



TechWatch

News at a glance

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TechWatch updates you on technical developments in financial reporting, auditing, regulation and business. The Institute welcomes your comment, emailed to commentletters@hkicpa.org.hk. Click [here](#) for past issues.

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Spotlight

1. Handbook Update 36

Update 36 encloses Practice Note 900 (Revised) *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard*, which is effective for auditor's reports dated on or after 31 December 2006 and replaces the existing PN 900 from that date.

Further details are set out in the "Auditing & Assurance" section below.

2. Alert: Forthcoming Operative Dates of Standards

Hong Kong Standards on Auditing ("HKSA") – the following standards are effective in December 2006:

- HKSA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* – effective for auditor's reports dated on or after 31 December 2006
- HKSA 701 *Modifications to the Independent Auditor's Report* – effective for auditor's reports dated on or after 31 December 2006
- HKSA 200 (Revised) *Objective and General Principles Governing an Audit of Financial Statements* – effective for audits of financial statements for periods beginning on or after 15 December 2005 and where the auditor's report is dated on or after 31 December 2006
- HKSA 560 (Revised) *Subsequent Events* – effective for auditor's report dated on or after 31 December 2006

Hong Kong Financial Reporting Standards – the following standards are effective for annual periods beginning on or after 1 January 2007:

- Amendment to HKAS 1 *Presentation of Financial Statements* – Capital Disclosures
- HKFRS 7 *Financial Instruments: Disclosures*

3. An Opportunity to Meet IASB Experts Face to Face at the HKFRS/IFRS Forum on 16 January 2007

The International Accounting Standards Board ("IASB") is continually developing new standards and improving existing standards. The upcoming HKFRS/IFRS Forum will be a good opportunity to hear from experts at the IASB about current developments and future directions.

Messrs. Warren McGregor and Tatsumi Yamada, IASB Board members, and Ms. Elizabeth Hickey, IASB Director of Technical Activities, will speak at the forum. Key topics to be addressed are:

- Future directions in accounting for leases
- The financial statement presentation project
- IASB work programme

The forum will be held on **16 January 2007**, at 9:00 a.m. at the Institute's Auditorium on 27/F of Wu Chung House. Click [here](#) for further details and register early to avoid disappointment.

Financial Reporting

4. Institute Invites Comment on IASB Discussion Paper on Fair Value Measurements

The Institute has issued an [Invitation to Comment](#) on the IASB Discussion Paper on *Fair Value Measurements*, with comments requested by **12 March 2007**.

The Discussion Paper sets out the IASB's preliminary views on providing consistency in the measurement of fair value, when already prescribed under existing International Financial Reporting Standards ("IFRSs"). The proposals do not introduce new requirements for measurements at fair value.

The Discussion Paper is aimed at addressing requests from a number of interested parties seeking additional guidance on the measurement of fair value. IFRSs already require some assets, liabilities and equity instruments to be measured

at fair value in some circumstances. However, guidance on measuring fair value is dispersed throughout IFRSs and is not always consistent. The IASB believes that establishing a concise definition of fair value and a single source of guidance for all fair value measurements required by IFRSs will both simplify IFRSs and improve the quality of fair value information included in financial reports.

Consistent with the IASB's commitment to the convergence of IFRSs and US Generally Accepted Accounting Principles, the IASB has decided to use Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* ("SFAS 157") recently issued by the US Financial Accounting Standards Board as the starting point for its deliberations. The Discussion Paper sets out the IASB's preliminary views on the principal issues contained in SFAS 157.

5. IASB/FASB Round-table Discussions on Conceptual Framework – 16 to 17 January 2007 Hong Kong

The IASB and Financial Accounting Standards Board ("FASB") are holding round-table discussions on measurement in conjunction with their joint conceptual framework project in Hong Kong on 16 to 17 January 2007.

Click [here](#) for more information about the round-table discussions, including background materials and observer registration.

6. FRSC Meeting Summary – 8 November 2006

This [FRSC meeting summary](#) covers:

- IASB Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information*
- IFRIC Draft Interpretation D20 *Customer Loyalty Programmes*
- Draft Paper *Oversight of Domestic Financial Reporting Standard Setting*

- Report from the SME Financial Reporting Framework Sub-Committee
- IASB Working Group on Lease Accounting
- IASB/FASB round-table discussions on measurement

Audit & Assurance

7. Practice Note on Audit of SME Financial Statements

PN 900 (Revised) *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard* requires an auditor of financial statements prepared in accordance with the Small and Medium-sized Entity Financial Reporting Standard ("SME-FRS") to comply with the requirements of HKSA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* and HKSA 701 *Modifications to the Independent Auditor's Report*. The revised PN 900 is effective for auditor's reports dated on or after 31 December 2006, and replaces the existing PN 900 from that date.

Practitioners are reminded that all HKSAs are applicable to the audit of financial statements prepared in accordance with SME-FRS, except where otherwise stated in the HKSAs concerned.

An example unqualified auditor's report on financial statements prepared in accordance with SME-FRS based on HKSA 700 is contained in the appendix to the revised PN 900.

8. Audit Issues Q&As on Accounts of Owners' Corporations of Buildings

The **Audit Issues Questions & Answers** ("Q&As") on Audit of Accounts of Owners' Corporations of Buildings, issued by the Institute in December 2006, are to raise practising members' awareness of common audit issues that may be encountered by auditors of accounts of Owners' Corporations of Buildings registered under the Building Management Ordinance (Chapter 344).

The set of Q&As addresses some of the common issues and questions to be considered in the planning process and the practical procedures that can be applied to an audit of the accounts of owners' corporation of building. They should be read in the light of applicable Hong Kong Standards on Auditing issued by the Institute.

Topics covered include:

- Responsibilities of the Management Committee ("MC") or the professional property manager employed by the Owners' Corporation or its MC
- Appointment of auditors
- Reference materials for auditors of accounts of owners' corporation
- Some special considerations arising from HKSA's, covering:
 - *Objective and general principles governing an audit of financial statements*
 - *Consideration of laws and regulations in an audit of financial statements*
 - *Understanding the entity and its environment and assessing the risks of material misstatement*
 - *The auditor's procedures in response to assessed risks*
 - *External confirmations*
 - *Analytical procedures*
 - *Audit of accounting estimates*
 - *Related parties*
 - *Going concern*
 - *Management representations*
- Example unqualified audit report effective for auditor's reports dated on or after 31 December 2006

9. Reporting on the Audit of Schools

The Institute issued a [Circular on Reporting on the Audit of Schools](#) on 22 December 2006 to provide guidance to practising members in relation to an audit of accounts of schools. Four

illustrative example audit reports are provided. Practising members are reminded to use their professional judgment to ascertain the exact circumstances of their audits.

Depending on the circumstances, a practising member may reach a different conclusion on either compliance with the Education and Manpower Bureau Code of Aid and other requirements or on whether the accounts "present fairly" or "give a true and fair view" of the transactions of the school in accordance with Hong Kong Financial Reporting Standards. The example audit reports will need to be modified to reflect the auditor's opinion.

10. Chinese Translation of an Unqualified Auditor's Report Based on HKSA 700

Click [here](#) to view the suggested Chinese translation of an unqualified auditor's report based on HKSA 700.

11. PCAOB Proposes Revised Auditing Standard on Internal Control over Financial Reporting

The Public Company Accounting Oversight Board ("PCAOB") has issued a [proposed standard on auditing internal control over financial reporting and other related proposals](#) for public comment by **26 February 2007**.

The proposed new standard on internal control is a principles-based standard designed to focus the auditor on the most important matters, increasing the likelihood that material weaknesses will be found before they cause material misstatement of the financial statements. It also eliminates audit requirements that are unnecessary to achieve the intended benefits, provides direction on how to scale the audit for a smaller and less complex company, and simplifies and significantly shortens the text of the standard.

The proposed standard seeks to replace the PCAOB's existing internal control standard, Auditing Standard No. 2 *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial*

Statements ("AS No. 2"), which was issued in 2004 following the implementation of section 404 of the Sarbanes-Oxley Act of 2002 ("the Act") by the US Securities and Exchange Commission ("SEC").

Over the last two years, the PCAOB has closely monitored the implementation of AS No. 2. Two basic propositions have emerged. First, the audit of internal control over financial reporting has produced significant benefits. Second, these benefits have come with significant cost.

The PCAOB has heard a consistent message that compliance with the internal control provisions of the Act has required greater effort and resulted in higher costs than expected. It agrees that auditors should perform internal control audits as efficiently as possible for companies that are required by the SEC's rules to obtain an audit report on internal control. With this in mind, the PCAOB has evaluated every significant aspect of the audit of internal control to determine whether the existing standard encourages auditors to perform procedures that are not necessary in order to achieve the intended benefits. The proposals result from that evaluation.

12. AASC Meeting Summary – 29 November 2006

This [AASC meeting summary](#) covers:

- Adoption of HKSRE 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*
- Proposed draft Circular on Reporting on the Audit of Schools
- Proposed Q&As on Audit of Accounts of Owners' Corporations of Buildings
- PN 900 (Revised) *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard*
- Proposed Chinese version of an unqualified auditor's report based on HKSA 700
- Draft provisions of the Companies (Revision of Accounts and Reports) Regulation

- Working Group on Continuing Connected Transactions

Banking

13. Implementation of Basel II

The Legislative Council ("LegCo") has completed its negative vetting on the Banking (Capital) Rules and Banking (Disclosure) Rules gazetted on 27 October 2006.

In addition, two resolutions containing minor refinements to the Rules were passed by LegCo on 29 November 2006 and published in the Gazette on 1 December 2006. These resolutions result from comments of the LegCo Secretariat during the negative vetting process and seek to further improve the clarity of the Rules such as by introducing or revising definitions of certain terms and achieve consistency in the terminology used in the Rules.

The two sets of Rules (as amended by the resolutions mentioned above) will come into operation on 1 January 2007.

Taxation

14. Broadening the Tax Base and GST

Members who follow the development of the goods and services tax ("GST") consultation (see [TechWatch Nos. 46](#) and [48](#)) will be aware that the Financial Secretary announced on 5 December 2006 that for the remainder of the period of public consultation on broadening the tax base and the GST, the government would not be advocating GST as the only or main option. The reason for this was that there was insufficient public support for a GST, even though the majority of the community appears to accept the need to broaden the tax base. The government issued an [interim report](#) on the consultation proposals at the same time.

Members' Forum

The Financial Secretary attended a forum for the Institute members on 11 December 2006 at which other options for broadening the tax base were discussed. The forum was a useful and

very interactive exchange between members and the Financial Secretary.

Members' Survey

The results of an independent survey of members, commissioned by the Institute, on broadening the tax base and GST were announced at a [press briefing](#) on 14 December 2006 conducted by the then president, Mr. Paul Chan.

In all 1,980 survey questionnaires were completed, representing a response rate of 7.6%, which is a fairly good response for a survey of this kind.

Some of the key findings were as follows:

- A large majority of respondents (77%) believe that Hong Kong has a fiscal problem. Over two thirds (69%) believe that the fiscal problem is structural, or partly structural, in nature, while 8% consider it is purely cyclical. 64% of respondents believe that the tax base needs to be broadened.
- Notwithstanding the support for broadening the tax base, there is no consensus on how to address the issue.
- 59% of respondents oppose the introduction of a GST in Hong Kong, while 35% support a GST.
- As regards alternatives to a GST, there is no common view among the respondents.
 - When asked to choose the single best option to broaden the tax base, 20% opt for a GST, which is the highest figure amongst the various options. A capital gains tax (19%) came second on that particular question.
 - However, when asked to indicate the level of support/opposition for a number of different possible measures for broadening the tax base, most (62%) favour a land and sea departure tax, with a capital gains tax coming second (46%). The next three most favoured options were a form of general consumption tax other than a GST

(e.g. retail or wholesale sales tax) at 37%, a tax on worldwide income at 36% and a GST at 35%.

- 67% of respondents feel the GST proposal has not been sufficiently explained. This seems to be reflected also in the response to a question that asked members' views on various opposing statements about the proposal. Around 50% are unsure if GST will result in various benefits or drawbacks. The clearest result on this question was that a majority (60%) believe that a GST will overly complicate Hong Kong's tax regime.
- Separately 65% still consider that government spending is too high.

Click [here](#) for detailed analysis of the survey result and cross analyses of the responses to individual questions.

15. Institute Submits Budget Proposals 2007/08 to the Financial Secretary

The Institute submitted proposals for the 2007/08 budget to the Financial Secretary on 21 December 2006 and the Institute's Taxation Committee chair, Ms. Yvonne Law, explained the proposals to the media at a [briefing](#) held on the same day. The title of this year's [submission](#) is "*The Dream Ticket : Competitiveness and Stability – Strengthening Hong Kong's Competitive Edge and Enhancing Stability*".

The Institute remains concerned about the increasing level of uncertainty amongst tax practitioners and their clients in relation to certain fundamental areas of the tax administration in Hong Kong, which could potentially be damaging to Hong Kong's economic interests. The submission calls for more clarity and certainty in the tax system, and outlines the areas where the Institute believes action needs to be taken to restore a higher degree of certainty and predictability in the tax system.

In view of the improving fiscal performance, the Institute recommends lowering the profits tax and salaries tax rates, and bringing the marginal tax rates and bandwidth back to 2002/03 levels.

To determine the longer-term direction of tax rates, it is proposed that a study should be carried out to investigate the viability of any further reductions, in line with the worldwide trend to reduce rates of direct taxation.

The submission puts forward a number of other proposals to improve Hong Kong's competitive edge, such as measures support Hong Kong's role as a location for regional headquarters and offices and to make Hong Kong more attractive as a centre for intellectual property development. It also contains various ideas to support efforts to build a stronger community and a knowledge-based society, such as environment tax initiatives; an increase in the deductions for self-education expenses and professional memberships; a stamp duty waiver for first-time buyers of owner-occupied property of up to HK\$3 million, and tax concessions for purchasing health insurance or making payments into a medical fund.

A summary of the main proposals is set out at section A1.4 of the [submission](#).

International Meetings

16. International Accounting Standards Board

The IASB met in London on 12 –14 December 2006 and discussed the following topics:

- Financial instruments
- Conceptual framework
- Business combinations II
- Financial statement presentation
- IAS 1 *Presentation of Financial Statements*
- Annual improvements process
- IFRIC Due Process Handbook
- Short-term convergence: borrowing costs
- Consolidations (including special purpose entities)
- Accounting standards for small and medium-sized entities

- Post-employment benefits
- Technical plan
- Change to October Update

Click [here](#) to view the December 2006 IASB Update. The IASB next meets on 22 – 26 January 2007.

17. International Financial Reporting Interpretations Committee

The IFRIC will meet in London on 11 and 12 January 2007. Further details about the meeting will be reported in the next issue of TechWatch.

18. International Auditing and Assurance Standards Board

The IAASB will meet in New York from 13 – 16 February 2007. Click [here](#) for registration and for the meeting summary of the October 2006 meeting held in New York and the audio recording of the December 2006 meeting held in London.

19. International Ethics Standards Board for Accountants

The IESBA met in London on 18 – 19 December 2006 to discuss the proposed revisions to Section 290 "Independence" of the Code of Ethics for Professional Accountants. Click [here](#) to read the papers discussed at the meeting, and the forthcoming Meeting Summary.

Comment Due Dates

26 January 2007: IAASB Exposure Drafts of ISA 260 (Revised and Redrafted) *Communication with Those Charged with Governance*, ISA 320 (Revised and Redrafted) *Materiality in Planning and Performing an Audit* and ISA 450 (Redrafted) *Evaluation of Misstatements Identified during the Audit*.

12 March 2007: IASB Discussion Paper on *Fair Value Measurements*

Please send comments to
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