



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. Alert: Operative Dates of Standards

HK(IFRIC) Interpretation 11 *HKFRS 2 – Group and Treasury Share Transactions* is effective for annual periods beginning on or after 1 March 2007.

2. New Technical Update Evening (TUE) Programme

The new **TUE programme** features a number of important financial reporting, ethics and auditing topics, which include:

- 702 (13 March) Fair Value Measurements Discussion Paper
- 703 (20 March) Group and Treasury Share Transactions and Service Concession Arrangements – HK(IFRIC) Interpretations 11 and 12
- 704 (17 April) Operating Segments – HKFRS 8
- 705 (24 April) Review of Interim Financial Information Performed by the Independent Auditor of the Entity – HKSRE 2410

To secure your seats, please register early by completing the [registration form](#) and returning it to the Institute.

Financial Reporting

3. Invitation to Comment on IASB ED of Proposed Amendments to IFRS 1

The Institute has issued an [Invitation to Comment](#) on the IASB Exposure Draft (“ED”) of Proposed Amendments to IFRS 1 *First-Time Adoption of International Financial Reporting Standards – Cost of an Investment in a Subsidiary*, with comments requested by **10 April 2007**.

In response to concerns about difficulties encountered by parent companies in measuring the cost of an investment in a subsidiary on adopting IFRSs, the IASB ED proposes to allow a parent to use a deemed cost to measure its investment in subsidiaries when it first adopts IFRSs. This deemed cost can be determined by reference to the parent’s investment in the net assets of the subsidiary or the fair value of the parent’s investment.

The ED also provides further relief by alleviating the need to restate the pre-acquisition accumulated profits of a subsidiary for the purposes of classifying dividends.

4. Extended Comment Deadline for IASB Discussion Paper on Fair Value Measurements

The consultation deadline for the Institute’s [Invitation to Comment](#) on the IASB Discussion Paper on *Fair Value Measurements* has been extended to **10 April 2007** as a result of the IASB extending its consultation period for the document.

5. Invitation to Comment on IASB ED of Proposed IFRS for SMEs

The Institute has issued an [Invitation to Comment](#) on the IASB ED of Proposed IFRS for Small and Medium-sized Entities (SMEs), with comments requested by **1 September 2007**.

The aims of the proposed standard are to provide high quality, understandable and enforceable accounting standards suitable for SMEs globally and reduce the financial reporting burden on SMEs that use global standards. In addition to the matters raised in the IASB ED, the Institute would also like to seek views on whether the IASB’s final approved IFRS for SMEs should be adopted in Hong Kong to replace the existing *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard*, which are developed locally.

Audit & Assurance

6. HKEx Supports the Institute's Guidance for Auditors regarding Preliminary Announcements of Annual Results

HKEx has published an [article](#) to remind listed issuers and auditors to familiarise themselves with the Institute's [Practice Note 730](#) *Guidance for Auditors Regarding Preliminary Announcements of Annual Result*. It highlighted some key points which listed issuers and their auditors should bear in mind:

- The review of a preliminary announcement is a separate engagement from the audit engagement and a separate engagement letter is necessary. A specimen engagement letter is provided in the Practice Note.
- Preliminary announcements can be based on either audited financial statements or draft financial statements:
 - If a preliminary announcement is based on draft financial statements, which will normally be the case, both the listed issuer and its auditors will need to be satisfied that any outstanding audit issues will not result in changes to the figures in the financial statements in the annual report sent to shareholders.
 - Listed issuers should not state that information in a preliminary announcement has been “audited” unless the audit report on the financial statements, upon which the announcement is based, has been signed by the auditors.
- Auditors should provide evidence of their agreement to the financial information content of a preliminary announcement by sending a written report to the directors. An example of such a report is provided in the Practice Note.
- Listed issuers should not release a preliminary announcement until they have obtained their auditors' written report.

- Listed issuers should encourage their auditors to attend the directors' meeting at which the draft consolidated financial statements and the preliminary announcement are approved by the directors.
- If the auditor is aware of the fact that an issuer has released its preliminary announcement without his agreement, the matter should be reported promptly to the Exchange's Listing Division. The Practice Note sets out the steps auditors should take in the event that they become aware that the listed issuer has released a preliminary announcement with which they disagree.
- The Exchange will normally require a suspension of trading in a listed issuer's securities if a listed issuer fails to publish periodic financial information in accordance with the Listing Rules. The suspension will normally remain in force until the listed issuer publishes the requisite financial information.

7. Institute's Response to the IAASB Strategic Review Questionnaire

The IAASB is conducting a review as part of the development of a strategic plan for its activities for the period 2008-2010. It is seeking stakeholders' views to assist it to identify key issues for discussion during the strategy review planned for 2007.

The Institute's [submission](#) recommends that the IAASB:

- Develop a set of International Standards on investment circular reporting;
- Develop more guidance for small and medium-sized practitioners;
- Develop more guidance on the reporting on internal control;
- Review the status of ISAE 3400 *The Examination of Prospective Financial Information* and its acceptance internationally;

- Give a higher priority to the finalisation of ISA 800 (Revised and Redrafted) *Considerations – Audit of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, with the aim of completing the project in late 2007 instead of Q2 of 2008 or later; and
- Develop more guidance on Special Purpose Reporting.

8. AASC Meeting Summary – 21 December 2006

This [AASC meeting summary](#) covers:

- Issuance of proposed Circular on Reporting on the Audit of Schools
- Proposed Chinese version of an unqualified audit report based on HKSA 700
- Comment letters received on the HKICPA Exposure Draft of Discussion Paper *Requests For Special Purpose Reports*
- Working draft of proposed Expert Panel on Securities Q&A Circular on the Audit of Licensed Corporations and Associated Entities
- Election Affairs Commission – Financial Assistance for Legislative Council Elections
- Draft provisions of the Companies (Revision of Accounts and Reports) Regulation

Ethics

9. Outgoing Auditors are Reminded to Note Section 441 of the Code of Ethics for Professional Accountants

The Institute issued in May 2005 a Professional Ethics Statement 1.207A *Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong*, now section 441 of the Code of Ethics for Professional Accountants, which establishes a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework 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.

Some key features in section 441 are:

- 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 are not limited to, “disagreements” and/or “unresolved issues” and these are further explained in the section.
- The outgoing auditors should note that disclosing the circumstances leading to their resignation or termination in the Letter of Resignation or Termination is an appropriate method of discharging their responsibilities during a change in professional appointment, without having to be concerned with the professional duty of confidentiality owed to the listed issuer.
- The incoming auditors should, before accepting the appointment, request a copy of the Letter of Resignation or Termination and any correspondence referred to in the letter directly from the listed issuer for consideration in addition to requesting professional clearance from the outgoing auditors.

Professional Ethics Statement 1.207A was developed in consultation with the Stock Exchange of Hong Kong and the Securities and Futures Commission due to concerns raised regarding announcements made by listed issuers of the reasons for changes in auditors. Concern was expressed that certain auditors were relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer might not be disclosed to investors and creditors and the market was therefore not

being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of misleading the market.

A study on the reasons for change of auditors in 107 company announcements published from 1 January 2006 to 30 September 2006, based on “[Summary of Announcements Concerning Changing Auditors of Listed Issuers](#)” posted on the HKEx’s website, revealed the following:

Reasons disclosed for change of auditors:	No. of instances	%
Could not reach an agreement over audit fees	71	66.4
Unresolved issues relating to current year audit identified by outgoing auditors	6	5.6
Result of combination of audit firms	6	5.6
Result of dissolution of an audit firm	4	3.7
Alignment of the auditors of the company to that of the holding company	4	3.7
Significant qualified issues raised in the previous year audit report	3	2.8
Good corporate governance	3	2.8
Change of core business	2	1.9
Could not agree completion date of audit	2	1.9
To maintain established good relationship with bank creditors	1	0.9
Resignation as one of the two joint auditors	2	1.9
Change of PRC auditors	1	0.9
Silent on reason for change of auditors	2	1.9
Total number	107	100

Taxation

10. The Financial Secretary Delivers Budget Speech 2007/08

On 28 February 2007, Mr. Henry Tang, Hong Kong’s Financial Secretary (“FS”), delivered his fourth [Budget Speech](#). Members may refer to the [2007/08 Budget Highlights](#) for a quick summary.

In terms of the overall fiscal position, the budget figures revealed a fairly robust performance by the economy in 2006/07. Government revenue is far higher than expected, due to the strengthening economy, increased corporate profits and salaries, the buoyant stock market and a stable property market. The FS forecast a consolidated surplus of HK\$55.1 billion for 2006/07 (a \$38.6 billion surplus on the operating account and a \$16.5 billion surplus on the capital account), compared with an estimated surplus of HK\$5.6 billion originally forecast last year. The positive outturn for 2006/07 has improved the government’s financial position significantly.

A consolidated budget surplus of HK\$25.4 billion is now forecast for 2007/08, compared with a surplus of HK\$10.3 billion for the same period forecast in last year’s budget. The fiscal reserves are expected to stand at HK\$365.8 billion as at 31 March 2007 and to be maintained in the range of HK\$390 billion and HK\$580 billion over the next five years, equivalent to 19 and 24 months of government expenditure.

Real GDP grew by 6.8% in 2006, following an average annual increase of 7.6% over the past three years. A 4.5% to 5.5% growth in GDP in real terms is forecast for 2007 and an annual trend growth rate forecast over the period 2008 to 2011 is estimated to be 4.5% in real terms.

The inflation rate, as measured by the Composite Consumer Price Index, was 2% in 2006, slightly lower than the 2.3% forecast in the 2006/07 budget, and the rate is expected to drop further, to 1.5%, in 2007.

Background

Members may recall that changes were made to the Copyright Ordinance in 2001, which had the effect of, amongst other things, criminalising many basic copyright infringements taking place “for the purpose of, in the course of, or in connection with, any trade or business”, such as photocopying newspaper articles without a licence. As a result of strong public opposition, including from the Institute, the government subsequently introduced the Copyright (Suspension of Amendments) Ordinance 2001 (“Suspension Ordinance”), which disappplied most of the criminal provisions, except in relation to four categories of copyright works, namely, computer programs, films, television drama and musical recordings.

Since that time, the government has conducted two consultation exercises and also enacted legislation to remove the criminal and civil sanctions on the parallel importation of computer software. The Copyright (Amendment) Bill 2003 (“2003 Bill”) had aimed to make permanent the Suspension Ordinance by limiting the end-user criminal sanctions, retaining them in relation to infringements generally (i.e., not limited to the four categories), primarily where they were performed for a commercial purpose, e.g., selling, hiring and distributing for profit or financial reward.

However, some copyright owners (of printed works and newspapers, in particular) objected strongly to the permanent exclusion of their works from business end-user criminal sanctions. At the same time, users of copyright works, such as the education sector, expressed serious concerns about the possible adverse impact of expanding end-user criminal liability on the dissemination of information and education. As a result of these different views, the government deleted the provisions on end-user criminal liability from the 2003 Bill and, in 2004/2005, conducted the second of the two consultation exercises. The Institute commented on the consultation document in a [submission](#) dated 26 February 2005.

Recent development

The 2006 Bill represents the government’s current proposals to deal with the issue of business end-user criminal liability and to accommodate the various competing interests. Its scope includes various matters discussed in the consultation papers, such as criminal liability of directors and partners, copyright exemptions (e.g., “fair dealing” exemptions), certain changes to the parallel importation regime, and proposals relating to enforcement.

On the central issue of business end-user criminal liability, the 2006 Bill aims to combat regular or frequent copying and distribution of four types of printed works (newspapers, magazines, periodicals and books). It provides certain statutory defences (e.g., where the user did not know that the copies made or distributed infringed copyright) and empowers the Secretary for Commerce, Industry and Technology to prescribe “safe harbour” rules (numeric limits within which copying will not be a criminal offence). The application of the law in relation to distribution by uploading onto an intranet will be deferred pending the availability of a licensing scheme and appropriate safe harbour rules, amongst other things.

The Institute’s [submission](#) on the 2006 Bill reiterates the Institute’s stance on a number of principles that have been discussed since the introduction of the 2001 legislation, and where appropriate, elaborates on them. It also comments on detailed aspects of the 2006 Bill. Some reservations are expressed about the adequacy of the safe harbour rules. In this regard, the Institute expresses support for a suggestion made by the Hong Kong Association of Banks, that distribution activities for the purpose of in-house dissemination of information and sharing of learning be exempted from the proposed criminal offences. Alternatively, the Institute suggests that consideration be given to extending the “fair dealing” exemption for the efficient administration of urgent business by the government, Executive and Legislative Councils, the judiciary and district councils, to regulatory and professional bodies when carrying out their statutory/regulatory functions.

Comment Due Dates

16 March 2007: IAASB Exposure Drafts of ISA 230 (Redrafted) *Audit Documentation*, ISA 560 (Redrafted) *Subsequent Events*, ISA 610 (Redrafted) *The Auditor's Consideration of the Internal Audit Function* and ISA 720 (Redrafted) *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*.

10 April 2007: IASB Discussion Paper on *Fair Value Measurements*.

10 April 2007: IASB Exposure Draft of Proposed Amendments to IFRS 1 *First-Time Adoption of International Financial Reporting Standards – Cost of an Investment in a Subsidiary*

16 April 2007: IAASB Exposure Drafts of ISA 540 (Revised and Redrafted) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* and ISA 580 (Revised and Redrafted) *Written Representations*.

16 April 2007: IFAC IESBA Exposure Draft on Auditor Independence Requirements – Section 290 of the Code of Ethics *Independence – Audit and Review Engagements* and section 291 of the Code of Ethics *Independence – Other Assurance Engagements*.

1 September 2007: IASB Exposure Draft of Proposed IFRS for Small and Medium-sized Entities

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