

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 Stephen Chan, Executive Director 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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Previous issues of TechWatch

Spotlight

1. Technical Update Evening (TUE)

The **new TUE programme** on financial reporting and auditing started on 27 September 2005 featuring a number of important new Financial Reporting and Auditing Standards:

- 507 (27 Sep) Balance sheet I: Non-financial tangible assets other than leases and investment property (attended by over 60 members)
- 508 (4 Oct) New Audit Risk Standards Introduce Risk-Based Audit Approach (Re-run)
- 509 (25 Oct) Balance sheet II: Intangible assets
- 510 (1 Nov) Balance sheet III: Leases and investment property / Non-financial liabilities
- 511 (8 Nov) Revised Standards on Fraud Consideration and Audit Planning (Re-run)
- 512 (22 Nov) Presentation issues
- 513 (29 Nov) New Quality Control Standards for Auditors (Re-run)
- 514 (7 Dec) Financial instruments: new disclosures and other changes
- 515 (16 Dec) 21 Replacement Hong Kong Auditing Standards (Re-run)

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

2. Handbook Updates No. 19 & 20

Update No. 19 encloses the new Insolvency Guidance Notes (1) – (4) (Statements 1.600 – 1.603) that are effective for insolvency appointments made on or after 1 October 2005. Further details are set out in the “Insolvency & Corporate Restructuring” section.

Update No. 20 encloses the latest version of the Professional Accountants Ordinance and Professional Accountants By-laws, and the following new Standard, Amendments to existing Standards and new Interpretation:

- New HKFRS 7 *Financial Instruments: Disclosures*
- HKAS 1 Amendment *Capital Disclosures*
- HKAS 39 & HKFRS 4 Amendments *Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts*
- New HK(IFRIC)-Int 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*

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

CPD & Events

3. Professional Development Activities September To December 2005

The world of business and finance is constantly evolving. Each week brings new challenges, new circumstances, new products, new services and new standards. So we, as CPAs, must remain firmly at the leading edge of that evolution. And how do we do that? **Through diligence, hard work, and a solid commitment to lifelong learning.**

Click [here](#) for the full programme. Enrol early to secure a seat as several of the seminars and workshops are already full.

4. New CPD Requirements Free Information Session

The Institute has issued a revised **Statement 1.500** (August 2005), which prescribes new CPD requirements as from 1 December 2005. Under the new requirements, all members are required to complete a minimum of 120 hours of relevant professional development activity in each rolling three-year period, of which 60 hours should be verifiable. A minimum of 20 hours of the above 120 hours should be completed each year.

To enable you to have a better understanding of the new CPD requirements and to answer any questions you may have, a number of information sessions will be organised. The first free session will be held on 24 October 2005 from 7 – 8 p.m. at the Institute. Click [here](#) for further details and registration.

Financial Reporting

5. New Disclosures About Financial Instruments And Capital

The IASB's Exposure Draft ED 7 *Financial Instruments: Disclosures* proposed disclosures relating to both financial instruments and capital. That Exposure Draft has resulted in both a standard addressing disclosures of financial instruments and an amendment to HKAS 1 to incorporate disclosures about capital.

(a) HKFRS 7 *Financial Instruments: Disclosures*

HKFRS 7 is based on its IFRS equivalent and will supersede HKAS 30 *Disclosures in Financial Statements of Banks and Similar Financial Institutions*. It is effective for annual accounting periods beginning on or after 1 January 2007. Earlier application is encouraged.

HKFRS 7 requires all entities to disclose risks arising from all types of financial instruments, except those covered by another more specific Standard. The extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risks. HKFRS 7 requires disclosure of:

- the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in HKAS 32 *Financial Instruments: Disclosure and Presentation*; and
- qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

(b) Amendment to HKAS 1 *Presentation of Financial Statements – Capital Disclosures*

Amendment to HKAS 1 is effective for annual accounting periods beginning on or after 1 January 2007. Earlier application is encouraged. The amendment adds requirements for all entities to disclose:

- the entity's objectives, policies and processes for managing capital;
- quantitative data about what the entity regards as capital;
- whether the entity has complied with any external capital requirements; and
- if it has not complied, the consequences of such non-compliance.

These disclosures provide information about the level of an entity's capital and how it manages capital, which are important factors for users to consider in assessing the risk profile of an entity and its ability to withstand unexpected adverse events.

6. Amendments To Existing Standards On Financial Guarantee Contracts

Amendments to HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 4 *Insurance Contracts – Financial Guarantee Contracts* are effective for annual accounting periods beginning on or after 1 January 2006. Earlier application is encouraged.

The amendments are to ensure that issuers of financial guarantee contracts include the resulting liabilities in their balance sheet. A financial guarantee contract is a 'contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument'.

The amendments require the issuer of a financial guarantee contract to measure a financial guarantee contract initially at fair value and subsequently at the higher of (i) the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply to such contracts either HKFRS 4 or the accounting treatment described above.

7. New HK(IFRIC)-Int 6

The Institute has issued **HK(IFRIC)-Int 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*** that is based on its IFRIC equivalent. HK(IFRIC)-Int 6 is effective for annual accounting periods beginning on or after 1 December 2005. Early application is encouraged.

HK(IFRIC)-Int 6 gives guidance on the accounting for liabilities for waste management costs under an EU Directive. It clarifies when certain producers of electrical goods will need to recognise a liability for the cost of waste management relating to the decommissioning of waste electrical and electronic equipment (historical waste) supplied to private households. It provides that the event giving rise to the liability for costs of such historical waste, and so its recognition, is the participation in the market during a measurement period, i.e. a period in which market shares are determined for the purposes of allocating waste management costs. Accordingly, it is this date, rather than the date of production of the equipment, that is the triggering event for liability recognition.

8. FRSC Meeting Summary – 13 July 2005

The **FRSC meeting summary** of 13 July 2005 covers:

- SME Financial Reporting Framework and Financial Reporting Standard
- Exposure Draft of proposed Accounting Guideline on Merger Accounting

- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*
- Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKFRS 6 *Exploration for and Evaluation of Mineral Resources*
- Reply letter from the IASB on four accounting issues discussed with Sir David Tweedie
- Withdrawal of Accounting Guideline 3 *Accounts of Dealers in Securities*
- Interest on funding cost of property under development
- Letter to IASB on an inconsistency between HKAS 17 and HKAS 38
- Companies (Amendment) Ordinance 2005
- Withdrawal of HKFRS-Int 3 *Emission Rights*

Audit & Assurance

9. New Standard On Comfort Letters And Due Diligence Meetings

The Institute will issue Hong Kong Standard on Investment Circular Reporting Engagements (HKSIR) 400 *Comfort Letters and Due Diligence Meetings on Financial and Non-financial Information* effective for engagements where the investment circular is dated on or after 1 January 2006.

HKSIR 400 sets out the standards for reporting accountants who undertake engagements to issue a comfort letter or take part in a due diligence meeting with sponsors on financial and non-financial information. This HKSIR covers the minimum contents of a comfort letter, the type of information that reporting accountants can report on under this HKSIR and the matters that reporting accountants should respond to in a due diligence meeting. In carrying out an engagement to issue a comfort letter, reporting accountants apply the principles in HKSRS 4400 *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*.

The Institute issued for public consultation last year an Exposure Draft of a suite of seven proposed professional pronouncements in relation to listing engagements (which includes HKSIR 400) aiming at bringing Hong Kong's reporting standard in line with international best practices. The Institute will finalise the remaining proposed professional pronouncements in consultation with the Stock Exchange and the Securities and Futures Commission (SFC).

10. Proposed Guidance For Auditors Regarding Preliminary Announcements

The Institute has issued an **exposure draft** of proposed Practice Note (PN) *Guidance for Auditors Regarding Preliminary Announcements of Annual Results* for comments by **31 October 2005**.

As reported in **TechWatch No. 36**, the proposed PN will provide guidance to auditors on their responsibilities with regard to preliminary announcements of results for the full financial year of listed issuers. The directors of a listed issuer are required by the Main Board Listing Rule 13.49(2) and GEM Listing Rule 18.49 to publish a preliminary announcement of the annual results which shall have been agreed with its auditors before it is published.

The Listing Rule requirements for a listed issuer to obtain its auditors' agreement with the preliminary announcement of its results have become effective for annual results announcements for accounting periods commencing on or after 1 July 2004, i.e., first applicable to June 2005 year end announcements.

11. Submissions To IAASB

Whilst the Institute is supportive of the following proposed revisions to the ISAs, it also set out, in the submissions, matters that the IAASB should consider carefully before finalising the revised ISAs:

- (a) **Submission** on Proposed revised ISA 260 *The Auditor's Communication with Those Charged with Governance*.
- (b) **Submission** on Proposed revised ISA 600 *The Audit of Group Financial Statements*.
- (c) **Submission** on Proposed ISA 705 *Modifications to the Opinion in the Independent Auditor's Report* and ISA 706 *Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report*.

Quality Assurance

12. Good Communication With Members On Practice Review

The Institute organised two seminars "Audit Documentation – Lessons from Practice Review cases" on 6 August and 3 September 2005, and a Discussion Forum on the revision of the Practice Review Programme on 27 September 2005. The seminars and the forum were well attended with over 700 practitioners and members.

The two seminars aimed at assisting practitioners and members to gain a better understanding of the requirements of SAS 230 "Documentation" and to learn the deficiencies identified by past practice review cases, a majority of which is inadequate audit documentation. The forum aimed at enabling practitioners and members to obtain a better understanding of the progress of the revision of the Practice Review Programme, and to obtain feedback on the "**Communication Paper on the Revision of the Practice Review Programme & Practice Review Questionnaire**". The deadline for comments on the Communication Paper is 30 September 2005.

If you missed these seminars and forums, you may find out the topics discussed by purchasing the handouts by clicking [here](#). Watch out for similar seminars/forums in the coming months.

Legislation & Government Initiatives

13. Financial Reporting Council Bill

The Institute has made a **submission** on the **Financial Reporting Council (FRC) Bill** to the LegCo Bills Committee, and the President, Mr. Edward Chow led a delegation of five members and spoke in support of the proposed legislation at a LegCo FRC Bills Committee meeting on 27 September 2005. Under the Bill, a FRC will oversee investigations by the Audit Investigation Board into irregularities by auditors of listed companies and enquiries into financial reports by Financial Reporting Review Committees.

The President issued a **Circular to Members** on 30 September 2005 clarifying some of the issues we are trying to resolve as we work on passing the FRC Bill.

14. Law Reform Commission Consults On Conditional Fees

The Law Reform Commission has released a **consultation paper on conditional fees**. The consultation period will end on 15 November 2005. One of the main proposals contained in the

consultation paper is that the existing prohibitions against the use of conditional fees should be lifted for certain types of civil litigation so that lawyers may choose to charge conditional fees in appropriate cases, including, e.g., personal injury cases, family cases not involving the welfare of children, insolvency cases, employees' compensation cases, professional negligence cases, some commercial cases, product liability cases and probate cases involving an estate.

Conditional fees are a form of "no-win, no fee" arrangement between lawyers and their clients. If the case is unsuccessful, the lawyer will charge no fees. In the event of success, the lawyer charges his normal fees with or without a bonus, usually referred to as an "uplift" fee. Conditional fees are different from the American form of contingency fee, where the lawyer's fee is calculated as a percentage amount of damages awarded by the court.

The Institute will consider the consultation paper and members will be kept informed of any further developments. Members are welcome to send in any views on the consultation paper, by 28 October 2005, to **John Tang**, Assistant Director, Specialist Practices, at the Institute.

Corporate Finance

15. SFC Amends Definitions Of Regulated Activities

The SFC has recently published **Consultation Conclusions** on proposed amendments to Schedule 5 to the Securities and Futures Ordinance (SFO) in relation to the definitions of "asset management" (Type 9 regulated activity), "dealing in securities" (Type 1 regulated activity), "advising on securities" (Type 4 regulated activity) and "advising on futures contracts" (Type 5 regulated activity).

The resulting amendments will be effected pursuant to section 142 of the SFO by way of notice published in the Gazette. Subject to the legislative process, the commencement date will be 9 December 2005.

16. Submission To The SFC On The Regulation Of Sponsors And Compliance Advisers

As reported in **TechWatch No. 35**, the SFC published a **consultation paper** to seek comments on a set of proposed additional requirements imposing specific entry criteria and ongoing compliance obligations on sponsors, as well as the proposed transitional arrangements for sponsors to prepare for compliance with the proposed requirements.

In general terms, the Institute finds the proposals in the consultation paper to be reasonable and acceptable, an exception being the qualification for compliance advisers, as explained below. At the same time, the Institute pointed out, in its **submission**, some areas of ambiguity and certain apparent differences between the description and explanation of the proposals contained in the main text of the consultation paper and the more specific provisions contained in Annex I to the consultation paper, which require clarification by the SFC.

The Institute disagrees with the proposed requirement that in order for a corporate finance adviser to act as a compliance adviser, the compliance adviser must first be qualified to act as a sponsor, as the Institute believes that the nature of a sponsor's work and that of a compliance adviser are different and distinct. As regards the qualification needed to be a compliance adviser, the Institute is of the view that corporate finance advisers licensed for Type 6 Regulated Activity under the SFO, in particular, those who have experience in providing advice on Listing Rule matters, should be eligible to act as compliance advisers, and such persons might not be sponsors.

Insolvency & Corporate Restructuring

17. New Insolvency Guidance Notes

The Institute announced the publication of the first set of Insolvency Guidance Notes (“IGNs”) at a press conference held on 14 September 2005. The IGNs establish good practice for members undertaking insolvency work. The initial set cover the following key areas of practice:

- (1) *An introduction explaining the scope and authority of the IGNs* (1.600)
- (2) *Liquidator’s investigation into the affairs of an insolvent company* (1.601)
- (3) *Preparation of insolvency office-holders’ receipts and payments accounts* (1.602)
- (4) *Disqualification of directors – statutory reports* (1.603)

The IGNs have been developed along similar lines to the Statements of Insolvency Practice (SIPs) issued by R3 (also known as the Association of Business Recovery Professionals) and adopted by the Recognised Professional Bodies in the UK. The publication of four IGNs is intended to be the start of an ongoing process, and it is envisaged that further guidance on other areas of insolvency practice will be produced in due course. Whilst they will not be mandatory, as indicated in IGN(1), members of the Institute may need to justify any departures from the IGNs in answering a complaint against them.

The IGNs are effective for insolvency appointments made or after 1 October 2005. At the same time, as insolvency cases can take one or more years to complete, early adoption will be encouraged and liquidators should consider adopting the IGNs for ongoing cases where their appointment was made prior to the release of the IGNs.

18. High Court Reminds Nominees In Individual Voluntary Arrangements To Submit Reports

The Registrar of High Court has asked the Institute, and other relevant professional bodies, to remind members, particularly those who have been appointed by the court as nominees in individual voluntary arrangements, to check their compliance with Rule 122Z of the Bankruptcy Rules (Cap. 6A). Rule 122Z specifies requirements on the submission of accounts and reports by a nominee.

The Registrar of High Court points out that, where nominees wish to be nominated in new cases, the court may take into consideration any defaults in complying with the rules.

Taxation

19. 2006 Annual Meeting With The Commissioner Of Inland Revenue - Agenda Items Invited

The Institute will be holding the next regular annual meeting with the Commissioner of Inland Revenue (CIR) in January 2006 to discuss matters of common concern in relation to tax practice and procedure. The annual meeting focuses on matters of broad concern and it is generally not a suitable forum for taking up specific cases with the Inland Revenue Department, unless these reflect a more general problem or trend. Any suggestions for agenda items, together with an explanation of the issue should be forwarded, by **14 November 2005**, to **John Tang**, Assistant Director, Specialist Practices, at the Institute.

For Your Information

20. Insurance Authority Revision Of Actuarial Review Guidance Note

The Insurance Authority has revised **GN 9: Guidance Note on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses** after consultation with The Hong Kong Federation of Insurers and the Actuarial Society of Hong Kong. The GN 9, as amended, should be complied with in respect of any actuarial review relating to a financial year ending on or after 31 December 2005.

International Newsbytes

21. Hurricane Katrina Is Big But Not Extraordinary!

In the USA, companies are still required to disclose specified items as extraordinary, where an extraordinary item is "an item that is both unusual in nature and nonrecurring". The **AICPA** has advised that Hurricane Katrina is not extraordinary because a "natural disaster of a type that is reasonably expected to re-occur would not meet both conditions. The magnitude of loss from a particular natural disaster does not cause that disaster to be unusual in nature or unlikely to re-occur." If the impact of an event such as Hurricane Katrina were to be material in Hong Kong, we would disclose the impact under HKAS 1 *Presentation of Financial Statements* paragraph 86 as a material item.

Even though Hurricane Katrina is not extraordinary, the **US Securities and Exchange Commission** considered that its impact was significant enough that companies affected deserve an extension in respect of filing documents.

22. International Developments In Trying To Improve Business Reporting

There has been much discussion internationally about problems with financial reporting including concerns that financial statements:

- are getting so complicated that ordinary people can't understand them
- only report the past and don't tell you where the company is going.

One solution that has been proposed is from the **Australia Institute of Company Directors**. They have released a model report for sending to shareholders – a Shareholder Friendly Report – which explains a company's future plans and past performance in simple language. They suggest that this should be provided in addition to the usual statutory reporting.

You Have Asked Us

Q. Can a Hong Kong incorporated company which does not have public accountability and meets the size criteria report under the Small and Medium-sized Financial Reporting Framework (SME-FRS) if it does not satisfy the criteria set out in section 141D of the Companies Ordinance?

A. No, it cannot. Hong Kong incorporated companies are required by the Companies Ordinance to prepare financial statements that give a true and fair view unless they satisfy the criteria set out in section 141D of that Ordinance and choose to apply that section, in which case financial statements that give a true and correct view are to be prepared. The application of the SME-FRS is presumed to result in financial statements that give a true and correct view.

Paragraph 13 of HKAS 1 *Presentation of Financial Statements* states that the application of HKFRSs, with additional disclosure when necessary, is presumed to result in financial statements that give a true and fair view. The application of the SME-FRS does not result in financial statements that give a true and fair view because mere compliance with SME-FRS does not meet the requirements of HKFRSs.

The SME-FRS is available at

www.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumell/sme-frf&sme-frs.pdf

Q. Is there an example auditors' report for reporting on financial statements prepared in accordance with the SME-FRS?

A. The Institute has issued an **Exposure Draft** of proposed Practice Note 900 "Audit of Financial Statements Prepared in Accordance with the SME-FRS" for consultation till 15 October 2005. The Exposure Draft contains an example auditors' report in its Appendix.

Comment Due Dates

DATE	SUBJECT
7 October 2005	Invitation to Comment on IAASB Exposure Drafts of proposed ISA 701 <i>The Independent Auditor's Report on Other Historical Financial Information</i> and ISA 800 <i>The Independent Auditor's Report on Summary Audited Financial Statements</i>
15 October 2005	Exposure Draft of Proposed Practice Note 900 <i>Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard</i>
31 October 2005	Exposure Draft of Proposed Practice Note <i>Guidance for Auditors Regarding Preliminary Announcements of Annual Results</i>
Please send comments to commentletters@hkicpa.org.hk	