Hong Kong Institute of Certified Public Accountants
香港會計師公會

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

New!

1. Financial Reporting Forum – IASB Exposure Drafts on *IAS 39 Replacement and Fair Value Measurement*

The Institute will hold a Financial Reporting Forum – IASB Exposure Drafts on *Financial Instruments: Classification and Measurement* ("IAS 39 Replacement"*) and Fair Value Measurement* on 1 September 2009 for the preparers and auditors of financial statements and others interested in financial reporting.

The proposals form part of the IASB's response to the global financial crisis and are consistent with the recommendations made by the G20, the financial stability board and others.

The Exposure Draft ("ED") on **IAS 39 Replacement** proposes a fundamentally new model for the classification and measurement of financial instruments.

The ED on **Fair Value Measurement** proposes to replace fair value measurement guidance contained in individual IFRSs with a single, unified definition of fair value, as well as further authoritative guidance on the application of fair value measurement in inactive markets. It does not require additional fair value measurements.

To secure seats, please register early by completing the **registration form**.

Members' Handbook

2. Update No. 66

Update No. 66 contains the following clarified pronouncements on auditing standards in response to the IAASB Clarity Project to improve understandability of the auditing standards including:

- HKSA 240 (Clarified) *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*
- HKSA 250 (Clarified) *Consideration of Laws and Regulations in an Audit of Financial Statements*
- HKSA 402 (Clarified) *Audit Considerations Relating to an Entity Using a Service Organization*
- HKSA 450 (Clarified) *Evaluation of Misstatements Identified during the Audit*
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- HKSA 550 (Clarified) *Related Parties*
- HKSA 560 (Clarified) *Subsequent Events*
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- HKSA 580 (Clarified) *Written Representations*
- HKSA 610 (Clarified) *Using the Work of Internal Auditors*
- HKSA 620 (Clarified) *Using the Work of an Auditor's Expert*

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

3. Update No. 67

In **Update No. 67**, the Institute issues amendments to HKFRS 2 *Share-based Payment* – Group Cash-settled Share-based Payment Transactions and other editorial changes.

The amendments to HKFRS 2 clarify:

- the scope of HKFRS 2. An entity that receives goods or services in a share-based payment arrangement must account for these goods or services regardless of which entity in the group settles the transaction, and whether the transaction is settled in shares or cash.

- the interaction of HKFRS 2 and other standards. The amendments clarify that in HKFRS 2 a 'group' has the same meaning as in HKAS 27 *Consolidated and Separate Financial Statements*, that is, it includes only a parent and its subsidiaries.

The amendments to HKFRS 2 also incorporate guidance previously included in HK(IFRIC) – Int 8 *Scope of HKFRS 2* and HK(IFRIC) – Int 11 *HKFRS 2 – Group and Treasury Share Transactions*.

An entity shall apply the amendments retrospectively to annual periods beginning on or after 1 January 2010, subject to the transitional requirements in HKFRS 2. If the information necessary for retrospective application is not available, an entity shall reflect in its separate or individual financial statements the amounts previously recognized in the group's consolidated financial statements. Early application is permitted.

Financial Reporting

4. HKFRS Insights on HKFRS 3 (Revised) *Business Combinations*

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

The main changes from previous requirements are as follows:

- For each business combination, the acquirer must measure any non-controlling interest in the acquiree either at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets. Previously, only the latter was permitted.

- The period during which changes to deferred tax benefits acquired in a business combination can be adjusted against goodwill has been limited to the measurement period.

- An acquirer is no longer permitted to recognize contingencies acquired in a business combination that do not meet the definition of a liability.

- The costs that the acquirer incurs in connection with the business combination must be accounted for separately from the business combination, which usually means that they are recognized as expenses (rather than included in goodwill).

- Consideration transferred by the acquirer, including contingent consideration, must be measured and recognized at fair value at the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities are recognized in accordance with HKAS 39, HKAS 37 or other HKFRSs, as appropriate (rather than by adjusting goodwill).

- For business combinations achieved in stages, having the acquisition date as the single measurement date has been extended to include the measurement of goodwill. An acquirer must remeasure any equity interest it holds in the acquiree immediately before achieving control at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss.

For practical guidance, members may refer to:

- **IAS plus** by Deloitte
- **IFRS briefing sheet** by KPMG
- **HKFRS news** by PwC

5. Invitation to Comment on IASB Exposure Drafts

(i) IASB ED of *Financial Instruments: Classification and Measurement*

The Institute has issued an **Invitation to Comment** on IASB ED of *Financial Instruments: Classification and Measurement*, with comments requested by 1 September 2009.

The proposals form part of the IASB's comprehensive review of financial instrument accounting and address how financial instruments are classified and measured. The IASB believes that the proposals will significantly reduce complexity and make it easier for investors to understand financial statements. The proposals also intend to answer concerns raised by interested parties during the financial crisis (for example, eliminating the different impairment approaches for available-for-sale assets and assets measured using amortized cost). The IASB plans to finalize the classification and measurement proposals in time for non-mandatory application in 2009 year-end financial statements.

The proposals also respond directly to and are consistent with the recommendations and timetable set out by the G20 leaders and other international bodies. In order to be responsive to calls for improved accounting, the IASB decided to split the comprehensive project into three phases (the other phases address the impairment methodology and hedge accounting). The IASB plans to complete the replacement of IAS 39 during 2010, although mandatory application will not be before January 2012.

A summary prepared by the IASB on the ED is set out in the Appendix to the Invitation to Comment.

(ii) IASB ED of *Rate-regulated Activities*

The Institute has issued an **Invitation to Comment** on IASB ED of *Rate-regulated Activities*, with comments requested by 30 October 2009.

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. A number of regulatory methodologies exist and the application is subject to the regulator, the entity being regulated and the particular circumstances.

The IASB added this rate-regulated activities project to its agenda in December 2008 because of the differing practical views about whether it was appropriate for entities to recognize assets and liabilities arising from rate regulation and ongoing requests for guidance on this issue. IFRSs do not currently provide guidance on the recognition and measurement of such assets and liabilities.

The IASB's proposals under the ED, if adopted, would define regulatory assets and regulatory liabilities, set out criteria for their recognition, specify how they should be measured and require disclosures about their financial effects.

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

(iii) IASB ED of *Management Commentary*

The Institute has issued an **Invitation to Comment** on IASB ED on *Management Commentary*, with comments requested by 8 February 2010.

Management commentary is an opportunity for management to outline how an entity's financial position, financial performance and cash flows relate to management's objectives and its strategies for achieving those objectives.

The proposals draw upon international best practice in the preparation and presentation of management commentary. The IASB believes that providing non-mandatory guidance will improve the consistency and the comparability of management commentary across jurisdictions.

A summary of the framework for the preparation and presentation of management commentary proposed in the ED is set out in the Appendix to the Invitation to Comment.

6. Institute Comments on IASB Draft Pronouncements

(i) IASB Discussion Paper on *Preliminary Views on Leases*

The Institute's **submission** is supportive of the proposed "right-of-use approach" to lease accounting. It is believed that the proposed approach will enhance the comparability for financial statement users and reduce structuring opportunities to keep assets and liabilities off the balance sheet.

However, some constituents in Hong Kong have expressed concerns that the analysis to justify the recognition of assets and liabilities is not adequate and implementation of the proposed standard may not provide more useful and meaningful information to users of financial statements.

In addition, the Institute has the following concerns regarding the Discussion Paper:

- A lessee should not have to revise its obligation to pay rentals for changes in the incremental borrowing rate.

- The model results in the recognition of a liability to pay rentals in respect of possible future extensions to the lease term that are at the option of the lessee. It is believed that these potential cash flows meet the definition of a liability, which requires there to be an obligation to pay cash or other resources of the entity, unless or until the lessee exercises the extension option.

- The contingent rental payment linked to the performance of the asset should not be taken into account when determining the obligation to pay rental. This type of payments is more like executory contracts that should be expensed as incurred.

(ii) IASB ED on *Income Tax*

The Institute has significant concerns about the proposals in a number of areas, in particular, deferred tax arising from investment property valuation gains.

The main concerns are as follows:

- It is considered that certain of the proposals, for example the replacement for the initial recognition exception and the practical application of the change in the tax basis, are likely to be more complex and difficult to follow than the current requirements under IAS 12 *Income Taxes*.

- Certain observers already take the view that the accounting for deferred tax has become so complex that it is no longer relevant to understanding an entity's financial position and that the entire approach needs to be revisited.

- The proposals do not appear to resolve the matter on deferred tax arising from investment property gains in Hong Kong. Due to the features of property/land ownership in Hong Kong and no capital gains tax in Hong Kong, there are issues with IAS 12 when recognizing deferred tax liabilities on investment property valuation gains, which in practice will never be settled.

Therefore, the Institute does not support replacing the current IAS 12 with this proposed standard. Instead, the Institute suggests that the IASB undertakes a more fundamental review of accounting for income taxes with the objective of issuing a new standard in the longer term. Meanwhile, as a short term solution to address the more significant issues like the deferred tax arising from investment property gains, limited amendments should be made to the current standard and additional guidance provided where needed.

Click **here** to view the Institute's submission.

(iii) IASB ED on *Proposed Amendments to IAS 39 and IFRS 7 – Derecognition*

The Institute's **submission** is not supportive of the derecognition model set out in the ED. On the other hand, the Institute supports the alternative view in the ED.

The main reasons for not supporting the proposed model are as follows:

- The proposed model is not a pure control model since it imposes a risk and rewards overlay in the form of an assessment of continuing involvement. Therefore, the proposed model will simply be replacing one mixed model with another and not provide the benefits that justify replacing the existing model.

- Gaps arising from the definition of control used in the ED. The requirement that the transferee should have a practical ability to dispose of the asset relies disproportionately on a single indicator of whether the transferee controls the asset.

- The proposed model does not reflect the transferor's true exposure to the cash flows of the financial asset.

However, the Institute supports the alternative view in the ED. This model is superior to the proposed model because it:

- prevents the recognition of assets in respect of which future economic benefits will not flow to the entity, and associated liabilities for which the entity has no obligation to give up its resources

- considers control over the cash flows of the asset, and avoids an overlay of risk and rewards

- is not built on the premise that assets are "sticky"; two entities with the same contractual rights and obligations will account for them consistently, irrespective of whether one of the entities previously owned the transferred asset

In addition, it does not believe that the proposed disclosure requirements are appropriately defined or risk focused. It is suggested that a disclosure principle be established. Preparers of financial statements could use the principle to provide appropriate and risk focused disclosures. The principle should also be applied to all derecognized financial assets in which the entity has continuing involvement.

7. HKFRSs Update

The **comparison table** between HKFRSs and IFRSs has been updated up to 1 July 2009.

Audit & Assurance

8. AASC Minutes – 16 June 2009

This **AASC minutes** covers:

- Endorsement of new revised and redrafted HKSAs
- Position paper on the adoption of ISA 800 and ISA 805
- Annual auditing update conference 2009

9. Modified Auditors' Reports on SME-FRS

The Institute has published examples of **modified auditors' reports** on financial statements prepared in accordance with the SME-FRS.

International Meetings

10. International Accounting Standards Board

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

- Classification of rights issues
- Consolidation
- Discontinued operations
- IFRIC update
- Insurance contracts
- Liabilities – amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- Post-employment benefits
- Related party disclosures
- Revenue recognition
- Technical plan
- Annual improvements

Click **here** to view the July IASB Update. The IASB next meets in August 2009.

11. International Financial Reporting Interpretations Committee

The IFRIC met in July 2009 and discussed the following topics:

- Debt to equity swap in a restructuring
- Classification of vesting conditions
- Rights issues denominated in a foreign currency
- Agenda decisions
- Tentative agenda decisions
- Work in progress

Click **here** to view the July IFRIC update. The IFRIC next meets in August 2009.

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) Financial instruments

- **CFOs guide** by Grant Thornton

(ii) Borrowing costs

- **IFRS outlook** by Ernst & Young

(iii) Summaries of IFRSs

- **Guide** by PwC
- **IFRS briefing sheet** by KPMG

(iv) Presentation of financial statements

- **Focus** by Grant Thornton

(v) Operating segments

- **Guide** by Grant Thornton

(vi) Project on replacement of IAS 39

- **HKFRS news** by PwC

(vii) Illustrative financial statements

- **Annual financial statements and interim financial reports under HKFRSs** by KPMG
- **Condensed consolidated interim financial information** by PwC

Comment Due Dates

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

10 August 2009: IASB Discussion Paper on *Credit Risk in Liability Measurement*

1 September 2009: IASB Exposure Draft on *Financial Instruments: Classification and Measurement*

7 September 2009: IASB Exposure Draft of *Fair Value Measurement*

30 October 2009: IASB Exposure Draft of *Rate-regulated Activities*

8 February 2010: IASB Exposure Draft of *Management Commentary*

Specialist Practices, Business Members, and Advocacy

New!

15. Join a Professional Interest Group

Members are invited to join the **Corporate Finance Interest Group** ("CFIG") and the **Taxation Interest Group** ("TIG"), which provide:

(i) a forum for CPAs and other professionals working in the same sector to network and exchange views on matters of common interest and concern

(ii) professional development in the relevant specialist field, through discussion forums and seminars

The new membership year runs from July 2009 to end June 2010. Join the **CFIG** and **TIG** now by returning the completed membership application forms to the Institute.

16. 2009 Best Corporate Governance Disclosure Awards

Now in its tenth year, a media briefing to launch the 2009 awards was held on 14 July 2009 and received wide media coverage.

This year, in addition to the Hang Seng Index (HSI)-constituents category, to encourage companies of all sizes to give attention to corporate governance and adopt best practices there will be two categories for the non-HSI group of companies - one for larger companies and one for mid-to-small companies by market capitalization. There will also be categories for H-share companies and public sector/not-for-profit organizations.

The submission deadline is 21 August 2009. Click **here** for more details of the awards.

Corporate Finance

17. HKEx Consultations and Publications

(i) Consultation on Proposals to Accelerate Rights Issues and Open Offers

To facilitate fund raisings by listed issuers, Hong Kong Exchanges and Clearing Limited ("HKEx") has published a **consultation paper** with proposals to:

- shorten the notice period for book closure for rights issues and open offers from 14 calendar days to five business days, with an extension, if necessary, to provide at least two uninterrupted trading days for trading in the securities with the entitlement to the subscription rights

- amend the minimum subscription period for rights issues and open offers from 14 calendar days to 10 business days

The consultation paper also contains other housekeeping amendments on notice of book closure and subscription periods.

The consultation ends on 30 September 2009. To submit views to the Institute on the consultation paper, please e-mail, under heading "Rights Issues & Open Offers", to **commentletters@hkicpa.org.hk**, no later than 11 September 2009.

(ii) Consultation on Proposed Changes to Filing and Checklist Requirements for Listing of Equity Securities

In another **consultation paper**, HKEx is proposing the following changes to the filing and checklist requirements for the listing of equity securities on the Stock Exchange of Hong Kong:

- filing and checklist requirements for initial public offerings ("IPOs")

- filing requirements for listing of additional equity securities by issuers

In practice, different documents requirements and timetables apply in filings for IPOs and listing of equity securities. HKEx aims to enhance the process by streamlining procedures and removing requirements to file unnecessary documents. No substantive changes in content requirements are proposed.

The consultation closes on 31 August 2009. To submit views to the Institute on the consultation paper, please e-mail, under heading "Filing and Checklist Requirements", to **commentletters@hkicpa.org.hk**, no later than 17 August 2009.

(iii) 2008 Consultation Conclusions on Proposal for Self-construction of Assets

HKEx has published its **conclusions** on the proposal for self-construction of assets.

In January 2008, HKEx published a consultation paper on proposals to address 18 substantive policy issues (see **TechWatch Issue no. 64**). Under issue 15, HKEx proposed to amend the listing rules regarding notifiable transactions to exclude any construction of fixed assets by a listed issuer for its own use in the ordinary and usual course of business. The proposal would not have exempted issuers from the notifiable transaction rules where the acquisition of a component of the self-constructed asset was in itself a transaction.

Based on the responses, HKEx has modified the original proposal to exempt self-construction of assets. The revised amendments will not apply the aggregation requirements when an issuer enters into a series of transactions to construct, develop or refurbish an asset for its own use in its ordinary and usual course of business, if the sole basis for aggregation is because the series of transactions form parts of one larger asset.

21. New Tax Judgments

(i) Datatronic Limited

Reversing the decision of the court of first instance, the court of appeal has ruled in favour of the Inland Revenue Department ("IRD") in the **Datatronic** case, an important case concerning a 50:50 apportionment claim. More details are available in the **news flash** by PwC and **tax alert** by KPMG.

(ii) Ngai Lik Electronics Co Ltd

The court of final appeal recently handed down a judgment on an anti-avoidance case, **Ngai Lik Electronics**. The taxpayer's appeal was allowed but the court ordered that the case be remitted back to the BOR for further action. More details are available in **news flash** by PwC.

Legislation and Other Initiatives

22. Anti-Money Laundering/Combating Terrorist Financing

(i) Guide for Accountants

The government has issued a guide for certain designated non-financial businesses and professions ("DNFBPs") on anti-money laundering/counter-terrorist financing ("AML/CFT"). **DNFBPs** are defined by the **financial action task force on money laundering** ("FATF") as including accountants, trust and company service providers, lawyers and other sectors. The guide, available in **English** and **Chinese**, aims to improve understanding of the following matters:

- money laundering and terrorist financing
- suspicious transaction reporting and suspicious activity indicators
- customer due diligence and record keeping
- international regulatory standards

(ii) Consultation for Financial Sectors

Hong Kong, as a member of the FATF is obliged to implement the international standards on AML/CFT, known as the **40 recommendations** + **9 special recommendations**.

The FATF conducted an evaluation of Hong Kong in 2007 and identified some deficiencies in respect of the requirements for customer due diligence and record keeping. To address this, the government has now launched a **consultation** on legislative proposals to enhance the regulatory regime for the financial sectors. The proposals include:

- codifying the customer due diligence and record-keeping requirements for financial institutions in law
- putting in place an anti-money laundering regulatory regime for remittance agents and money changers

A **summary** of the proposals is available and the government will hold **consultative sessions** designated for specific financial sectors, with certain sessions opened to interested members of the public. At a later date, it is expected that legislation will be introduced on customer due diligence and record-keeping in respect of DNFBPs.

(iii) International Sanctions Updates and Other AML/CFT-related Notices

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

- **Government notice 1692**: "Relevant persons and entities" specified under the United Nations Sanctions (Democratic Republic of Congo) Regulation 2009 ("Congo Regulation"). The Congo Regulation was made under the United Nations Sanctions Ordinance (Cap. 537) and published as **legal notice 37** in the gazette.

- **Government notice 3473**: "Relevant persons and entities" specified under the United Nations Sanctions (Liberia) Regulation 2009 ("Liberia Regulation"). The Liberia Regulation was made under the United Nations Sanctions Ordinance (Cap. 537) and published as **legal notice 38** in the gazette.

- **Legal notice 58**: United Nations Sanctions (Somalia) Regulation made under the United Nations Sanctions Ordinance (Cap. 537).

- **Government notice 3019**: "Relevant entities" specified under the United Nations Sanctions (Democratic People's Republic of Korea) Regulation.

- **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".

- **Government notice 4579**: Terrorists and terrorist associates specified under the United Nations (Anti-Terrorism Measures) Ordinance.

- **Financial action task force on money laundering statement**: Draws attention of its members (Hong Kong has been a member since 1990) on the progress made in addressing deficiencies by and/or risks of transactions involving Iran, Uzbekistan, Turkmenistan, Pakistan and São Tomé and Príncipe.

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".

23. Guide on Directors' Duties Renamed

The *non-statutory guidelines on directors' duties*, issued by the Companies Registry, has been amended and renamed as ***a guide on directors' duties***.

External circular 3/2009 outlines the relevant amendments and a supplementary note has been added to **forms** AR1, AR2, AR3, D2A, D5, D6, N3, N4, NC1 and NC1G.

24. Latest Companies Registry Statistics and Proposed Service Enhancement

The companies registry announced that a record high number of companies was incorporated in March, which the registry attributes mainly to the waiver of business registration fees for new companies in 2008/09.

The registry aims to introduce electronic incorporation services in late 2010. A bill to facilitate this will be introduced into LegCo in the last quarter of this year. More details are available in a **press release.**

Useful Resources

25. New Books in the Library

Featured titles and **new books** of high reference value for members are now available in the library.

26. Other Publications

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

(i) Expectations for internal audits by audit committees

- **Audit committee brief** by Deloitte

(ii) Risk management steps for enterprises

- **Risk intelligence publication** by Deloitte

(iii) Profits from sales of property units immediately upon completion of redevelopment held to be non-taxable

- **Hong Kong tax alert** by Ernst & Young

(iv) Hong Kong government to explore introduction of R&D tax incentives

- **Tax alert** by KPMG

(v) Measures to administer non-resident taxes in China and status of China tax resident enterprises

- **Tax talk** by Grant Thornton

(vi) Updates on international tax

- **Worldwide tax news** by BDO

(vii) Topical articles for SMEs by ICAEW

- **SME access to finance research report**
- **Get set for recovery**
- **Establish a foolproof expenses procedure**