



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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Financial Reporting, Auditing and Ethics by:
Steve Ong (Editor), Selene Ho, Winnie Chan, Katherine Leung, Ben Lo

Specialist Practices, Business Members and Advocacy by:
Elena Chai (Editor), Peter Tisman, Mary Lam, Sharon Yeung

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Financial Reporting, Auditing and Ethics

New!

1. Seminar on Solicitors' Accounts Rules and PN 840 Reporting Engagements

On 24 July 2009, the Institute will hold a seminar on Solicitors' Accounts Rules and PN 840 Reporting Engagements, for accountants and auditors who work on this area.

The seminar will:

- explain solicitors' obligations with respect to the handling of clients' money
- identify the common breaches of such obligations
- recommend controls that can minimize such risks
- focus on the requirements of PN 840 in performing work on the accountant's report

To secure seats, please register early by completing the [registration form](#).

2. Chief Executive Update No. 2

The Institute issued [Chief Executive Update No. 2](#), which covers:

- examination paper exemption under CEPA VI
- formation of the Asian-Oceanian Standards Setters Group
- IFRS for SME
- deferred tax on investment property revaluation gains

3. Financial Reporting and Auditing Alert – Issue 4

The Institute issued [Financial Reporting and Auditing Alert – Issue 4](#) to update members on the new Hong Kong Standards on Auditing.

4. Institute Issues Report on Quality Assurance

The quality assurance department issued a [report](#) for the year 2008 on its activities, under the practice review and professional standards monitoring programmes.

The report summarizes common issues and educational points identified by the reviews. It is recommended that members read the findings on the following relevant areas of work:

- Practitioners: Findings that may assist in revising audit approach and procedures where they recognize the situations as potentially applying to them. For more information, please see Part I – Practice Review Programme, item 6.
- Auditors and preparers of financial statements: Findings that may be helpful references for audit and/ or preparation of financial statements. Common deficiencies include matters on functional currency, impairment of assets, business combinations, financial instruments, presentation of financial statements, related party disclosures and segment reporting. For more information, please see Part II – Professional Standards Monitoring Review Programme, item 5.

Members' Handbook

5. Handbook Update No. 65

[Update No. 65](#) contains the following clarified pronouncements on auditing standards to improve comprehension of the standards:

- (i) Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Revised)
- (ii) HKSQC 1 (Clarified) *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*
- (iii) HKSA 200 (Clarified) *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*

- (iv) HKSA 210 (Clarified) *Agreeing The Terms of Audit Engagements*
- (v) HKSA 220 (Clarified) *Quality Control for an Audit of Financial Statements*
- (vi) HKSA 230 (Clarified) *Audit Documentation*
- (vii) HKSA 260 (Clarified) *Communication with Those Charged with Governance*
- (viii) HKSA 265 (Clarified) *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*
- (ix) HKSA 300 (Clarified) *Planning an Audit of Financial Statements*
- (x) HKSA 315 (Clarified) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*
- (xi) HKSA 320 (Clarified) *Materiality in Planning and Performing an Audit*
- (xii) HKSA 330 (Clarified) *The Auditor's Responses to Assessed Risks*

These standards are effective for audits of financial statements for periods beginning on or after 15 December 2009 (unless otherwise specified).

Financial Reporting

6. HKFRS Insights on HKAS 27 (Revised) *Consolidated and Separate Financial Statements*

HKAS 27 (Revised) *Consolidated and Separate Financial Statements* is effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted provided that HKFRS 3 *Business Combinations* (revised in 2008) is applied at the same time.

The revised standard is about accounting for non-controlling interests (NCI) and the loss of control of a subsidiary. The main changes are:

- (i) The term minority interest is replaced by the term NCI, which is defined as the equity in a subsidiary not attributable, directly or indirectly, to a parent.

- (ii) An entity must attribute total comprehensive income to the owners of the parent and NCI even if this results in a deficit balance of the NCI. Previously, the standard required excess losses to be allocated to the owners of the parent, except to the extent that the NCI had a binding obligation and were able to make an additional investment to cover the losses.
- (iii) Changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions and no gain or loss is recognized in profit or loss. Previously, the standard did not have requirements for such transactions.
- (iv) The revised standard specifies how an entity measures any gain or loss arising on the loss of control of a subsidiary, i.e.,
 - Any gain or loss is recognized in profit or loss.
 - Any investment retained in the former subsidiary is measured at its fair value at the date when control is lost.
 - The remaining investment is accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures*, as appropriate.

Previously, the standard required the carrying amount of an investment retained in the former subsidiary to be regarded as its cost thereafter.

For practical guidance, members may refer to:

- [IAS plus](#) by Deloitte
- [IFRS briefing sheet](#) by KPMG
- [HKFRS news](#) by PwC

7. Invitation to Comment on IASB Draft Pronouncements

- (i) IASB Exposure Draft (ED) of Proposed Amendments to IFRIC 14 - *Prepayments of a Minimum Funding Requirement*

The Institute has issued an **Invitation to Comment** on IASB ED of Proposed Amendments to IFRIC 14 - *Prepayments of a Minimum Funding Requirement*, with comments requested by 13 July 2009.

The proposed amendments are aimed at correcting an unintended consequence of IFRIC 14, i.e., an interpretation of IAS 19 *Employee Benefits*.

The IASB proposes that an entity shall apply the amendment from the beginning of the earliest comparative period presented in the first financial statements in which the entity applied IFRIC 14. An entity shall recognize in retained earnings at the beginning of that period any initial adjustment arising from the application of those amendments.

- (ii) IASB ED of *Fair Value Measurement*

The Institute has issued an **Invitation to Comment** on IASB ED of *Fair Value Measurement*, with comments requested by 7 September 2009.

The proposed IFRS defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements.

The IASB's objectives for publishing the proposed IFRS are to:

- establish a single guidance for all fair value measurements required or permitted by IFRSs, to reduce complexity and improve consistency in their application
- clarify the definition of fair value and related guidance, in order to communicate the measurement objective more clearly
- enhance disclosures about fair value so that users of financial statements can

assess the extent to which fair value is used, and know of the inputs used to derive those fair values

The proposed IFRS does not require additional fair value measurements.

A summary of the main proposals in the ED is set out in the Appendix to the Invitation to Comment.

- (iii) IASB Request for Information ("Expected Loss Model") Impairment of Financial Assets: Expected Cash Flow Approach

The Institute has issued an **Invitation to Comment** on IASB Request for Information ("Expected Loss Model") Impairment of Financial Assets: Expected Cash Flow Approach, with comments requested by 10 August 2009.

Impairment is one of the issues that the IASB is addressing in the second phase of its comprehensive review of IAS 39 *Financial Instruments: Recognition and Measurement*. The request seeks inputs on the feasibility of an expected loss model for the impairment of financial assets.

The current model requires an entity to account for credit losses in financial assets only if an event that has occurred, has a negative effect on future cash flows, which can be reliably estimated (but not the effects on future expected losses). The IASB is reviewing that approach and examining the expected loss model as an alternative.

The expected loss model requires an entity to make an ongoing assessment of expected credit losses, which may require earlier recognition of credit losses. This would better reflect the way financial assets are priced and the way companies manage their business.

A summary of the main features of the expected cash flow approach is set out in the Appendix to the Invitation to Comment.

(iv) IASB Discussion Paper (“DP”) on Credit Risk in Liability Measurement

The Institute has issued an [Invitation to Comment](#) on IASB DP on *Credit Risk in Liability Measurement*, with comments requested by 10 August 2009.

Credit risk in liability measurement is often referred to as “own credit risk”. Credit risk is one component of fair value. As a result, changes in “own credit risk” are recognized when an entity’s debt is fair valued. Some see this outcome as counter-intuitive and recent developments in the financial markets have led to concerns about the gains arising from reductions in the fair value of an entity’s liabilities.

The IASB has issued DP and an accompanying IASB staff paper that describe the common arguments for and against including credit risk when measuring liabilities. The issue of “own credit risk” is relevant to a range of IASB projects, in particular the accounting for financial instruments, insurance, fair value measurement and provisions, contingent liabilities, and contingent assets.

The DP also examines alternative approaches to liability measurement other than fair value. A summary of the approaches described in the DP is set out in the Appendix to the Invitation to Comment.

8. Institute Comments on IASB Discussion Paper on Preliminary Views on Revenue Recognition in Contracts with Customers

The Institute’s [submission](#) supports the boards’ objective to develop a single, contract-based revenue recognition model to address the inconsistencies and lack of guidance currently in IFRSs and US GAAP. In addition, this should also enhance comparability of revenue across industries and geographical boundaries.

However, the Institute is concerned that there may be undue focus on a single legalistic indicator of which party has “control” of the

asset, which may result in inconsistency in revenue recognition between long term contracts completed “off site” and “on site”. More examples may help to clarify key concepts such as “enforceable obligation” and “transfer of control”, to ensure proper interpretation and consistent application.

Audit & Assurance

9. AASC Minutes – 19 May 2009

This [AASC minutes](#) covers:

- Endorsement of new revised and redrafted HKSAAs
- Position paper on the adoption of ISA 800 and ISA 805
- Draft examples modified auditor’s reports on financial statements prepared in accordance with SME-FRS
- Joint education programme with Law Society
- Annual auditing update conference 2009

International Meetings

10. International Accounting Standards Board

The IASB met in June 2009 and discussed the following topics:

- Financial instruments
- Conceptual framework
- Financial instruments with characteristics of equity
- Insurance contracts
- Joint ventures
- Leases
- Liabilities – amendments to IAS 37
- Rate-regulated activities

- Revenue recognition
- Annual improvements

Click [here](#) to view the June IASB Update. The IASB next meets in July 2009.

11. International Financial Reporting Interpretations Committee

The IFRIC next meets in July 2009. Click [here](#) for the next meeting's details.

12. International Auditing and Assurance Standards Board

The IAASB next meets in September 2009. Click [here](#) for the next meeting's details and previous meeting summary.

13. International Ethics Standards Board for Accountants

The IESBA next meets in October 2009. Click [here](#) for the next meeting's details and previous meeting summary.

Useful Resources

14. Publications

The following are publications on various topics:

- (i) HKAS 34 *Interim financial reporting*
 - [Guide](#) by Deloitte
- (ii) Amendments to IFRS 7: *Financial Instruments: Disclosures*
 - [Bulletin](#) by BDO
- (iii) Improvements to IFRSs
 - [Financial reporting update](#) by KPMG
- (iv) Summaries of IFRS, IAS and IFRIC
 - [Update](#) by Ernst & Young

- (v) Tentative guidance on impairment of equity instrument classified as available-for-sale
 - [Supplement to IFRS outlook](#) by Ernst & Young

- (vi) Asian-Oceanian Standards Setters Group
 - [Insight article](#) by IASCF

- (vii) Project on replacement of IAS 39
 - [IFRS outlook](#) by Ernst & Young

- (viii) New model for loan loss provisioning
 - [Financial reporting news](#) by Grant Thornton

- (ix) ED and DP on revenue recognition, income tax and lease accounting
 - [HKFRS news](#) by PwC

- (x) The June issue of the [GAA journal](#) featured financial reporting and fair value and stories from accounting institutes worldwide

Comment Due Dates

13 July 2009: IASB ED of Proposed Amendments to IFRIC 14 – *Prepayments of a Minimum Funding Requirement*

10 August 2009: IASB Request for Information ("Expected Loss Model") Impairment of Financial Assets: Expected Cash Flow Approach

10 August 2009: IASB DP on Credit Risk in Liability Measurement

7 September 2009: IASB ED of *Fair Value Measurement*

Specialist Practices, Business Members, and Advocacy

Corporate Finance

15. HKEx Releases Findings on Review of Listed Companies' Financial Reports

The Hong Kong Exchanges and Clearing Limited ("HKEx") has published a [report](#) summarizing key findings from its review of 100 financial reports (covering annual, interim and quarterly reports) released by listed issuers between July 2007 and September 2008. The report intends to increase awareness of the pitfalls in the preparation of periodic financial reports, so listed issuers can learn from the experience of others and improve their reports.

HKEx's review found that, except in two cases, there were no significant breaches of the listing rules or accounting standards that would render the financial statements false or misleading, or warrant additional investigation or enforcement action. However, some disclosures could be improved. Preparers of financial reports, in particular preparers for listed issuers, are encouraged to take note of the report's findings.

The major findings are:

- disclosures of material "other" account balances and income and expense items are too brief
- discussions in the "management discussion and analysis" should be more detailed
- disclosures made on the outcome of the auditors' work on continuing connected transactions should be improved
- clearer disclosure in accounting for associates and joint ventures would assist readers in understanding how associates and joint ventures are reflected in issuers' financial statements

- disclosure of factors that resulted in the recognition of goodwill on acquisitions should be improved
- explanations as to why no impairment provisions are made for significant assets where there are indications of possible impairment should be improved
- further disclosures on the assessment and management of fair value and risks associated with financial instruments would help readers to understand the risk exposure in these instruments
- in addition, the review this year took, as a specific theme, issuers involved in the toll road industry. In this context, HKEx has recommended that clearer descriptions of the usage-based approach adopted for amortizing infrastructure assets should be provided by issuers whose major activities include toll road investment, construction, operation and management

16. HKEx Publishes Consultation Paper on Certified Emission Reduction Futures

HKEx has published a [consultation paper](#) on certified emission reduction ("CER") futures to seek views on the feasibility of developing an emissions trading platform in Hong Kong and CER futures as a product concept.

The consultation paper includes:

- an overview of the development of carbon trading around the world
- a potential design for CER futures which may be suitable for exchange trading in Hong Kong
- views shared by emission market players in Hong Kong, Singapore, Australia and the United Kingdom on CER futures contract specifications
- six questions for potential respondents' consideration

The consultation closes on 31 August 2009. To submit views to the Institute on the consultation paper, please e-mail, under heading "CER Futures", to commentletters@hki CPA.org.hk, no later than 14 August 2009.

Taxation

17. Exchange of Information Legislation Introduced into Legislative Council

The financial secretary announced in his 2009-10 budget that the government would put forward legislative proposals by the middle of this year to align Hong Kong's exchange of information (Eol) arrangements with the international standard.

Proposed amendments to the Inland Revenue Ordinance (Cap. 112) to enable Hong Kong to adopt the latest international standard Eol in double taxation agreements was published in the gazette on 26 June 2009.

The bill, [Inland Revenue \(Amendment\)\(No.3\) Bill 2009](#) will be introduced into the Legislative Council on 8 July 2009. More information can be found in the [press release](#).

Legislation & Other Initiatives

18. Consultation on Review of the Trustee Ordinance

The government has issued a [consultation paper](#) proposing amendments to the Trustee Ordinance (Cap. 29) ("TO") and the law relating to trusts, to provide a modern framework for the operation of trusts and strengthen the competitiveness of the trust services industry. The proposals make reference to recent reforms in other comparable common law jurisdictions.

Key proposals in the consultation paper are as follows:

- introduce a new statutory duty of care for trustees
- retain the range of authorized investments in the 2nd Schedule to the TO to provide reasonable "safe harbour" limits of investments by trustees

- enhance the safeguard in temporary delegation of trustees' powers so that the number of trustees will not be reduced to one against the will of the settlor
- repeal section 8(3)(a) of the Enduring Powers of Attorney Ordinance so that the power of delegation by an individual trustee is entirely governed by the TO
- provide trustees with a general power to appoint nominees and custodians with necessary safeguards
- provide trustees with wider powers to insure trust property
- provide a default charging clause to enable the remuneration of professional trustees of non-charitable trusts
- provide some basic rules on beneficiaries' right to information
- provide an alternative court-free route for certain beneficiaries to remove trustees
- subject trustee exemption clauses, seeking to exempt professional trustees who receive remuneration for their services, to some statutory control and promulgate a code of best practices regarding the use of trustee exemption clauses by the relevant professional bodies
- reform or abolish the rules against perpetuities and accumulations of income

The consultation closes on 21 September 2009. To submit views to the Institute on the consultation paper, please e-mail, under heading "Review of the TO", to commentletters@hki CPA.org.hk, no later than 28 August 2009.

19. Institute Comments on the Deposit Protection Scheme

As reported in [TechWatch No. 80](#), the Hong Kong Deposit Protection Board issued a [consultation paper](#) to seek views on recommendations to enhance the Deposit Protection Scheme (“DPS”) for the better protection of depositors in Hong Kong. In a submission to the Deposit Protection Board, the Institute welcomes the review of the DSP, which is timely given the attention that deposit protection arrangements have been given globally since the onset of the financial crisis and its impact on public confidence in financial institutions.

The Institute supports the recommended enhancements to the current scheme, and considers that it is also important for them to be introduced before the expiry of the Deposit Guarantee at the end of 2010, so that the public will be protected under an upgraded DPS thereafter.

The Institute’s comments on the key recommendations set out in the consultation paper are contained in the [submission](#).

20. Business Registration Fees Waiver Proposed to Legislative Council

Business registration fees will be waived for one year from 1 August 2009 subject to the approval of the Legislative Council.

The financial secretary announced on 26 May 2009 that a package of relief measures, including the waiving of business registration fees would be introduced, to alleviate the burden of the people of Hong Kong and certain sectors that are most seriously affected by the economic downturn and human swine flu.

The [Revenue \(Reduction of Business Registration Fees\) Order 2009](#), which seeks to implement the proposal, was published in the gazette on 26 June 2009. More information can be found in the [press release](#).

21. Combating Money Laundering / Terrorist Financing

Members may wish to note that the following updated lists and statements have been published in the government gazette or other publications:

- [Government notice 3192](#): Terrorists and terrorist associates specified under the United Nations (Anti-Terrorism Measures) Ordinance.
- US Executive Order 13224: Adds names of individuals and entities to the list relating to “Blocking Property and Prohibiting Transactions with Persons who Commit, Threaten to Commit or Support Terrorism”.

For more background information on the current law in Hong Kong relating to anti-money laundering, see the Institute’s [Legal Bulletin 1](#), “Requirements on anti-money laundering, anti-terrorist financing and related matters”.

Useful Resources

22. New Books in the Library

[Featured titles](#) and [new books](#) of high reference value for members are now available in the library.

23. Other Publications

The following articles / publications on topical issues may be of interest to members:

- (i) Implications of the current regulatory environment for audit committees
 - [Audit committee brief](#) by Deloitte
- (ii) Corporate governance study of the 25 largest European banks
 - [Bank boards and the financial crisis](#) by Nestor Advisors Ltd (introduction and executive summary)

- (iii) New China tax rules on corporate restructuring
 - [Tax analysis](#) by Deloitte
 - [China tax](#) by BDO
- (iv) [Latest developments on countering international tax evasion](#) by PwC
- (v) [Driving performance effectiveness in the finance and tax functions](#) by PwC
- (vi) Tips for small business
 - [Create an effective sales forecast](#) by ICAEW