

Information Paper

Setting Hong Kong Financial Reporting Standards



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**INFORMATION PAPER
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INTRODUCTION

1. Hong Kong Financial Reporting Standards (“HKFRSs”)¹ were fully converged with International Financial Reporting Standards (“IFRSs”) with effect from 1 January 2005. This convergence arose from a decision by the Council of the Hong Kong Institute of Certified Public Accountants (“Council”) in 2001, after broad discussion with interested parties. With the international convergence programme fully in place following the removal of a legal impediment through the amendment to the Companies Ordinance (“CO”) in 2005, and the Statements of Standard Accounting Practice superseded, Council has taken the view that the end of the first phase of the convergence programme is an appropriate time to take stock.
2. In converging with IFRSs, Hong Kong stands with other key capital markets such as Europe. In all, more than 100 countries have converged with IFRSs for all or some companies or are in the process of doing so. Key jurisdictions that have a convergence programme in place but have not completed their convergence include the United States (where the IASB and the US Financial Accounting Standards Board are working to align IFRSs and US GAAP), Canada (which plans to require listed companies to use IFRSs within five years) and Japan (which has a joint programme for convergence with the IASB). Further, Mainland China recently released its Chinese Accounting Standards System that brings about substantial convergence with IFRSs from 2007 for listed companies.
3. In setting its convergence policy in 2001, Council was aware that HKFRSs that were to be converged with IFRSs would be more exacting than necessary for many smaller companies required to report under the CO. Accordingly, Council decided to develop reporting requirements for Small and Medium-sized Entities (“SMEs”) that would better meet the needs of users of SME financial statements. This decision resulted in Council releasing the SME Financial Reporting Framework and Financial Reporting Standard (“SME-FRF & FRS”) in August 2005 and effective for reporting periods starting on or after 1 January 2005.
4. Concurrently with the developments at the Institute, there have been legislative developments. Since March 2002, the Joint Government/HKICPA Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance (“JWG”) has been reviewing the relevant provisions of the CO, including the Tenth Schedule. The Tenth Schedule presently comprises a detailed list of disclosure requirements that were first developed in an era before the Institute had started to promulgate accounting standards². While the Tenth Schedule has been amended over the years, it has not been able to keep pace with the very significant developments in financial reporting culminating in the issuance of fully-converged HKFRSs. HKFRSs now contain an extensive set of the recognition, measurement and disclosure requirements expected in modern financial statements. Companies are required to comply with HKFRSs, including their disclosure requirements, by virtue of sections 123 and 126 of the CO requiring financial statements to give a true and fair view or receive a qualified audit opinion. As a consequence of these developments, there is a perception that most of the items on the detailed list of disclosures in the Tenth Schedule are either redundant or outdated.

¹ HKFRSs comprise all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Hong Kong Interpretations approved by the Council of the Hong Kong Institute of Certified Public Accountants.

² References in this paper to standards are to be read broadly as including interpretations.

5. Against this background, the JWG has recommended the repeal of the Tenth Schedule in its present form. One significant benefit of removing the overwhelming majority of the financial reporting disclosure requirements from the Tenth Schedule is that the existing potential for differences between the Tenth Schedule and HKFRSs will disappear. Further, it will be easier to amend HKFRSs than the CO to take account of constantly evolving financial reporting, as HKFRSs are non-statutory standards. The JWG also recommends the retention of a small number of items in a modernised version of the Tenth Schedule regarding disclosures with a significant public interest or corporate governance dimension, such as auditors' remuneration, which are not presently required in HKFRSs. Other items proposed to be included in the modernised Tenth Schedule, which have no equivalent in HKFRS, include the aggregate amount of any outstanding loans to directors and employees to acquire shares in their employing company made under the authority of sections 47C(4)(b) and (c) of the CO and information regarding a company's ultimate parent undertaking as is currently required under section 129A of the CO.
6. With full convergence with IFRSs achieved, Council determined that the second phase of its convergence programme should address the roles it should perform now that the converged standards are in place. These roles include maintaining the convergence of its process and product, supporting the effective implementation of the converged standards and facilitating the transmission of stakeholders' comments and concerns to the international standard setters.
7. Council views its future standard-setting role as including being a trusted and effective conduit between the Hong Kong reporting community and the IASB. In this role, Council proposes to work with stakeholders to identify issues and then to transmit those issues to the IASB. Council will also seek ways to improve the general understanding and application of HKFRSs as a basis for supporting Hong Kong's position as an international financial centre.
8. This Paper is structured as follows. Phase I outlines the existing structure and processes in Hong Kong, while Phase II outlines the steps Council plans in supporting the development of IFRSs and the implementation of HKFRSs in Hong Kong.
9. Council intends to issue further Information Papers to address the following standard-setting issues:
 - a. whether Council should set financial reporting standards for public sector and not-for-profit entities; and
 - b. the framework and process for the maintenance and update of the SME-FRF & FRS.

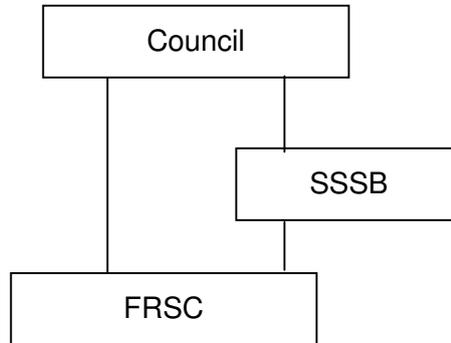
PHASE I: PRESENT STRUCTURE AND PROCESSES

10. The standard-setting structure and processes is summarised in the Preface to Hong Kong Financial Reporting Standards (“the Preface”). Firstly, the Preface notes Council’s role as the statutory financial reporting standard setter as follows:
- “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 HKICPA. 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.”
11. The Preface then identifies the structures Council has established for the standard-setting process and its oversight:
- “2. Council has mandated the Financial Accounting Standards Committee (FASC)³ to develop accounting standards 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.”
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- “4. The HKICPA’s Standard-Setting Steering Board (SSSB) is responsible for reviewing and advising on the HKICPA’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.”
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- “31. 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. 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.”
12. The SSSB’s terms of reference in relation to financial reporting standards require it to:
- a. review from time to time the Institute’s overall strategy, policies and processes in respect of setting financial reporting standards, taking into account, when relevant, factors such as:
- i. the need to attain or maintain international comparability both in the standards applicable and in the processes applied in setting those standards;

³ Since the Preface was released, the Financial Accounting Standards Committee (FASC) has been reconstituted as the Financial Reporting Standards Committee (FRSC).

- ii. the need to consult with stakeholders in the standards in Hong Kong and relevant professional and standard-setting bodies internationally;
 - iii. the need to ensure adequate publicity and stakeholders' access to information on the Institute's overall strategy, policies and processes in respect of setting standards; and
 - iv. the need to have regard to the legislative and regulatory framework in Hong Kong;
 - b. make recommendations to Council after consulting with the Financial Reporting Standards Committee; and
 - c. identify emerging issues and to give advice on agenda decisions and work priorities.
13. The SSSB meets once or twice a year to receive reports on all standard-setting activities and to address other issues as they arise. Council has requested the SSSB to review its Terms of Reference at its next meeting and, in doing so, to take account of the completion of Phase 1 of the convergence programme.
14. The FRSC's terms of reference require it to:
- a. prepare, in accordance with the due process approved by Council, new and revised Accounting Standards, Interpretations and accounting guidance for adoption by Council, taking into consideration the need to achieve convergence, as far as practicable, with International Financial Reporting Standards;
 - b. develop and issue Accounting Bulletins and Discussion Papers to provide information and/or guidance to members or to stimulate debate on important accounting issues;
 - c. advise Council in connection with legislation, regulations and other matters directly related to accounting, financial reporting and international convergence;
 - d. gather and communicate information relating to financial reporting between stakeholders in Hong Kong and the IASB;
 - e. undertake research work for financial reporting projects committed by Council;
 - f. develop comments on the consultative documents issued by the IASB and other consultative documents relating to financial reporting for consideration by Council;
 - g. identify issues that might require interpretations and request the IFRIC or the IASB to address the issues and, when needed, develop local interpretations for adoption by Council; and
 - h. make Council or other relevant Committees aware of any particular educational needs and, when needed, assist in preparing educational materials.

15. The FRSC meets every month and also addresses emerging issues between meetings. To enable interested parties to follow its activities, it publishes a summary of each meeting. Current standard-setting activities are also summarised in the Institute’s TechWatch summary of activities and events.
16. The relationship between the bodies identified above can be illustrated as follows.



17. In adopting its convergence policy, Council was aware that it needed to take a different approach to the appointment of members of the SSSB and the FRSC. One effect of the convergence programme is that Council has transferred the responsibility for detailed oversight and setting of HKFRSs to an international body operating within an extensive oversight structure. By stepping back from the role of primary standard setter, Council took the view that membership of the SSSB and FRSC should be broadened to ensure that due process was followed and that international convergence was maintained for the benefit of Hong Kong as a major financial centre. This decision had regard to the recommendations by the Standing Committee on Company Law Reform in the Consultation Paper on Phase I of the Corporate Governance Review that the membership of the then Financial Accounting Standards Committee should be broadened to include the representatives of stakeholders affected by financial statements. This broadening of membership and stepping back from the role of primary standard setter is the basis for Council’s decision that an oversight body for the setting of HKFRSs separate from the Institute has no meaningful role and therefore is not required.
18. In appointing members to the SSSB and the FRSC, Council considers the views of existing SSSB and FRSC members and seeks comments and nominations from other interested parties. It seeks to maintain a balance between preparers, auditors and users of financial statements and the broader reporting community. This breadth of membership reflects the fact that financial reporting standards are a matter for the Hong Kong business community and that the impact of HKFRSs is not limited to certified public accountants that are preparers or auditors of financial statements. HKFRSs affect users of financial statements including regulators, preparers and other users who may not be certified public accountants. The following table illustrates the diversity of membership of the SSSB and FRSC in 2006.

Category	SSSB	FRSC
Big 4 firms	1	5*
Small and medium-sized practices	1	4
Professional accountants in business	3*	2
Representatives of regulators, government and, industry bodies and academics	7	9
TOTAL	12	20
Percentage of members nominated by relevant stakeholders	58%	45%

* The Chairmen of the SSSB and FRSC are appointed without regard for their background.

19. The current standard-setting due process is described in the Preface as follows.

“23. HKFRSs and Interpretations of HKFRSs are developed through a due process that involves members and member practices of the HKICPA, listed companies in Hong Kong, the stock exchange, regulatory and legal authorities, academics and other interested individuals and organisations.”

“24. The FASC consults the SSSB on major projects, agenda decisions and work priorities. The UII⁴ assists the FASC in identifying potential agenda items for which timely guidance can be provided. 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;

⁴ Council approved the proposal from the FRSC that urgent issues and interpretations are best addressed by the FRSC itself rather than a sub-committee and disbanded the UII in June 2005.

- 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.”

“24A. On occasion, the FASC may consult and raise issues specific to Hong Kong proactively with the IASB.”

20. Council has requested the FRSC to review the Preface to take account of the completion of Phase I of the convergence programme as, in practice, the short comment periods on Exposure Drafts allowed by the IASB and the IFRIC (generally 120 days for a Standard and 60 days for an Interpretation), has resulted in a curtailed due process commencing at step (f). Exposure Drafts of changes to IFRSs are usually issued as Invitations to Comment within days of the IASB issuing an Exposure Draft or an Invitation to Comment, to allow the maximum amount of time for stakeholders to develop their views. Standards and amendments to Standards are generally considered by the FRSC within a month after being issued by the IASB, to enable timely consideration and forwarding to Council for approval. The present convergence policy requires an HKFRS to have the same effective date as the equivalent IFRS.
21. Council’s present objective is to maintain convergence with IFRSs without losing the ability within Hong Kong to contribute to the international standard-setting process. Council’s aim is to ensure that issues of concern to Hong Kong are understood by the IASB and addressed appropriately in IFRSs. Council’s focus is to ensure that the IASB develops international standards of as high a quality as possible so that HKFRSs that are converged with IFRSs are automatically of high quality.
22. While considering that HKFRSs should apply to all general purpose financial statements giving a true and fair view, Council does not take the view that HKFRSs are necessarily appropriate for all purposes. For example, Council took note of the special reporting needs of small and medium-sized entities (“SMEs”) in issuing the SME Financial Reporting Framework and Financial Reporting Standard (SME-FRF & FRS) in 2005. Further, Council is aware that prudential and other regulators may require regulated entities to submit information to support regulatory objectives that are additional to, and even measured or recognised on different bases from, that provided in general purpose financial statements. Issues related to the oversight and setting of financial reporting standards for SMEs will be addressed in a separate paper.

PHASE II: SUPPORTING IMPLEMENTATION

23. Supporting implementation of HKFRSs takes a number of forms. First, HKFRSs need to remain converged with IFRSs through both product and process. Second, Hong Kong needs to be positioned to ensure that issues of importance to Hong Kong are addressed by the IASB. This requires participation in international processes at as many levels as considered appropriate.
24. The IASB has recently released a Statement of Best Practice: *Working Relationships between the IASB and other Accounting Standard-Setters*. Key points in this Statement support Council's aims in Phase II of the international convergence programme and are discussed in the following sections. In particular, the Statement expects Accounting Standard-Setters such as the Institute to:
- a. play a key part in the development of IFRSs by providing a conduit between the IASB and stakeholders in Hong Kong;
 - b. assist stakeholders in understanding proposals for developments in IFRSs and encourage stakeholders to comment on IASB consultative documents both to the Institute and to the IASB;
 - c. prepare its own comments on IASB consultative documents;
 - d. monitor the work of the IASB so that conceptual differences of opinion can be conveyed to the IASB as early as possible in the life of a project;
 - e. work with other Accounting Standard Setters on issues of common interest; and
 - f. consider opportunities provided by the IASB to participate in IASB projects or to provide staff assistance on a specific IASB project.

Convergence of HKFRSs with IFRSs – product convergence

25. Product convergence refers to the convergence of the content of each HKFRS with the equivalent IFRS. Product convergence of HKFRSs with IFRSs is an “all or nothing” concept. IAS 1 *Presentation of Financial Statements*, paragraph 14, states that “financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs”. It follows that the only changes to IFRSs that are generally possible while maintaining convergence are limited to mandating additional disclosures or removing options in IFRSs. Changes to recognition or measurement requirements usually result in a failure of convergence.
26. In setting financial reporting standards for Hong Kong as an international financial centre, Council took note of the many reasons put forward for converging with IFRSs. These reasons include:
- a. responding to the increasingly global business environment and the consequent need for entities to be able to present financial statements that are comparable with those in other jurisdictions;
 - b. reducing entities' costs of capital by ensuring that suppliers of funds and purchasers of goods and services understand the financial position and performance of the entity regardless of location of the parties to any transaction;

- c. reducing financial analysis costs through analysts not having to restate information to a common basis and only needing to understand a single set of financial reporting standards;
 - d. reducing financial reporting costs for companies operating in more than one jurisdiction;
 - e. improving the quality of global financial reporting; and
 - f. reducing the cost of setting standards and ensuring that the skills available to develop and apply financial reporting standards are utilised efficiently.
27. Some hold the view that jurisdictions should acknowledge that IFRSs are not perfect and that only the 'best' standards should be adopted by a jurisdiction. Those who make this comment rarely note that the suite of standards in their home jurisdiction is also less than perfect. Council has taken the view that the benefits of convergence globally and for Hong Kong as a major financial centre outweigh the (arguably) better financial reporting that would result from selecting the 'best' standards from a range of jurisdictions. Council is also aware that such a process of standard selection would produce standards that are likely to be inconsistent and incomplete and reflect the biases of the group making the selection rather than being based on a consistent framework.
28. Some have suggested that the convergence programme be amended to give entities more time to understand a new standard before they are required to apply it. The compliance requirement in IAS 1 means that entities can only claim compliance with IFRSs if they comply with all standards that are effective at the date of preparing the financial statements. If Council were to extend the application date for any HKFRS equivalent to an IFRS, users of financial statements could no longer assume convergence of HKFRSs with IFRSs, thus losing the benefits of the convergence programme.
29. Council is aware that some do not support the convergence of HKFRSs with IFRSs for reasons that include:
- a. the adoption of an external set of financial reporting standards is not consistent with the legal autonomy of a jurisdiction;
 - b. the international standard setter cannot take account of the unique circumstances of each jurisdiction. An example of this in Hong Kong is the special circumstances surrounding land leases; and
 - c. private companies do not anticipate any benefits from international convergence and are impacted by increased costs of preparing financial statements.
30. Council proposes to maintain the convergence of HKFRSs with IFRSs while retaining the power to set financial reporting standards in Hong Kong at this time. Although some jurisdictions are adopting IFRSs, Council considers that Hong Kong should retain the flexibility to set different standards for different groups such as SMEs and the public sector. As an independent, albeit converged, standard setter, Council anticipates that it will retain the skills and ability to influence the future direction of IFRSs.

31. Council is aware that many smaller entities do not perceive benefits in the convergence of HKFRSs with IFRSs. This was one impetus for the development of the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & FRS). The only way to avoid unlisted companies having to apply all the requirements of HKFRSs would be to extend the SME-FRF & FRS or to establish a framework and suite of financial reporting standards for larger unlisted companies. Council anticipates that the IASB's SME project will reduce the reporting burden for many unlisted entities. Therefore, Council will carefully examine the IASB's proposals as they emerge with the aim of reducing reporting requirements, where practicable, while minimising any difficulties arising from having multiple sets of standards.

Convergence of HKFRSs with IFRSs – process convergence

32. Process convergence relates to the need to align the timing of issuing Exposure Drafts, Standards and Interpretations in Hong Kong as closely as possible with the timing of issuing Exposure Drafts, Standards and Interpretations by the IASB. The benefits of aligning the timing of the issuance of Exposure Drafts, Standards and Interpretations include:
- a. stakeholders in Hong Kong are able to comment on international Exposure Drafts while they are still under consideration by the IASB, thus enabling the views of Hong Kong stakeholders to be heard before proposals are finalised; and
 - b. process convergence is necessary to ensure product convergence. If a Standard or Interpretation is issued in Hong Kong after it is issued internationally, entities in Hong Kong may not be able to apply that Standard or Interpretation until after the international application date.
33. Council has aligned the Institute's due process with the international due process as a result of its convergence policy. Probably the greatest concern with the existing due process is the short time available for stakeholders to comment on Exposure Drafts. Council notes that stakeholders would be better positioned to comment in the time available if they were to follow the debate as issues develop so that they understand the issue before an Exposure Draft is issued. This issue is discussed further below.
34. As Council attempts to reflect the views of its constituency in the comments it sends on IASB Exposure Drafts, the comment period in Hong Kong is constrained by the IASB comment period (usually 120 days). Maintaining convergence also limits the potential steps in the due process (such as the preparation of a discussion document) to the documents issued by the IASB.
35. Council notes that its due process also needs to take account of the development of domestic requirements that are outside the convergence programme. The most notable domestic development in recent years is the issuance of the SME-FRF & FRS. Council has asked the FRSC to consider separating its published due process between international convergence issues and domestic financial reporting issues (although developing domestic Standards or Interpretations other than for SMEs is not expected). Clearly identifying a domestic due process would clarify that an extended due process with additional consultations may be appropriate for major domestic projects, such as that followed in developing the SME-FRF & FRS.

Encouraging stakeholder participation in the standard-setting process

36. Standard setters in many jurisdictions are experiencing reduced participation by stakeholders in the setting of financial reporting standards. Possible reasons for this apparent lack of interest include that stakeholders may consider that:
- a. there are too many requests for comments, and they do not have the time to participate;
 - b. they do not have the skills to comment now that standards are complex;
 - c. the comment period is too short;
 - d. the standard setters have already made their decisions and commenting is a waste of time; and
 - e. the standard setters will only listen to comments from major players such as regulators, large companies and accounting firms, so there is no point in other people commenting.
37. Standard setters are affected by the rapid rate of change as much as businesses. Even if a suite of standards were perfect at one point in time, those standards would have to be revised and new standards developed to address new and changing events and transactions. Add to that the need to improve standards by removing options, developing better treatments and addressing issues more specifically, and it becomes likely that financial reporting standards will continue to evolve. It is also the case that transactions are becoming increasingly complex as they seek to address more issues for the parties to the transaction. Complex transactions frequently require complex financial reporting treatments such as the separation into components of compound financial instruments.
38. Council is aware that some stakeholders are concerned about the amount of change in the last few years and notes that the rate of change associated with the final implementation of the international convergence programme is unlikely to continue. Now that convergence has been achieved, Council expects to only issue a few new Standards and Interpretations each year in its process of maintaining convergence.
39. Council is conscious that the short comment period on Exposure Drafts may make it difficult for some to participate in the consultation process. Because Exposure Drafts usually have a long gestation period, it is possible for stakeholders to follow the development of an issue through various media. For example, the IASB undertakes a number of steps to assist stakeholders to follow its standard-setting activities, including:
- a. holding all technical meetings in public to enable stakeholders to observe the IASB's deliberations;
 - b. developing technological solutions such as web-casting meetings to reduce the need to travel to the IASB's meeting location to observe its meetings;
 - c. providing summaries for observers on its website that identify how the IASB will be addressing each topic on the agenda for each meeting;
 - d. providing summaries of each project on the IASB's active agenda; and

- e. providing a report after each meeting describing the outcomes of that meeting.

However, Council is not aware of the extent to which stakeholders have the time or inclination to follow the IASB's deliberations in the lead up to the issuance of an Exposure Draft.

- 40. Those who are reluctant to comment on Exposure Drafts often feel that their practical input will not be appreciated. Standard setters are constantly seeking input from those stakeholders with the experience to see the practical ramifications of a proposal and make suggestions for improvements or explain why the proposals are impracticable. Further, regulators and practitioners do not have a detailed understanding of the practical impact of standards and standard setters rely on preparers to share their special expertise.
- 41. Although standard setters consider all the relevant issues that they can identify as part of the process of developing an exposure draft, this does not mean that standard setters are not prepared to reconsider the proposals in the exposure draft. An analysis of differences between exposure drafts and the resulting standards shows that a standard may be significantly different from the exposure draft because of comments that identify the inappropriateness or impracticability of the proposal. Indeed, there are cases where an exposure draft has not led to a standard or has led to further exposure because of the comments received.
- 42. If commenting on exposure drafts can affect the resulting standard, the issue becomes how to elicit comments from preparers and users of financial reporting standards that address the needs of standard setters. Standard setters are seeking informed comment from people who have considered the issues from both a theoretical perspective and a practical perspective. Theoretical issues include whether the proposals conform to the *Framework*, and whether they are a complete and consistent solution to the issue being addressed. Practical issues include whether the proposals can be followed by preparers, can be audited and provide more useful information than that previously provided, after considering the costs and benefits of the proposal. Standard setters also seek well-articulated reasons for the views expressed.
- 43. Council plans to devote more resources to explaining proposals to stakeholders during the development of financial reporting standards in order to hear their views and reflect their comments. Council will be considering, on a case-by-case basis:
 - a. assisting stakeholders in following the international debates in the lead up to an exposure draft by highlighting developments in key projects;
 - b. providing a summary of the key points of each exposure draft;
 - c. presenting seminars outlining and analysing the proposals in an exposure draft;
 - d. holding meetings or roundtables to hear views on the exposure draft;
 - e. establishing an advisory group to assist in explaining the exposure draft; and
 - f. discussing the proposals with key industry groups.
- 44. Council will be asking the FRSC to maintain its role as the interface between Hong Kong stakeholders and the IASB. Council will carefully consider a well-argued case

for resources necessary to develop additional services for stakeholders if such a case is presented by the FRSC.

Influencing international financial reporting activities

45. Council is very aware of the need to maintain a high standard-setting profile internationally. It is in the interests of all those using HKFRSs that Hong Kong is a well-respected participant in the development of IFRSs rather than blindly adopting IFRSs. A well-articulated concern about a proposal in an exposure draft or a provision of an international standard from a party respected internationally is more likely to receive attention from the IASB or the IFRIC than a poorly explained issue from an unknown party.
46. Hong Kong currently has a number of representatives in the international financial reporting arena, including representatives on :
 - a. the IASB's oversight body, the IASCF;
 - b. the IASB's Standards Advisory Council ("SAC");
 - c. the IASB's Performance Reporting Working Group; and
 - d. the IASB's SME Working Group.
47. The *Due Process Handbook for the IASB* was issued in April 2006 and describes six stages of standard-setting. Each of the stages is briefly discussed and opportunities for parties external to the IASB to participate in each stage are identified.
 - a. *Setting the agenda:* the IASB selects agenda items from issues identified by staff or raised by stakeholders and consults with the SAC and financial reporting standard setters such as the FRSC. Stakeholders can participate by suggesting issues for the IASB to address, with reasons why the issue deserves attention. Suggestions can be sent directly to the IASB, or to the SAC or the FRSC for forwarding on to the IASB.
 - b. *Project planning:* the IASB decides whether to conduct a project alone or jointly with another standard setter and may establish a working group. The IASB advertises working group vacancies, and membership of a working group gives input into the development of the project. Council monitors these vacancies and identifies potential members.
 - c. *Development and publication of a discussion paper:* a discussion paper is normally issued on a major new topic. Stakeholders can follow the technical debate during the development stage by reading material provided by the IASB such as notes for observers and meeting summaries. If the IASB issues a discussion paper, it is still open to the direction it should take and the discussion paper provides an opportunity for stakeholders to explain to the IASB where they agree with its thinking and where they disagree and the reasons for their views. The FRSC seeks stakeholders' views on discussion papers for inclusion in Council's comments to the IASB.
 - d. *Development and publication of an exposure draft:* the exposure draft is the IASB's main vehicle for public consultation. By the time of issuing an exposure draft, the IASB has considered the relevant issues in great detail. To be effective in changing a proposal, disagreements need to be based on

carefully argued conceptual grounds, or detailed explanations of practical issues and their consequences, or a cost-benefit analysis. The FRSC seeks stakeholders' views on exposure drafts for inclusion in Council's comments to the IASB.

- e. *Development and publication of a standard:* the IASB reviews the exposure draft in the light of comments received and posts developments on its website. The IASB may expose revised proposals for public comment where significant changes are made to the original proposals. In such cases, the FRSC seeks stakeholders' views on any invitations to comment for inclusion in Council's comments to the IASB.
 - f. *Procedures after a standard is issued:* IASB members and staff meet with interested parties to help understand unanticipated issues related to the practical implementation and potential impact of its proposals. The IASB may also initiate studies in the light of the review of the standard's application, changes in the financial reporting environment and comments from interested parties.
48. In addition to commenting during the IASB's due process, other ways in which Hong Kong can participate internationally and which Council is considering include:
- a. continuing to send the SSSB chairman and/or the FRSC chairman to international meetings to provide personal representations of Hong Kong issues and concerns;
 - b. continuing to nominate appropriate individuals to IASB bodies, including the IASCF, the Standards Advisory Council, the IFRIC, working parties and project teams;
 - c. providing extensive and well-considered comments on all documents issued by the IASB. Comment letters are already sent on key issues, but further input from all stakeholders expanding the issues to be addressed is welcomed;
 - d. bringing issues that are of importance to Hong Kong to the attention of the IASB or the IFRIC, as is already done through formal and informal channels;
 - e. supporting the development of, and working with, regional bodies with a view to developing a "regional voice" to balance the views from Europe and North America;
 - f. conducting in-depth monitoring of the work programmes of the IASB and the IFRIC, with a view to advising the IASB of concerns while approaches to issues are being developed; and
 - g. inviting members of the IASB and its related bodies to Hong Kong. Council encourages and financially supports visits from IASB members.
49. For principles-based standards to work effectively, all stakeholders need to understand the purpose and content of the standards sufficiently for their purposes. The Institute provides a range of Continuing Professional Development activities and has arranged access for members to activities provided by other educational suppliers. Council acknowledges that the Institute has a part to play, but takes the

view that stakeholders need to take ultimate responsibility for their own education and the development of their knowledge and understanding.

Supporting the implementation of HKFRSs

50. Council has a number of roles with differing objectives in the implementation of HKFRSs:
 - a. *as standard setter*, Council must ensure that any implementation support does not inadvertently provide guidance that will be seen as official interpretations of HKFRSs and thus damage the convergence of HKFRSs with IFRSs;
 - b. *as provider of member services*, Council must ensure that its members are equipped to apply HKFRSs appropriately; and
 - c. *as regulator of its members*, Council must ensure that members that do not apply HKFRSs appropriately are subject to appropriate regulatory action.
51. The key to success in dealing with these varying roles is to provide members with sufficient education and training that they can rise to the challenges posed by principles-based standards. Principles-based standards require preparers and auditors to move from seeking directive rules to accepting that their role is now to understand transactions and then account for them by applying the relevant principles, requirements and guidance in the *Framework* and standards. Principles-based standards require users of financial statements to accept that if an entity's results are faithfully represented in the financial statements, the entity may show profits that are more volatile than under rules-based standards. That is, users of financial statements must accept that even in normal circumstances, a company's profits can move both up and down.