



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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TechWatch is prepared by the Hong Kong Institute of CPAs and is intended for general guidance only. Professional advice should be taken before applying the content of this publication to your particular circumstances. While the Institute 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 Institute.

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[Previous issues of TechWatch](#)

Spotlight

1. **Handbook Updates 25 & 26**

Update 25 encloses the following:

- HKAS 21 Amendment *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation*
- Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement*
- HK(IFRIC)-Int 7 *Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies*

Update 26 encloses the new HKSA 230 *Audit Documentation*.

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

CPD & Events

2. **Technical Update Evening (TUE)**

The **new TUE programme** covering the period from January to April 2006 features a number of important auditing, financial reporting and ethics topics:

- 603 (21 Feb) New Code of Ethics – Issues relevant to Auditors and CPAs in Public Practice
- 604 (14 Mar) Introduction to Financial Instruments
- 605 (21 Mar) New Code of Ethics – Issues relevant to Professional Accountants in Business
- 606 (11 Apr) Issues in Preparing Financial Statements
- 607 (25 Apr) Improving Audit Documentation

To secure your seats, please register early by completing the **registration form** and returning it to the Institute.

3. **Professional Development Activities February to May 2006**

The Institute is committed to provide an all rounded CPD programme to suit the varying needs of members. Highlights for the months of February to May are:

HKFRS Training

- **HKASs 16, 17 and 40 and Interpretations 1, 2 and 4 (Re-run)** (27 Mar)
- **Internal Control and Risk Management** (10 Apr)

Other CPD events

- **Luncheon on Budget Commentary 2006/07** (24 Feb)
- **Negotiation Techniques** (8 Mar)
- **An Update on Anti-money Laundering Policies and Procedures – Revised SFC’s Guidelines** (20 Mar)
- **Chinese Employment Law** (24 Mar)

- **Intellectual Property Issues in Merger and Acquisition Transactions** (3 Apr)
- **Warrant Market – Risk and Opportunity** (7 Apr)
- **PRC Corporate Tax Reform and the Double Taxation Arrangement between the PRC and the Hong Kong SAR – An Update** (21 Apr)
- **Privacy Guidelines: Monitoring & Personal Data Privacy at Work** (15 May)

View the full programme [here](#) and enrol early to secure a seat.

4. **New CPD Requirements Effective From 1 December 2005**

Members are reminded that the new CPD requirements in **Statement 1.500** (August 2005) have become effective from 1 December 2005. Go to the Institute's webpage under **Mandatory CPD Requirements** for more information.

Financial Reporting

5. **New HK(IFRIC)-Int 7**

The Institute issues **HK(IFRIC)-Int 7** *Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies* with effect for annual accounting periods beginning on or after 1 March 2006. The Interpretation is based on its international equivalent.

The requirements of the Interpretation are:

- In the period in which the economy of an entity's functional currency becomes hyperinflationary, the entity shall apply the requirements of HKAS 29 as if the economy had always been hyperinflationary.
- Deferred tax amounts in the opening balance sheet are determined in two stages:
 - (a) Deferred tax items are remeasured in accordance with HKAS 12 *Income Taxes* after restating the nominal carrying amounts of the non-monetary items in the opening balance sheet by applying the measuring unit at that date.
 - (b) The deferred tax items remeasured in this way are restated for the change in the measuring unit from the date of the opening balance sheet to the date of the closing balance sheet.

6. **Amendments To HKAS 21 and HKAS 39**

- (i) Amendment to HKAS 21 *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation*

The Institute issues limited amendments to **HKAS 21** *The Effects of Changes in Foreign Exchange Rates* with effect for annual periods beginning on or after 1 January 2006 (with earlier adoption encouraged). The amendment is based on its international equivalent.

The amendment clarifies the requirements of HKAS 21 regarding an entity's investment in foreign operations and associated hedges of that investment. It helps the financial reporting by entities that invest in businesses operating in a currency different from that used by the entity. In particular, as regards a monetary item that forms part of an entity's investment in a foreign operation, it concludes that the accounting treatment in

consolidated financial statements should not be dependent on the currency of the monetary item, nor on which entity within the group conducts a transaction with the foreign operation.

(ii) *HKAS 39 Financial Instruments: Recognition and Measurement*

The Institute amends the transitional provision for available-for-sale financial assets set out in paragraph 104(d) of **HKAS 39 Financial Instruments: Recognition and Measurement**.

The amendment allows entities to make the opening balance adjustments arising from the initial application of HKAS 39 directly to equity, where appropriate. This is particularly relevant to those financial instruments that were classified as investment securities and carried at cost prior to the adoption of HKAS 39 and are to be classified as available-for-sale and carried at fair value with changes being recognised in equity after adopting HKAS 39. The amendment permits this type of financial instruments to take into account the related reserve when determining the profit or loss on disposal.

7. Institute Agrees In Principle To Adopt IASB Revised Guidance On Implementing IFRS 4

The International Accounting Standards Board (IASB) published revised Guidance on Implementing IFRS 4 *Insurance Contracts* ("Revised Guidance"). This revision reflects the changes made to IFRS 4 in August 2005 by IFRS 7 *Financial Instruments: Disclosures*. IFRS 7 amended and superseded the disclosures about risk that were previously required by IAS 32 *Financial Instruments: Disclosure and Presentation*. These changes necessitated consequential amendments to IFRS 4 *Insurance Contracts*, which previously required disclosure of 'information about interest rate risk and credit risk that IAS 32 would require if the insurance contracts were within the scope of IAS 32'. The changes affect only the disclosure section of the guidance.

Given that the Revised Guidance is only consequential on the issue of IFRS 7, which has already been adopted in Hong Kong, the Institute agrees in principle to issue a Hong Kong equivalent of the Revised Guidance in accordance with the Institute's convergence policy. The Hong Kong equivalent of the Revised Guidance will be published on the Institute's website once it has been approved by Council.

8. Institute Invites Comments On A Proposed IFRS And An IFRIC Draft Interpretation

(i) *IFRS ED 8 Operating Segments*

The Institute has issued an **Invitation to Comment** on an exposure draft (ED) of a proposed new IFRS on operating segments, with comments requested by **4 May 2006**.

ED 8 results from the IASB's comparison of International Accounting Standard (IAS) 14 *Segment Reporting* with the US standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. The proposed IFRS would replace IAS 14 and align segment reporting with the requirements of SFAS 131.

ED 8 would require an entity to adopt the 'management approach' to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments. Such information may be different from what is used to prepare the income statement and balance sheet. The proposals would therefore require explanations of the factors used to identify operating segments and the basis on which the segment information is prepared and reconciliations to the amounts recognised in the income statement and balance sheet.

(ii) IFRIC Draft Interpretation D18 *Interim Financial Reporting and Impairment*

The Institute has issued an [Invitation to Comment](#) on an IFRIC Draft Interpretation, D18 *Interim Financial Reporting and Impairment*, with comments requested by **17 March 2006**.

The draft interpretation proposes that impairments recognised in an interim period for goodwill and investments in equity instruments classified as available for sale should not be reversed in subsequent interim periods or in the annual financial statements. This proposal helps clarify the interaction between the requirements of IAS 34 and the recognition of impairment losses on goodwill in IAS 36 and certain financial assets in IAS 39. However, the effect of this proposal is that the frequency with which an entity reports may affect its annual profit result.

9. **All SSAPs And SSAP Interpretations Will Be Removed From The Members' Handbook After March 2006**

Statements of Standard Accounting Practice (SSAPs) and SSAP Interpretations are all replaced by new Hong Kong Accounting Standards and HK(SIC) Interpretations with effect from accounting periods beginning on or after 1 January 2005. Accordingly, the Institute will remove all SSAPs and SSAP Interpretations from Volume II of the Members' Handbook after March 2006. These will be stored in the archive section of the e-Handbook for members' reference.

10. **FRSC Meeting Summary – 11 January 2006**

This [FRSC meeting summary](#) covers:

- The appropriate treatment for an owner-used property in Hong Kong
- HKAS 39 – Transitional arrangements for available-for-sale financial assets
- Limited amendment to IAS 21 *The Effects of Changes in Foreign Exchange Rates*
- Revised Guidance on Implementing IFRS 4 *Insurance Contracts*
- Work Programme for 2006

Audit & Assurance

11. **New Audit Documentation Requirements**

The Institute has issued [HKSA 230 Audit Documentation](#), which is effective for audits of historical financial information for periods beginning on or after 15 June 2006.

HKSA 230 will contribute to enhancing auditor performance and audit quality by establishing stricter requirements for audit documentation. It places increased emphasis on timely preparation of audit documentation necessary to provide a sufficient and appropriate record of the basis for the auditor's report. It establishes new requirements that:

- The audit is carried out in accordance with HKSAs and applicable legal and regulatory requirements.
- If in exceptional circumstances the auditor judges it necessary to depart from relevant HKSA requirements, the auditor documents how the alternative audit procedures performed meet the objective of the audit and, if not otherwise clear, the reasons for the departure.

- The auditor completes the assembly of the final audit file on a timely basis after the date of the auditor's report.
- The auditor does not delete or discard audit documentation after the final audit file has been assembled, unless the retention period for the audit documentation has lapsed.

HKSA 230 results in conforming changes to HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*, such that:

- Firms are required to set up policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalised. The guidance indicates that 60 days after the date of the auditor's report is ordinarily an appropriate time limit within which to complete the assembly of the final audit file.
- Firms are required to set up policies and procedures for the retention of engagement documentation. The guidance indicates that the retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or if later, the date of the group auditor's report.

12. **Related Party Transactions – Audit Issues**

The AASC Working Group on Mainland Audit Issues published the fifth set of Q&As on “**Related Party Transactions**”, which addresses some of the more common issues of related party transactions.

13. **AASC Meeting Summary – 21 December 2005**

This **AASC meeting summary** covers:

- Draft Discussion Paper: Issues arising from requests for Assurance, Agreed-upon Procedures and Compilation Reports
- Request from the Stock Exchange of Hong Kong on the proposed type of reporting for Share Option Scheme Adjustments
- Proposed development of Practice Note of Building Management Accounts
- IAASB March 2006 meeting in Hong Kong
- Revised example report by the auditors on Annual Return on Employees' Compensation Gross Premium and example report on Calculation of Fund Expense Ratio for MPF Investment Funds

Banking

14. **Institute Comments On Basel Committee Consultative Document On Sound Credit Risk Assessment And Valuation For Loans**

The Institute has been invited by the Hong Kong Monetary Authority (HKMA) to comment on the **Basel Committee Consultative Document on Sound Credit Risk Assessment and Valuation for Loans** issued by the Basel Committee on Banking Supervision.

The Consultative Document seeks to provide banks and supervisors with guidance on sound credit risk assessment and valuation policies and practices for loans regardless of the financial reporting framework applied. The draft supervisory guidance is structured around ten principles that fall within the following two broad categories:

- Supervisory expectations concerning sound credit risk assessment and valuation for loans
- Supervisory evaluation of credit risk assessment for loans, controls and capital adequacy

The Institute's **submission** suggests discussions between the Institute and the HKMA to be undertaken on the external auditors' role in validating the internal credit risk assessment models used by authorized institutions prior to the implementation of the Basel requirements in Hong Kong.

Taxation

15. 2006 Annual Meeting With The Commissioner Of Inland Revenue

As reported in **TechWatch No. 37**, representatives of the Institute met the Commissioner of Inland Revenue ("CIR") and members of her staff in January 2006. The minutes of the 2006 annual meeting are being prepared and, once they have been agreed, they will be published as a Tax Bulletin, as in previous years. Tax Bulletins from previous years can be accessed at the **Institute's website**.

At the annual meeting, the Institute requested to be able to release information regarding some of the more urgent matters prior to the publication of the Tax Bulletin. On this basis, the following information, which relates to issues discussed at the meeting, is for members to note and act upon, as appropriate.

DIPN 1 – Treatment for losses on long-term construction contracts under paragraphs 6 and 7 of Part B of DIPN 1 – Provisions for foreseen losses on long-term contracts

The position of the Inland Revenue Department ("IRD") is as set out below.

The Hong Kong Court of Final Appeal's decision in *CIR v Secan Ltd. and Ranon Ltd.* ((2000) 5 HKTC 266) ("*Secan*") establishes the principle that the tax treatment should follow the accounting treatment. The IRD's view is that the principle should generally apply to all types of income and expense, except as otherwise provided for by the Inland Revenue Ordinance ("IRO"). As the making of provisions for foreseen losses is required by generally accepted accounting principles, and is not inconsistent with the provisions of the IRO, the IRD has confirmed that paragraphs 6 and 7 in Part B of DIPN 1, which was issued before *Secan*, are no longer applicable. Following *Secan*, the IRD agrees to allow a full deduction in the year the provisions are recognised in the accounts, provided that they are (i) made in accordance with the established accounting practice; and (ii) estimated with sufficient accuracy.

The new practice will apply to any open years of assessment (current or back years) including those under objection.

The IRD will revise DIPN 1 in due course to reflect the above position.

Section 51(2) of the IRO

The IRD's view on a taxpayer's legal liability to report chargeability to tax in "N" Code cases (i.e. with an accounting period ended in the months April to November) is as set out below. The same point will also be explained in the Block Extension Letter.

A person who fails to comply with the reporting requirement under section 51(2) of the IRO is liable to be penalised under section 82A only if the person has failed to comply "without reasonable excuse". Accordingly, the IRD's view is that, where such a taxpayer has been receiving profits tax returns in past years, and can reasonably expect that, in the normal course of events, a return will be issued in the current year, there will be no need to advise chargeability within the four-month period. However, if a taxpayer has been advised that a profits tax return will no longer be issued to him annually, or if it is a commencement case, the taxpayer will be required to notify the CIR within the stipulated period.

Employer's return filing on cessation of employment or departure of employee

Under section 52(7) of the IRO, an employer must withhold payments to a departing employee for one month after the employer has filed notice of the employee's departure from Hong Kong, or until a letter of release is received from the IRD. The letter of release issued in respect of the original IR 56G Form only applies to the amount reported in the original IR 56G Form. In the case where the employee is subsequently paid a deferred remuneration after his departure from Hong Kong, this effectively means that the amount of total remuneration as declared by the employer in the original IR 56G was incorrect. The employer should file an "additional" IR 56G to report the additional remuneration paid to the employee. The employer should insert the additional amount (**not** the total revised amount) in the appropriate item on the IR 56G and mark the word "ADDITIONAL" clearly on the right-hand top corner of the sheet. For further information, employers may refer to the [IRD's Homepage](#).

The "letter of release" issued in respect of the "original" IR 56G only applies to the moneys reported in the original IR 56G. The employer should likewise, in accordance with section 52(7) of the IRO, withhold all moneys payable to that employee for a period of one month from the date of filing the "additional" IR 56G, or until receipt of a letter of release from the IRD, if earlier. It should be noted that compliance with section 52(7) will constitute a defence in any proceedings against an employer in respect of his failure to make any payment to, or for the benefit of, the employee during the withholding period concerned.

Filing deadlines for the year of assessment 2005/06

The CIR has confirmed that the deadlines for lodging tax returns for the year of assessment 2005/06 will be as follows:

- "N" Code – 2 May 2006 (no extension)
- Under the Block Extension Scheme:
 - "D" Code – 15 August 2006 (no change)
 - "M" Code – 15 November 2006 (no change)
 - "M" Code current year loss cases – 31 January 2007 (changed)

The extended due date for "M" code "current year" loss cases in 2007 has been changed back to 31 January because, unlike this year, when Chinese New Year fell early, in 2007, it will fall in the middle of February.

Declaration of due representation in the application for block extension

The IRD has indicated that in the Block Extension Letter to be issued in March 2006 (and thereafter) it will be asking tax representatives to make a declaration in their application for block extension for the coming year confirming that they have received written authorisation from their respective clients appointing them as the tax representative. The authorisation should be made in writing bearing the client's signature and authorisation by way of emails is not acceptable. The IRD agrees to this item being amongst those to be announced in advance of publication of the minutes, so that tax representatives can secure written authorisations from their clients in good time.

Evidence of payment of foreign tax to be supplied when claiming tax credit

Note 4 to the Supplementary Form IR 51S specifies, among other things, that:

"(1) ... If a tax credit is claimed, evidence of payment of tax in the specified territory showing the nature, amount of income taxed and computation of tax paid should be submitted...."

The IRD has encountered a number of cases where a tax credit has been claimed but evidence of payment has not been provided. The IRD urges tax representatives to ensure that such evidence is supplied when filing the return. This will save time and effort on the part of practitioners and IRD.

Corporate Finance

16. HKEx Seeks Market Views On Growth Enterprise Market

Hong Kong Exchanges and Clearing Limited (HKEx) released a [Discussion Paper on the Growth Enterprise Market](#) ("GEM") on 20 January 2006. The discussion paper invites public discussion on the GEM for the purpose of enhancing its further development and ensuring that its objectives and functions appropriately align with the expectations and needs of the various market stakeholders.

The paper summarises some of the more prominent comments from market practitioners and users on the GEM. It highlights three possible structural options for the GEM, based on the market practitioners' and users' views and comments, and on HKEx's preliminary study of various overseas growth boards. The three options are:

- (1) GEM to be positioned as a stepping-stone for companies aiming to list eventually on the Main Board.
- (2) GEM and the Main Board to merge as a single board. The merged single board could be an undifferentiated market or would have two tiers of which the growth market would form the lower tier.
- (3) A separate new alternative market to be opened for growth companies, under an enhanced regime, where they would stay for the long term. The existing GEM companies would be grandfathered into the Main Board.

Comments on the matters discussed in the paper are invited by no later than 30 April 2006. The Institute's Corporate Finance Committee (CFC) will consider the discussion paper and members will be kept informed of any significant further developments. Members who wish to do so can pass on their views to the CFC, by sending them to [Mary Lam](#), Assistant Director, Specialist Practices at the Institute before 20 March 2006.

Legislation & Government Initiatives

17. Institute Expresses Concern About Implications Of Conditional Fees

As reported in [TechWatch No. 37](#), the Law Reform Commission has been consulting the public on the issue of conditional fees. One of the main proposals contained in the consultation paper is that the existing prohibitions against the use of conditional fees could be lifted for certain types of civil litigation, including professional negligence cases, so that lawyers could choose to charge conditional fees in appropriate cases.

In its [submission](#) on the consultation paper, the Institute explains that while it understands the argument for proposing conditional fees as means of improving access to the system of justice, given our concerns over the existing system of joint and several liability, we would have serious reservations about supporting a proposal that would be likely to tip the balance even further against professionals. Under the circumstances, the Institute considers that the introduction of the proposed conditional fee regime should be put on hold, at least until substantial progress has been made towards implementing professional liability reform, including, in particular, a framework for proportionate liability.

International Meetings

18. International Accounting Standards Board Meeting

The IASB met in London on 24 and 25 January 2006 and discussed the following topics:

- Business Combinations II
- Financial Instruments and Insurance working group: update
- Short-term convergence: borrowing costs
- Performance reporting
- Accounting standards for small and medium-sized entities
- Earnings per share
- Update on IFRIC activities

Click [here](#) to view the January 2006 IASB Update of the Board Decisions on IFRS. The IASB next meets on 20 to 24 February 2006.

19. International Financial Reporting Interpretations Committee Meeting

The IFRIC met in London on 12 and 13 January 2006 and discussed the following topics:

- D15 *Reassessment of Embedded Derivatives* – Proposal for a final Interpretation
- Service Concessions
- Customer Loyalty Programmes
- One tentative and one final agenda decision
- Proposals for an IFRIC Handbook
- Hedging Inflation Risk

Click [here](#) to view the January 2006 IFRIC Update of the newsletter of the IFRIC. The IFRIC next meets on 2 and 3 March 2006.

20. International Auditing and Assurance Standards Board Meeting

The IAASB will meet on 6 to 10 March in Hong Kong at the Harbour-Plaza Hotel in Hung Hom, Kowloon to discuss the following topics:

- Group Audits
- Auditing Accounting Estimates
- Clarity
- Communication with those charged with Governance
- Special Reports
- Terms of Reference
- Modifications to Audit Reports
- Service Organizations

The meeting is open to the public. If you wish to attend the IAASB's meeting as observers, you should advise the IAASB in accordance with the [IAASB Guidelines](#). The proposed agenda and background are now available. Click [here](#) for details.

21. International Ethics Standards Board For Accountants Meeting

The IESB's next meeting will be held in New York from 20 to 22 February 2006. Topics to be discussed are:

- Revised definition of network firm
- Revisions to the independence section
- Ethics guidance for professional accountants in business when encountering fraud or illegal acts

Click [here](#) to view the agenda papers.

For Your Information

22. XBRL Progress Updates

As part of its initiative to revive the XBRL (extensible Business Reporting Language) in Hong Kong, the Securities and Futures Commission (SFC) announced in January 2006 that the second phase of "Regulatory Reporting Survey" on the Consumption Side has been completed. The survey report and the latest development of XBRL are now available on the XBRL section of the SFC's website (under the section "[Document Repository](#)").

23. Companies Registry News

- (i) The statistics for company registrations in 2005 are contained in a [press release](#) issued by the Companies Registry (CR) on 3 February 2006.
- (ii) The CR has advised that the following revisions have been posted on its website:

- Due to the termination of JETCO payment service through ESD Life, the documents “General Information”, “Equipment Requirements” and “Registration Procedures”, have been revised (under the section “**Electronic Services – Electronic Search Services**”).
- The answers to questions 38 and 41 of the Frequently Asked Questions relating to the Companies Registry's Electronic Search Services have been made clearer (under the section “**Public Services - Frequently Asked Questions – Electronic Search Services**”).
- Performance Pledge 2005 (under the section, “**About Us - Performance Pledges**”) and Statistical bar charts for 2005 (under the section “**Statistics**”) have been updated.
- The particulars of the Committee Members of the Standing Committee on Company Law Reform have been updated (under the section “**Standing Committee on Company Law Reform - Committee Members**”).

Comment Due Dates

| DATE | SUBJECT |
|---|---|
| 17 March 2006 | IFRIC Draft Interpretation D18 Interim Financial Reporting and Impairment |
| 10 April 2006 | IAASB Exposure Draft of ISA 550 (Revised) on Related Parties |
| 12 April 2006 | IASB Discussion Paper on Management Commentary |
| 28 April 2006 | IASB Discussion Paper on Measurement Bases for Financial Accounting – Measurement on Initial Recognition |
| 4 May 2006 | IASB Exposure Draft of IFRS 8 Operating Segments |
| Please send comments to commentletters@hkicpa.org.hk | |