

This is the 21st 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 Stephen Chan, Technical Director (Ethics & Assurance) & Head of Standards & Technical Department Coordination (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/>.*

Members have been informed by a circular dated 18 September 2003 that TechWatch has been incorporated into The Hong Kong Accountant, and will no longer appear in printed form as a publication in its own right. If you have previously elected to receive only the printed version of TechWatch, you will need to refer to The Hong Kong Accountant for future issues. Electronic version will be published on the HKSA website generally prior to publication in The Hong Kong Accountant. If you are currently not receiving the electronic edition of TechWatch but would like to receive it in future, you may choose to do so by entering this 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, Standards & Technical Department by email: karen_moy@hksa.org.hk or Tel: 2287 7089.

Headlines Of This Issue

Financial Reporting

1. [IASB Issues IFRS 2 Share-based Payment](#)
2. [FASC Meeting – 14 January 2004](#)

Audit & Assurance

3. [New Guidance To Auditors Of Listed Companies Where The SFC Exercises Its Statutory Power To Require The Production Of Audit Working Papers](#)
4. [New Practice Note 820 Providing Guidance On The Audit Of Licensed Corporations And Associated Entities Of Intermediaries And Consequential Withdrawal Of Existing Guidance](#)
5. [Auditors' Agreement Of Preliminary Announcement Of Annual Results Of Listed Issuers Before Publication](#)
6. [New IAASB Auditing And Assurance Pronouncements](#)
7. [AASC Meeting – 18 November 2003](#)

Corporate Governance

8. [Revision Of OECD Corporate Governance Principles](#)

9. [SCCLR Issues Final Recommendations Arising From Phase II Of The Corporate Governance Review](#)
10. [Companies Registry Releases Non-Statutory Guidelines On Directors' Duties](#)

Listing

11. [Amendments To The Listing Rules Relating To Corporate Governance Issues](#)
12. [HKEx Invites Comments On The Draft Code On Corporate Governance Practices And Corporate Governance Report](#)
13. [Amendments To The Listing Rules Based On Consultation Conclusions Relating To Initial Listing Criteria And Continuing Listing Obligations](#)

Risk Management

14. [Professional Indemnity Insurance Master Policy Bulletin 10](#)

Banking

15. [HKMA Guidance On Supervision Of E-banking](#)

Corporate Restructuring & Insolvency

16. [HKSA Comments On The Clearing And Settlement Systems Bill](#)

Legislation & Government Initiatives

17. [HKSA Comments On The Proposed Code Of Conduct For Expert Witnesses In Criminal Cases](#)
18. [HKSA To Comment On Proposed Changes To Land Titles Bill](#)
19. [Companies Registry Issues New/Revised Information Pamphlets](#)

Taxation

20. [Inland Revenue \(Amendment\) Bill 2000 – HKSA Comments On Response From The Government On The Revised Committee Stage Amendments](#)
21. [HKSA Responds To Consultation On Exemption Of Offshore Funds From Profits Tax](#)

Innovation & Technology

22. [Anti-Fraud Symposium Now Available Online Under HKSA E-seminar](#)
23. [IFAC Guidance On Controlling Computers In Business For SMPs And SMEs](#)

CEPA

24. [Government Issues Updated CEPA Leaflets](#)

Comment Key Dates**Appendices**

- (i) [AASC Meeting Summary – November 2003](#)
- (ii) [FASC Meeting Summary – January 2004](#)
- (iii) [A Summary Of The SCCLR's Major Recommendations Arising From Phase II Of The Corporate Governance Review](#)
- (iv) [A Summary of The Changes To Main Board Listing Rules Based On The Consultation Conclusions Relating To Initial Listing Criteria And Continuing Listing Obligations](#)

Financial Reporting

1. IASB issues IFRS 2 Share-based Payment

The International Accounting Standards Board (IASB) has published IFRS 2 *Share-based Payment* on accounting for share-based payment transactions, including grants of share options to employees.

The objective of IFRS 2 is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, the IFRS requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

Before the issue of IFRS 2, there was no existing International Financial Reporting Standard on the recognition or measurement of share-based payments. The requirements in IFRS 2 replace the disclosure requirements in IAS 19 *Employee Benefits* that deal with equity compensation benefits.

Accompanying the publication of IFRS 2 are two other booklets: the IASB's Basis for Conclusions, which sets out the IASB's reasoning behind the requirements in the IFRS; and implementation guidance for IFRS 2, which includes various illustrative examples. Further details on IFRS 2 can be found on the IASB's website at: <http://www.iasb.org/news/press.asp>.

Under the HKSA's due process for setting accounting standards, the HKSA Financial Accounting Standards Committee (FASC) had earlier issued an Invitation to Comment on the IASB's exposure draft with comments requested by 15 February 2003. The FASC plans to consider at its March 2004 meeting a proposed HKFRS 2, based on IFRS 2, with a view to recommending Council's approval of the new Standard to become effective from 1 January 2005 – concurrent with the effective date of IFRS 2.

2. FASC Meeting – 14 January 2004

The FASC met on 14 January 2004 and discussed the following items:

- ✓ IASB Improvements Project
- ✓ Accounting and Reporting by Retirement Benefit Plans – proposed ED/SSAP 37 and replacement of Statement 2.302

A copy of the meeting summary is attached as Appendix (ii) to this issue of TechWatch. The summary has also been posted on the HKSA's website at:

<http://www.hksa.org.hk/professionaltechnical/accounting/fascupdate>.

Audit & Assurance

3. New Guidance To Auditors Of Listed Companies Where The SFC Exercises Its Statutory Power To Require The Production Of Audit Working Papers

The HKSA has issued General Guidance 1.307 "Production of audit working papers to the Securities and Futures Commission under section 179 of the Securities and Futures Ordinance", which can be accessed at: <http://www.hksa.org.hk/professionaltechnical/ethics/guidance/index.php>. The final Guidance is identical to the exposure draft issued for consultation.

The Guidance was developed in consultation with the Securities and Futures Commission (SFC) to provide guidance to auditors of listed companies in respect of the power conferred upon the SFC under section 179 of the Securities and Futures Ordinance. This power requires the auditors of listed companies

to produce their audit working papers to assist the SFC in its investigations of listed companies where the SFC suspects that persons involved in the management of the affairs of the listed companies have engaged in defalcation, fraud, misfeasance or other misconduct.

4. New Practice Note 820 Providing Guidance On The Audit Of Licensed Corporations And Associated Entities Of Intermediaries And Consequential Withdrawal Of Existing Guidance

The HKSA has issued Practice Note (PN) 820 “The audit of licensed corporations and associated entities of intermediaries”, which can be accessed at:

<http://www.hksa.org.hk/professionaltechnical/pronouncements/handbook/volume3b/pn820a.htm>,
to provide guidance in respect of:

- the special considerations arising from the application of Statements of Auditing Standards to the audit of the financial statements of these regulated entities;
- the auditors' reporting responsibilities under the Securities and Futures (Accounts and Audit) Rules; and
- the communications between auditors and the Securities and Futures Commission.

PN 820 also provides new example auditors' reports.

As a result of the issuance of PN 820, the following existing guidance is withdrawn:

- PN 620.1 “Communications between auditors and securities and futures regulators” (*now included as part of the new PN*).
- Industry Auditing Guideline 3.403 “The audit of the accounts of commodities dealers” (*superseded*).
- Industry Auditing Guideline 3.404 “The audit of the accounts of dealers in securities” (*superseded*).
- Example auditors' reports 14 to 17 in Appendix 2 to SAS 600 “Auditors' reports on financial statements” (*superseded*).

The HKSA will hold a CPD seminar on 25 March 2004 on PN 820. To register, please go to:
<http://www.hksa.org.hk/membership/cpd/index.php> under “List of Activities”.

5. Auditors' Agreement Of Preliminary Announcement Of Annual Results Of Listed Issuers Before Publication

As a result of the recent Listing Rule changes abolishing the two-phased publication arrangement relating to simplified and full annual results announcement, listed issuers are required to publish full annual result announcement containing both income statement and balance sheet that must have been agreed with the company's auditors. The new requirements will be effective for accounting period commencing on or after 1 July 2004. Early adoption of the new disclosure requirements by listed issuers is encouraged. Further information is contained in paragraph 42 of *Rule Amendments Relating to Corporate Governance Issues*, which is available on the HKEx's website at: <http://www.hkex.com.hk/news/hkexnews/0401304news.pdf>.

The new requirements are set out in paragraph 45 of Appendix 16 to the Main Board Listing Rules and Chapter 18 (paragraph 18.49) of the GEM Listing Rules.

The AASC will develop guidance to assist auditors of listed issuers in discharging their responsibilities with regard to the agreement of preliminary result announcements.

6.

New IAASB Auditing And Assurance Pronouncements

The IAASB has recently issued the following five new Auditing and Assurance Pronouncements, which can be viewed on the IAASB's website at: <http://www.ifac.org/IAASB/> :

- International Framework for Assurance Engagements
- ISAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information"
- Revised ISA 240 "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements"
- New International Standard on Quality Control 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"
- Revised ISA 220 "Quality Control for Audits of Historical Financial Information"

The AASC will adopt these IAASB Pronouncements as part of its International Convergence Programme so that Hong Kong Auditing and Assurance Standards maintain conformity with current International Auditing and Assurance Standards at all times.

International Framework for Assurance Engagements and ISAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information"

The International Framework for Assurance Engagements ("Framework") and ISAE 3000 jointly replace the existing ISA 100 "Assurance Engagements". The Framework defines and describes the elements and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs) and International Standards on Assurance Engagements (ISAEs) apply. ISAEs are applicable to assurance engagements, other than audits or reviews of historical financial information. ISAE 3000 has been written for general application to assurance engagements, while other ISAEs, which are expected to follow, may be topic or subject matter specific. ISAE 3000 will be effective for assurance engagements where the assurance report is dated on or after 1 January 2005.

Revised ISA 240 "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements"

The revised ISA 240 builds on the new Audit Risk standards and requires the auditors to focus on areas where there is a risk of material misstatement due to fraud, including management fraud. The revised standard emphasizes the need for the auditors to maintain an attitude of professional skepticism throughout the audit, notwithstanding the auditors' past experience about the honesty and integrity of management and those charged with governance. The standard is effective for audits of financial statements for financial periods beginning on or after 15 December 2004.

New International Standard on Quality Control 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" and Revised ISA 220 "Quality Control for Audits of Historical Financial Information"

The new International Standard on Quality Control 1 (ISQC 1) establishes a firm's responsibilities to set up and maintain a system of quality control for all audits and assurance engagements. In addition to setting out guidance on client acceptance and retention criteria that firms should consider, the standard requires that an engagement quality control review must be performed for audits of listed entities and such other engagements as a firm determines. Systems of quality control in compliance with this ISQC are required to be established by 15 June 2005.

The revised ISA 220 establishes standards for the specific responsibilities of firm personnel for an individual audit engagement and is premised on the requirements of the firm-wide quality control

standards set out on ISQC1. This ISA is effective for audits of historical financial information for periods commencing on or after 15 June 2005.

7. AASC Meeting – 18 November 2003

The meeting summary of the AASC meeting held in November 2003 is attached as Appendix (i) to this issue of TechWatch. The meeting summary has also been posted on the HKSA's website at: <http://www.hksa.org.hk/professionaltechnical/assurance/aasc/index.php>.

Corporate Governance

8. Revision Of OECD Corporate Governance Principles

The OECD has recently released an invitation to comment on a draft revision of its Corporate Governance Principles ("Revised Principles"). The draft Revised Principles and the accompanying news release, together with the existing OECD Corporate Governance Principles ("OECD Principles"), can be accessed on the OECD's website at:

http://www.oecd.org/document/24/0,2340,en_2649_201185_23892248_1_1_1_1,00.html.

Comments on the draft Revised Principles received from the public consultation can also be found on the aforesaid OECD website.

The OECD Principles are the result of a consensus between participating governments on minimum requirements for best practice and, since they were adopted in 1999, they have been a reference for corporate governance initiatives around the world.

The OECD Principles already cover many of the issues that have been at the centre of recent corporate scandals, including recommendations on high quality standards of accounting and audit, the independence of board members and the need for boards to act in the interests of the company and the shareholders. Although they are non-binding, they provide a reference for national legislation and regulation, as well as guidance for stock exchanges, investors, corporations and other parties.

The draft Revised Principles set more demanding standards in the following areas: -

- Investors' right to nominate company directors and have a more forceful role in electing them.
- Shareholders' right to express their views about compensation policy for board members and executives and submit questions to auditors.
- Disclosure of institutional investors' overall voting policies and how they manage material conflicts of interest that may affect the way they exercise key ownership functions, e.g. voting.
- Effective protection of creditor rights and an efficient system for dealing with corporate insolvency.
- Disclosure of conflicts of interest in respect of those parties that could influence investor decisions (e.g. rating agencies, brokers and other providers of information) and how such conflicts are being managed.
- Disclosure of related party transactions.
- Protection of "whistle blowers", e.g. allowing them confidential access to a contact at board level.

The OECD Secretariat anticipates that a final version of the Revised Principles will be submitted to OECD governments for approval at the annual meeting of the OECD Council at Ministerial Level on 13-14 May 2004.

9. SCCLR Issues Final Recommendations Arising From Phase II Of The Corporate Governance Review

The Standing Committee on Company Law Reform (SCCLR) issued its final recommendations arising from Phase II of the Corporate Governance Review on 20 January 2004. The main recommendations are contained in the accompanying press release, which is published on the Companies Registry's website at: <http://www.info.gov.hk/cr/message/040120.htm>.

According to Mr. Justice Rogers, who has recently retired as the Chairman of the SCCLR, most of the proposals contained in the Consultation Paper on Phase II of the Corporate Governance Review ("Consultation"), published in June 2003, received strong support from respondents. The proposals have been included in the SCCLR's final recommendations to the Government, subject to some refinements.

The HKSA's comments on the SCCLR's Consultation were summarised in the November 2003 issue of TechWatch (Issue No. 18), and the HKSA's submission can be accessed at: <http://www.hksa.org.hk/professionaltechnical/corporategov/index.php>.

A summary of the SCCLR's major recommendations is set out in Appendix (iii) to this issue of TechWatch.

10. Companies Registry Releases Non-Statutory Guidelines On Directors' Duties

As reported in the January 2004 issue of TechWatch (Issue No. 20), the Companies Registry published a set of "Non-statutory Guidelines on Directors' Duties" on 20 January 2004 to help company directors to better understand their roles. The objective of the Guidelines is to outline the general principles for a director in the performance of his functions and the exercise of his powers.

The general principles of directors' duties are:

- Principle 1: Duty to act in good faith for the benefit of the company as a whole
- Principle 2: Duty to use powers for a proper purpose for the benefit of members as a whole
- Principle 3: Duty not to delegate powers except with proper authorisation and duty to exercise independent judgement
- Principle 4: Duty to exercise care, skill and diligence
- Principle 5: Duty to avoid conflicts between personal interests and interests of the company
- Principle 6: Duty not to enter into transactions in which the directors have an interest except in compliance with the requirements of the law
- Principle 7: Duty not to gain advantage from use of position as a director
- Principle 8: Duty not to make unauthorised use of company's property or information
- Principle 9: Duty not to accept personal benefit from third parties conferred because of position as a director

Principle 10: Duty to observe the company's memorandum and articles of association and resolutions

Principle 11: Duty to keep proper books of account

The above is merely a statement of the principles. Members are encouraged to view the full text of the Guidelines, which is available on the Companies Registry's website (as well as through the websites of the Hong Kong Exchanges and Clearing Limited, the Securities and Futures Commission, the Official Receiver's Office and the Hong Kong Monetary Authority) at:

http://www.info.gov.hk/cr/download/list/director_guide_e.pdf. Hard copies of the Guidelines are also available at the Companies Registry's office.

It is important to note that the statements in the Guidelines are principles only and are **NOT** intended to be exhaustive statements of the law. Furthermore, statute or case law could require certain forms of conduct under specified circumstances. If directors are in doubt about the nature of their responsibilities and obligations, they should seek legal advice.

[Listing]

11. Amendments To The Listing Rules Relating To Corporate Governance Issues

HKEx published the revised Main Board and Growth Enterprise Market (“GEM”) Listing Rules on 30 January 2004. The amendments are based on the recommendations set out in the Conclusion Report of the Consultation on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues (“Consultation Conclusion Report”) published in January 2003. The areas that are substantially revised include the notifiable transaction and connected transaction requirements, the Code on Corporate Governance Practices and the disclosure requirements for the report on Corporate Governance Practices.

The Consultation Conclusion Report can be accessed on the HKEx's website at:

<http://www.hkex.com.hk/library/listpaper/cc-e.pdf>. Key areas of the conclusions were summarised in the February 2003 issue of TechWatch (Issue No. 12).

In its news release announcing the revised Listing Rules, HKEx states that subsequent to the Consultation, additional amendments to Listing Rules, which were not included in the Consultation, were also considered to enhance further the transparency of listed issuers, codify HKEx's existing practice in interpreting and applying the Listing Rules and make the Listing Rules clearer and more concise. The major areas that have been re-considered since publication of the Consultation Conclusion Report are set out below. Further details are available on the HKEx's website at:

<http://www.hkex.com.hk/news/hkexnews/0401304news.pdf>.

- Definition of “transactions” for the purpose of notifiable transactions
- Classification of notifiable transactions and connected transactions
- Definition of “reverse takeover”
- Disclosure of financial information in circulars on notifiable transactions
- Definition of “associate”
- “Relatives” of a connected person as deemed associates
- Financial assistance as a connected transaction
- Refreshment of general mandate
- Disclosure of directors' remuneration
- Disclosure of information relating to proposed directors before election at the general meeting

The English version of the revised Main Board Listing Rules and GEM Listing Rules are available on the HKEx's website at: http://www.hkex.com.hk/rulereg/listrules/mb_ruleupdate.htm and http://www.hkgem.com/listingrules/amendments/e_main.htm respectively.

The revised Listing Rules will take effect on 31 March 2004, except that certain corporate governance Rule amendments will be subject to transitional arrangements. The transitional arrangements is contained in Part B of *Rule Amendments Relating to Corporate Governance Issues*, which can be found on the HKEx's website at: <http://www.hkex.com.hk/news/hkexnews/0401304news.pdf>.

12. HKEx Invites Comments On The Draft Code On Corporate Governance Practices And Corporate Governance Report

HKEx issued an exposure paper on 30 January 2004 on the draft Code on Corporate Governance Practices ("Code") and Corporate Governance Report. The deadline for submission of comments is 31 March 2004. The contents of the exposure paper are largely an elaboration and extension of the recommendations contained in the Consultation Conclusion Report published in January 2003. The purpose of the exposure paper is to seek market views on the timing of the proposed implementation of the Code and Corporate Governance Report, and to allow the market the opportunity to comment on the detailed wording, with a view to removing ambiguities, providing clarity and ensuring that the language adopted in the Code is clear and concise.

The full text of the exposure paper can be accessed on the HKEx's website at:
<http://www.hkex.com.hk/library/listpaper/edc-e.pdf>.

The HKSA is currently reviewing the exposure paper with a view to preparing a submission to HKEx. If members have any comments on the exposure paper, these may be submitted to the HKSA's Corporate Governance Committee, c/o Mary Lam, Assistant Director (Business Members and Specialist Practices) by 19 March 2004.

13. Amendments To The Listing Rules Based On Consultation Conclusions Relating To Initial Listing Criteria And Continuing Listing Obligations

HKEx announced on 30 January 2004 its conclusions on the consultation on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures ("July 2002 Consultation Paper") (except for Part C on continuing listing eligibility criteria and Part E on cancellation of listing procedures). The consultation conclusions ("Conclusions") are contained in a report entitled *Consultation Conclusions on Proposed Amendments to the Listing Rules relating to Initial Listing Criteria and Continuing Listing Obligations*, which is available on the HKEx's website at: <http://www.hkex.com.hk/library/listpaper/cc2-e.pdf>.

The HKEx's accompanying press release can be accessed at:
<http://www.hkex.com.hk/index.asp?id=news/hkexnews/0401303news.htm>.

The Conclusions focus on three elements of the July 2002 Consultation Paper, as follows:

- Initial listing criteria
- Continuing obligations
- Certain disclosure requirements at the time of initial listing

Appendix (iv) to this issue of TechWatch summarises the major changes to the Main Board Listing Rules based on the Conclusions.

The revised Rules will take effect on 31 March 2004, except that a transitional period up to 31 December 2004 will be given to existing Main Board listed companies to comply with the new continuing obligation to publish timely periodic financial information, failing which their securities will be subject to immediate suspension.

Risk Management

14. Professional Indemnity Insurance Master Policy Bulletin 10

HKSA Professional Indemnity Insurance (“PII”) Master Policy Bulletin 10 has been issued, which provides an update on the 2003-2004 renewal of the HKSA PII Master Policy.

The Bulletin is prepared by Aon Hong Kong Limited and Windsor Professional Indemnity Insurance Limited, the appointed brokers of the HKSA PII Master Policy, and can be accessed at:
<http://www.hksa.org.hk/publications/bulletins/pii/pii10.pdf>.

Banking

15. HKMA Guidance On Supervision Of E-banking

The Hong Kong Monetary Authority (“HKMA”) has issued a new Supervisory Policy Manual (“SPM”) TM-E-1: Supervision of E-banking, setting out the HKMA’s approach to the supervision of authorized institutions’ electronic banking (e-banking) services and provides authorized institutions with guidance on the general principles for risk management of e-banking. On-line access to the SPM is available at the HKMA’s website at: <http://www.info.gov.hk/hkma/eng/bank/spma/attach/TM-E-1.pdf>.

The HKSA has made a submission to the HKMA during the consultation stage of the SPM commenting on the following sections:

- 2.4 Regular independent assessment
- 4 Major technology-related controls relevant to e-banking
- 5 Customer security and risk management controls,

which has been posted on the HKSA’s website at:

<http://www.hksa.org.hk/professionaltechnical/banking/submission/HKMA-SPMTME1.pdf>.

Corporate Restructuring & Insolvency

16. HKSA Comments On The Clearing And Settlement Systems Bill

The Clearing and Settlement Systems Bill, which was introduced into the Legislative Council (“LegCo”) on 10 December 2003, is a technical piece of legislation that introduces a legal framework for supervisory oversight of clearing and settlement systems in Hong Kong. It aims to provide express statutory backing for (a) the oversight role of the Monetary Authority in relation to major clearing and settlement systems, addressing concerns expressed by the International Monetary Fund; and for (b) the finality of settlements effected through such systems, so as to facilitate the inclusion of the Hong Kong Dollar in the Continuous Linked Settlement System. The LegCo Brief on the Bill may be accessed at:
http://www.legco.gov.hk/yr03-04/english/bills/brief/b33_brf.pdf.

The HKSA has made a submission on the Bill, which may be accessed at the HKSA’s website at:
http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/clearing_settlement_bill.pdf.

The principal area of concern to the profession in the Bill is in the potential implications of the proposed framework for insolvency law and procedures in Hong Kong.

The submission points out that, although there is no dispute about the principle of ensuring the integrity of the clearing and settlement system as a conduit for the processing of financial transactions, the Bill seems to go further than it needs to do in order to protect the system, by introducing new insolvency provisions in relation to e.g., transactions at an undervalue and preferences, which differ from the existing general insolvency law and from provisions introduced under the Securities and Futures Ordinance (“SFO”) in relation to the Central Clearing and Settlement System.

It is considered that it is not desirable to create a third insolvency regime in Hong Kong with different causes of action depending upon whether an underlying transaction is regulated under the Bill, the SFO or the general insolvency law. The Society understands that, in the United Kingdom, for example, where the insolvency regime is similar, the corresponding legal framework has achieved the same intended purpose, i.e. of protecting the integrity of the process of transfer through the clearing system, without replacing the existing transactions at an undervalue and preference claims available to insolvency office holders with alternative provisions.

Legislation & Government Initiatives

17. HKSA Comments On The Proposed Code Of Conduct For Expert Witnesses In Criminal Cases

Unlike other common law jurisdictions, Hong Kong does not presently have a code of conduct for expert witnesses in criminal matters. In the light of recent judicial decisions in Hong Kong, the Department of Justice (“DoJ”) is proposing to introduce a Code of Conduct for Expert Witnesses in Criminal Cases (“Code”), and it has requested comments from the HKSA on the draft Code. It is also noted from the DoJ consultation paper that the judiciary is in the process of drafting a code of conduct for expert witnesses in civil cases.

The HKSA issued a submission on the draft Code on 18 February 2004, the main points of which are as follows:

- The HKSA supports the introduction of a Code.
- Since an expert witness has an overriding duty to assist the court impartially on matters relevant to his or her area of expertise, the Code should expressly require an expert witness to duly disclose any actual or potential conflict of interests, so that the court can properly assess the weight to be given to his or her evidence in light of the conflict.
- Consideration should be given to including advice in the Code, or some other appropriate place, to the effect that an expert should consider carefully before accepting instructions that are not clear and unambiguous.
- The expert witness should set out in the report his or her qualifications and experience in the field in relation to which he or she is proposing to give evidence, and, where appropriate, his or her experience as an expert witness.

The submission may be accessed at the HKSA’s website at:

http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/expert_witnesses.pdf.

18. HKSA To Comment On Proposed Changes To Land Titles Bill

The HKSA's previous submission to the Bills Committee on this subject, dated 22 April 2003, was reported in TechWatch Issue No.14. The submission may be accessed at the HKSA's website at: http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/land_titles_bill_220403.pdf. The proposed Land Titles system will generally dispense with the need to review the historical title deeds to establish title, as required under the existing deeds registration system, and replace this with the title register which will provide conclusive evidence of an owner's title to land.

The Government has recently requested comments from the HKSA on two major changes proposed to the Land Titles Bill.

The first proposed change concerns the mechanism to convert existing properties from the deeds register to the title register. Given that the Law Society has indicated that it cannot support the issue of certificates of good title unless these can be qualified, and unless a means to review and advise on difficult cases is established, the Government has revised the proposals such that the safeguard against extinguishing rights by the act of registration is provided by time, coupled with new provisions for notice under the Land Registration Ordinance, rather than by the certificates.

Under the revised proposals, other than new land grants, which will come directly onto the title register, all property will await the lapse of 12 years from the commencement date (the limitation period under the Limitation Ordinance for actions to recover land). At that point, all properties will be transferred to the title register, except those for which either a "caution against conversion" has been registered or where matters previously submitted for registration under the Land Registration Ordinance are not yet complete. The "caution against conversion" is a form of notice that prevents a property from coming onto the title register until an action to resolve a claim has been concluded. If the applicant fails to take court action within 12 months, the caution will lapse.

The effect of these changes is that there will be a much more gradual development of the title register over the first 12 years. At the end of that period, almost all property will come onto the title register. A purchaser of property will take it subject only to registered matters and specified overriding interests. Before conversion to title registration, solicitors will continue to have to conduct the full historical examination of title required by the Conveyancing and Property Ordinance (Cap. 219).

The second proposed change relates to clause 81 of the Bill (on rectification by the court). It is proposed that, in respect of all registered land:

- (a) Rectification of the title register will be given in favour of a former innocent owner if the change of ownership is procured by a forgery (that is, a transfer or transmission procured by forged signature, forged document or forged entry or any combination of them). An innocent registered owner in such a case will be given an indemnity up to a capped amount under the Bill; and
- (b) rectification will be allowed in other fraud cases if the court considers it unjust not to rectify the title register against the present registered owner. This is at the discretion of the court. Any innocent party who loses title as a result of rectification in such cases will be entitled to an indemnity up to capped amount under the Bill.

The Government has indicated that, in preparing the draft legislation to reflect these proposed changes, the comments in the HKSA's April 2003 submission on the overall drafting of clause 81 will be taken into account. The HKSA's Expert Panel on Legal Matters has reviewed the proposals and has no objection to them in principle. The HKSA's submission is being finalised and this, together with the Government's letter, will be posted on the HKSA's website at:

http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/land_titles_bill_160304.pdf.

19. Companies Registry Issues New/Revised Information Pamphlets

The Companies Registry (“CR”) has advised the HKSA that it has reviewed and updated all of its existing 18 information pamphlets to cater for the changes brought about by the Companies (Amendment) Ordinance 2003 on 13 February 2004 (reported in TechWatch Issue No. 20). Two new information pamphlets, namely “Registration of Oversea Companies” and “Filing Requirements of an Oversea Company after Registration”, have been introduced. The information pamphlets may be downloaded from the CR’s website at: <http://www.info.gov.hk/cr/new/index.htm> under “List of Handouts”, or obtained at the CR’s information counter at 13th and 14th floors of the Queensway Government Offices, 66 Queensway, Hong Kong, or by fax through the CR’s Enquiry Hotline 2234 9933.

Taxation

20. Inland Revenue (Amendment) Bill 2000 – HKSA Comments On Response From The Government On The Revised Committee Stage Amendments

Introduced in late 2000, the Inland Revenue (Amendment) Bill 2000 gave rise to concerns on the part of the HKSA and various other professional and industry bodies in relation to clause 5 (introducing the proposed new section 15(1)(ba) to the Inland Revenue Ordinance (“IRO”)), which appeared to extend the reach of the royalty provisions in a way that was inconsistent with the rules on “source” of profits under the Hong Kong tax regime, and, more particularly, clause 6 (relating to sections 16(2)(d), (e) and (f) of the IRO), which introduced new anti-avoidance provisions on the deduction of interest expenses.

In a submission of 8 December 2003 on revised draft Committee Stage Amendments (“CSAs”) to the Bill, the HKSA welcomed the fact that the proposed CSAs on clause 6 of the Bill defined more clearly the scope of the anti-avoidance provisions under section 16. At the same time, the submission proposed extending the grandfathering provisions contained in the CSAs (the new section 16(5A)), which currently cover certain existing financial arrangements, where the Commissioner of Inland Revenue has given an advance clearance or ruling that the arrangement would not fall within the scope of the anti-avoidance provisions of section 61A of the IRO. As there are no changes in the CSAs to address the objections on the royalty-related provisions, the submission also reiterated our disagreement with the proposed amendment to section 15 (see TechWatch Issue No. 19).

More recently, the LegCo Bills Committee has requested comments from various professional and industry bodies on the Government’s responses to their submissions on the revised draft CSAs. The HKSA has, therefore, issued a further submission, dated 4 February 2004, indicating (a) that the Government’s response has not alleviated the concerns regarding section 15 of the IRO; and (b) that the limited scope of the proposed grandfathering provisions could be unfairly prejudicial to financial transactions that are similar in nature to those that are grandfathered, but which have not been the subject of a specific advance clearance or ruling application.

The submission dated 4 February 2004 may be accessed at the HKSA’s website at:
http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/ir_amendment2000.pdf.

21. HKSA Responds To Consultation On Exemption Of Offshore Funds From Profits Tax

The Government has requested comments from the HKSA on the proposed amendments to the IRO to put into effect the Financial Secretary’s announcement in the 2003/04 Budget to exempt offshore funds from profits tax.

The aim of the proposed legislation is to reinforce Hong Kong’s status as an international financial centre, by increasing its appeal to offshore fund managers and to bring Hong Kong into line with other major international financial centres, which do not tax offshore funds. The HKSA believes that the

requirements of the proposed legislation may be difficult for certain offshore funds to satisfy given, in particular, that it is common for an associate of the fund manager to hold an investment in the offshore fund.

The draft legislative amendments propose to exempt the profits derived by offshore funds by linking the new exemption provision (section 20AB of the IRO) with the existing provisions applying to brokers and approved investment advisers (section 20AA of the IRO), which exempt brokers and approved investment advisers from being treated as agents of a non-resident person, provided certain conditions are met. Specifically, the proposed exemption under section 20AB requires offshore funds to meet a non-resident beneficial ownership threshold (of not less than 80%) and to comply with the existing provisions of section 20AA of the IRO. Section 20AA(3) requires, inter alia, that the approved investment adviser must not have been an associate of the non-resident during the year of assessment and that the approved investment adviser must have been acting for the non-resident person in an independent capacity.

In a submission to the Financial Services Branch of the Financial Services and the Treasury Bureau, dated 25 February 2004, the HKSA points out that the legislation as drafted may not extend to a number of offshore funds that have investment advisory operations through an associate in Hong Kong. In addition, the non-resident threshold test requires identification of the ultimate beneficial owners of companies, partnerships or trusts, involved in the investment structure of a relevant fund. This could prove very onerous or impracticable in the case of a large multi-national listed group, for example, which, under the proposed legislation, would be required to trace the beneficial owners of its holding company.

Among the suggestions contained in the HKSA's submission, which may be accessed at: http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/offshore_funds.pdf, are the following:

- Remove the section 20AA "associate" and "independence" tests in the application of section 20AB, and rely primarily on the non-resident test. In some other fund management centres (e.g. Singapore) satisfying a non-residency threshold is sufficient in itself for an offshore fund to qualify for exemption. The fact that the broker or approved investment adviser are associated entities or may not be acting in an independent capacity should not affect the application of the exemption. The general anti-avoidance provisions of section 61A could instead be used to prevent "round-tripping" of local funds from taking advantage of the tax exemption, which is the principal tax mischief that the anti-avoidance provisions in section 20AB are designed to prevent.
- Review the proposed 80:20 criterion in respect of non-resident ownership of an offshore fund.
- Review the basis of the resident/non-resident test in the light of the fact that traditional concepts of residency may not be relevant to Hong Kong, given that the liability to tax depends primarily upon whether or not an entity is considered to be "carrying on business in Hong Kong".
- Simplify the requirement to look thorough the corporate structure to ascertain the ultimate individual beneficial ownership of listed and publicly-owned companies.
- Rather than linking a new exemption provision to the conditions under section 20AA of the IRO, consideration should be given to providing for the proposed profits tax exemption under section 26 of the IRO, which applies to instances where certain profits are excluded from profits tax.

Innovation & Technology

22.

Anti-Fraud Symposium Now Available Online Under HKSA E-seminar

The HKSA Anti-Fraud Symposium held on 25 October 2003 featuring the then Commissioner of Police, Mr. Tsang Yam-pui as the keynote speaker, is now available online under the e-seminar. Subscriptions to

view this 3 hours event remain unchanged at \$200 for HKSA members for unlimited viewing over a six-month period.

The seminar can be viewed at: <http://www.hksa.org.hk/e-learning/index.php> .

23. IFAC Guidance On Controlling Computers In Business For SMPs And SMEs

Since April 2003, the International Federation of Accountants (IFAC) has produced in association with an international accounting firm a series of five guidance notes on computing controls for small and medium-sized practitioners/enterprises on the following topics:

- Backup, Archive and Restore
- Physical Security
- Logical Access Security
- Selection, Implementation and Testing of Packaged Software
- Computer Disaster Recovery Planning

The documents are available for free download at the IFAC's website at: <http://www.ifac.org> under "Bookstore Section - Small and Medium Practices" Category. Printed copies are also available for order online at US\$25 per copy.

[CEPA]

24. Government Issues Updated CEPA Leaflets

- (i) The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) came fully into effect on 1 January 2004. The Trade and Industry Department ("TID") advises that it has recently updated the leaflet setting out the implementation details. The leaflet may be accessed at the TID's website at: <http://www.tid.gov.hk/english/cepa/leaflets.html> . A limited number of printed copies may be obtained at the HKSA reception counter.
- (ii) In order to help Hong Kong enterprises grasp and fully utilise the business opportunities arising from CEPA, the Hong Kong Economic and Trade Office in Guangdong ("GDETO") has recently produced a leaflet, which lists out the websites containing information on the implementation measures relating to CEPA introduced in Hong Kong, Guangdong Province and the nine cities in the Pearl River Delta as well as the contact details of the relevant authorities. The leaflet may be accessed at the GDETO's website at:
http://www.gdeto.gov.hk/eng/new/docs/GD_PRD_CEPA_websites_TPD_4.doc .

Comment Key Dates

<u>Date</u>	<u>Subject</u>
19 March 2004	HKEx exposure paper on the draft Code on Corporate Governance Practices and Corporate Governance Report. The exposure paper can be accessed on the HKEx's website at: http://www.hkex.com.hk/library/listpaper/edc-e.pdf . [HKEx deadline: 31 March 2004]
31 March 2004	FASC Invitation to Comment on IASB Exposure Draft: ED 6 <i>Exploration for and Evaluation of Mineral Resources</i> , which has been posted on the IASB's website at: http://www.iasb.org.uk . The ED is accompanied by the IASB's Basis for Conclusions. The Hong Kong Invitation to Comment has been posted on the HKSA's website at: http://www.hksa.org.hk/professionaltechnical/accounting/exposedraft/ . [IASB deadline: 16 April 2004]
30 April 2004	FASC Exposure Draft of a Proposed SSAP <i>Accounting and Reporting by Retirement Benefit Plans</i> . The Invitation to Comment has been posted on the HKSA's website at: http://www.hksa.org.hk/professionaltechnical/accounting/exposedraft/ .
Please send comments to commentletters@hksa.org.hk .	

TechWatch is prepared by the HKSA Standards & Technical Department and intended for general guidance only. Professional advice should be taken before applying the content of this publication to your particular circumstances. While the HKSA endeavours to ensure that the information in this publication is correct, no responsibility for loss to any person acting or refraining from action as a result of using any such information can be accepted by the HKSA.

The Technical Directors of the HKSA Standards & Technical Department are:

Stephen Chan, Technical Director (Ethics & Assurance) & Head of Department Coordination

Simon Riley, Technical Director (Financial Reporting)

Peter Tisman, Technical Director (Business Members & Specialist Practices)

Gary Wong, Project Director (Innovation & Technology)

Further information on the HKSA Standards & Technical Department is available at:

<http://www.hksa.org.hk/professionaltechnical/> .

Hong Kong Society of Accountants

4th Floor, Tower Two, Lippo Centre, 89 Queensway, Hong Kong

Tel: (852)2287 7228 Fax: (852)2865 6776

E-mail: hksa@hksa.org.hk

Website: <http://www.hksa.org.hk>

Comments may be submitted to HKSA by email to:

commentletters@hksa.org.hk

Appendices

(i) AASC Meeting Summary – November 2003

The HKSA Auditing and Assurance Standards Committee (Committee) met on 18 November 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, Lucia Li, Man Mo Leung, Phyllis Mo and Paul F. Winkelmann.

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

The following agenda items were discussed:

1. Adoption of the IAASB new Audit Risk Standards and conforming changes to ISA 200 “Objective and General Principles Governing an Audit of Financial Statements”
2. Adoption of International Auditing Practice Statement 1014 “Reporting by Auditors on Compliance with International Financial Reporting Standards”
3. PN 840 “The audit of solicitors’ accounts under the Solicitors’ Accounts Rules and the Accountant’s Report Rules” – proposed amendment to paragraph 19(b)
4. Proposed PN 820 “The audit of licensed corporations and associated entities of intermediaries”
5. Working Group on Mainland audit issues
6. Joint Working Group on “Auditor resignation”

1. Adoption of the IAASB new Audit Risk Standards and conforming changes to ISA 200 “Objective and General Principles Governing an Audit of Financial Statements”

The Committee considered the new and revised Audit Risk ISAs and conforming changes to ISA 200 issued by the IAASB and endorsed their adoption verbatim as new and revised SASs in Hong Kong as part of the HKSA International Standards Convergence Programme:

- new SAS 315 “Understanding the entity and its environment and assessing the risks of material misstatement”;
- new SAS 330 “The auditor’s procedures in response to assessed risks”;
- new SAS 500 “Audit evidence”; and
- revised SAS 100 “Objectives and general principles governing an audit of financial statements”.

2. Adoption of International Auditing Practice Statement 1014 “Reporting by Auditors on Compliance with International Financial Reporting Standards”

The Committee considered the adoption of IAPS 1014 in Hong Kong as part of the HKSA International Standards Convergence Programme and agreed that it should be issued as an Exposure Draft for a consultation period of two months.

[The HKSA Exposure Draft is available on-line at:

http://www.hksa.org.hk/professionaltechnical/assurance/exposuredraft/ed-pn1014_cover.pdf]

3. PN 840 “The audit of solicitors’ accounts under the Solicitors’ Accounts Rules and the Accountant’s Report Rules” – proposed amendment to paragraph 19(b)

The Committee considered that the proposed amendment should set out both the Law Society’s interpretations of the requirements of its Practice Direction J “Interest on Clients’ Account”

applicable prior to and after 13 August 2003 provided to the HKSA. The Committee requested the secretariat to present a further draft for the Committee's consideration at the next meeting.

4. Proposed PN 820 “The audit of licensed corporations and associated entities of intermediaries”

The Committee considered the revised proposed PN 820, which had been endorsed by the Expert Panel on Securities after taking into account the comments received on the Exposure Draft. Subject to a few minor drafting amendments, the Committee endorsed that the final proposed PN 820 be submitted to the Securities and Futures Commission (SFC) to see if it had any further comments, before its submission to Council for approval for issuance as a final statement.

[Post meeting note: The final proposed PN 820 was approved by Council at its February 2004 meeting.]

5. Working Group on Mainland audit issues

The Committee considered the draft Questions and Answers on “Recognition of sales in the Mainland” prepared by the Working Group for publication in The Hong Kong Accountant and proposed some editorial changes. The Working Group was requested to revise the draft Q&As to take into account the Committee's above comments and to note that a copy of the draft Q&As should be passed to the SFC for input before its publication.

[Post meeting note: The final Q&As were published in the January 2004 issue of The Hong Kong Accountant.]

6. Joint Working Group on “Auditor resignation”

The Committee noted that the HKSA had agreed to form a Working Group to consider the request from the SFC on what additional guidance can be provided by the HKSA on how much and what sort of information should resigning auditors provide to the market and to the incoming auditors.

Four members of the Committee volunteered to join the Working Group. Other members of the Working Group would be drawn from the Ethics Committee together with a lawyer member from the Professional Risk Management Committee.

[Post meeting note: The Working Group held two meetings in November 2003 and January 2004 respectively. On 18 February 2004, a meeting was held with the SFC/HKEx to exchange views on how HKSA Professional Ethics Statement 1.207 “Changes in a professional appointment” and the Listing Rules might be amended to enhance the disclosure of reasons for the resignation of auditors.]

Copyright 2004 The Hong Kong Society of Accountants. All rights reserved. Permission is granted to make copies of this Meeting Summary provided that such copies are for use in academic classrooms or for personal use and are not sold or disseminated, and provided further that each copy bears the following credit line: “Copyright by the Hong Kong Society of Accountants. All rights reserved. Used by permission”. Otherwise, written permission from the Hong Kong Society of Accountants is required to reproduce, store or transmit this document, except as permitted by law.

Meeting Summaries are 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.

(ii) **FASC Meeting Summary – January 2004**

The Society's Financial Accounting Standards Committee (Committee) met on 14 January 2004.

Present at the Committee's meeting were: Messrs. Paul F. Winkelmann (Chairman), Wilson Fung (Deputy Chairman), Nigel Reid (Deputy Chairman), Chan Lok Sang, Choy Chung-foo (represented by Mr. Vingle Yuen), Tommy Fung, Robert Gibson, Philip Hilliard, Quinn Y.K. Law, Tommy Tam, Stephen Taylor, Ms. Rebecca Chan, Ms. Susanna Lau, Mrs. Catherine Morley, Mr. Simon Riley (HKSA Technical Director, Financial Reporting) and Ms. Elsa Ho (HKSA Assistant Director, Financial Reporting).

The Chairman welcomed Mr. Wilson Fung, Ms. Rebecca Chan and Ms. Catherine Morley to the meeting as members of the Committee. The Committee expressed gratitude to the retiring members, Messrs. Roger Best, Carlson Tong, William Crowe and Woody Wu and Ms. Olivia Cheung for their support and contribution to the Committee.

The Committee discussed the following items:

- ✓ IASB Improvements Project
- ✓ Accounting and Reporting by Retirement Benefit Plans - proposed ED/SSAP 37 and replacement of Statement 2.302

IASB Improvements Project

The Committee considered draft revised accounting standards based on the following revised International Accounting Standards released recently by the IASB as part of its improvements project:

- ✓ IAS 2 *Inventories*
- ✓ IAS 10 *Events after the Balance Sheet Date*
- ✓ IAS 16 *Property, Plant and Equipment*
- ✓ IAS 21 *The Effects of Changes in Foreign Exchange Rates*
- ✓ IAS 24 *Related Party Disclosures*
- ✓ IAS 33 *Earnings Per Share*

The Committee agreed to the following:

- ✓ In respect of the revised IASB's Standards, so as to maintain convergence, comparable changes would be made to the Hong Kong accounting standards. An explanatory note will be developed identifying the changes made to the Hong Kong SSAPs as a result of the Improvements Project.
- ✓ The revised Hong Kong standards should be published within the next few months, will come into effect for periods beginning on or after 1 January 2005, will be re-named as "Hong Kong Accounting Standards" and the numbering will be aligned with the IASB's documents.
- ✓ For those SSAPs not revised as a result of the IASB's improvements, and for which significant differences remain, the Committee will issue in the forthcoming months an exposure draft proposing convergence with the IASB's Standards. Joint ventures, investment property and leases will be included in this ED.

Accounting and Reporting by Retirement Benefit Plans – proposed ED/SSAP 37 and replacement of Statement 2.302

The Committee considered a draft proposed ED/SSAP 37, which is converged with IAS 26 on accounting and reporting by retirement benefit plans. The Committee considered comments received from the HKSA

Expert Panel on Insurance and the Mandatory Provident Fund Schemes Authority and agreed to release the exposure draft for public comment.

Date of Next Meeting

The Committee will next meet on 11 February 2004.

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.

(iii) A Summary Of The SCCLR's Major Recommendations Arising From Phase II Of The Corporate Governance Review

Proposals relating to Different Aspects of Directorship

- Non-statutory guidelines stating the principles of law in relation to directors' duties should be adopted.
- The following proposals apply to all listed and unlisted public companies in Hong Kong, including companies registered under Part XI of the Companies Ordinance ("CO") save for oversea public companies not listed in Hong Kong or those with a secondary listing in Hong Kong:
 - A director should be required to abstain from voting at a board meeting on a transaction in which he has an interest, with exceptions for immaterial transactions.
 - For transactions or arrangements above a threshold value involving directors or persons connected with directors, the approval of disinterested shareholders voting on a poll should be obtained.
 - Requirements for disinterested shareholders' approval for connected party transactions should be extended to transactions between a company and an "associated company". The test of control through the exercise of a "dominant influence" should be adopted for the purpose of defining "associated companies".
- The following proposals apply to listed companies: -
 - The board should have a minimum of three independent non-executive directors (INEDs), and where nomination committees exist, they should take a more systematic approach to identifying suitable non-executive directors (NEDs).
 - The establishment of an audit committee should be made a mandatory requirement, and at least one INED on the audit committee should have some "financial expertise".
 - The Code of Best Practice (of the Listing Rules) should be amended to provide for the following:
 - (i) Strengthened board procedures, including e.g. the frequency of full board meetings and the provision of agenda and board papers to all directors.
 - (ii) The establishment of nomination and remuneration committees should be made a recommended best practice.
 - (iii) The disclosure of directors' other directorships, the system for deciding the remuneration of NEDs and the arrangements made to train directors, and in particular new NEDs, on both an initial and continuous basis.
- The Listing Rules and the CO should be amended to require listed companies to disclose full details of all elements of individual director's remuneration package. The CO should be amended to require unlisted public companies or private companies, if directed to do so by holders of not less than 5% of all the nominal issued share capital of the company, to disclose full details of all elements of individual directors' remuneration packages. There should also be specific disclosures on key aspects of a company's remuneration policy.

Proposals relating to Shareholders' Rights and Conflicts of Interests

- The following proposals apply to all listed and unlisted public companies in Hong Kong including companies registered under Part XI of the CO, except for oversea public companies not listed in Hong Kong or those with a secondary listing in Hong Kong:
 - Subject to certain exceptions (e.g. transactions entered into by liquidators) connected transactions should be disclosed and subject to a disinterested shareholders' vote conducted by poll.
 - The definition of a connected person in relation to controlling shareholders should include the controlling shareholder's children or step-children, his spouse; the trustee of any trusts in which the controlling shareholder, his spouse, children or step children are beneficiaries under the trust, and any corporation associated with the controlling shareholder.
 - The court's power to determine whether or not a transaction constitutes a waste of corporate assets should be preserved.
 - Failure to comply with the connected transaction requirements should render the transaction voidable at the instance of the company or any shareholder.
- "Controlling shareholder" should be defined, for the purpose of connected transactions, using the same criterion as that under the Listing Rules for "substantial shareholder", i.e. a person controlling 10% or more of the voting power at any general meeting of the company.
- The following proposals are in relation to enhancing the effectiveness and transparency of company general meetings:
 - A Hong Kong company should be permitted to hold a general meeting at more than one location. The meeting should take place at the venue specified in the notice of the meeting, which would be regarded as the principal venue, and subsidiary or satellite venues should be allowed. Both visual and audio real-time communications should be permitted by legislation.
 - The timing of the Annual General Meeting should be changed to within a certain period after the end of each financial year of the company. For private companies with a share capital and companies limited by guarantee, the period should be nine months, and for other public companies the period should be six months.
 - Notices should be given personally or sent by post to shareholders unless the shareholders agree to adopt electronic means of communication, including the use of personal identification numbers.
 - There should be a requirement of minimum information to be given in the meeting notices regarding the proposed resolutions.
 - Absentee voting and electronic voting should be permitted and there should be rules and guidance for such voting procedures.
 - The empowerment of proxies should be reformed.

Proposals relating to Corporate Reporting, focusing mainly on External Auditors

- The CO should be amended to remove the requirements for the shareholders to fix the auditors' remuneration or determine the manner in which it is to be fixed.
- To improve auditors' access to information, the present requirement for directors and officers of the company to provide such information and explanations as the auditors think necessary should be extended to include employees.
- 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.
- A retired partner of the firm auditing the company's accounts should be prohibited absolutely from acting as the chairman of an audit committee, but such a partner should be allowed to act as a member of an audit committee subject to a cooling-off period of 3 years.

Proposals relating to Corporate Regulation

- Statutory backing should be given to the relevant Listing Rules together with tougher statutory sanctions including fines against non-compliance.
- Regulation of unlisted companies should be improved by enhancing the Companies Registry's capability as a corporate regulator on an incremental basis.

(iv) **A Summary Of The Changes To Main Board Listing Rules Based On The Consultation Conclusions Relating To Initial Listing Criteria And Continuing Listing Obligations**

(a) **Introduction of alternative financial standards to profit requirement**

While the current profit requirement has been maintained as one of the quantitative tests for assessing the track record financial performance of a listing applicant, the Main Board Listing Rules have been revised to introduce two alternative financial tests to provide more flexibility and cater for the wide variety of companies seeking to list on the Main Board.

(i) *Market capitalisation / revenue test:*

Criteria include:

- a market capitalisation of at least HK\$4 billion at the time of listing;
- revenue of at least HK\$500 million for the most recent financial year comprising 12 months; and
- a demonstrable ability to command significant investor interest (having at least 1,000 shareholders at the time of listing).

(ii) *Market capitalisation / revenue / cash flow test:*

Criteria include:

- a market capitalisation of at least HK\$2 billion at the time of listing;
- revenue of at least HK\$500 million for the most recent financial year comprising 12 months;
- a positive cash flow from operating activities that are to be listed of at least HK\$100 million in aggregate for the 3 preceding financial years; and
- compliance with the trading record period requirement of not less than 3 financial years.

(b) **Waiver of the 3-financial-year trading record requirement for certain listing applicants**

Listing applicants that propose to list under the market capitalisation / revenue test will be granted a waiver of the full 3-financial-year trading record requirement if the Stock Exchange is satisfied that such listing applicants are able to demonstrate, among other things, that:

- their management has sufficient and satisfactory experience of at least 3 years in the line of the business and industry of the listing applicants; and
- they have a minimum of 1,000 shareholders at the time of listing.

(c) **Increase of the minimum expected market capitalisation at the time of listing**

An increase in the initial minimum expected market capitalisation to HK\$200 million.

(d) **Determination of market capitalisation**

The term “market capitalisation” has been defined to refer to the entire size of a listing applicant, which would include both the class of shares to be listed on the Stock Exchange and other class(es), if any, that are either unlisted or listed on other regulated markets of a listing applicant at the time of listing. The extrapolated share offer price of the securities to be listed will be used as the basis for determining the market value of the other class(es) of securities that are unlisted, or listed on other regulated markets.

(e) Increase in the minimum number of shareholders at the time of listing

The minimum number of shareholders required of issuers at the time of listing has been increased to 300. For listing applicants to be listed under the market capitalisation / revenue test, the required minimum number of shareholders has been raised to 1000.

(f) Suspension on failure to publish financial information on time

For the protection of investors and to promote a higher standard of financial reporting, the trading of securities of issuers that fail to publish their financial results on the due date will be immediately suspended.

The English version of the revised Listing Rules can be accessed on the HKEx's website at:

http://www.hkex.com.hk/rulereg/listrules/mb_ruleupdate.htm .