

Professional and Technical



News at a glance



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This is the 16th 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/professionaltechnical/techwatch/> >.

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.

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Accounting & Financial Reporting

1. **IASB Approves IFRS 1, "First-time Adoption Of International Financial Reporting Standards"**

The International Accounting Standards Board (IASB) has issued IFRS 1, "First-time Adoption of International Financial Reporting Standards", which explains how an entity should make the transition to IFRSs from another basis of accounting. IFRS 1 becomes effective for financial statements prepared in accordance with International Financial Reporting Standards for periods that begin on or after 1 January 2004 with earlier application encouraged.

The IASB through IFRS 1 has sought to address the demand of investors to have transparent information that is comparable over all periods presented, while giving reporting entities a suitable starting point for their accounting under IFRSs.

IFRS 1 requires an entity to comply with every IASB standard in force in the first year when the entity first adopts IFRSs, with some targeted and specific exceptions after consideration of the

cost of full compliance. Accordingly, an entity's first IFRS-compliant financial statements will include both amounts for the current period as well as comparatives that conform to the requirements of IFRS 1. Under IFRS 1, entities must explain how the transition to IASB standards affects their reported financial position, financial performance and cash flows.

In Hong Kong, the FASC plans to consider at its next meeting scheduled for 13 August 2003 a proposed HKFRS 1, based on IFRS 1, with a view to recommending Council's approval of the new Standard to become effective from 1 January 2004 - concurrent with the effective date of IFRS 1.

2. **FASC Invitation To Comment On IASB Exposure Draft: ED 4, "Disposal Of Non-current Assets And Presentation Of Discontinued Operations"**

The International Accounting Standards Board (IASB) has published for public comment an exposure draft, ED 4, "Disposal of Non-current Assets and Presentation of Discontinued Operations".

The Exposure Draft is the first to arise from the IASB's joint short-term convergence project with the United States' Financial Accounting Standards Board (FASB) and results from the IASB's review of the FASB standard SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets", which was issued in 2001. The Exposure Draft proposes that assets that are expected to be sold and meet specific criteria should be measured at the lower of carrying amount and fair value less costs to sell, should not be depreciated and should be presented separately in the balance sheet. The ED also proposes that any operation with separately identifiable cash flows should be classified as 'discontinued' once the assets involved in the operation meet the criteria to be classified as held for sale if the cash flows of the operation will be eliminated from the ongoing operations of the entity and there will be no continuing involvement in the operation after its disposal. These proposals, when implemented, would achieve convergence with the equivalent requirements in US GAAP.

Under the HKSA's due process for setting accounting standards, the HKSA has issued an Invitation to Comment on the IASB's exposure draft with comments requested by 30 September 2003. The Invitation to Comment has been posted on the HKSA's website at < <http://www.hksa.org.hk/professionalttechnical/accounting/exposedraft/> > and a copy of the ED has been sent to HKSA members and others who are on the Members' Handbook (paper version) mailing list.

Following from the IASB's final approved Standard, the FASC intends to recommend the adoption of a new Hong Kong Financial Reporting Standard (HKFRS) on discontinuing operations so that the HKFRSs maintain conformity with the IASB's standards. The FASC does not intend to issue a specific Hong Kong exposure draft on the matters covered in the IASB's exposure draft.

3. HKSA Comment Letter On The IFRIC's Draft Interpretation D1, "Emission Rights"

The HKSA has sent a comment letter to the IASB in response to the International Financial

Reporting Interpretations Committee's Invitation to Comment on Draft Interpretation D1, "Emission Rights".

The key issue raised in our comment letter was in relation to the proposal to restrict certain treatments that would otherwise be permitted under IAS 20, Accounting for Government Grants and Disclosure of Government Assistance. We noted that the treatment proposed in the Draft was consistent with that in the recently issued IAS 41, Agriculture, but we expressed our concern about the attempt to restrict certain treatments currently permitted under IAS 20 for a specific subset of government grant and the resultant creation of two different bodies of GAAP. We suggested that the more appropriate approach would be to eliminate options from IAS 20.

A copy of the comment letter has been posted on the HKSA website at < <http://www.hksa.org.hk/professionalttechnical/accounting/submissions/> >.

4. CAPA Study On Small And Medium Enterprise Financial Reporting

The Confederation of Asian and Pacific Accountants (CAPA), the Asia-Pacific regional accountancy organisation, has released a report, "A Framework For Differential Reporting - A Response to ISAR's Accounting and Financial Reporting Guidelines for Small and Medium-sized Enterprises".

The report highlights the events leading to development of differential reporting practices in some countries and explores the draft financial reporting guidance for small and medium-sized enterprises issued earlier this year by the United Nations' Conference on Trade and Development's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR).

A copy of the report is available on the CAPA website at: < <http://www.capa.com.my/article.cfm?id=125> >.

ISAR is the only intergovernmental working group devoted to accounting and auditing issues at the corporate level. Further details about ISAR,

and a copy of the ISAR ad hoc consultative group report on accounting by small and medium-sized enterprises, is available at: < <http://www.unctad.org/isar> >.

5. FASC Meeting - 14 May 2003

The FASC met on 14 May 2003 and discussed the following items:

- ✓ Proposed ED/SSAP 13, Investment Property (revised)
- ✓ Referral from the Accountants' Report Task Force - requested FASC endorsement of 2 draft Accounting Guidelines
- ✓ IASB agenda survey - for comment and feedback to the HK representative on the IASB's Standards Advisory Council
- ✓ Deferred tax liability arising on the revaluation of non-depreciable assets

A copy of the meeting summary is attached to this issue of TechWatch. The meeting summary has also been posted on the HKSA website at: < <http://www.hksa.org.hk/professionalttechnical/accounting/fascupdate/> >.

Audit & Assurance

6. ED Of Proposed Practice Note 820 "The Audit Of Licensed Corporations And Associated Entities Of Intermediaries"

The HKSA has issued an ED of proposed Practice Note 820 "The Audit of Licensed Corporations and Associated Entities of Intermediaries" for consultation until 15 September 2003 < <http://www.hksa.org.hk/professionalttechnical/assurance/exposedraft/ed-pn820.pdf> >.

In 1999, the Government announced legislative reform for the securities and futures market. This reform has resulted in the enactment of the Securities and Futures Ordinance (SFO) which came into effect on 1 April 2003, replacing the ten existing Ordinances which regulated the securities and futures market.

In order to ensure that the HKSA provides up-to-date guidance to practising members on the

audits of licensed corporations and associated entities of intermediaries, the ED is developed to assist auditors in discharging their reporting responsibilities under the SFO by providing guidance in the following areas:

- ✓ special considerations arising from the application of Statements of Auditing Standards to the audit of financial statements of licensed corporations and associated entities of intermediaries;
- ✓ auditors' reporting responsibilities under the Securities and Futures (Accounts and Audit) Rules which is a subsidiary legislation under the SFO; and
- ✓ ad hoc communications between auditors and the Securities and Futures Commission (SFC).

The SFC has posted some Frequently Asked Questions (FAQs) on its website which are intended to provide assistance on the understanding of the policy of SFC staff on the implementation of certain provisions of the Securities and Futures Ordinance and related subsidiary legislation. The FAQs are available on-line at the SFC's website at: < <http://www.hksfc.org.hk/eng/bills/html/sfo-faq.htm> >. FAQs that are of particular concern to auditors of licensed corporations and associated entities of intermediaries can be found in the section "Accounts and Audit Rules" under the heading "Intermediaries supervision and related matters".

7. ED Of Proposed PN 852 "Review Of Lottery Accounts"

The HKSA has issued an ED of proposed PN 852 "Review of lottery accounts" for consultation until 5 September 2003 < <http://www.hksa.org.hk/professionalttechnical/assurance/exposedraft/ed-pn852.pdf> >.

The purpose of the ED is to provide guidance to practising members on the review procedures and reporting requirements in connection with lottery accounts. A review of the lottery accounts by the CPAs is required once the revised Condition 6 of the TELA licence introduced by the Gambling (Amendment) Regulation 2002 becomes

effective. The effective date of the Gambling (Amendment) Regulation 2002 has yet to be determined by the Government.

8. HKSA Invitation To Comment On IAASB's Exposure Draft Of Proposed ISA On Review Of Interim Financial Information Performed By The Auditor Of The Entity

The International Auditing and Assurance Standards Board (IAASB) issued an Exposure Draft (ED) of proposed ISA "Review of Interim Financial Information Performed by the Auditor of the Entity".

The IAASB's ED applies to engagements to review interim financial information when all of the following criteria are met:

- the review is performed by the entity's auditor;
- the interim financial information is prepared in accordance with an identified financial reporting framework;
- the entity is required or permitted under legislation, regulation, or equivalent authority to issue such interim financial information; and
- the audited annual financial statements of the entity are required to be filed with a regulatory authority, or equivalent, and are publicly available.

In accordance with the HKSA's ISA Convergence Due Process, the HKSA Auditing and Assurance Standards Committee (AASC) has issued an invitation to comment to solicit the views of members and interested parties on the IAASB's ED in preparing the HKSA's submission to the IAASB. The invitation to comment and the IAASB's ED have been posted on the HKSA's website at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment.fi.pdf >.

Members and interested parties are requested to submit their comments on the IAASB's ED to the HKSA on or before 5 September 2003 so that they can be considered and included in the HKSA's submission to the IAASB.

Upon finalization of the IAASB's ED, the AASC will revise the existing SAS 700 "Engagements to review interim financial reports", which is based on the equivalent ISA 910, in line with the revised ISA. This is to ensure that Hong Kong Auditing and Assurance Standards maintain conformity with current International Auditing and Assurance Standards at all times.

9. HKSA Submission Of Comments On IAASB's Assurance Engagements Exposure Draft

The HKSA has made a submission on the IAASB's Assurance Engagements Exposure Draft which contains:

- a proposed International Framework that defines and describes the elements of an assurance engagement and identifies those engagements to which International Standards on Auditing (ISAs) and International Standards on Assurance Engagements (ISAEs) apply; and
- a proposed ISAE 2000 which establishes standards and provides guidance to practitioners for the performance of assurance engagements on subject matters other than historical financial information.

The HKSA submission supports the IAASB's initiative to split the current ISAE 100 into the above 2 documents. However, the HKSA is concerned about the confusion that may be created by the new terminology used in the proposed Framework such as "reasonable assurance", "limited assurance" and "acceptably low level of engagement risk" that have been introduced in place of the current "high level of assurance" and "moderate level of assurance". The HKSA therefore requests that more guidance and clarifications should be provided in the final Framework in order to facilitate a better understanding of the Framework for the performance of assurance engagements.

The HKSA submission and the IAASB's Exposure Draft can be viewed at: < <http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/ED100703.pdf> >.

10. HKSA Submission Of Comments On IAASB's Exposure Draft On Proposed Amendments To IAPS 1005 "The Special Considerations In The Audit Of Small Entities"

The HKSA has made a submission on the IAASB's Exposure Draft on the proposed amendments to IAPS 1005 which take account of ISAs issued since March 1999 through March 2003.

There is a plan by the IAASB to eliminate IAPS 1005 over time so that considerations in the audit of small entities will be included in the body of ISAs. The HKSA submission supports this proposal and recommends that during the transitional period, for clarity and ease of reference, an appendix should be attached to the IAPS setting out which ISAs are addressed in IAPS 1005 and which ISAs include guidance on how to apply them in the body of the text directly. The submission also highlights that certain parts of the IAPS may no longer comply with the principles proposed in the recent Exposure Draft of ISA on Audit Risks, which establishes a risk-based approach.

The HKSA submission and the IAASB's Exposure Draft can be viewed at: < <http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/ED100703b.pdf> >.

11. SFC Issues New Audit Questionnaire For The Audit Of Licensed Corporations

For the purpose of assisting the SFC to carry out its functions of supervising licensed corporations, auditors are currently requested by the SFC to complete an Audit Questionnaire, on a voluntary basis, providing information that is not readily available from the audited financial statements.

A revised Audit Questionnaire which is applicable for financial periods ended/ending on or after 1 April 2003 has been issued by the SFC, which can be downloaded from the SFC's website at: < <http://www.hksfc.org.hk/eng/licensing/html/audit.htm> >.

12. Proposed Registration System For Public Accounting Firms By The US Public Company Accounting Oversight Board

On 30 July 2002, the US President George W. Bush signed into law the Sarbanes-Oxley Act of 2002, implementing sweeping reforms to combat corporate and accounting fraud in the US. The Sarbanes-Oxley Act involves regulation of the accounting profession and the auditing and financial reporting process in the US. Auditors of companies listed in the US are now regulated by a new independent Public Company Accounting Oversight Board (PCAOB) with authority to establish rules governing audits, conduct inspections and investigations, and impose sanctions. The PCAOB operates under the oversight of the US SEC.

The PCAOB has just finalized a set of rules requiring registration with it of firms that audit US listed companies. The rules are of interest to auditors in Hong Kong because they are not restricted to US audit firms. Foreign audit firms that prepare or furnish audit reports with respect to any US listed companies are required to register under the Act. Further, the PCAOB has discretion to extend the Act's registration requirements to foreign audit firms that play a "substantial role" in the preparation of audit reports for any US listed company. This is defined as being responsible for 20 per cent or more of total audit hours, audit fees or the client's consolidated revenues or consolidated assets. Thus, any firm auditing a subsidiary of a US listed company, or a subsidiary of a Hong Kong company with a listing in the US could be required to register if the subsidiary is fairly large relative to the group as a whole.

The Act also has implications for any US registered audit firm that relies on the opinion of a foreign audit firm in issuing part of any audit report. In such cases, the US firm is deemed to have:

- consented to supplying the audit work papers of the foreign audit firm in response to a request by the PCAOB or SEC; and

- secured the agreement of the foreign audit firm to such production as a condition of its reliance on the opinion.

The Act sets the deadline for registration 180 days after the SEC determined that the PCAOB has the capacity to carry out the requirements of the Act. The SEC made that determination on 25 April, 2003. US audit firms must therefore register with the Board no later than 22 October, 2003. Foreign audit firms must register six months later, which has been set at 19 April 2004.

Further details can be obtained at the PCAOB's website at: < http://www.pcaobus.org/pcaob_registration.asp >.

13. AASC Meeting - 29 April and 20 May 2003

The meeting summaries of the AASC meetings held in April and May 2003 are attached to this issue of TechWatch. The meeting summaries have also been posted on the HKSA website at: < <http://www.hksa.org.hk/professionaltechnical/assurance/aasc/index.php> >.

Ethics

14. HKSA Invitation To Comment On IFAC Exposure Draft (ED) Of Proposed Revisions To The Code Of Ethics

IFAC has issued an ED of proposed revisions to the Code of Ethics. The IFAC ED proposes to elevate the IFAC Code from a "model code" on which to base national requirements to a more authoritative code which all member bodies must meet as a minimum set of standards. The IFAC Code has been rewritten in a threats and safeguards style consistent with that used in Section 8 on Independence issued in November 2001.

The IFAC ED provides expanded guidance for all accountants on issues of integrity, objectivity, professional competence, confidentiality, and professional behaviour, and also new and in-depth guidance for professional accountants

in business by addressing issues such as potential conflicts, preparing and reporting information, financial interests, inducements, and disclosing of information. The IFAC ED is currently being exposed for comments by 30 November 2003.

The HKSA issued last October an ED of a Proposed HKSA Code of Ethics which is closely modelled on the extant IFAC Code. Finalization of the HKSA ED has been postponed due to the substantial revision of the IFAC ED.

The HKSA has issued an "Invitation to Comment" on the IFAC ED in accordance with the HKSA's due process convergence with international standards to solicit the views of members and interested parties on the IFAC ED in preparing the HKSA's submission to the IFAC. Members and interested parties are requested to submit their comments to the HKSA on or before 17 October 2003 so that their comments on the IFAC ED can be considered and included in the HKSA's submission to IFAC.

The HKSA Invitation to Comment and the IFAC ED have been posted on the HKSA's website at: < <http://www.hksa.org.hk/professionaltechnical/ethics/exposedraft/> >.

15. ICAC Issues New Ethics Guide For Business Managers In The Use Of IT

A new publication "ethics@work - a guide for business managers in the use of IT", which is developed by the Independent Commission Against Corruption (ICAC) in collaboration with the HKSA and 12 other professional organizations/ chambers of commerce, has been published. This Guide offers business managers who are not trained IT experts practical advice on how to identify integrity risks in the workplace and proactively reduce them by ethical management.

Limited hard copies of the Guide are available upon request on a first-come-first-served basis. Such a request may be made on-line to the Hong Kong Ethics Development Centre of the ICAC at: < <http://www.icac.org.hk/hkedc> >.

Listing & Securities Matters

16. SEHK/SFC Consultation Paper On The Regulation Of Sponsors And Independent Financial Advisers

The Stock Exchange of Hong Kong Limited (the SEHK) and the Securities and Futures Commission (the SFC) jointly published in May 2003 a Consultation Paper on Regulation of Sponsors and Independent Financial Advisers < <http://www.hkex.com.hk/> >. The deadline for submission of comments is 31 July 2003.

The core proposals in the Consultation Paper will establish a common regime, administered by the SEHK, to establish the acceptability of corporate finance advisers who wish to act as sponsors or Independent Financial Advisers (IFAs) whether to prospective applicants or listed issuers on either the Main Board or GEM. The proposed regime will place emphasis on the experience of individuals but also impose obligations on them to ensure that sponsor and IFA work is performed to acceptable standards. Implementation of the proposals will also see the introduction of Code of Conduct for Sponsors and Independent Financial Advisers which with guidance to clarify the responsibilities of sponsors and IFAs.

Other proposals under consultation include a proposed requirement for a declaration in a prospectus by the sponsor and lead underwriter about the due diligence work they have performed in providing the SEHK with assurances on the completeness and accuracy of the prospectus.

The HKSA is preparing a submission to the SEHK/SFC on the Consultation Paper.

Corporate Governance

17. SCCLR Consults On Phase II Of Its Review Of Corporate Governance

The Standing Committee on Company Law Reform (SCCLR) has issued its Corporate Governance Review Phase II Consultation Paper,

which details proposals to enhance Hong Kong's corporate governance regime. The public consultation will end on 30 September 2003.

The main areas covered by the SCCLR's proposals encompass company directors, including the issues of directors' roles, duties, qualifications, training and remuneration, as well as connected transactions, board procedures and board committees etc; shareholders' rights and conflicts of interests; and corporate reporting, which focuses mainly on external auditors and corporate regulation.

The SCCLR's specific proposals in key areas are summarized as follows:

Company directors

- adopt a set of non-statutory guidelines on directors' duties
- require a director to abstain from voting at a board meeting on a transaction in which he has an interest and require the approval of disinterested shareholders voting on a poll for significant transactions/arrangements involving directors

Transactions between directors / connected parties with an associated company

- require the approval of disinterested shareholders for such transactions

Board procedures and board structure

- require listed companies to have a minimum of three independent non-executive directors
- make audit committees mandatory, with a requirement for at least one independent non-executive director on the committee with financial expertise
- establishment of nomination and remuneration committees should remain as a best practice

Directors' qualifications and training

- provide in the Code for disclosure of arrangements made to train directors

Directors' remuneration

- listed companies should disclose individual

director's remuneration packages by name in their annual financial statements

- provide in the Code for disclosure in the annual report regarding the system for deciding the remuneration of non-executive directors

Shareholders' rights and conflicts of interests

- connected transactions should be disclosed and subject to a disinterested shareholders' vote made by poll
- define in the law "connected person" in relation to controlling shareholders
- preserve the court's power to determine whether or not a transaction constitutes a waste of corporate assets

Enhance the effectiveness and transparency of company general meetings

- permit a Hong Kong company to hold a general meeting at more than one location, and permit visual and audio real time communications
- change the timing of the Annual General Meeting to within a certain period after the end of each financial year
- permit absentee voting and electronic voting and develop rules and guidance for such voting
- reform the empowerment of proxies

Enhance and strengthen the functioning and quality of external auditors

- remove the Companies Ordinance's requirements for shareholders to fix the auditors' remuneration or determine the manner of how it is to be fixed
- impose a duty on employees (in addition to directors) to provide information to auditors
- require outgoing auditors to volunteer material information to their successors
- require mandatory rotation of the lead and concurring partners every five years
- the Government and the HKSA should

undertake work to identify the types of non-audit services which are incompatible with the principles underlying auditor independence, and enhance the disclosures of the nature and value of all services provided by auditors to audit clients, defining what falls into the categories of audit, audit-related and non-audit

Corporate Regulation

- seek views on whether, in principle, statutory backing should be given to the Listing Rules together with tougher statutory sanctions including civil fines against non-compliance
- seek views on whether the regulation of unlisted companies needs to be improved

The consultation paper, and the consultancy study reports commissioned by the Government as part of the Corporate Governance Review, are available on the Companies Registry website at: < <http://www.info.gov.hk/cr/scclr/index.htm>>.

Various of the HKSA committees are reviewing different aspects of the consultation paper with a view to coordinating a submission to the SCCLR in due course. If members have comments on the consultation paper, these may be submitted to the HKSA's Corporate Governance Committee, c/o Mary Lam, Assistant Director (Business and Practice) by [5 September 2003]

18. Proposal To Empower The SFC To Initiate A Derivative Action On Behalf Of A Company

The Financial Services and the Treasury Bureau (FSTB) and the Securities and Futures Commission (SFC) have jointly released a consultation paper on the proposal to empower the SFC by law to initiate a derivative action.

A derivative action generally refers to legal action brought by a minority of a company's shareholders in their own names seeking a remedy for the company in respect of a wrong done to it. Any damages awarded as a result of the action, therefore, would be awarded to the company rather than the members initiating the action.

The proposal stems from a recommendation made by the SCCLR, as part of its Phase I Review of Corporate Governance. If the proposal is implemented, the SFC would be empowered to initiate, without court approval, a derivative action against wrongdoers in relation to a listed company on various grounds including fraud, negligence, default in relation to any legislation and breach of any fiduciary or statutory duty, where the company is unwilling or unable to do so. Under the proposal, the SFC would only be empowered to exercise such statutory right where it is in the public interest and in the interest of the company concerned to do so.

Arguments for and against, including whether it would be appropriate for a regulator to expend public monies on private commercial disputes, and other information relevant to the consideration of implementing the SCCLR recommendation at this stage, are presented in the consultation paper. Public views are also sought on the funding issues, if the proposal is to be implemented, as well as other aspects of how such a power might be implemented.

The consultation paper is available on the website of the FSTB at: < <http://www.info.gov.hk/fstb/fsb/consult/index.htm> > and that of the SFC at: < http://www.hksfc.org.hk/eng/press_releases/html/index/index2.html > under the "Consultation Papers and Conclusions" section.

Relevant committees of the HKSA are currently reviewing the consultation paper with a view to the Society making a submission on due course. The Society has obtained an extension to the original deadline for submissions in order to allow proper consideration to be given to the detailed proposals. If members have comments on the consultation paper, these may be submitted to the HKSA's Corporate Governance Committee, c/o Mary Lam, Assistant Director (Business and Practice) by [5 September 2003].

19. OECD-led Roundtable Releases White Paper On Corporate Governance In Asia

In the previous issue of TechWatch (Issue No.

15), members were informed that there would be a formal official presentation of the Asian Corporate Governance White Paper ("White Paper") in Tokyo in mid-June. Due to unforeseen developments in relation to the spread of atypical pneumonia, the official launch of the White Paper was postponed. However, the White Paper received a "soft launch" on the OECD website on 10 June 2003.

The White Paper is a non-binding document reflecting the discussions and recommendations of the Asian Roundtable meetings that have taken place throughout the region from 1999-2003, attended by Asian policy makers, regulators and business leaders, as well as regional and international experts. The Society has been among the few professional bodies participating in the Roundtable.

Building on the OECD Principles of Corporate Governance, the White Paper surveys recent developments in Asian corporate governance, particularly since the financial crisis, describes various corporate governance frameworks and makes recommendations for reform, taking into account the region's legal, cultural and economic diversity. The White Paper also considers issues relating to family-run businesses, which represent the backbone of Asian economies.

Key recommendations of the White Paper include:

- > full convergence with international accounting and auditing standards;
- > better protection of minority investors;
- > stronger implementation and enforcement of existing laws and regulations; and
- > improved bank governance.

The White Paper may be accessed and downloaded at the OCED website at < http://www.oecd.org/document/24/0,2340,en_2649_37439_2048216_1_1_1_37439,00.html > .

Corporate Restructuring & Insolvency

20. HKSA Comments On Draft Procedural Guides For Taxation/Determination Of Liquidators' Bills Issued By Registrar Of High Court

As reported in TechWatch (Issue No.15), the Registrar of High Court (HCR) invited the Society to comment on two sets of procedural guides for taxation of remuneration, one for liquidators and provisional liquidators, and other for their agents including solicitors. According to the HCR, in view of the steadily increasing number of winding-up cases, the judges and masters have been considering how to streamline the process of taxation and/or determination of the remuneration of the liquidators, provisional liquidators and their agents. A copy of the draft procedural guides may be accessed at the Society's website at: < http://www.hksa.org.hk/professionalttechnical/whatsnew/docs/procedural_guides.pdf >.

The Society's Insolvency Practitioners Committee prepared the response to the draft guides, which was issued to the HCR by the 30 June 2003 deadline for consultation. While welcoming the initiative from the High Court to issue the procedural guides, in order to clarify the situation and achieve greater consistency in dealing with fee taxation/determination, the Society's submission raised some concerns.

Amongst the main points were, firstly, that it was unclear whether the requirements were intended to apply only to approval by the Court (i.e. where the liquidator and the committee of inspection (COI) had not reached agreement on the liquidator's remuneration or where there was no COI), or whether they were intended to apply even if the COI and the liquidator had reached an agreement. In the Society's view, under the current law, where the COI had agreed the basis of remuneration with the liquidator, that should be the end of the matter. Secondly, there appeared to be an emphasis in the guides on the requirement to provide documents and explanations relating to the recovery of assets in order to justify fee claims, whereas the Society considered that a liquidator was entitled to be

remunerated for all necessary work conducted by him, including, for example, investigating into and reporting on the company and directors' conduct, conducting meetings and dealing with uncooperative company officers and incomplete records.

A meeting will be held in August between the taxing masters and representatives from the Society and the Official Receiver's Office on issues relating to office holders' fees and it is hoped that further clarification can be sought on the draft guides at that meeting.

The Society's submission may be accessed at its website at: < http://www.hksa.org.hk/professionalttechnical/whatsnew/docs/taxation_bills.pdf >

Legislation & Government Initiatives

21. Companies Registry Announces Tougher Policy On Prosecution Of Filing Offences

As previously highlighted on the "What's New" section of the Society's Homepage, the Companies Registry has announced a new prosecution policy in relation to filing offences with effect from 1 August 2003. The Registry has concluded that, subsequent to the implementation of its revised prosecution policy in August 2002 (as reported in TechWatch Issue No.7), which involved initiating prosecutions against companies that were in breach of their filing obligations under the Companies Ordinance, only after issuing warning letters to such companies to comply with their reporting obligations within 28 days, the improvement in the compliance rates has not commensurate with the time-consuming procedures and level of resources involved. The Registry has therefore revisited its policy once again.

As explained in the Companies Registry External Circular No.2/2003, with effect from 1 August 2003, the Registry will no longer issue warning letters to advise companies and their officers of breaches that have occurred. Instead the Registry will issue summonses for summary prosecution against companies that are in

breach of their filing obligations or that have filed relevant documents beyond the statutory time limit.

Please click < <http://www.info.gov.hk/cr/new/index.htm> > or visit the Companies Registry website to view the full version of the Companies Registry External Circular No.2/2003.

22. LegCo Passes Companies (Amendment) Bill 2002

The Companies (Amendment) Bill 2002, which sought to implement some of the recommendations made in "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance" (February 2000), was passed by the Legislative Council ("LegCo") on 2 July 2003 with Committee Stage Amendments (CSAs) moved by the Government. It appeared in the Government Gazette ("Gazette") on 11 July 2003 as the Companies (Amendment) Ordinance 2003. (The electronic version of the Gazette can be accessed at: < <http://www.gld.gov.hk/egazette/> > Click on "What's New" (light bulb icon) and then "T.O.C." (turning page icon) for previous issues of the Gazette).

The recommendations to be implemented by the legislation, and the Society's submission on the Bill dated 10 October 2002 (accessible at the HKSA website at: < <http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/bill-2002.pdf> >) were reported in TechWatch (Issue Nos.3 and 9). The Society vigorously pursued several issues in relation to this Bill and managed to obtain LegCo's and the Government's agreement to some important CSAs, as well as responding to LegCo queries on the amendments to s165 of the Ordinance, which will allow a company to purchase insurance cover for its directors, officers and auditors in certain circumstances. The relevant CSAs concerned (a) the requirement in clause 63 of the Bill, which replaced section 161B of the Ordinance, that accounts should contain particulars of every transaction in relation to loans to officers, and (b) the removal of the requirement for a company

to include the details of "shadow directors" in its register of directors and secretaries under s158.

In relation to (a), this would have become potentially very onerous given that the extended disclosure requirements under the new section 161B, which included, e.g. a credit transaction entered into between a company and a director of the company, or a body corporate in which such a director at any time during the financial year held (jointly or severally or directly or indirectly) a controlling interest. Eventually, the Government accepted the Society's suggestion to adopt disclosure requirements similar to those in the Hong Kong Statement of Standard Accounting Practice on Related Party Disclosures (SSAP 2.120), such that items of a similar nature might be disclosed in aggregate to avoid voluminous and unnecessary detailed disclosures.

As regards (b), this makes it very difficult, if not impossible, for the auditors to come to a conclusion by themselves as to whether the company has any "shadow directors" and who are the "shadow directors", and as a result, whether any loans have been granted by the company to the "shadow director". Where the accounts that are required to be laid before a company in general meeting does not include information relating to loans, etc. made by the company to its directors (which include "shadow directors" by virtue of the CSAs introduced), s161B (6) places a specific duty on the company's auditors to include in their reports, as far as they are reasonably able to do so, a statement giving the required particulars. Eventually, the Government agreed to leave intact the requirement for a company to include the details of "shadow directors" in its register of directors and secretaries under s158. The Administration also introduced a CSA requiring any shadow director of a company and any person who had at any time during the preceding five years been a shadow director of the company to give notice in writing to the company of particulars of relevant transactions as may be necessary for inclusion in the accounts of loans to officers.

Clause 58 of the Bill proposed to extend the

prohibitions on a company making a loan to a director under section 157H of the Ordinance to cover quasi-loans and credit transactions. As reported in TechWatch (Issue No.9)), the Society had previously pointed out that the ceiling of HK\$500,000 on exempted transactions, covering, e.g. an arm's length transaction or series of transactions with a director in the course of the company's normal business, could be unduly restrictive. Although we would have favoured a more flexible arrangement that would have regard to the size of transactions normally carried out by the company, nevertheless the CSA introduced by the Government, to increase the ceiling to \$750,000, should be welcomed.

23. Companies (Amendment) Bill 2003 Introduced Into LegCo

The Companies (Amendment) Bill 2003 has been introduced into the LegCo to improve the prospectus regime to facilitate market development, to enhance corporate governance standards by strengthening remedies for shareholders and aligning the definition of "subsidiary" for the purposes of preparing group accounts with the International Accounting Standards (IASs), and to modernise the registration regime for overseas companies. The Bill may be accessed and downloaded at the LegCo website at: < http://www.legco.gov.hk/yr02-03/english/bills/brief/b59_brf.pdf >.

The Bill is being considered by the Expert Panel on Legal Matters and other relevant committees/panels of the Society. The proposed amendment to the "subsidiary" definition in the Companies Ordinance for group account purposes was initiated by HKSA and has been developed in close consultation with the Society. Members will be kept informed of further significant developments in relation to the Bill.

24. HKSA Comments On The Copyright (Amendment) Bill 2003

As reported in TechWatch (Issue No.1), the Intellectual Property (Miscellaneous Amendments) Ordinance 2000 (the "2000 Ordinance"), implemented in April 2001,

criminalised many basic copyright infringements that took place for the purpose of, in the course of, or in connection with, any trade or business. This included such activities as photocopying newspaper articles without a licence. Due to the public outcry the Government subsequently introduced the Copyright (Suspension of Amendments) Ordinance 2001 (the "Suspension Ordinance"), which disappplied most of the criminal provisions except in relation to four categories of copyright works, namely, computer programs, films, television drama and musical recordings (hereinafter referred to as the "Four Categories of Works"). The Society had objected to the original amendments to the Ordinance and supported the suspension provisions.

To formulate a long-term solution, the Government conducted a public consultation exercise in October 2001 (the "2001 Consultation"). The Society's submission on the Consultation Document, which was reported in TechWatch Issue No.2, may be accessed at the Society's website at: < http://www.hksa.org.hk/professionaltchnical/whatsnew/docs/copyright_review.pdf >.

As reported in TechWatch (Issue No.14), the Copyright (Amendment) Bill 2003 (the "Bill") was introduced into the LegCo to resolve the various problems created by the passage of the 2000 Ordinance. The main purpose of the Bill is, in effect, to make permanent the Suspension Ordinance by limiting the criminal sanctions against copyright infringements in the business context to the use of pirated copies of the Four Categories of Works. However, it retains criminal sanctions in relation to infringements generally (i.e. not limited to the Four Categories of Works) where they are performed for a commercial purpose, e.g. selling, hiring and distributing for profit or financial reward. The Bill may be accessed and downloaded at: < http://www.legco.gov.hk/yr02-03/english/bills/brief/b30_brf.pdf >.

The Bill also provides a defence for employees, other than officers and management staff, in respect of possession of infringing copies of the

Four Categories of Works, where the infringing copy was supplied by their employer.

The existing restrictions on parallel imports, mainly in respect of commercial dealings, e.g. selling, hiring and distributing for profit or financial reward, are retained (other than in respect of computer software, which was dealt with separately in the Copyright (Amendment) Bill 2001. (This latter Bill has now been passed by LegCo and appeared in the Gazette on 11 July 2003 as the Copyright (Amendment) Ordinance 2003.) At the same time, the 2003 Bill removes any civil and criminal liabilities on importation and possession by end-users. ("Parallel importation" refers generally to the importation into Hong Kong without the permission of the copyright owner, of a copy of that work which was lawfully made in the country of origin and which is therefore not a pirated copy.)

In its submission on the Bill, the Society expressed its support for the principal provisions of the Bill to make the effect of the Suspension Ordinance permanent. This is consistent with the view that the Society has expressed since the original changes were made to the Copyright Ordinance.

On the other issues dealt with in the Bill, the submission basically reiterates the position taken on the various matters in the Society's response to the 2001 Consultation. This includes suggesting that consideration be given to exempting registered charities from the criminal sanctions, querying whether the phrase "in the course of business" is sufficiently unambiguous, and proposing a further liberalisation of the restrictions on parallel imports of copyright works.

The Society's submission on the Bill may be accessed at: < http://www.hksa.org.hk/professionalttechnical/whatsnew/docs/copyright_bill2003.pdf >.

25. FATF Revised Forty Recommendations On Money Laundering Cover Accountants

As reported in TechWatch (Issue No.9), the Financial Action Task Force on Money Laundering (FATF), which is an international governmental anti-money laundering organisation, proposed

in its "Consultation Paper on the Review of the FATF Forty Recommendations" that the Forty Recommendations (40Rs), which have primarily been applied to financial institutions, including banks and "non-bank" financial operations such as remittance agents, should also apply to a number of categories of non-financial businesses and professions, including the accounting profession. The consultation paper may be accessed at the FATF website at: < http://www.fatf-gafi.org/pdf/Review40_en.pdf >. In its submission on the consultation paper, the Society expressed the view, inter alia, that the 40Rs (in particular Rs 10-21 and 26-29) dealing with customer identification, due diligence, etc. should not apply to accountants other than those directly in the front-line in relation to financial transactions, either receiving or handling monies on a regular basis, such as financial institutions, or those acting as financial intermediaries other than on an infrequent or incidental basis.

The FATF has recently released its revised 40Rs, a copy of which may be accessed and downloaded at: < <http://www.fatf-gafi.org> >.

The major changes adopted that are most relevant to the accounting profession include the following:

1. Under Recommendation 12 (R.12), the anti-money laundering (AML) measures are extended to designed non-financial businesses and professions, including accountants, in relation to the conduct of certain financial transactions for clients. The relevant activities that relate to accountants, amongst others (e.g. the creation, operation or management of legal persons or arrangements, and buying and selling of business entities), are described in R.12(d). **The extension of AML measures has been limited more or less in line with the Society's suggestion in its submission to the FATF that the AML regime should only apply to accountants who are directly in the front-line in relation to financial transactions.** In addition, trust and company services providers who prepare for or carry out transactions for a client concerning a variety of company secretarial services, e.g. acting as a formation

agent of legal persons and providing a registered office or business address for legal persons, will be subject to the AML regime.

2. Under R.16, the reporting requirements are also extended to the designated non-financial businesses and professions. This Recommendation also includes the specific statement: **“Countries are strongly encouraged** to extend the reporting requirement to the rest of the professional activities of accountants, **including auditing”** [emphasis added]. As the existing statutory reporting requirements, in Hong Kong, under the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap.405, Laws of Hong Kong), Organised and Serious Crimes Ordinance (Cap.455) and United Nations (Anti-Terrorism Measures) Ordinance (Cap.575) etc., already extend to all persons, it would seem that, in principle, this particular Recommendation will not necessitate the imposition of any additional burden on the profession.

3. Having said this, under R.2, countries are expected to ensure that “the intent and knowledge required to prove the offence of money laundering is consistent with the standards set forth in the Vienna and Palermo Conventions, including the concept that such mental state may be inferred from objective factual circumstances”. This should be read in conjunction with R.13, which proposes that a financial institution (and by extension, under R.16, designated professions when conducting the specific activities) should be required to report if it **“suspects or has reasonable grounds to suspect** that funds are the proceeds of a criminal activity” [emphasis added]. This is likely to lead in due course to a re-opening of the whole debate that the Society and other professional bodies had with the Government, in the context of the Drug Trafficking and Organised Crimes (Amendment) Bill 2000, over the merits of a subjective versus an objective test for reporting.

The Society’s Expert Panel on Legal Matters is in the process of reviewing and updating the

Society’s Technical Bulletin (TB 13) - “Drug Trafficking (Recovery of Proceeds) Ordinance 1989”, to reflect the various changes in the legislative and regulatory framework and environment since TB 13 was originally issued. The Panel will review the revised 40Rs and consider whether and how they should be taken into account in the revised Bulletin. Further developments in relation to the matter will be covered in future issues of TechWatch.

26. Dr. Eric Li’s Survey Results On Article 23

The Society helped Eric Li, the Accountancy Functional Constituency representative in the LegCo, to distribute a survey to gauge members’ sentiments on the National Security (Legislative Provisions) Bill 2003, which was introduced to implement Article 23 of the Basic Law. The draft legislation was reported in TechWatch (Issue No. 14).

The survey results (as at 9 a.m on 7 July 2003) were as follows:

	No. of replies	%
Yes (in support of passing the bill)	421	8.0
NO (against the passage of the bill)	4612	87.5
Abstain	95	1.8
Proxy	145	2.7
Total	5273	100

For more information on this subject, members may refer to the memorandum dated 9 July 2003 from Mr. K.F. Lee, the Society’s Registrar and Secretary General, which may be accessed at : < <http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/art23.pdf> >.

Taxation

27. LegCo Passes Revenue Bill 2003 And Revenue (No.2) Bill 2003

The Revenue Bill 2003 and Revenue (No.2) Bill

2003, which seek to implement some of the revenue proposals announced in the Budget 2003-04 (which were reported in TechWatch Issue No.13), were passed by the LegCo on 25 June 2003.

Revenue Bill 2003

The Revenue Bill 2003 was introduced to the LegCo to amend the Motor Vehicles (First Registration Tax) Ordinance (Cap.330) to give effect to the proposals in the Budget 2003-04 to abolish the tax exemption for accessories and for distributors' warranties, adjust the width of tax bands and tax rates, and introduce a marginal tax rate system for private cars. For the purpose of revenue protection, the proposed measures were arranged to be covered by the Public Revenue Protection (Revenue) Order 2003 with effect from 2:30 p.m. on 5 March 2003, for a maximum period of four months (and would cease to have effect from 5 July 2003 should the Revenue Bill 2003 not be passed by the LegCo by then).

A table setting out the superseded and revised tax bandwidths and rates may be accessed at the Society's website at: < http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/Appendix_Table.pdf >.

Revenue (No.2) Bill 2003

The Revenue (No.2) Bill 2003 seeks to implement the revenue proposals related to salaries tax, profits tax and property tax announced in the Budget 2003-04. The revenue measures introduced by the Bill, which take effect from 1 April 2003, are set out below.

Salaries tax

- The standard rate is increased from 15% to 16% in two equal phases over two years (in 2003/04 and 2004/05 years of assessment).
- The size of the incremental steps is increased from 5% to 6%, and the marginal tax rates will be adjusted upward to 2%, 8%, 14% and 20% respectively. The bandwidth will be reduced from \$35,000 to 30,000. The changes are to be implemented in two equal phases

over two years (in 2003/04 and 2004/05 years of assessment).

- The basic and married person's allowances are reduced from \$108,000 to \$100,000 and from \$216,000 to \$200,000 respectively in two equal phases over two years (in 2003/04 and 2004/05 years of assessment).
- Single parent allowance is lowered from \$108,000 to \$100,000 in two equal phases over two years (in 2003/04 and 2004/05 years of assessment).
- The allowance for the third to ninth child is increased from \$15,000 to \$30,000, equivalent to that for the first and second child, with effect from year of assessment 2003/04.
- The exemption for holiday warrants and passage is removed with effect from year of assessment 2003/04.
- The ceiling of tax deductible charitable donations is increased from 10% to 25% of the assessable income with effect from year of assessment 2003/04.

Profits tax

- The tax rate for corporations is increased from 16% to 17.5% with effect from year of assessment 2003/04.
- The tax rate for unincorporated businesses is increased from 15% to 16% in two equal phases over two years (in 2003/04 and 2004/05 years of assessment).
- The rate of deeming assessable profits for certain payments made to non-resident persons, such as royalties and licence fees is increased from 10% to 30%. The new deeming rate applies to sums received by or accrued to non-resident persons on or after 1 April 2003.
- The ceiling of tax deductible charitable donations is increased from 10% to 25% of the assessable profits with effect from year of assessment 2003/04.

Property tax

- The property tax rate is increased from 15%

to 16% in two equal phases over two years (in 2003/04 and 2004/05 years of assessment).

28. Revenue (No.3) Bill Introduced Into LegCo

The Revenue (No.3) Bill 2003, which seeks to implement certain tax concession measures announced in the Budget 2003-04, has been introduced into the LegCo.

Under the Bill, the Inland Revenue Ordinance (Cap.112) and the Stamp Duty Ordinance (Cap. 117) will be amended to effect two tax concession proposals, which relate to increased tax concessions for qualifying debt instruments (QDIs) and exemption from fixed stamp duty for unit trusts respectively.

The first proposal is to extend the current 50% profits tax concession for trading profits and interest income derived from QDIs with an original maturity period of not less than five years, to QDIs with a maturity period of not less than three years, and to increase the profits tax concession from 50% to 100% for profits and interest income derived from QDIs with a maturity period of not less than seven years.

The second proposal is to exempt subscriptions to and redemptions of units in unit trust funds in Hong Kong from the \$5 fixed stamp duty.

It is proposed in the Bill that the concession on profits and interest income from QDIs should apply to all issues made on or after 5 March 2003, whereas the concession on fixed stamp duty should apply to all subscriptions and redemptions of unit trusts in Hong Kong which take place after enactment.

The Bill is being considered by the Society's Taxation Committee. Members will be kept informed of further significant developments in relation to the Bill.

29. CIR's Response To HKSA's Request To Consider Measures To Alleviate The Effects Of SARS On Taxpayers

As reported in TechWatch (Issue No.15), as it will take some time for the economy to fully recover from the effects of the SARS outbreak and that a significant number of business will

encounter difficulties in meeting deadlines for tax filing and payment, the Society wrote to the Commissioner of Inland Revenue (CIR) to suggest that the Inland Revenue Department (IRD) should consider taking steps to reduce the burden of the situation on taxpayers and tax representatives by giving some administrative concessions, in deserving cases, in relation to tax filing deadlines and delayed payments. The Society further proposed that consideration be given to deferring for a limited period the normal due dates for the payment of profits and salaries taxes.

In her reply to the Society, whilst the CIR, Mrs. Alice Lau Mak Yee-ming, did not commit to exercising administrative discretion in relation to individual cases of late filing or payment, she confirmed that IRD had decided to extend formally the filing date of "D" code profits tax returns from 15 August to 31 August 2003, and that tax representatives would be notified directly of the decision. In view of the other relief measures taken by the Government, in particular the tax rebates, the IRD did not, however, consider that there was sufficient justification to implement other across-the-board measures to extend tax filing deadlines or defer payment due dates. A copy of the CIR's reply may be accessed at the Society's website at: < <http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/special-measures.pdf> >.

Comment Key Dates	
Date	Subject
5 September 2003	Exposure Drafts of Eight Proposed Practice Notes adopting International Auditing Practice Statements, which have been posted on the HKSA's website at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/practice_notes.pdf >.
5 September 2003	Exposure Draft Of Proposed ISA On Review Of Interim Financial Information Performed By The Auditor Of The Entity, which has been posted on the HKSA's website at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment_fi.pdf >. [IAASB deadline: 30 September 2003]
5 September 2003	Exposure Draft Of Proposed Practice Note 852 "Review Of Lottery Accounts", which has been posted on the HKSA's website at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/ed-pn852.pdf >.
5 September 2003	SCCLR Corporate Governance Review Phase II Consultation Paper, which may be accessed at the Companies Registry website at: < http://www.info.gov.hk/cr/scclr/index.htm >. [SCCLR deadline: 30 September 2003]
5 September 2003	Consultation Paper on the Proposal to Empower the SFC to Initiate a Derivative Action on Behalf of a Company, which may be accessed at the FSTB website at: < http://www.info.gov.hk/fstb/fsb/consult/index.htm >.
15 September 2003	Exposure Draft of Proposed Practice Note 820 "The Audit of Licensed Corporations and Associated Entities of Intermediaries", which has been posted on the HKSA website at:< http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/ed-pn820.pdf >.
30 September 2003	Hong Kong Invitation to Comment on IASB Exposure Draft: ED 4, "Disposal of Non-current Assets and Presentation of Discontinued Operations ", which has been posted on the IASB website at: < http://www.iasb.org.uk >. The ED is accompanied by the IASB's Basis for Conclusions and draft illustrative examples. The Hong Kong Invitation to Comment has been posted on the HKSA website at: < http://www.hksa.org.hk/professionaltechnical/accounting/exposedraft/ >. [IASB deadline: 24 October 2003]
17 October 2003	HKSA Invitation to Comment on IFAC Exposure Draft: Proposed Revised Code of Ethics for Professional Accountants, which has been posted on the HKSA's website at: < http://www.hksa.org.hk/professionaltechnical/ethics/exposedraft/ >. [IFAC deadline: 30 November 2003]
Please send comments to < commentletters@hksa.org.hk >	

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(i) Auditing and Assurance Standards Committee

Meeting summary - April 2003

The Society's Auditing and Assurance Standards Committee (Committee) met on 29 April 2003.

Members present at the meeting were: Wong Tak Wai, Alvin (Chairman), Charles Chow (Deputy Chairman), Richard George (Deputy Chairman), Deborah Annells, Albert Au, Andrew Bennett, Patrick Cheng, Kim Chong, William Crowe, Charles Grieve, Raymond Li, Man Mo Leung, Phyllis Mo, Shum Man To, Paul F. Winkelmann and Desmond Yuen.

Secretariat staff present at the meeting were: Stephen Chan, Elaine Chan and Steve Ong.

The agenda items were:

1. Welcome to new member
2. Minutes of March 2003 (245th) Meeting
3. Meeting summary
4. Matters arising
5. Invitation to Comment on IAASB's Exposure Drafts of Assurance Engagements and Proposed Amendments to IAPS 1005 "The Special Considerations in the Audit of Small Entities"
6. FASC's referral on auditors' reports on financial statements
7. Handbook restructure
8. Issues Paper on the adoption of the International Auditing Practice Statements
9. Revised statement of auditors' responsibility in audit report
10. Submission from a member practice on Exposure Draft "Engagement to report on compliance with the Billing and Metering Integrity Scheme of OFTA"
11. Draft proposed PN "The audit of licensed corporations and associated entities of intermediaries"
12. Accountants' Report Project
13. Proposal for a PN on the review of lottery accounts
14. Proposed series of publications on China matters
15. Draft revised FATF 40 Recommendations
16. Date of Next Meeting

1. Welcome to new member

The Chairman welcomed Deborah Annells (nominee of the Hong Kong General Chamber of Commerce) to her first meeting of the Committee.

2. Minutes of March 2003 (245th) Meeting

The Committee endorsed the Minutes.

3. Meeting summary

The Committee discussed and agreed that a Meeting Summary for each Committee meeting

should be prepared for publication in the HKSA's Technical Newsletter "TechWatch" and on the HKSA's website.

4. Matters arising

a. Work Plan for 2003

The Committee noted that its Work Plan for 2003 had been approved by Council.

b. HKSA's submission on IAASB's Audit Risk Exposure Drafts

The Committee noted that the HKSA's submission was sent to the IAASB on 9 April 2003 after its approval by Council.

5. Invitation to Comment on IAASB's Exposure Drafts of Assurance Engagements and Proposed Amendments to IAPS 1005 "The Special Considerations in the Audit of Small Entities"

The Committee ratified the issuance of the Invitation to Comment which had previously been endorsed by the Committee by circulation.

6. FASC's referral on auditors' reports on financial statements

The Committee agreed to consider further the referral from the FASC in respect of the proposed amendments to SAS 600 "Auditors' reports on financial statements" as a result of the HKSA Exposure Draft of Proposed Preface to Hong Kong Financial Reporting Standards and Accounting Guidelines.

7. Handbook restructure

The Committee agreed that it would not be necessary to form a sub-committee to take up the project and that the secretariat should take charge of the project.

8. Issues Paper on the adoption of the International Auditing Practice Statements

The Committee considered the following IAPs and agreed on their dispositions as follows:

- IAPs 1000, 1001, 1002, 1003, 1012 and 1013 would be adopted verbatim as Practice Notes;
- IAPS 1005 would be put on hold pending its current revision by the IAASB;
- IAPs 1004 and 1006 would be adopted as part of the Expert Panel on Banking's project of the development of proposed PN on the audit of authorized institutions;
- IAPS 1008 would not be adopted given that it would be withdrawn by the IAASB as part of the Audit Risk project in October 2003; and
- IAPS 1009 would be adopted verbatim as a PN to replace Auditing Guideline 3.262 "Computer-assisted audit techniques (CAATs)".

The secretariat was requested to prepare an issues paper on the adoption of IAPs 1010 and 1014 for the Committee's consideration.

9. Revised statement of auditors' responsibility in audit report

The Committee considered and agreed on a proposed revised statement of auditors' responsibility in audit reports, and requested the secretariat to submit the proposal to Counsel for review.

The Committee noted that as Accountants' Reports are governed by section 40 of the Companies Ordinance, they fall outside the scope of this project.

A Committee Member requested that legal advice should be obtained in relation to the position of the auditors where they are requested by their clients for permission to include the audited financial statements in Circulars to Shareholders (e.g. Circulars on major transactions) and the audit report contains a revised statement of auditors' responsibility.

10. Submission from a member practice on Exposure Draft "Engagement to report on compliance with the Billing and Metering Integrity Scheme of OFTA"

The Committee considered the submission from a member practice and agreed to amend the proposed PN to take into account certain editorial changes recommended by the member practice. It was agreed that the proposed PN as revised should be submitted to Council for approval for issuance as a final PN.

11. Draft proposed PN "The audit of licensed corporations and associated entities of intermediaries"

The Committee considered the draft proposed PN which was developed by the Expert Panel on Securities and noted that there are certain outstanding issues which require clarification with the SFC. The Committee endorsed the submission of the proposed PN to Council for approval for issuance as an Exposure Draft for a consultation period of 3 months.

12. Accountants' Report Project

One Committee Member pointed out, and the Committee noted, a potential implication concerning independence arising from the proposed new framework, under which the directors would be responsible for the preparation of the historical financial information for inclusion in investment circulars and the reporting accountants would be responsible for reporting on the historical financial information as prepared by the directors.

It was agreed that Members of the Committee should review the draft proposed statements prepared by the Accountants' Report Task Force and forward their comments, if any, to the secretariat.

13. Proposal for a PN on the review of lottery accounts

It was agreed that the reporting requirements of the Television and Entertainment Licensing Authority should be dealt with in a separate Practice Note.

14. Proposed series of publications on China matters

The Committee agreed to give a mandate to the Chairman for him to discuss with the Chairman of the Mainland Affairs Committee as to how the project of developing a series of publications on China matters should be handled.

15. Draft revised FATF 40 Recommendations

The Committee agreed that its previous comments as reflected in the HKSA Submission dated 30 September 2002 were still valid and had no further comments on the proposals.

16. Date of Next Meeting

The Committee's next scheduled meeting date is 20 May 2003.

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This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. Decisions reported are tentative and may be changed or modified by the Committee at a later date. Decisions become final only after completion of the formal due process required to finalize and release documents. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this meeting summary, or for any errors or omissions in it.

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(ii) Auditing and Assurance Standards Committee

Meeting summary - May 2003

The Society's Auditing and Assurance Standards Committee (Committee) met on 20 May 2003.

Members present at the meeting were: Wong Tak Wai, Alvin (Chairman), Charles Chow (Deputy Chairman), Richard George (Deputy Chairman), Deborah Annells, Albert Au, Andrew Bennett, Patrick Cheng, Kim Chong, William Crowe, Charles Grieve, Raymond Li, Man Mo Leung, Phyllis Mo, Shum Man To and Desmond Yuen.

Secretariat staff present at the meeting were: Stephen Chan, Elaine Chan and Steve Ong.

The agenda items were:

1. Minutes of April 2003 (246th) Meeting
2. Meeting Summaries of March 2003 (245th) and April 2003 (246th) Meetings for publication
3. Documents approved by Council
4. Proposed revisions to SAS 600 "Auditors' reports on financial statements"
5. Seven proposed PNs adopting International Auditing Practice Statements
6. Issues Paper on the adoption of International Auditing Practice Statements 1010 and 1014
7. Accountants' Report Project
8. Proposed Professional Risk Management Bulletin No. 2 - "Auditors' Duty of Care to Third Parties and The Audit Report"
9. SFC Consultation Paper "The Draft Code on Real Estate Investment Trusts"
10. The Land Titles Bill and the Companies (Amendment) Bill 2002
11. Date of next meeting

1. Minutes of April 2003 (246th) Meeting

There were comments by members on the paragraphs "Revised statement of auditors' responsibility in audit report" and "Accountants' Report Project", and the secretariat was asked to revise the draft minutes accordingly.

2. Meeting Summaries of March 2003 (245th) and April 2003 (246th) Meetings for publication

The Meeting Summary of March 2003 Meeting was approved by the Committee subject to an amendment. The secretariat was asked to update the Meeting Summary of April 2003 Meeting to reflect the changes which had been agreed to be made to the draft Minutes.

3. Documents approved by Council

The Committee noted that Council had approved the issuance of Practice Note "Engagement to report on compliance with the Billing and Metering Integrity Scheme of OFTA" as a final Statement, and proposed Practice Note "The audit of licensed corporations and associated entities of intermediaries" as an exposure draft for consultation.

4. Proposed revisions to SAS 600 "Auditors' reports on financial statements"

The Committee agreed that before coming to a decision on whether to adopt the FASC's proposal to amend the wording of the example audit reports in SAS 600 by replacing the term "accounting

principles generally accepted in Hong Kong" with "Hong Kong Financial Reporting Standards" (HKFRSs), the Committee should first seek a clarification from the FASC as to whether by adopting the term "HKFRSs", this would continue to impose an obligation for financial statements to be prepared with reference to the applicable Accounting Guidelines issued by the HKSA.

The secretariat was asked to seek the required clarification from the FASC.

5. Seven proposed PNs adopting International Auditing Practice Statements ("IAPs")

The Committee considered and endorsed the following proposed Practice Notes, which are identical to the equivalent IAPs, to be submitted to Council for issuance as Exposure Drafts for a consultation period of three months:

- PN 1000 "Inter-Bank Confirmation Procedures"
- PN 1001 "IT Environments - Stand-Alone Personal Computers"
- PN 1002 "IT Environments - On-Line Computer Systems"
- PN 1003 "IT Environments - Database Systems"
- PN 1009 "Computer-Assisted Audit Techniques"
- PN 1012 "Auditing Derivative Financial Instruments"
- PN 1013 "Electronic Commerce - Effect on the Audit of Financial Statements".

6. Issues Paper on the adoption of International Auditing Practice Statements 1010 and 1014

The Committee agreed that IAPS 1010 "The Consideration of Environmental Matters in the Audit of Financial Statements" would be adopted verbatim as a Practice Note, and endorsed the submission of the proposed PN to Council for issuance as an Exposure Draft for a consultation period of three months together with the seven proposed PNs mentioned in (5) above.

The Committee also agreed that IAPS 1014 "Reporting by Auditors on Compliance with International Financial Reporting Standards" would need further consideration and modification before it could be adopted. The secretariat was asked to consider the required modifications.

7. Accountants' Report Project

The Committee noted that the Accountants' Report Task Force's (ARTF) proposals represent a change from the current Hong Kong and UK practices and as a result, they would require consequential changes to the Listing Rules, and that the ARTF had already alerted the Securities and Futures Commission and The Hong Kong Exchanges and Clearing Limited of the proposals through a presentation and a number of meetings.

It was also noted that profit forecasts and "comfort letters to sponsors" would be dealt with under the proposed SAS 730 "The examination of prospective financial information" and a proposed Practice Note respectively.

The Committee had a few comments on the proposed professional statements drafted by the ARTF for referral to the ARTF for consideration.

8. Proposed Professional Risk Management Bulletin No. 2 - "Auditors' Duty of Care to Third Parties and The Audit Report"

The Committee considered the final marked-up draft Proposed Professional Risk Management Bulletin No. 2 (PRMB2) prepared by the secretariat in consultation with the Chairman, which

had reflected the comments received from members of both the Committee and the Professional Risk Management Committee.

The Committee agreed on a few further editorial changes and the secretariat was asked to revise the proposed PRMB2 and submit it to Council for approval by circulation for issuance as a final document.

9. SFC Consultation Paper “The Draft Code on Real Estate Investment Trusts”

It was noted that the HKSA had not been formally invited by the SFC to comment on the Consultation Paper. The Committee agreed that, despite the fact that the consultation period had expired, a submission should be made by the HKSA. The secretariat was asked to prepare a draft submission setting out the comments on the proposed audit reporting requirements, and forward it to the Committee for endorsement by circulation before submitting it to Council for approval.

10. The Land Titles Bill and the Companies (Amendment) Bill 2002

The Committee considered the referral from the Expert Panel on Legal Matters (EPLM) on the Land Titles Bill and the Companies (Amendment) Bill 2002.

a. The Land Titles Bill - Historical land titles records

The identified issue raised by the EPLM was whether under the Land Titles Bill, going forward, historical land titles records would be made available in a land search for audit purposes.

The Committee noted that there was an apparent attempt by the Administration to address the Society’s concern by setting out in paragraph 16 of the Draft Land Titles Regulation (released in 1994) that the Registrar General shall provide, on application by a person, any document (including any historical record) which is kept in a land registry. In addition, written assurances were given to the Society by the Registrar General back in December 1993 and the Government Secretariat Planning, Environment and Lands Branch again in March 1995 that historical records would be made available for audit purposes.

On the basis of the above, the Committee was of the view that the identified issue had already been resolved and recommended that the secretariat should liaise with the Land Registry requesting for an update on the issue, including ascertaining whether any amendments had been made to paragraph 16 of the draft Land Titles Regulation, and if so, obtain a copy of the updated Regulation, and to reconfirm that it should be possible to make both a current search as well as a historical search on the basis of the assurances given in 1993 and 1995 and the type of documents that would be retained for such search.

b. The Companies (Amendment) Bill 2002 - Clause 63/section 161B - Particulars of relevant transactions

The Committee supported that the Society should reiterate the suggestion to require a company, for the purpose of the new s161B, only to disclose similar items in aggregate, rather than the details of each transaction that took place during the company’s financial year.

The secretariat was asked to convey the above views of the Committee to the EPLM.

11. Date of next meeting

The Committee’s next scheduled meeting date is 17 June 2003.

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This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. Decisions reported are tentative and may be changed or modified by the Committee at a later date. Decisions become final only after completion of the formal due process required to finalize and release documents. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this meeting summary, or for any errors or omissions in it.

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(iii) Financial Accounting Standards Committee

Meeting summary - May 2003

The Society's Financial Accounting Standards Committee (Committee) met on 14 May 2003.

Present at the Committee's meeting were: Messrs. Roger Best (Chairman), Carlson Tong (Deputy Chairman), Paul F. Winkelmann (Deputy Chairman), Chan Lok Sang, Edward K.F. Chow, Choy Chung-foo (represented by Mr. Vingle Yuen), William Crowe, Raphael Ding, Tommy Fung, Robert Gibson, Philip Hilliard, Andrew Huke, Quinn Y.K. Law, Tommy Tam, Stephen Taylor, Ms. Olivia Cheung, Ms. Susanna Lau, Mr. Simon Riley (HKSA Deputy Director, Accounting) and Ms. Elsa Ho (HKSA Assistant Director, Accounting).

The Chairman welcomed Mr. Chan Lok Sang and Mr. Quinn Y.K. Law to their first meeting as members of the Committee.

The Committee discussed the following items:

- ✓ Proposed ED/SSAP 13, Investment Property (revised)
- ✓ Referral from the Accountants' Report Task Force - requested FASC endorsement of 2 draft Accounting Guidelines
- ✓ IASB agenda survey - for comment and feedback to the HK representative on the SAC
- ✓ Deferred tax liability arising on the revaluation of non-depreciable assets

Proposed ED/SSAP 13, Investment Property (revised)

The Committee continued to consider a draft ED of a proposed revision to SSAP 13, Accounting for Investment Properties, and Invitation to Comment thereon. The ED is based primarily on IAS 40, Investment Property but proposes to carry forward a number of requirements presently found in SSAP 13, primarily concerning the treatment of valuation changes from one period to the next, pending developments on the IASB's income statement project. The Committee tentatively agreed to the following:

Draft ED

- ✓ The ED would not be released until the IASB had finalised the proposed improvements to IAS 17 and IAS 40.
- ✓ For a transfer from investment property to owner-occupied property carried at valuation under SSAP 17, a revaluation surplus in respect of the individual asset concerned should be transferred to the relevant revaluation reserve account applying in respect of the owner-occupied property.
- ✓ For a transfer from investment property to owner-occupied property carried at valuation under SSAP 17, a revaluation deficit for the individual asset (which had been recognised as a debit in the investment property revaluation reserve on the basis that the reserve had a credit on a portfolio basis) is effectively an impairment loss and therefore should be expensed in the income statement upon transfer.
- ✓ For a transfer from investment property to inventory, a revaluation surplus for the individual asset should be frozen until the asset is disposed of, or reclassified back to investment property.
- ✓ For a transfer from investment property to inventory, a revaluation deficit for the individual asset should be recognised as an expense in the income statement, consistent with the accounting requirements applying to inventories under SSAP 22 (lower of cost and NRV).
- ✓ For a transfer from inventory to investment property, a so-called "death bed" valuation would

be made at the time of transfer and thereafter the newly classified asset would be accounted for as investment property.

- ✓ The treatment of investment property revaluations should be analogous to the IAS 39 treatment applying to available for sale financial instruments.
- ✓ The gain or loss of disposal of an investment property should be determined as the difference between the net disposal proceeds and the cost of the asset to ensure that revaluation is recycled through the income statement on realisation.

Invitation to Comment

- ✓ Comments should not be invited on areas where the ED proposes to adopt requirements applying in IAS 40. Instead, there should be a summary of the areas that do apply in IAS 40, and which are proposed to be adopted in the ED and which differ to the current treatment under SSAP 13. Similarly, the summary should identify areas that currently apply under SSAP 13 but which are not carried forward in the ED (for example, the “15% rule” and the “20 year rule”).
- ✓ Comments should primarily be invited on areas where the ED proposes to deviate from the requirements applying in IAS 40.

The Committee considered that guidance in addition to that found in IAS 40 may be required in respect of the criteria applying for an asset to be accounted for as investment property. This guidance would be particularly relevant to the treatment applied to service apartments and owner-occupied hotels. The Committee agreed that the matter should be referred to the Urgent Issues and Interpretations Sub-committee for consideration.

The Committee also considered whether additional guidance on the use of valuation standards (for example, those applying in Hong Kong, as issued by the IVSC and/or standards that conform to those issued by the IVSC) - appearing in the IAS 40 Basis for Conclusions - should be included within the ED. The Committee agreed that the two valuation institutes should be approached to discuss the professional valuation requirements proposed in the draft ED with a view to determining whether Hong Kong valuation standards and guidance conforms to that issued by the IVSC.

The Committee agreed to further consider the proposed ED at its next meeting.

Referral from the Accountants' Report Task Force - requested FASC endorsement of 2 draft Accounting Guidelines

The Committee considered the proposed Accounting Guideline (AG) 2.211 “Preparation of historical financial information for inclusion in investment circulars” and the proposed AG 2.212 “Preparation of pro forma financial information for inclusion in investment circulars” that were referred to for its consideration by the HKSA's Accountants' Report Task Force.

The Committee endorsed the two proposed AGs subject to certain specific comments. The Committee also made the general note that the proposed AGs should be updated regularly in order to bring them in line with SSAPs. In particular, the IASB has recently issued an exposure draft on Improvements to IAS that would result in changes to a number of SSAPs. Accordingly, there is a need to revisit the proposed AGs when the IASB exposure draft is finalised. These comments would be passed to the ARTF for consideration.

SAC agenda survey - for comment and feedback to the HK representative on the SAC

The Committee noted that a survey was being carried out by the IASB's Standards Advisory Council (“SAC”) on the IASB agenda items. This survey invites the views of the members of the

SAC and the Board on the current work programme and on the active research agenda of the IASB, and also on topics being addressed by national standard-setters with a request for responses by 28 May 2003. Its aim is to assist the Board in the ongoing development of its work programme.

The Committee considered that the following six projects, comprising both active research topics currently being undertaken by the IASB and other possible agenda items that national standard setters are addressing, deserve the highest priority and should be ranked in the following order:

1. The application of IFRSs to small and medium sized entities and in emerging economies
2. Lease accounting
3. Impairment of Assets
4. Derecognition issues, other than those addressed in IAS 39
5. Accounting concepts/ Definition of Elements of Financial Statements
6. Management's discussion and analysis

The Committee also considered that the following topics should be included in the research agenda:

1. Related party transactions between entities under common control other than as part of a business combination
2. Discounting

The Committee also considered that the following six projects, on which the IASB is already actively engaged, deserve the highest priority and these projects should be ranked in the following order:

1. Reporting Performance
2. Consolidation (including SPEs)
3. Business Combinations
4. Revenue - definition and recognition - and related aspects of liabilities
5. Improvements to IAS
6. Share based payments

The Committee would communicate the above agenda priorities to the Hong Kong representative on the SAC.

Deferred tax liability arising on the revaluation of non-depreciable assets

The Committee considered an issue regarding the measurement of a deferred tax liability arising on the revaluation of a tangible non-current asset that is not subject to a depreciation expense in the income statement, such as an investment property carried at fair value.

The Committee noted that there is a difference between SIC-21 and Hong Kong Interpretation 20. Under SIC-21 that component of an investment property, which, if IAS 16 were to be applied, would be considered to be depreciable (i.e. the building component) is scoped out of SIC-21. This is not the case under Interpretation 20.

The Committee considered that the application of Interpretation 20 to an investment property carried at valuation where the applicable tax rate is zero would result in a temporary difference

that is not taxable and therefore the revaluation would not give rise to a deferred tax liability (save for the effect of any balancing charge).

In addition, the Committee considered that:

- ✓ The IFRIC should be approached with regard to the Committee's concerns on the application of SIC-21, specifically on how IAS 12 should be applied differently in concept depending on whether the investment property is carried primarily for capital appreciation or for rental income purposes.
- ✓ SIC-21 is somewhat outdated now that IAS 40 has replaced IAS 25.
- ✓ Differences may arise under the application of Interpretation 20 depending on whether the valuation is performed on a pre-tax or after-tax basis.
- ✓ The difference in Interpretation 20 vis-a-vis SIC-21 should be attended to when SSAP 13 is revised.

The Committee also considered another issue with regard to the initial adoption of the revised SSAP 12 and the impact on goodwill. The Committee considered that, if the initial adoption of the revised SSAP 12 has an impact on the calculation on goodwill at the time of acquisition of an enterprise, an adjustment to goodwill would be made in accordance with SSAP 2 unless the amount that relates to prior periods is not reasonably determinable.

Date of Next Meeting

The Committee's next meeting is tentatively scheduled to be held on 20 June 2003.

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

The IASB publishes summaries of its meetings and projects. 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>.

(iv) Upcoming CPD Programmes for HKSA Members

Date		Topic
29 Aug	Fri	Is your Money Spent Tax Deductible
01 Sep	Mon	How Does a Company Prepare its Financial Information for Listing (Re-run)
09 Sep	Tue	Tax Issues Associated with the Telecoms Industry
10 Sep	Wed	商業信貸監控 (Credit Control)
18 Sep	Thu	什麼是《內地與香港關於建立更緊密經貿關係的安排》?
20 Sep	Sat	Making Effective Presentation (<i>Workshop</i>)
22 Sep	Mon	Crises in Accounting: The Way Forward? (Joint Seminar with CIMA)
23 Sep	Tue	What is Outsourcing - Understanding the Reasons and Raising Important Questions
24 Sep	Wed	Real Estate Investment Trust (REIT)
25 Sep	Thu	Economic Implications of Policy Choices
27 Sep	Sat	Annual Taxation Update Conference

Source: 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.