



# STANDARDS & TECHNICAL

## NEWS AT A GLANCE

TechWatch is a publication designed to alert members to topics and issues that impact on CPAs and their working environment. We welcome your comments and feedback. Comments and suggestions on TechWatch should be addressed to Stephen Chan, Executive Director by [email](#).

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### [Previous issues of TechWatch](#)

## **CPD & Events**

### **1. Upcoming professional development activities for May/June 2005**

Mark your diary with the following training events:

#### **Hot topics presented by experienced professionals**

- Annual Taxation Update Conference (28 May)
- The New PRC Enterprise Bankruptcy Law (26 May)
- Trust Management and Administration (9 June)
- How Effective Resource Management Affects the Competitive Advantage of Enterprises (16 June)
- Recent Development in Group Accounting (18 June)

Please click for [more programmes](#) and to [register](#).

#### **Meet the technical directors at the Technical Update Evenings (TUE)**

- New Audit Risk Standards Introduce Risk-Based Audit Approach (30 May)
- New Quality Control Standards for Auditors (14 June)

Click [here](#) for details and register.

#### **Executive Programme for Accountants – Information Technology Risk Management (commencing 21 May 2005)**

Designed for accountants and controllers who wish to obtain a structured knowledge of risk management under the IT environment, and to be able to scrutinize the business model of an IT project proposal, this programme will give you the success ingredient to manage the risk of IT related processes and deliverables during your day-to-day work. Click [here](#) to view how the past graduates of this course present their IT proposals. The 5<sup>th</sup> intake will commence on 21 May 2005. Click [here](#) for the programme details and enrolment information.

#### **Training Programme for Audit Seniors (commencing 27 May 2005)**

Designed for member practices who wish to provide structured audit training to their professional staff. Click [here](#) for the programme details and enrolment information.

#### **Open Forum on CEPA (9 May 2005)**

Come to this forum to find out the opportunities and challenges facing practitioners under CEPA and the key issues concerning “Practise in the Mainland”, “Mutual Recognition of Professional Qualification” and “Residency Requirements”. Click [here](#) to enroll.

## **Professional Liability Reform**

### **2. Institute Issues A Comprehensive Paper Calling For Professional Liability Reform in Hong Kong**

The Institute released on 14 March 2005 a [Comprehensive Paper](#) “A Case for Professional Liability in Hong Kong” in support of the Institute’s urgent call for professional liability reform to safeguard Hong Kong’s position as a global financial centre.

The Paper explains why the Institute's three liability reform proposals are necessary to ensure a level playing field with other major capital markets:

1. Introduction of Proportionate Liability in Hong Kong
2. Repeal of section 165 of the Companies Ordinance which prohibits auditors from contractually limiting liability with clients in respect of audit work
3. Introduction of Limited Liability Partnerships in Hong Kong

In summary, the Institute adamantly believes that Hong Kong's liability framework has not evolved in step with developments in the economic, financial and litigious environment in which its members are currently practising and is no longer appropriate to the nature of work performed by professionals in Hong Kong. The imperatives which have driven the need for change are:

- Hong Kong has transformed itself over the last ten years from a local financial centre to a global financial centre.
- Globalisation results in the need for an appropriate liability framework for the business and other risks arising from cross border transactions.
- The increased internationalisation of commerce has resulted in the development of an increasingly litigious environment while Hong Kong does not provide the legal protections available in other similar jurisdictions.
- Hong Kong is the focus of fund raising for Mainland enterprises, creating an increase in the volume and scale of assurance work whilst the liability framework remains unchanged.
- Adequate insurance cover is becoming increasingly scarce and the collapse of one or more of the major accounting firms, which Enron/Andersen graphically demonstrated can happen, would have an extremely damaging effect on everyone with an interest in a healthy financial market.
- Most sophisticated jurisdictions have or are introducing liability reforms. If Hong Kong is left behind, Hong Kong will be less attractive to talented individuals which will inevitably reduce its competitiveness as a global financial centre.
- Uncertainties regarding the future of the profession will make recruitment and retention of the best people more difficult.

In conjunction with the profession's LegCo representative, the Hon. Mandy Tam who fully supports the Institute's initiative, the Institute hosted a [media briefing](#) on 31 March 2005 before meeting with the LegCo Panel on Administration of Justice and Legal Services to present our views on professional liability reform. The briefing resulted in a dozen reports in the press and on-line media the following day, with the Institute's position stated very clearly.

### **Members' Handbook**

### **3. Update No. 12 Issued**

[Update No. 12](#) was issued in March 2005 enclosing:

## Financial Reporting Standards – Volume II

- A minor revision to HKAS-Int 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*
- New Interpretation 24 *Revenue – Pre-completion Contracts for the Sale of Development Properties*

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

### **Financial Reporting**

#### 4. **Institute Issues Interpretation 24 Revenue – Pre-completion Contracts For The Sale Of Development Properties**

**Interpretation 24** concludes that pre-completion contracts for the sale of development properties (“pre-completion contracts”) do not meet the definition of construction contracts if the contracts in question are not specifically negotiated for the construction of the properties. Accordingly, the stage of completion method shall not be used to recognise revenue arising from such contracts. Property developers shall apply HKAS 18 or SSAP 18 *Revenue* in recognising revenue arising from pre-completion contracts and recognise revenue only when all of the criteria specified in those Standards for the sale of goods are met.

Interpretation 24 becomes effective for pre-completion contracts entered into on or after 1 January 2005 with earlier application encouraged. For pre-completion contracts entered into before 1 January 2005, an entity should either apply this Interpretation or continue to account for those contracts using the existing method of accounting.

#### 5. **Institute Withdraws Proposed Guidance On The Accounting Of A Deemed Disposal**

This proposed Guidance was originally intended to give guidance on the accounting for a deemed disposal following the withdrawal of AB 4 *Deemed Acquisitions and Disposals*. In particular, it contained a proposed requirement to account for the gain or loss arising from a deemed disposal in equity. However, comments received on the ED raised concerns that issuing this proposed Guidance would result in the Institute moving ahead of the International Accounting Standards Board (IASB) on some fundamental issues regarding the basis on which consolidated accounts are prepared, in particular, the accounting for the transactions with minority interests.

In the light of the above and the fact that the accounting for a deemed disposal is an issue to be addressed in Phase II of the IASB Business Combinations project, the Institute decided not to proceed further with this proposed Guidance and agreed to withdraw the ED and wait for the outcome of the IASB’s project.

#### 6. **Institute Amends The Effective Dates Of HKAS-Int 21 And The Option In Paragraphs 93A-93D Of HKAS 19 Amendment**

- (a) HKAS-Int 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*

The Institute has amended the effective date of **HKAS-Int 21** from “1 January 2005” to “accounting periods beginning on or after 1 January 2005”.

- (b) The option in paragraphs 93A-93D of HKAS 19 Amendment

The Institute has amended the effective date of the option set out in paragraphs 93A to 93D of the **Amendment to HKAS 19** which was issued in February 2005. The changes would allow entities to use the option for annual periods ending on or after 16 December 2004 if an entity decides to early adopt HKAS 19 for a period beginning before 1 January 2005.

## 7. Institute Invites Comments On

- (a) **Draft Interpretation 25 Leases – Determination Of The Length Of Lease Term In Respect Of Hong Kong Land Leases**

The **Exposure Draft** proposes to address the issue of how the length of the lease term of a Hong Kong land lease should be determined for the purpose of applying the amortisation (depreciation) requirements under HKAS 16 *Property, Plant and Equipment* and HKAS 17 *Leases*, as appropriate. It proposes that lease term of a Hong Kong land lease should be determined by reference to the legal form and status of the lease. Renewal of a lease term is assumed only when the lessee has a renewal option and it is reasonably certain at the inception of the lease that the lessee will exercise the option. Options for extending the lease term that are not at the discretion of the lessee shall not be taken into account by the lessee in determining the lease term. Consultation expired on 22 April 2005.

- (b) **Proposed Accounting Guideline On Merger Accounting**

The **Exposure Draft** sets out the proposed basic principles and procedures of merger accounting and will result in the withdrawal of SSAP 27 *Accounting for Group Reconstructions* upon its finalisation. Comments are requested by **31 May 2005**.

- (c) **IFRIC Draft Interpretations**

- (i) **Accounting for Service Concession Arrangements**

The Institute has issued an **Invitation to Comment** on the IFRIC Draft Interpretations: D12 *Service Concession Arrangements – Determining the Accounting Model*; D13 *Service Concession Arrangements – the Financial Asset Model*; and D14 *Service Concession Arrangements – the Intangible Asset Model*. Consultation expired on 18 April 2005.

These Draft Interpretations have been developed by the IFRIC in response to requests for guidance on how International Financial Reporting Standards (IFRSs) apply to service concession arrangements. Service concession arrangements are arrangements whereby a government or other body grants contracts for the supply of public services, e.g., roads, energy distribution, prisons or hospitals, to private operators. These Draft Interpretations will not amend existing IFRSs. Instead, they will clarify how concession operators should apply existing IFRSs to account for the obligations they undertake and rights they receive in service concession arrangements.

- (ii) **Reassessment of Embedded Derivatives**

The Institute has issued an **Invitation to Comment** on the IFRIC Draft Interpretation: D15 *Reassessment of Embedded Derivatives*. Comments are requested by **17 May 2005**.

This Draft Interpretation proposes to address the issue of when an entity or a first time adopter of IFRSs should assess whether any embedded derivatives contained in a contract are required to be separated from the host contract and accounted for as derivatives under IAS 39 *Financial Instruments: Recognition and Measurement*.

## 8. **FRSC Meeting Summaries – 16 February And 9 March 2005**

The **FRSC meeting summary** of 16 February 2005 covers:

- Terms of Reference – Financial Reporting Standards Committee and Financial Reporting Interpretations Sub-Committee
- Exposure Draft of SME Financial Reporting Framework and Financial Reporting Standard
- Length of Lease Term in respect of Hong Kong Land Leases
- Meeting with Hong Kong Institute of Surveyors
- Adoption of Amendment to IAS 39 *Transitional and Initial Recognition of Financial Assets and Financial Liabilities*
- Guidance to replace SSAP 27 *Accounting for Group Reconstructions*
- Inconsistency between Deferred Tax on Revaluation Surpluses and Deficits on Freehold Investment Properties and Long-term Leasehold Properties
- Annual Accounting Update 2005
- Submission to LegCo re Proposed Legislative Changes to the Definition of Subsidiary

The **FRSC meeting summary** of 9 March 2005 covers:

- Draft Interpretation 25 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*
- Proposed Accounting Guideline on Merger Accounting
- Proposed Guidance on the Accounting for a Deemed Disposal
- Draft Interpretation 24 *Revenue – Pre-completion Contracts for the Sale of Development Properties*
- Feedback on the issues raised in connection with the HKASs issued as a result of the convergence project
- Draft Operations Report of the Professional Standards Monitoring Committee’s Review of Financial Statements in 2004
- Revised Terms of Reference – Financial Reporting Standards Committee and Financial Reporting Interpretations Sub-Committee
- Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules
- Annual Accounting Update
- Enquiries raised by a member

### **Audit & Assurance**

## 9. **Institute Invites Comments On IAASB Exposure Drafts of Revised ISAs on Group Audits And Communications**

The Institute has issued an **Invitation to Comment** on the IAASB Exposure Drafts of:

- (1) Proposed revised ISA 600 “The Audit of Group Financial Statements”; and
- (2) Proposed revised ISA 260 “The Auditor’s Communication with Those Charged With Governance”.

The ED of proposed revised ISA 600 contains standards and guidance on the audit of group financial statements. Following comments received on an earlier exposure draft, and in the interest of uniform and high quality standards, the IAASB has modified the original proposals that were previously exposed.

The ED of proposed revised ISA 260 includes new guidance dealing with the communication process in recognition of its importance in audit effectiveness and sets out a framework for communication with those charged with governance.

Comments are requested by **30 June 2005**.

#### 10. **AASC Meeting Summary – 11 January 2005**

The **AASC meeting summary** of 11 January 2005 covers:

- Proposed Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services
- ISA 700 (Revised) “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” and the new ISA 701 “Modifications to Independent Auditor’s Report”
- Draft sample audit report on SME-Financial Reporting Standard financial statements
- Annual Auditing Update Conference
- Disclosure in 2004 Financial Statements of impact of new HKFRSs

#### **Ethics**

#### 11. **Proposed Professional Ethics Statement To Seek Improvement In Information Made Available In Audit Resignation Letters**

The Institute is finalizing the proposed **Professional Ethics Statement 1.207A** “Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong” which will establish a framework to enhance communication by auditors with a listed issuer where there is a change of auditors.

The key aspects of the framework are:

- It requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.
- The circumstances to be disclosed in the letter of resignation or termination are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.
- Occurrences that affect the relationship between the listed issuer and the outgoing auditors include, but not limited to, disagreements and unresolved issues as defined in the proposed Statement.
- As the listed issuer is required to make an announcement pursuant to the Listing Rules setting out the reasons for the change of auditors, the outgoing auditors should read and assess whether the circumstances as reported in their letter of resignation or termination, which in their opinion, need to be brought to the attention of the shareholders, are reflected in the announcement made by the listed issuer. If not, what further actions should be taken by the outgoing auditors.

## **Corporate Finance**

### **12. Institute Comments On The Review Of The Disclosure Of Interests Regime Of The SFO**

As reported in [TechWatch No. 31](#), the Securities and Futures Commission (SFC) published a [Consultation Paper](#) to seek comments on proposals to address market concerns identified by the SFC in the course of the review of Part XV of the Securities and Futures Ordinance (SFO), and on proposals to make the SFO more user-friendly.

The Institute made a [submission](#) on the proposal for the disclosure of pledges of shares made by substantial shareholders and lenders.

The Institute submitted that, from the perspective of good governance, and for the sake of promoting market transparency, a disclosure should be made by the pledgor at the time the shares were pledged. It was believed that disclosure would put investors and shareholders on notice of the possibility of a future change of control and thus it would serve as a statement of “caveat emptor”.

The Institute believed that the rationale for requiring disclosure was primarily that a forced sale, were it to occur, could result in a sudden change in control and/or possibly a significant drop in the share price. The threshold for disclosure should be set at a level that would be meaningful in this context. It suggested, therefore, that a reasonable option would be to require controlling shareholder(s) to make a disclosure at the time that they pledged 5% or more of the issued share capital of the listed company.

The Institute also submitted that the proposal for the lender to have to inform the Stock Exchange and the listed company “forthwith” (as opposed to the current requirement of within 3 business days) that its power of sale of pledged shares has become exercisable and that it has offered the shares or part of the shares for sale in the market, would not be practicable or meaningful.

### **13. Institute Comments On Legislative Proposals To Enhance The Regulation Of Listing**

As reported in [TechWatch No. 31](#), the Financial Services and the Treasury Bureau released a [Consultation Paper](#) to seek comments on enabling provisions to be added into the Securities and Futures Ordinance in order to give statutory backing to major listing requirements and to provide for their enforcement.

The Institute supports in its [submission](#) the principle of giving statutory backing to the more important listing requirements by codifying the requirements in the statute. The Institute submitted that, in broad terms, the proposed areas to be codified in the statute were those of most concern to minority shareholders and that affected the public interest. However, there was some concern among corporate finance practitioners as regards making the disclosure of price-sensitive information a statutory obligation. They considered that decisions as to whether certain information would be regarded as price-sensitive, at any particular time, would often involve a significant degree of subjectivity and it would put listed company directors and corporate finance practitioners in an invidious position if a judgment made in good faith were, potentially, to render them liable to severe, possibly even criminal, sanction.

In addition, the Institute expressed serious reservations about the practical implementation and the enforcement structure for the statutory listing requirements. The proposals left a number of important questions unanswered and pointed to potential problems with the operational arrangements.

As regards the proposal to introduce civil fines on issuers and directors/officers for breaches of the statutory listing requirements, the Institute was, in general, supportive of it. The institute also had no objection to empowering both the SFC and the Market Misconduct Tribunal to impose civil fines, given that there would be a provision in law to prevent “double jeopardy”.

Given the various doubts about issues of implementation, the Institute expressed concern about whether criminal sanctions should be introduced for breaches of the statutory listing requirements from the outset. The submission suggested that consideration should be given to deferring the introduction of criminal sanctions, at least until the requirements had been in place and operating for a period, so that any significant problems of interpretation and enforcement could be ironed out first.

#### 14. **Institute Comments On HKEx’s Proposed New Structure For Listing Decision-making**

As reported in [TechWatch No. 31](#), Hong Kong Exchanges and Clearing Limited (HKEx) published a [Consultation Paper](#) on a new structure for listing decision-making. The paper sets out proposals developed by the Listing Division of the HKEx, in consultation with the SFC, with the aim of putting in place a clearer and more efficient administrative framework for decision making in listing matters, such as listing applications and suspected breaches of the Listing Rules.

In particular, under the proposals, the existing committee structure, comprising the Listing Committee, GEM Listing Committee, Listing (Review) Committee and Listing Appeals Committee would be replaced by:

- Listing Policy Committee;
- Listing Decisions Panel;
- Listing Review Panel;
- Adjudicator; and
- Disciplinary Review Panel

The Institute expressed support, in principle, in its [submission](#) for the proposed structure, subject to some specific comments.

### **Banking**

#### 15. **Banking (Amendment) Bill 2005 On Capital Adequacy Framework**

The [Banking \(Amendment\) Bill](#) (“the Bill”) was gazetted on 4 March 2005. The main purpose of the Bill is to amend the Banking Ordinance (“the Ordinance”) to provide for the implementation of the revised international capital adequacy framework promulgated by the Basel Committee on Banking Supervision in June 2004, commonly known as “Basel II”, in Hong Kong. In particular, the Bill proposes that locally incorporated authorized institutions’ capital adequacy ratio (CAR) shall be calculated, and information on financial affairs including CAR shall be disclosed, in a manner according to rules prescribed by the Hong Kong Monetary Authority (HKMA) under the Ordinance. Such rules will be developed based on the requirements of Basel II and will have the status of subsidiary legislation and hence will be subject to negative vetting by the Legislative Council. The [press release](#) issued by the HKMA on the Bill is available at the HKMA’s website.

The Institute’s Expert Panel on Banking has reviewed the draft Bill and did not have any comments thereon.

## 16. HKMA's Guidance On The Impact Of New Hong Kong Accounting Standards On Authorized Institutions' Capital Base And Regulatory Reporting

The HKMA has issued **guidance** on the impact of new Hong Kong Accounting Standards on authorized institutions' (AIs) capital base and regulatory reporting after consultation with the banking industry associations and the Institute's Expert Panel on Banking.

The guidance covers the following areas:

- Interest recognition on impaired loans
- Provisioning
- Available-for sale instruments
- Cash flow hedges
- Consolidation of special purpose entities
- Land and interest in land
- Fair valuation of own credit risk
- Classification of revenue from new categories of assets and liabilities.

The HKMA will make changes to the completion instructions of banking returns to provide AIs with appropriate guidance in regulatory reporting. The changes to regulatory reporting should be made to banking returns submitted to the HKMA from June 2005. The changes will affect locally incorporated AIs and overseas-incorporated AIs whose head offices have chosen to adopt comparable standards from 2005 only.

### Corporate Restructuring & Insolvency

## 17. Institute Makes Further Submissions On The Bankruptcy (Amendment) Bill 2004

As reported in **TechWatch No. 30**, the Institute made a submission to the Bills Committee on the Bankruptcy (Amendment) Bill 2004 ("the bill") in December 2004. The submission indicated that while, in principle, the Institute supported the contracting out of bankruptcy cases to suitably qualified private sector insolvency practitioners, there needed to be an adequate framework and procedure, and the availability of sufficient financial resources, to ensure that persons with the requisite skills and experience were in a position to, and were encouraged to, take up the office of trustee in bankruptcy.

The Institute's Insolvency Practitioners' Committee (IPC) noted that the Administration had not fully addressed a number of the points previously raised by the Institute. Consequently, a further **submission** was issued to reiterate the Institute's concerns regarding, e.g. the availability of sufficient funds for suitably qualified private sector practitioners acting as trustees to be remunerated at reasonable level for work properly undertaken; the priority of trustee's remuneration; the duties of a trustee, and various other issues.

As a follow-up to the discussion by the Bills Committee, the Administration consulted the Institute and other relevant stakeholders on a proposal to set out in the legislation the minimum qualification criteria for appointment of private sector insolvency practitioners ("IPs") as provisional trustees for outsourced summary bankruptcy cases. In its **response** the Institute suggested that express minimum qualifications for IPs were required to enhance transparency and to ensure that professionals with appropriate expertise were appointed to act as (provisional) trustees. However, the Institute believed that, in line with the outsourcing arrangements for summary liquidation cases and other outsourcing conducted by the Official Receiver's Office ("ORO"), it would be sufficient, for the time being, for the minimum qualification requirements to

be contained in the tender terms, i.e., to be contractual in nature, rather than statutory requirements.

However, it appears that the Bills Committee is still considering the possibility of prescribing certain basic qualification criteria in the subsidiary legislation under the Bankruptcy Ordinance, in order to ensure the quality of services of IPs and enhance the transparency of the outsourcing scheme. Members will be informed of further developments.

**For Information**

**18. Government Publishes Updated List Of Terrorists And Terrorist Associates**

A notice was published in the **Government Gazette** on 24 March 2005 specifying, under section 4 of the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575), the updated list of terrorists and terrorist associates as designated by the United Nations Security Council Committee, as of 17 February 2005.

**19. Updates From The Land Registry**

The Land Registry recently issued the following information pamphlets:

1. **A Guide to Services Under the Integrated Registration Information System**
2. **Understanding the Computerised Land Register**
3. **Guidance Notes for Persons Applying for the Incorporation of an Owners' Corporation at the Land Registry**

**Comment Due Dates**

DATE	SUBJECT
17 May 2005	<b>Invitation to Comment</b> on IFRIC Draft Interpretation: D15 <i>Reassessment of Embedded Derivatives</i>
31 May 2005	<b>Invitation to Comment</b> on <i>Proposed Accounting Guideline on Merger Accounting</i>
30 June 2005	<b>Invitation to Comment</b> on IAASB EDs of Proposed ISA 600 (Revised) "The Audit of Group Financial Statements" and Proposed ISA 260 (Revised) "The Auditor's Communication with Those Charged with Governance"
<b>Please send comments to <a href="mailto:commentletters@hki CPA.org.hk">commentletters@hki CPA.org.hk</a></b>	