



# 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](mailto:commentletters@hkicpa.org.hk) >. Click [here](#) for past issues.

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## Financial Reporting

### 1. Invitation to Comment on IFRIC Draft Interpretation: D22 *Hedges of a Net Investment in a Foreign Operation*

The Institute has issued an [Invitation to Comment](#) on the IFRIC Draft Interpretation: D22 *Hedges of a Net Investment in a Foreign Operation*, with comments requested by **29 September 2007**.

The Draft Interpretation clarifies two issues that have arisen on two accounting standards — IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 39 *Financial Instruments: Recognition and Measurement* — about accounting for hedging foreign currency risk within a company and its foreign operations.

The IFRIC proposal clarifies what qualifies as a risk in the hedge of a net investment in a foreign operation and where within a group the instrument that offsets that risk may be held. It proposes not to allow the use of hedge accounting when translating a functional currency into a presentation currency because it takes the view that this mere translation of currency for presentation use does not represent a hedgeable economic risk. It proposes that a hedged risk is the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity (the immediate, intermediate or ultimate parent entity) of that foreign operation.

The IFRIC also proposes that the hedging instrument may be a derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) and may be held by any subsidiary or parent entity within a group regardless of the entity's functional currency. To assess how effective the hedging instrument is in offsetting the risk from the foreign operation, the company calculates the change in value of the hedging instrument in the functional currency of the parent hedging its risk and not the functional currency of the subsidiary holding the instrument.

## Audit & Assurance

### 2. Institute Comments on Proposed ISA 250 (Redrafted) *The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements*

The Institute's [submission](#) to the International Auditing and Assurance Standards Board ("IAASB") on the exposure draft of proposed ISA 250 (Redrafted) *The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements* indicates that it is supportive of the redrafting and that, generally, the objective to be achieved by the auditor, as stated in the proposed redrafted ISA, is appropriate.

Furthermore, the Institute comments that the criteria identified by the IAASB for determining that a requirement has been applied appropriately and consistently will promote consistency and the use of professional judgement by auditors.

The key comment of the Institute was requesting the IAASB to consider whether it would be appropriate to include some generic guidance on anti-money laundering in the proposed redrafted ISA, given the recent developments in this area by the Financial Action Task Force on Money Laundering.

### 3. Invitation to Comment on IAASB Exposure Drafts

The Institute has issued an [Invitation to Comment](#) on a number of IAASB exposure drafts, which is set out in three parts:

#### Part A

- ISA 510 (Redrafted) *The Initial Audit Engagement – Opening Balances*
- ISA 530 (Redrafted) *Audit Sampling*

Comments are requested by **15 October 2007**.

## **Part B**

- ISA 700 (Redrafted) *The Independent Auditor's Report on General Purpose Financial Statements*
- ISA 705 (Revised and Redrafted) *Modifications to the Opinion in the Independent Auditor's Report*
- ISA 706 (Revised and Redrafted) *Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report*
- ISA 800 (Revised and Redrafted) *Special Considerations – Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*
- ISA 805 (Revised and Redrafted) *Engagements to Report on Summary Financial Statements*

Comments are requested by **15 November 2007**.

## **Part C**

- ISA 220 (Redrafted) *Quality Control for an Audit of Financial Statements*
- ISQC 1 (Redrafted) *Quality Control for Firms that Perform Audits and Reviews of Financial Statement, and Other Assurance and Related Services Engagements*

Comments are requested by **14 December 2007**.

The Explanatory Memorandum to the exposure drafts provides background information and explanation of the proposed ISAs and ISQC 1.

In summary, the IAASB's intentions in developing the revisions to the ISAs and ISQC 1 are to provide clearer requirements and easy to understand application guidance. It is seeking comments only on changes resulting from applying the clarity drafting conventions and their effect on the content of the ISAs and ISQC 1, and certain significant matters explained in the Explanatory Memorandum.

## **Corporate Finance**

### **4. Consultation on the Growth Enterprise Market**

Hong Kong Exchanges and Clearing Limited ("HKEx") has recently released a new [consultation paper](#) on proposals for the Growth Enterprise Market ("GEM"), following an earlier discussion paper on GEM issued in January 2006.

The latest paper puts forward HKEx's proposals for further developing GEM as a second board and invites comments from interested parties on the proposals by **31 October 2007**. It explains that the HKEx and the Securities and Futures Commission do not believe that Hong Kong is ready to move to a secondary market that follows the successful approach of the AIM (Alternative Investment Market) in the United Kingdom, even though most respondents to the 2006 discussion paper preferred this option. As the 2006 consultation exercise found no support for a merger of the Main Board and the GEM, the current consultation paper focuses on the third option outlined at that time, which was to retain the GEM as a secondary market, largely in its present form, and position it as a stepping stone to the Main Board.

In its [submission](#) on the 2006 discussion paper, as reported in [TechWatch No. 43](#), the Institute favoured retaining the GEM as a second board, but not specifically positioning it as a stepping stone to the the Main Board. Instead, it was suggested that more effort and resources should be invested in developing and promoting the GEM's own brand and establishing a more robust regulatory regime.

### **5. Institute Comments on Revised Approach to Giving Statutory Backing to Certain Listing Rules Requirements**

In early 2005, the Securities and Futures Commission ("SFC") published a [consultation paper](#) to seek comments on proposed amendments to the Securities and Futures (Stock Market Listing) Rules, as part of the process of codifying certain important requirements of the existing Stock Exchange

Listing Rules as subsidiary legislation under the Securities and Futures Ordinance (“SFO”).

The Institute issued a **submission** responding to the consultation, in May 2005, and this was reported in **TechWatch No. 33**.

Although the government and the SFC received support from the market for the principle of giving statutory backing to certain Listing Rules, the proposed statutory rules were considered to be unduly detailed and concern was expressed that minor technical breaches of the statutory requirements could attract legal sanctions. Following discussions with stakeholders, a revised three-tier approach was proposed and explained in the **Consultation Conclusions** paper released by the SFC on 28 February 2007 (see **TechWatch No. 54**).

Under the revised approach, the proposed detailed statutory listing rules would be separated into three inter-related elements, namely,

- (i) general principles and fundamental obligations to be complied with by listed issuers, to be incorporated into a new Part IIIA of the SFO;
- (ii) ancillary provisions (including definitions) to supplement the general principles, which would be subsidiary legislation set out in a new schedule to the SFO, and
- (iii) more detailed and technical provisions to assist compliance, to be set out in a non-statutory code issued by the SFC.

The Institute considers that, while the revised proposals have sought to address some of the concerns raised during the 2005 consultation and, as such, represent a step forward, there remain problems with the new approach.

Therefore, while acknowledges its previous support for the broad principle of giving statutory backing to major listing requirements, in the **submission** on the revised approach, the Institute also highlights some problems with the reworked proposals. These include:

- The way in which the different elements of the three-tier approach will interact with one another is not clear and could be confusing to the market. In addition, more guidance may be required on the interpretation of certain fundamental principles (e.g., price sensitive information).
- Some of the specific provisions in the proposed subsidiary legislation, which borrow text not only from the existing listing rules, but also from numerous overseas sources, including International Organisation of Securities Commissions (“IOCSO”) and Organisation for Economic Cooperation and Development (“OECD”) principles and Australian and UK listing rules, are complicated and not easy to follow. In some cases, the drafting seems to make matters less clear than under the existing listing rules, which raises questions about the rationale for proposing certain changes.
- The whole package, including the draft non-statutory code, should be presented together to facilitate understanding and enable the proposals to be considered in their entirety.
- The transitional arrangements for the administration of the proposed statutory requirements, which will be taken up largely by the SFC, are not clearly set out.

## Government Legislation

### 6. Copyright (Amendment) Ordinance 2007 Enacted

The **Copyright (Amendment) Ordinance 2007** has been enacted by the Legislative Council and was published in the Government Gazette on 6 July 2007.

Deliberations of the Bills Committee on the Copyright (Amendment) Bill 2006 (“2006 Bill”) were set out in a comprehensive **report** to the Legislative Council. Details of the proposals in the 2006 Bill and the Institute’s comments were reported in **TechWatch No. 53**. The Institute’s submissions on related issues were reported in **TechWatch No. 44**.

## Taxation

### 7. IRD Revises DIPN 10 “The Charge to Salaries Tax”

The Inland Revenue Department (“IRD”) issued [Departmental Interpretation and Practice Notes No.10 \(“DIPN 10”\) \(Revised\)](#) “*The Charge to Salaries Tax*” in June 2007.

The basic charge to salaries tax is imposed by section 8(1) of the Inland Revenue Ordinance (“IRO”) on income “arising in or derived from Hong Kong” from any office or employment of profit. No general rules are given in the IRO for determining whether income “arises in or is derived from Hong Kong”. However, in deciding this question in connection with employment, it has long been accepted that it is necessary to establish the place where the employment, the source of income, is located.

In this revised DIPN 10, the IRD does not seek to introduce a new approach in determining the source of employment. It still holds the view that the following three factors, namely, (a) contract of employment, (b) residence of the employer, and (c) place of payment of remuneration, are the major factors in determining the source of employment. The revised DIPN 10 intends to set out in clearer terms the IRD’s practices in determining the source of employment.

In June 2005, the Institute [submitted comments](#) on the then DIPN 10 and its application.

## International Meetings

### 8. International Accounting Standards Board

The IASB will meet in London from 18 – 21 September 2007. Click [here](#) for the forthcoming meeting papers.

### 9. International Financial Reporting Interpretations Committee

The IFRIC will meet in London on 6 and 7 September 2007. Click [here](#) for the meeting papers.

### 10. International Auditing and Assurance Standards Board

The IAASB will meet in Madrid, Spain from 24 – 28 September 2007. Click [here](#) for the background papers of the September meeting and access the meeting summary, audio recording and background papers of the July 2007 meeting in Warsaw, Poland.

### 11. International Ethics Standards Board for Accountants

The IESBA will meet in Toronto, Canada from 24 – 26 October 2007. Click [here](#) to register for the October meeting and access the minutes, meeting summary and background papers of the June 2007 meeting in Berlin, Germany.

## For Information

### 12. Appointment of Registrar of Companies

On 17 August 2007, the government [announced](#) the appointment of Ms. Ada Chung Lai-ling, Deputy Law Officer of the Department of Justice, to the post of Registrar of Companies to succeed Mr. Gordon W E Jones with effect from 27 August 2007.

Mr. Jones retires after 34 years of service with the government, including serving on the Institute’s Council as representative of the Financial Secretary since May 1993.

### 13. Clarification of “Professional Accountants” and “Professional Company Secretaries” referred to in Companies (Forms) Regulations

The Companies Registry has issued [Companies Registry External Circular No. 3/2007](#) “*Companies Registered under Part XI of the Companies Ordinance (Cap. 32) – Certification and Translation of Documents (Supplementary)*” to clarify the definition of “professional accountants” and “professional company secretaries” referred to in paragraphs 3 and 6 of the Companies (Forms) Regulations.

A professional accountant certifying documents and the competence of a person making a translation of document in Hong Kong under the

Companies (Forms) Regulations must be a certified public accountant (practising).

#### 14. New IFAC Paper on Internal Control

The Professional Accountants in Business Committee of the International Federation of Accountants (“IFAC”) has released a new publication on **Internal Control from a Risk-Based Perspective**.

This publication features the experience of senior executives in large corporations on establishing effective internal control systems. It demonstrates the importance of a risk-based approach to internal control in helping an organisation manage its overall risk. It also sheds light on the nature of risk in organisations, how to establish an internal control system focused on driving performance and supporting the delivery of strategic objectives, and success stories that can help organisations in considering improvements to their approach.

#### Comment Due Dates

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

**11 September 2007: IFRIC Draft Interpretation:** D21 *Real Estate Sales*

**28 September 2007: IESBA Exposure Draft** on additional requirements on Auditor Independence

**29 September 2007: IASB Discussion Paper** on *Preliminary Views on Insurance Contracts*

**29 September 2007: IFRIC Draft Interpretation:** D22 *Hedges of a Net Investment in a Foreign Operation*

**15 October 2007: IAASB Exposure Drafts** of

- ISA 510 (Redrafted) *The Initial Audit Engagement – Opening Balances*
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