

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

Spotlight

1. Institute Issues Handbook Update No. 16

Update No. 16 was issued in July 2005 enclosing:

Financial Reporting Standards – Volume II

- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions*
- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*
- Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKFRS 6 *Exploration for and Evaluation of Mineral Resources*

Auditing and Assurance Standards – Volume III

- PN 720 “Acting as Scrutineer at a General Meeting of a Listed Issuer”

In addition, the following statements have been withdrawn:

- HKFRS-Int 3 *Emission Rights*
- Accounting Guideline 3 *Accounts of Dealers in Securities*

Further details are set out in the “Financial Reporting” and “Audit & Assurance” sections below.

2. Institute Issues Communication Paper On The Revised Practice Review Programme And Practice Review Questionnaire

Council issued a **Communication Paper** providing details on the progress of the revised practice review programme, which will adopt a risk-based approach. The Communication Paper also seeks comments on the proposed practice review self-assessment Questionnaire.

The Communication Paper outlines the principles and considerations of practice review, for example, the basis for selecting CPA firms for practice review. To keep members and other stakeholders informed, another Communication Paper will be issued later this year after the substantial completion of the development of the revised practice review programme.

3. Institute Issues Report Of Findings On Review Of Auditors

The Practice Review Committee (PRC) issued an **Operations Report** on its review of 53 auditors involving 272 files in 2004. The general findings reveal that there is generally a problem of inadequate audit documentation.

As part of the Institute’s self-regulatory function, the Council has tasked the PRC to review whether auditors observe, maintain or apply professional standards in their audit and assurance work under the practice review programme since 1992.

CPD & Events

4. Professional Development Activities For August To December 2005

Enrol early to secure a seat in the following popular training activities, as several of the seminars and workshops listed below are already full:

➤ **HKFRS/IFRS Training**

- A Closer Look on HKAS 21 – The Effects of Changes in Foreign Exchange Rates (8 August)
- Issues in Applying HKFRS 5 and HKAS 27, 28 and 31 (9 August) **FULL**
- Issues in Applying HKAS 16, 17 and 40 (Re-run) (19 August) **FULL**
- HKAS 19 Employee Benefits & HKFRS 2 Share-based Payment (Relating to Employee Benefits) (27 August) **FULL**
- Issues in Applying HK Interpretations 1, 2 and 3 (5 September)
- HKAS 16 Property, Plant and Equipment & HKAS 36 Impairment of Assets (17 September) **FULL**
- HKFRS 6 Exploration for and Evaluation of Mineral Resources & HKAS 41 Agriculture (5 October)
- HKAS 38 Intangible Assets & HKAS 2 Inventories (15 October) **FULL**
- Overview of HK(IFRIC) Interpretations 1, 2, 3, 4 and 5 (1 November)
- HKAS 21 The Effects of Changes in Foreign Exchange Rates, HKAS 18 Revenue, HKAS 20 Accounting for Government Grants and Disclosure of Government Assistance, HKAS 11 Construction Contracts and HKAS 23 Borrowing Costs (26 November) **FULL**
- HKAS 12 Income Taxes (10 December) **FULL**

➤ **HKICPA/FTC Joint Accountancy Programmes** (August to December 2005)

➤ **Other CPD events**

Seminars

- PRC Tax and Forex Issues Associated with Logistics Industry (5 August)
- Improving Information Quality Through Knowledge Management Processes (25 August)
- Setting Up Macau Offshore Companies in Macau (29 August)

Workshops

- Managing EQ with Success (MDC Workshop) (6 August)
- Business Networking (2 Sessions - 13 and 20 August)

e-Learning

- Annual Auditing Update Conference 2005
- Annual Accounting Update Conference 2005
- Annual Taxation Update Conference 2005

➤ **Other programmes and activities**

- **HKICPA Diploma in Insolvency** (one-year programme commencing on 3 September 2005)
- **Technical Update Evening (TUE)** seminar on “21 Replacement Hong Kong Auditing Standards” (Re-run) (6 September)
- **Audit Orientation Programme** (2, 3 and 10 September)
- **Driving Trip to Zhaoqing, Kaiping and Zhuhai** [肇慶、開平及珠海自行駕車團] (16 – 19 September)

Financial Reporting

5. Institute Issues Two Amendments To HKAS 39 *Financial Instruments: Recognition And Measurement*

(a) Cash Flow Hedge Accounting of Forecast Intragroup Transactions

This **Amendment** permits the foreign currency risk of a highly probable forecast intragroup transaction to qualify as the hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

It also specifies that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with the hedge accounting rules in HKAS 39 must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

(b) The Fair Value Option

This **Amendment** revises the option available in HKAS 39 to designate irrevocably on initial recognition of any financial instruments as ones to be measured at fair value through profit or loss by limiting its use to those financial instruments that meet certain conditions. The conditions are:

- where such designation eliminates or significantly reduces an accounting mismatch;
- when a group of financial assets, financial liabilities or both are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy; and
- when an instrument contains an embedded derivative that meets particular conditions.

Both Amendments become effective for annual periods beginning on or after 1 January 2006 with earlier application encouraged.

6. Institute Issues Amendments To HKFRS 1 *First-time Adoption Of Hong Kong Financial Reporting Standards* And HKFRS 6 *Exploration For And Evaluation Of Mineral Resources*

The IASB has published for public comment an Exposure Draft of Proposed Amendments to IFRSs 1 and 6. Under the Institute's due process for setting accounting standards, the Financial Reporting Standards Committee (FRSC) issued an **Invitation to Comment on the Exposure Draft** and made a **submission** to support the proposed amendments to the IASB.

The IASB finalised the amendments to IFRSs 1 and 6. The Institute adopts the amendments and accordingly issues amendments to HKFRSs 1 and 6.

These **Amendments** amend HKFRS 1 and the Basis for Conclusions on HKFRS 6 to clarify that an entity adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 6 before 1 January 2006 is not only exempt from providing comparative disclosures, but also exempt from the recognition and measurement requirements of HKFRS 6 for the comparative period.

7. Institute Comments On Four IFRIC Draft Interpretations

- (a) D12 *Service Concession Arrangements – Determining the Accounting Model*
D13 *Service Concession Arrangements – the Financial Asset Model*
D14 *Service Concession Arrangements – the Intangible Asset Model*

IFRIC Draft Interpretations D12, D13 and D14 seek to clarify how concession operators should apply existing IFRSs to account for the obligations they undertake and rights they receive in service concession arrangements.

Under the Institute's due process for setting accounting standards, the FRSC issued an [Invitation to Comment on the Draft Interpretations](#) and made a [submission](#) to the IFRIC. The Institute welcomed the development of these Interpretations to give guidance on the accounting by operators for public-to-private infrastructure service concessions. However, it expressed concerns that the guidance in these Interpretations on determining which accounting model should be applied is not sufficient and robust enough to avoid abuse or selective treatment.

- (b) D15 *Reassessment of Embedded Derivatives*

IFRIC Draft Interpretation D15 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*.

Under the Institute's due process for setting accounting standards, the FRSC issued an [Invitation to Comment on the Draft Interpretation D15](#) and made a [submission](#) to the IFRIC. The Institute is generally supportive of the treatments proposed in D15. However, given that both IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 1 *First-time Adoption of International Financial Reporting Standards* are silent on the issue addressed in D15, the Institute does not consider it principally correct to give guidance on the issue in an Interpretation.

Following from the IASB's final approved Interpretations, the FRSC intends to recommend the adoption of four new Hong Kong (IFRIC) Interpretations so that the Hong Kong interpretations maintain conformity with the IASB's interpretations. The FRSC does not intend to issue specific Hong Kong draft interpretations on the matters covered in the IFRIC draft interpretations.

8. Withdrawal Of HKFRS-Int 3 *Emission Rights* And AG 3 *Accounts Of Dealers In Securities*

- (a) The Institute adopts the IASB's June 2005 decision to withdraw HKFRS-Int 3 *Emission Rights*, with immediate effect. IFRIC 3 which was intended to explain how to apply existing IFRSs to 'cap and trade' emission rights schemes.

The IASB noted that the markets for emission rights are at present thin. It concluded that it is questionable whether there is an urgent need for such an Interpretation as some governments have yet to issue emission rights to companies. Both the IFRIC and the IASB acknowledged that as a consequence of following existing IFRSs, IFRIC 3 creates unsatisfactory measurement and reporting mismatches. In the light of the reduced urgency for an Interpretation, the IASB decided to withdraw IFRIC 3 with immediate effect. This will enable the IASB to address the underlying accounting in a more comprehensive way than originally envisaged by the IFRIC. Consequently, the Institute decided to withdraw the Hong Kong equivalent, HKFRS-Int 3.

- (b) Accounting Guideline (AG) 3, which was issued in 1986, sets out guidance on the format of securities dealers accounts and audit reporting. As the relevant guidance is now either set out in the Accounts Disclosure Document issued by the Securities and Futures Commission or **Practice Note 820** “The Audit of Licensed Corporations and Associated Entities of Intermediaries”, the Institute decided to withdraw AG 3.

Audit & Assurance

9. Institute Issues Guidance On Acting As Scrutineer At A General Meeting Of A Listed Issuer

The Institute has issued **Practice Note 720** “Acting as Scrutineer at a General Meeting of a Listed Issuer”. This PN is prepared in consultation with the Stock Exchange of Hong Kong Limited and the SFC to provide guidance to practitioners who have been requested by a listed issuer to act as scrutineer when a poll is called at a general meeting.

10. Institute Invites Comments On IAASB EDs Of Special Purpose Audit Reports

Comments are invited by **7 October 2005** on the following **IAASB Exposure Drafts**:

- (a) Proposed ISA 701 “The Independent Auditor’s Report on Other Historical Financial Information”
- (b) Proposed ISA 800 “The Independent Auditor’s Report on Summary Audited Financial Statements”

The proposed ISA 701 is to establish standards and provide guidance for the independent auditor’s report issued as a result of an audit of historical financial information other than a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation.

The proposed ISA 800 is to establish standards and provide guidance for the independent auditor’s report on summary financial statements derived from audited financial statements.

The Explanatory Memorandum to the Exposure Drafts provides background information and explanation of the proposed ISAs and raises seven questions for commentators to respond on the significant proposals.

11. AASC Meeting Summary – 25 May 2005

This **AASC meeting summary** covers:

- Referral from the Small and Medium Practitioners Committee on the Audit of Building Owners’ Corporations
- Audit Report Exposure Drafts
- Proposed ED of PN on Acting as scrutineer at a general meeting of a listed issuer
- Auditors’ Report on Financial Statements of Investment Funds Authorized under the SFC Code on Unit Trusts and Mutual Funds
- Developing a generic Practice Note on Reporting on Charitable Fund-raising Events
- Revision of Practice Note 870 “The assessments of Certification Authorities under the Electronic Transactions Ordinance”
- Proposed PN “Guidance to Auditors with regard to Preliminary Announcements of Results for the Full Year”
- Working Group on Types of Reporting in Hong Kong

Ethics

12. Institute Invites Comments On Proposed Revision To IFAC Code Of Ethics

The Institute has issued an **Invitation to Comment** on the proposed revision to the definition of network firm in the IFAC Code of Ethics. Comments are requested by **3 September 2005**.

The IFAC ED proposes a new definition of network firm and provides background material on the interpretation of this new definition. Network firms are required to be independent of an audit client of a firm within the network. The proposed changes would classify a firm as a network firm of another firm if the two share a common brand name or if they share significant professional resources or revenues, profits, costs or expenses. The revised definition focuses not only on how the firms operate, but also on how they present themselves. When firms present themselves as part of a larger structure, as is the case with many of the global firms, it is expected that the independence requirements apply to the complete network.

The Institute adopted in November 2003 the “Independence for Assurance Engagements” section of the IFAC Code of Ethics as Professional Ethics Statement 1.203A “Independence for Assurance Engagements” and Professional Ethics Guidance 1.308 of the same title. Paragraph 3(q) of Professional Ethics Statement 1.203A contains a definition of “network firm”, which is the same as that contained in the IFAC Code of Ethics issued in November 2001 which is proposed to be revised.

The revised definition of network firm will be adopted by the Institute once it is finalised by the IFAC.

Banking

13. Banking (Amendment) Ordinance 2005 Enacted

The main purpose of the **Banking Amendment Ordinance (BAO) 2005** is to amend the Banking Ordinance (BO) to put in place a legislative framework for the implementation in Hong Kong of the Basel Committee on Banking Supervision's revised capital adequacy standards (Basel II).

The provisions of the BAO 2005 will come into operation in phases. Those relating to the new capital adequacy regime will commence operation in accordance with the timetable for implementing Basel II in Hong Kong.

14. HKMA's Guidance On New HKAS: Impact On Interim Financial Disclosure

As reported in **TechWatch No. 32**, the Hong Kong Monetary Authority (HKMA) issued in April 2005 a **Guidance Note** on the impact of the new Hong Kong Accounting Standards (HKAS) on authorized institutions' capital base and regulatory reporting.

In response to requests for clarification, the HKMA issued in July 2005 **Additional Guidance** clarifying the implications of the Guidance Note for interim financial disclosure. This additional guidance aims to assist AIs with their preparation of the interim disclosures in accordance with the requirements of the HKMA's Supervisory Policy Manual for the reporting period ending on 30 June 2005.

Corporate Governance

15. Institute Invites Entries For Best Corporate Governance Disclosure Awards 2005

A press conference to launch the Institute's 2005 Best Corporate Governance Disclosure Awards ("2005 BCGD Awards") was held on 7 July 2005. The competition is now entering its sixth year.

The BCGD Awards aims to promote greater awareness of corporate governance, encourage improvements in the standard of corporate governance disclosures, and to give recognition to those companies and organisations whose annual reports represent the best or most improved in their class, in terms of corporate governance disclosures and underlying governance structures and practices.

The Institute is now inviting entries from companies listed on the Main Board and the Growth Enterprise Market (GEM) of the Stock Exchange, as well as public sector/not-for-profit organisations to take part in the 2005 BCGD Awards.

With the introduction of new Listing Rules in 2004 and a revised Code on Corporate Governance Practices and new Corporate Governance Report requirements, which took effect in 2005, the judging criteria have been reviewed and refined this year to take into account these changes. The revised criteria will give an indication of how companies are gearing up for the new corporate governance regime.

Awards will be presented in four different categories, namely,

- (i) Hang Sang Index (HSI)-constituent companies
- (ii) Non-HSI Main Board-listed companies
- (iii) GEM-listed companies
- (iv) Public sector/Not-for-profit organisations

Entrants will be judged on the quality and standard of presentation and disclosure of corporate governance information contained in their annual reports covering the 2004/05 financial year (i.e., financial years that ended between 1 April 2004 and 31 March 2005 both dates inclusive). The reviewers and judges are looking in particular for voluntary disclosures that go beyond the minimum legal and regulatory requirements.

In addition to the Diamond, Platinum and Gold Awards, a Significant Improvement Award will be presented in each of the above four categories.

We hope that members working in companies/organisations that are eligible to enter the 2005 BCGD Awards, or who are working as auditors of such companies/organisations, will show their support to the competition by encouraging their employer companies/organisations or clients, respectively, to participate in the 2005 BCGD Awards. The deadline for entry is **20 August 2005**.

The 2005 BCGD Awards [pamphlet](#) contains further details, including an entry form.

Taxation

16. IRD Consults On Exchange Of Information Provisions In Comprehensive Double Taxation Agreements Between Hong Kong And Other Jurisdictions

As reported in [TechWatch No. 34](#), the Inland Revenue Department (IRD) has requested comments from the Institute on expanding the existing Arrangement for the Avoiding of Double Taxation on Income with the Mainland.

The IRD is also seeking views on whether Hong Kong should liberalise the exchange of information provisions in comprehensive double taxation agreements to be negotiated between Hong Kong and other jurisdictions. The matter is being considered by the Institute's Taxation Committee and members will be kept informed of any further developments.

Insolvency & Corporate Restructuring

17. ORO To Contract Out Summary Bankruptcy Cases To Private Sector Insolvency Practitioners

The Bankruptcy (Amendment) Bill 2004 (see [TechWatch Nos. 30, 32 and 34](#)) has been enacted as the Bankruptcy (Amendment) Ordinance 2005. Under the legislation, the Official Receiver's Office ("ORO") may appoint private sector insolvency practitioners to act as Trustees in Bankruptcy. The appointments will be confined to those cases where individuals have filed for their own bankruptcy and the anticipated value of the estate does not exceed HK\$200,000.

According to the ORO, the detailed qualification criteria for individuals wishing to take up bankruptcy appointments will be set out in the tender documents. However, the Institute understands that the requirement that appointment takers in bankruptcy cases contracted out by the ORO should be members of either the Institute, the Law Society or the Hong Kong Institute of Company Secretaries, will be set out in subsidiary legislation. The proposed **qualification criteria** will be modelled on those currently used in the tender contract for the outsourcing of summary liquidation work.

The ORO has indicated its intention to outsource the bankruptcy cases in batches of, say, 750 to 1,000 per firm each year with a variation of up to 30%. The initial contract will be for one year, though, generally speaking, each case allocated will have to be administered for four years when the bankrupt will usually be automatically discharged from bankruptcy.

As the vast majority of summary cases produce little by way of realisation of assets, the ORO will make available to appointment takers part of the deposit paid on the filing of the petition (currently HK\$8,650), to pay for their remuneration and disbursements. Taking into account various disbursements to be paid for by the ORO once the Bankruptcy Order is made, it is estimated by the ORO that there should be a balance of up to HK\$5,500 per case available for meeting the remuneration and disbursements of appointment holders.

The ORO anticipates going out to tender by, at the latest, the third quarter of 2006. The subsidiary legislation (including the rules) is being prepared to ensure that any necessary changes are consistent with those made to the principal legislation.

The ORO intends to conduct a series of Orientation Seminars at its premises from September 2005 onwards for those who might be interested in, and meet the qualifying criteria for, taking up appointments as Trustee in Bankruptcy. The ORO has requested that members of the Institute that are interested in taking up such work register their interest with Mr. Paul Li, Chief Insolvency Officer (Information Technology & Technical), 12/F, Queensway Government Offices, 66 Queensway, Hong Kong (Tel: 2867 2528; Fax: 2104 7151; Email: kcli@oro.gov.hk).

The ORO has indicated that it attaches great importance to upholding professional standards, and that anyone wishing to take on this work must know beforehand what will be required. Because of the relatively large volume of casework, the firms that will be undertaking the bankruptcy work must be staffed and resourced to an appropriate level to ensure that professional standards are maintained.

Corporate Finance

18. SFC Consults On Regulatory Requirements On Sponsors

The Securities and Futures Commission published its **Consultation Paper on the Regulation of Sponsors and Compliance Adviser** on 29 June 2005. The consultation period will end on **31 August 2005**. The Institute's Corporate Finance Committee is considering the consultation paper.

The consultation paper sets out a set of proposed additional requirements imposing specific entry criteria and ongoing compliance obligations on sponsors, as well as the proposed transitional arrangements for sponsors to prepare for compliance with the proposed requirements.

The proposals aim to strengthen the following key aspects of a sponsor's operations, namely:

- organisational structure, internal controls and resources
- formation of transaction teams and proper supervision
- appointment of principals
- management responsibility
- on-going compliance

For Information

19. Competition Policy Advisory Group Publishes 2004-2005 Annual Report

The Competition Policy Advisory Group (COMPAG), chaired by the Financial Secretary, was established in December 1997 to provide a high-level and dedicated forum to review competition-related issues that have substantial policy or systemic implications, and examine the extent to which more competition should be introduced in the public and private sectors.

COMPAG has recently published its **2004-2005 annual report**, which outlines the government's efforts to promote competition in various sectors during the reporting period.

20. Companies Registry Adds 'Enquiries' Section To Its Website

The Companies Registry has added an "Enquiries" section to the homepage of the **Companies Registry website**.

Financial Reporting - Continued

21. Institute Invites Comments On IASB EDs Of Proposed Amendments To IFRS And IASs

The Institute has issued an **Invitation to Comment** on three IASB Exposure Drafts of Proposed Amendments to:

- (a) IFRS 3 *Business Combinations*
- (b) IAS 27 *Consolidated and Separate Financial Statements*
- (c) IAS 37 *Provisions, Contingent Liabilities And Contingent Assets* and IAS 19 *Employee Benefits*

- (a) The proposed amendments to IFRS 3 contains the first joint proposals by the IASB and the US Financial Accounting Standards Board (FASB) to improve the accounting and reporting of business combinations. This ED retains the fundamental requirements in the current version of IFRS 3 to account for all business combinations using a single method – where one party is always identified as acquiring the other. The principal change being proposed is a requirement for a business combination to be measured and recognized as of the acquisition date at the fair value of the acquiree, even if the business combination is achieved in stages or if less than 100 per cent of the equity interests in the acquiree are owned at the acquisition date (instead of measuring and recognizing on the basis of the accumulated cost of the combination under the current IFRS 3).

Another principal change is a proposal to require recognition of goodwill as the difference between the fair value of the acquiree, as a whole, and the fair value of the identifiable assets acquired and liabilities assumed (instead of the difference between the cost of the interest acquired and the acquirer’s proportional interest in the fair value of the identifiable assets acquired and liabilities assumed).

- (b) The proposed amendments to IAS 27 are also joint proposals by the IASB and FASB arising from the project on business combinations. This ED proposes that non-controlling interests should be classified as equity within the consolidated financial statements and that the acquisition of non-controlling interests should be accounted for as an equity transaction.
- (c) The proposed amendments to IASs 37 & 19 seek to require recognition as liabilities of some items which were previously described as “contingent liabilities” and only disclosed in the notes to the financial statements. Uncertainty about the amount or timing of the economic benefits that will be required to settle a liability would be reflected in the measurement of that liability instead of affecting whether it is recognized.

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

Comment Due Dates

DATE	SUBJECT
3 September 2005	Invitation to Comment on IFAC ED of Proposed Revision to the IFAC Code of Ethics on the Definition of Network Firm
30 September 2005	Invitation to Comment on IASB Exposure Drafts of Proposed Amendments to: (a) IFRS 3 <i>Business Combinations</i> (b) IAS 27 <i>Consolidated and Separate Financial Statements</i> (c) IAS 37 <i>Provisions, Contingent Liabilities And Contingent Assets</i> and IAS 19 <i>Employee Benefits</i>
7 October 2005	Invitation to Comment on IAASB Exposure Drafts of proposed ISA 701 “The Independent Auditor’s Report on Other Historical Financial Information” and ISA 800 “The Independent Auditor’s Report on Summary Audited Financial Statements”
Please send comments to commentletters@hkicpa.org.hk	