

Under SSAP 13.18, where a revaluation deficit arises in an individual company, which is part of a group, and there is a net surplus on revaluations of investment properties in the group, the deficit can be charged against the revaluation reserve in the consolidated financial statements.

Is it appropriate for a revaluation surplus or deficit in an associated company or jointly controlled entity to be taken into account when determining the net revaluation surplus or deficit on a portfolio basis for the group?

A: Under SSAP 32.08, a group consists of a parent and all its subsidiaries. Associates and jointly controlled entities are not part of the reporting group. Consistent with the principles of equity accounting and the requirements of SSAP 10 and SSAP 21, it is not appropriate under SSAP 13 to take into account the group's share of post-acquisition revaluation surpluses or deficits of associates or jointly controlled entities against the investment property revaluation reserve of the group.

Please note that the answers above are given in accordance with the HKSA Staff Policy on Handling Technical Queries, which is available for reference on the HKSA website at <http://www.hksa.org.hk/professional>.

The HKSA Professional and Technical Department is headed by Ms. Winnie Cheung, Senior Director. Section heads of the Professional and Technical Department are:

Mr. Simon Riley, Deputy Director (Accounting)
Mr. Stephen Chan, Deputy Director (Assurance)
Mr. Peter Tisman, Deputy Director (Business & Practice)

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Appendices

FASC Meeting - 15 May 2002

The Society's Financial Accounting Standards Committee (Committee) met on 15 May 2002 and discussed the following items:

- ✔ Business Combinations
- ✔ Land Use Rights Certificates issued in the People's Republic of China
- ✔ Improvements to IAS and Hong Kong SSAPs
- ✔ Proposed Framework for Differential Reporting

Business Combinations

The Committee noted progress made by the IASB on its project to revise IAS 22 and considered the following issues:

- ✔ The proposal to require goodwill to remain on the balance sheet, unamortised, but subject to an annual impairment review
- ✔ The proposed treatment for negative goodwill
- ✔ Transitional provisions required for Hong Kong

Goodwill and the impairment model

The impairment model currently under consideration by the IASB is broadly similar to the principles in IAS 36 (SSAP 31) in respect of the 'trigger' that gives rise to the need to conduct a detailed impairment review and, once triggered, the nature of the impairment review by reference to the recoverable amount of the underlying assets.

The Committee also considered the conceptual merit of permitting goodwill to remain unamortised on the balance sheet. Under the current (SSAP 30) approach to purchased goodwill, such goodwill is gradually replaced by goodwill generated internally through advertising, brand maintenance and other similar activities. The longer that goodwill stays on the books unamortised (and, in the case of a successful business), the more likely it is to actually have the nature of internally generated goodwill. The Committee agreed to address this apparent conceptual inconsistency with the IASB and whether, for example, this may open the door to argue that internally generated intangible assets should be able to be recognised on the balance sheet under IAS 38.

Negative goodwill

The IASB has indicated it intends to find a replacement term for "negative goodwill". The amount that represents the 'true' excess of the aggregate fair values of the identifiable net assets over the cost of acquisition - regardless of the underlying reason/s - is to be treated as a 'windfall gain' and recognised in income immediately.

The IASB proposal would simplify significantly the 'three tier' approach currently under IAS 22. The Committee agreed with the principles underlying the IASB proposal in respect of negative goodwill.

Transitional provisions

SSAP 30 differs from IAS 22 (1998) in respect of transition, most notably in relation to the treatment of goodwill previously written off directly to shareholders' interests (permitted in Hong Kong prior to SSAP 30 but the then IASC discontinued the practice following the 1993 revision to IAS 22).

The Committee noted that the implied transition from IAS 22 (1998) to a successor IFRS would not require goodwill to be reinstated on the balance sheet. The proposal appears to be similar to the transitional provision stated in SSAP 30 except that, in the case of the IASB, impairment would be required only in respect of goodwill actually carried on the balance sheet. With goodwill having been "written off" previously to reserves (but which remains as a separately analysed and reported component of equity subject to impairment) the Committee noted that the Hong Kong transitional provision would necessarily be less straightforward than that expected in the pending IFRS.

A paper on the potential transitional provisions applying under SSAP 30 would be discussed at the Committee's next meeting.

Land Use Rights Certificates issued in the People's Republic of China

The Committee considered a background paper on Land Use Rights Certificates (LURC) issued in China. The paper set out the generic terms and conditions of a LURC and discussed the appropriate accounting treatment for LURCs under Hong Kong SSAPs.

The Committee tentatively concluded that the typical LURC has the same characteristics as a lease and, as such, would usually be accounted for under SSAP 14.

The Committee noted that the specific exemption under SSAP 14 paragraph 11 accorded to leases of property owned by the Hong Kong SAR government would not apply in the case of a LURC issued in the PRC but that common practice in Hong Kong had been to extend the exemption to LURCs. This issue is expected to be only short term, however, with the impending proposal to amend the leasing and investment properties accounting standards.

The Committee agreed to review a revised draft of the paper at its next meeting.

Improvements to IAS and Hong Kong SSAPs

The Committee considered a draft version of the Hong Kong Invitation to Comment on the IASB's Exposure Draft Improvements to the International Accounting Standards. The Committee agreed that, prior to publication, the Invitation to Comment would be considered further by the Improvements and Convergence Sub-committee.

Proposed Framework for Differential Reporting

The Committee considered a draft Framework for Differential Reporting and Discussion Paper, on referral from the Society's GAAP for Small Businesses Working Group. The Framework seeks to set out criteria by which entities qualify for financial reporting exemptions from the SSAPs and to guide the standard setter in establishing differential reporting exemptions in those Statements.

The Committee agreed with the principles set out in the Exposure Draft and Discussion Paper but recorded comments on two significant issues:

First, the approach taken in maintaining the differential reporting requirements - there are essentially two approaches, namely:

- The "integrated approach", of the type adopted in Canada and New Zealand, whereby differential reporting exemptions are highlighted in the Framework and in the body of each standard otherwise applicable on a generic basis; and
- The "separate approach", of the type adopted in the United Kingdom, whereby a completely separate accounting standard is developed and maintained and which applies to qualifying entities exclusive of all other accounting standards.

The Committee indicated its strong support for the integrated approach and considers that the documents (in particular, the Discussion Paper) should not take a neutral stance. The Committee considers that if the separate approach was adopted in Hong Kong, this would create a significant drain on resources. The Committee is concerned that the Discussion Paper should not imply that the Society is willing to adopt an approach to setting differential reporting exemptions that it has no realistic way of meeting.

Second, whether certain limited measurement differences should be permitted under the proposed Framework. The draft Framework proposes primarily disclosure differences to the existing SSAPs but, in keeping with the principles outlined in the Framework and comparable measures put into place in countries such as Canada and New Zealand, the Exposure Draft and Discussion Paper proposes limited measurement differences in respect of SSAPs 12, 13 & 17. The Committee noted that in leading jurisdictions where differential reporting exemptions were in place (whether in Canada or the United Kingdom) measurement differences to one extent or other were permitted.

Date of Next Meeting

The Committee's next meeting will be held on 12 June 2002.

This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. All conclusions reported are tentative and may be changed at future meetings.

The IASB publishes summaries of its meetings and these can be found on the IASB's website at <http://www.iasb.org.uk>.

The Committee welcomes comments on its technical agenda. Please e-mail us at <commentletters@hksa.org.hk>.

"Areas Of Focus In Relation To The Audits Of Securities Dealers" Prepared By The SFC

Circularisation of clients' accounts

Circularisation of clients' account balances is one of the recommended audit procedures set out in Industry Auditing Guideline 3.404 "The audit of the accounts of dealers in securities" issued by the Hong Kong Society of Accountants (HKSA) to be performed by auditors to obtain audit evidence on the existence, accuracy and completeness of the clients' assets. Statement of Auditing Standards 402 "External Confirmations" issued by the HKSA in August 2001 establishes standards and provides guidance on auditors' use of external confirmations as a means of obtaining audit evidence.

We appreciate that auditors exercise their professional judgment in relation to the performance of circularisation of clients' account balances. In order to enhance consistency of audit procedures for all auditors, we set out below a list of guidelines which we consider worth highlighting for auditors' consideration regarding circularisation of clients' account balances:-

- Auditors should exercise their judgment in determining sufficient coverage of samples over the total population of clients' accounts both in terms of the number of clients and money value of clients' assets;
- Confirmation should be prepared in language that the clients of the securities dealer are familiar with;
- Confirmation should be directly sent to and received from clients. Clients should be provided with convenient means of responding to the auditors;
- Be aware of any client enquiries regarding any discrepancies in their account balances;
- Auditors should independently select samples for circularisation;
- Auditors to determine appropriate procedures in assessing the reliability of the confirmation letters received such as verifying client signatures on the confirmation against client agreements; and/or directly calling the clients to verify the agreed balances on sample basis; and
- Adequate and timely follow-up procedures for the non-reply confirmations should be carried out such as considering sending reminders or directly calling the non-reply clients etc. and/or reviewing a sample of trade orders and withdrawals of funds and stocks recorded in their accounts.

Statutory reporting requirements for auditor of securities dealer

Section 89 of the Securities Ordinance ("SO") requires the auditor to report to the Commission in writing as soon as practicable when he identifies any contravention of section 81, 81A, 83 or 84 of the SO and the Financial Resources Rules ("FRR").

Similar requirements for securities margin financiers and futures dealers are set out in section 121AU of the SO and section 51 of the Commodity Trading Ordinance.

Although we understand that auditors have reported any contravention to the Commission, we would like to emphasise that timeliness of reporting is essential for us to take any necessary regulatory actions.

Other financial issues

Under the current economic and market environment, we would suggest that the following issues may be also taken into account during the course of audit, where applicable:-

- Adequacy of provision for amounts receivable by securities dealer;
- Securities dealer may improve the appearance of its liquid capital position by effecting transactions just before and reversing them after month end and year end dates;
- Going concern assessment; and
- Identification and disclosure of contingent liabilities and commitments.

Upcoming CPD Programmes For HKSA Members

Date		Topic
29 Jun	Sat	Annual Taxation Update Conference
03 Jul	Wed	Loan Syndication Market
08 Jul	Mon	Five Years On: An Overview of Asia Post Crisis
16 Jul	Tue	Setting up a Holding Company in China - Update on Requirements and Tax Impacts
17 Jul	Wed	Auditing of the GEM Companies
18 Jul	Thu	中國大陸稅務稽查
23 Jul	Tue	Securing Corporate Information with Security Management Framework: An Introduction to British Standard 7799

Source: HKSA's Education and Training Department (E & T)

For more information, please visit HKSA's website at <http://www.hksa.org.hk/membership/cpd/index.php> or contact the Education & Training Department on 2287 7058.