



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



TechWatch

News at a glance

Issue 95 • September 2010

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.

Contents

Financial Reporting, Auditing and Ethics

New!

1. [Annual Update Conferences 2010](#)

Members' Handbook

2. [Handbook Updates No. 91 & 92](#)

Financial Reporting

3. [Guidance on the Determination of Realised Profits and Losses](#)
4. [FRSC Minutes](#)
5. [Invitations to Comment on IASB Pronouncements](#)
6. [Institute Comments on IASB Discussion Paper on *Extractive Activities*](#)

International Meetings

7. [IASB](#)
8. [IFRS Interpretations Committee](#)
9. [IAASB](#)
10. [IESBA](#)

Useful Resources

11. [Publications](#)

Comment Due Dates

Specialist Practices, Business Members and Advocacy

Professional Accountants in Business

12. [IFAC Consultation Paper on Changing Roles and Employer Expectations of PAIBs](#)

Taxation

13. [Revised DIPN 40](#)
14. [New Advanced Ruling](#)
15. [Double Taxation Agreement with Liechtenstein Signed](#)

Legislation & Other Initiatives

16. [Institute's Views on the Companies Bill Second Phase Consultation](#)
17. [Companies Bill First Phase Consultation Conclusions](#)
18. [New Search System for Land Records](#)
19. [Combating Money Laundering/Terrorism Financing – FATF looks back over the past 20 years](#)

Useful Resources

20. [Library Resources](#)
21. [Other Publications](#)

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

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

TechWatch is prepared by the Hong Kong Institute of CPAs and is intended for general guidance only. Professional advice should be taken before applying the content of this publication to your particular circumstances. While the Institute endeavours to ensure that the information in this publication is correct, no responsibility for loss to any person acting or refraining from action as a result of using any such information can be accepted by the Institute.

Financial Reporting, Auditing and Ethics

New!

1. Annual Update Conferences 2010

Two annual update conferences will be held in the coming months – auditing update on 25 September 2010 and accounting update on 6 November 2010. Speakers from major accounting firms will speak on the latest standards and requirements. The highlights are:

Annual Auditing Update

- HKSAE 3402 *Assurance Reports on Controls at a Service Organisation*
- HKSA 600 (Clarified) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*
- HKSA 800 (Clarified) *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*
- HKSA 805 (Clarified) *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*
- HKSA 540 (Clarified) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- HKSA 550 (Clarified) *Related Parties*

Annual Accounting Update

- HKFRS 9 *Financial Instruments*
- Highlights of new and amended HKFRSs that are applicable in 2010
- Accounting Bulletin 4 – *Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance*
- HKFRS for Private Entities

To secure your seats, please register early. Click [here](#) for more information and enrolment details.

Members' Handbook

2. Handbook Updates No. 91 & 92

- (i) **Update No. 91** contains consequential amendments to HKFRSs which were previously set out in the appendix to the interpretations as they were not yet effective. The Institute has taken this opportunity to incorporate amendments applicable on 1 January 2010 in the relevant affected Interpretations, Basis for Conclusions and Implementation Guidance, for greater clarity.
- (ii) **Update No. 92** contains changes to Statement 1.500 *Continuing Professional Development* clarifying certain paragraphs, namely, on the criteria for granting exemptions. Appendix 2 is added to provide further guidance on exemptions. The revised Statement 1.500 is effective upon issuance.

Financial Reporting

3. Guidance on the Determination of Realised Profits and Losses

In May 2010, the Institute issued HKICPA **Accounting Bulletin 4** ("AB 4") *Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance* to provide guidance on the determination of realised profits and losses for the purposes of making distributions under sections 79A to 79P of the Hong Kong Companies Ordinance ("CO"). The most common form of a distribution is a cash dividend paid pro rata to ordinary shareholders.

Under sections 79A to 79P of the CO, a company can only make a distribution, such as a dividend, out of its accumulated "realised profits" (so far as not previously utilised or capitalised) less its accumulated, realised losses (so far as not previously written off in a reduction or reorganisation of capital).

“Realised profits” are defined in section 79A(3) of the CO as those profits that fall to be treated as realised in the company’s accounts in accordance with principles generally accepted with respect to the determination for accounting purposes of realised profits at the time those accounts were prepared. Although the CO refers to such profits being determined in accordance with generally accepted accounting principles, in practice it should not be assumed that all amounts which have been recorded in the company’s income statement prepared in accordance with HKFRSs can be regarded as “realised” and hence distributable. This is because increasingly the concept of income recognition in the income statement under HKFRSs is unrelated to the concept of realisation under Hong Kong law. Similarly, profits and losses or other changes in net assets recorded outside of the income statement under HKFRSs are not necessarily “unrealised”.

As a result, interpretive difficulties may arise when directors need to determine the full extent of a company’s distributable profits, e.g., if they intend to utilise all of those profits to make a distribution, or, in the case of a company listed on the Stock Exchange of Hong Kong, they need to satisfy the disclosure requirements under the Stock Exchange Listing Rules.

AB 4 provides guidance on the principles to be applied in analysing any given transaction to determine whether it has given rise to a realised profit or loss, as well as commentating on specific areas of complexity that may arise in this regard when a company prepares its financial statements in accordance with HKFRS.

Section 3 of AB 4 provides a detailed discussion of the principles underlying the determination of realised profits and losses as follows:

Realised profits

The discussion in section 3 begins with the principle that a profit shall be treated as realised only when realised in the form of (i) cash; or (ii) other assets, the ultimate cash realisation of which can be assessed with reasonable certainty.

Section 3 expands this principle to set out six categories of circumstances under which an increase in net assets may be regarded as a “realised profit”. These six categories of circumstances include the following two concepts which are key to determining whether a profit is realised (i) qualifying consideration; and (ii) readily convertible to cash.

Realised losses

Consistent with the broad definition of realised losses in section 79K(1) of the CO, AB 4 states that any provision, including one for depreciation or diminution in value, as well as provisions for liabilities, charges or losses should be treated as a realised loss. In general therefore, where amounts are charged against profit or loss (and hence recorded in retained earnings), the charge should be regarded as being “realised” irrespective of whether it arose on re-measurement of the carrying value of an asset or liability, or the charge has crystallised, for example, on settlement of a law suit.

Moreover, the guidance in AB 4 on determining whether a profit or loss is realised can be used to determine which adjustments need to be made to accumulated retained profits as reported under HKFRS in the company’s statement of financial position in order to arrive at net realisable profits available for distribution. These adjustments will generally fall into one of the following four categories:

- excluding unrealised profits recognised in profit or loss;
- including realised profits recognised outside of profit or loss
- deducting realised losses recognised outside of profit or loss
- other permissible or required statutory adjustments

In order to assist in its application, the Institute issued [HKICPA Standard Setting Department Staff Summary](#) (“the Staff Summary”). The appendix to the Staff Summary assists with applying this guidance, by identifying common

adjustments to retained earnings under HKFRS to arrive at an estimate of net realisable profits available for distribution.

AB 4 and the Staff Summary are issued for general guidance only and do not introduce additional accounting, disclosure or legal requirements. They are available as a source of guidance immediately on issue. Members should seek legal advice where necessary when applying AB 4 and the Staff Summary.

4. FRSC Minutes

This [FRSC minutes](#) on 6 July 2010 covers:

- Report on IFRS Advisory Council Meeting (previously known as IASB Standards Advisory Council) on 21 and 22 June 2010
- Consultation Paper on CO Rewrite relating to Accounts and Audit
- Accounting Application Issue
- HKFRS For Private Entities
- IASB ED on *Conceptual Framework for Financial Reporting: The Reporting Entity*
- Comment on Various Consultation Documents
- Visit of Mr. Robert Garnett on 22 July 2010
- Agenda of National Standard Setters Meeting (September 2010)

5. Invitations to Comment on IASB Pronouncements

(i) IASB ED of *Insurance Contracts*

The Institute has issued an [Invitation to Comment](#) on IASB ED of *Insurance Contracts*, with comments requested by **15 November 2010**.

The ED proposes a single International Financial Reporting Standard that all insurers, in all jurisdictions, could apply to all contract types on a consistent basis.

When the IASB was established in 2001 there were no international financial reporting requirements for insurance contracts. In 2004 the IASB introduced IFRS 4 *Insurance Contracts* as an interim standard that permitted many existing international accounting practices to be retained, whilst beginning a more comprehensive review of insurance accounting as a second phase of the project. The proposals published are the result of that review.

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

(ii) IASB ED of *Leases*

The Institute has issued an [Invitation to Comment](#) on IASB ED of *Leases*, with comments requested by **30 November 2010**.

The proposals are one of the main projects included in the IASB and the US FASBs' Memorandum of Understanding. The proposals, if adopted, will greatly improve the financial reporting information available to investors about the financial effects of lease contracts.

The accounting under existing requirements depends on the classification of a lease. Classification as an operating lease results in the lessee not recording any assets or liabilities in the statement of financial position (balance sheet) under either IFRSs or US GAAP. This results in many investors having to adjust the financial statements (using disclosures and other available information) to estimate the effects of lessees' operating leases for the purpose of investment analysis.

The proposals would result in a consistent approach to lease accounting for both lessees and lessors – a "right-of-use" approach. Among other changes, this approach would result in the liability for payments arising under the lease contract and the right to use the underlying asset being included in the lessee's statement of

financial position, thus providing more complete and useful information to investors and other users of financial statements.

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

(iii) IASB ED of *Removal of Fixed Dates for First-time Adopters (Proposed Amendments to IFRS 1)*

The Institute has issued an **Invitation to Comment** on IASB ED of *Removal of Fixed Dates for First-time Adopters (Proposed Amendments to IFRS 1)*, with comments requested by **11 October 2010**.

The proposal would amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* by replacing references to a fixed transition date of "1 January 2004" with "the date of transition to IFRSs". As a result, entities adopting IFRSs for the first time would not have to restate derecognition transactions that occurred before the date of transition to IFRSs. In addition, first-time adopters would also not have to recalculate "day 1" differences on initial recognition of financial instruments, where the transaction occurred before the date of transition to IFRSs.

(iv) IFRS Interpretations Committee ED of *Stripping Costs in the Production Phase of a Surface Mine*

The Institute has issued an **Invitation to Comment** on IFRS Interpretations Committee ED of *Stripping Costs in the Production Phase of a Surface Mine*, with comments requested by **15 November 2010**.

The IFRS Interpretations Committee, the interpretative body of IASB, has published for public comment proposed guidance on the accounting for stripping costs in the production phase of a surface mine.

In response to request for considering how to account for stripping costs (the process of removing waste from a surface mine in

order to gain access to mineral ore deposits) given the divergence in practice that exists, the committee has proposed that costs associated with a "stripping campaign" should be accounted for as an additional component of an existing asset, and this component should be written down over the reserves that directly benefit from the campaign.

6. Institute Comments on IASB Discussion Paper on *Extractive Activities*

The Institute's **submission** to IASB Discussion Paper ("DP") on *Extractive Activities* generally supports the objective of developing guidance for companies operating in extractive industries, given there is diversity in accounting practices across jurisdictions and within the industries.

The Institute supports the use of historical cost as the measurement basis for extractive activities discussed in the DP and the development of a set of disclosure requirements for extractive activities. However, it does not support the development of an accounting standard specific to extractive activities; rather it is believed that the IASB should develop a set of principles-based standards in accordance with the *Framework* to meet the needs of all users. It is noted that the recognition proposals contained in the DP do not appear to be consistent with the *Framework*. In addition, it is not convinced that the proposal to apply impairment rules other than those within IAS 36 *Impairment of Assets* has been sufficiently justified.

International Meetings

7. International Accounting Standards Board

The IASB met on 3 August and 24 August 2010, and discussed the following topics:

- Amortised cost and impairment
- Hedge accounting: hedge effectiveness testing
- Hedge accounting: eligible hedged items

- Hedge accounting for investment in equity investments at fair value through OCI
- Income tax

Click to view the IASB Update on the meetings on **3 August** and **24 August**. The IASB next meets in September 2010.

8. IFRS Interpretations Committee

The IFRS Interpretations Committee met on 2 and 3 September 2010. Click [here](#) for the meeting details and [here](#) for the forthcoming IFRIC Update on the September meeting.

9. International Auditing and Assurance Standards Board

The IAASB next meets on 20-24 September 2010. Click [here](#) for the next meeting's details and previous meeting summary.

10. International Ethics Standards Board for Accountants

The IESBA next meets in November 2010. Click [here](#) for the next meeting's details and previous meeting summary.

Useful Resources

11. Publications

The following are publications on various topics:

- (i) Summary on segment reporting:
 - [Executive summary](#) by KPMG
- (ii) Illustrative financial statements:
 - [International GAAP illustrative financial statements for year ended 31 December 2010](#) by Ernst & Young
- (iii) Impairment of assets:
 - [Overview](#) by Ernst & Young

(iv) IAS 39 replacement project:

- [Update](#) by BDO

(v) Convergence update between IFRS and US GAAP:

- [Newsletter](#) by Grant Thornton

Comment Due Dates

13 September 2010: IASB ED of *Presentation of Items of Other Comprehensive Income (Proposed amendments to IAS 1)*

17 September 2010: IASB Request for Comment on FASB *Financial Instruments* ED

8 October 2010: IASB ED of *Revenue from Contracts with Customers*

11 October 2010: IASB ED of *Removal of Fixed Dates for First-time Adopters (Proposed Amendments to IFRS 1)*

15 October 2010: IAASB ED on Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and ISA 610 (Revised), *Using the Work of Internal Auditors*

15 November 2010: IASB ED of *Insurance Contracts*

15 November 2010: IFRS Interpretations Committee ED of *Stripping Costs in the Production Phase of a Surface Mine*

30 November 2010: IASB ED of *Leases*

Specialist Practices, Business Members and Advocacy

Professional Accountants in Business

12. IFAC Consultation Paper on Changing Roles and Employer Expectations of PAIBs

The Professional Accountants in Business Committee of the International Federation of Accountants ("IFAC PAIBC") met in Bucharest in early September, hosted by the Romanian accountancy body ("CECCAR"). One of the projects undertaken by the IFAC PAIBC has been to produce a consultation paper, *Competent and Versatile: How Professional Accountants in Business Drive Sustainable Organisational Success*, which highlights how employer expectations of PAIBs are anticipated to change in light of global trends and evolving organisational needs. The paper aims to help PAIBs think about and prepare for the roles they will be expected to fill in the future, and the skills and competences required for these changing requirements and circumstances. The consultation paper has now been released.

The paper defines employer expectations in terms of a number of drivers of sustainable organisational success, based on an analysis of three long-term trends influencing organisations, namely globalisation, complexity, and technology. Against the background of these drivers, the paper looks at key activities that PAIBs will be expected to perform, analysed in terms of four roles that are the cornerstones of the services provided by PAIBs: (1) creators, (2) enablers, (3) preservers and (4) reporters, of sustainable value.

Discussion questions that precede the paper ask for feedback on the usefulness of developing an international competency framework that would cover the roles and domain of PAIBs and other relevant issues.

Click [here](#) to access the consultation paper or submit a comment to IFAC by **30 November 2010**.

If you wish to send comments to the Institute, please send them to [<commentletters@hkicpa.org.hk>](mailto:commentletters@hkicpa.org.hk) by **30 October 2010**.

Taxation

13. Revised DIPN 40

DIPN 40 *Profits tax – Prepaid or Deferred Revenue Expenses* has been revised to clarify the accounting standards that would be acceptable for the preparation of financial statements where a profits tax return is filed by a foreign company. The amendment is made in paragraph 19.

14. New Advanced Ruling

Advance ruling case no. 43, relating to section 14 of the Inland Revenue Ordinance, has been published.

15. Double Taxation Agreement with Liechtenstein Signed

Hong Kong signed a comprehensive **agreement** with Liechtenstein on the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital on 12 August 2010.

Legislation & Other Initiatives

16. Institute's Views on the Companies Bill Second Phase Consultation

As reported in **TechWatch no. 92**, the government released the second phase consultation on the draft Companies Bill ("CB"), as part of the Companies Ordinance rewrite project, to seek views on draft legislative provisions on various areas, including share capital, accounting and auditing provisions, and company investigations. The Institute issued a **submission** commenting on various matters.

The Institute asked that reconsideration be given to the proposal of expanding the use of the financial reporting standards for small- and medium-sized enterprises in Hong Kong ("SME-FRS") to private companies that would not qualify as small companies on the size criteria,

where members holding at least 75% of the voting rights so resolved and no other member objected. The view was that the SME-FRS was designed with small, private companies in mind, which were more likely to have simple accounts for which historical information would be adequate. While it may be acceptable for the use of SME-FRS to be extended to groups of small companies that meet the size criteria, this framework might not be seen as providing sufficient disclosure in relation to the financial performance and position of larger companies/groups, given the economic impact of such companies/groups on the community. The Institute believes that larger private companies/groups should adopt HKFRS for Private Entities in order to keep the financial reporting of their businesses aligned with international standards.

While the Institute supported the proposal to give auditors greater access to information to facilitate the performance of their duty, the need to empower auditors to interview any current and former employee, at any level in the company, and to subject an employee who does not comply to criminal sanctions, is less clear cut. The submission suggested that extension of the auditors' right to information be defined more clearly and restricted to personnel who are more likely to possess relevant information.

Clarification is needed regarding the new requirement to disclose in the financial statements the nature of services and the amount of remuneration received or receivable by an "associate of the auditor", in addition to the auditor. Questions arise as to how "associate of the auditor" should be defined, whether the disclosure would be confined to the company or to encompass the group, and whether the disclosure should be separated between audit and non-audit services.

The Institute considered that the new provision requiring a principle-based, more analytical and forward-looking business review to be included in the directors' report, is not clear enough for compliance purposes. Some of the information required to be contained in the review may reflect a significant degree of subjective judgment.

The CB introduces a new criminal sanction for an auditor who knowingly or recklessly causes certain statements required to be contained in an auditor's report to be omitted from the report. The submission queried whether criminal sanctions were necessary given the Institute's power to discipline auditors under the Professional Accountants Ordinance. It also raised a number of other questions, e.g., the timeframe for prosecution, the persons liable to prosecution, the party with the primary responsibility for investigation, whether the concept of materiality would be taken into consideration and whether the court would be the most suitable forum to judge on an opinion requiring the exercise of professional judgment.

17. Companies Bill First Phase Consultation Conclusions

On 30 August 2010, the government published the [conclusions](#) drawn from the public consultation on the first phase consultation on the draft Companies Bill, under the CO rewrite project, to seek views on draft provisions and on a number of specific issues. See [TechWatch no. 90](#) for the Institute's submission.

The respondents' comments and the government's responses, including the proposals to be implemented, are summarised in the [conclusions paper](#). These include:

- Retaining the headcount test for members' schemes and creditors' schemes under section 166 of the CO. Nevertheless, the court would be given discretion to dispense with the headcount test for members' schemes so as to tackle the problem of share splitting by parties opposing a scheme, but this discretion would not be extended to creditors' schemes.
- In view of rising concerns over protection of personal privacy and information, directors would be allowed to provide a service address for display on the public register while their residential addresses would be kept on the confidential record. In addition, certain digits of the identification numbers of individuals would be masked on the public register. Access to full details would be

restricted to public and enforcement/regulatory authorities, liquidators and provisional liquidators and others pursuant to a court order.

- Subject to the introduction of a new disinterested members' approval exception to prohibitions on loans and similar transactions in favour of directors and their connected persons for public companies, the concept of relevant private companies* would be modified to cover only private companies which are subsidiaries of a public company (*i.e., private companies that are treated as a public or listed company in the CO in respect of prohibitions on loans, quasi-loans and credit transactions in favour of directors or directors of its holding company or another company controlled by one or more of its directors).
- Common law derivative action currently preserved in CO would be retained.
- Not to modify the proposal of codifying directors' duty of care, skill and diligence with a "mixed objective/subjective test" along the lines of the UK Companies Act 2006.

18. New Search System for Land Records

The Land Registry has introduced a new search system ("NSS") for land records, which incorporates a technical design to ensure enhanced stability in the delivery of search services. Operation of the NSS over the Internet is 20 hours daily running from 7:30 am to 3:30 am (with last order cut-off at 2:30 am) the next day.

The existing Integrated Registration Information System ("IRIS") Online Services has been migrated to operate on the new system. Customers can continue access the IRIS Online Services on the NSS via the same existing domain name at < www.iris.gov.hk > and use their current login IDs to conduct online searches. All search screens, functions, delivery methods for search orders and online payment options are same as the IRIS.

More details can be found in the [Land Registry Circular Memorandum no. 2/10](#).

19. Combating Money Laundering/Terrorism Financing – FATF looks back over the past 20 years

The [Financial Action Task Force](#) ("FATF"), which issues the international standards on combating money laundering/terrorism financing ("ML/TF"), has published a document, "[20 years of the FATF Recommendations – 1990-2010](#)". This document outlines its work over the past 20 years since it first issued the standards on combating ML known as the [40 Recommendations](#). This was followed by another [9 recommendations](#) on combating TF in 2001. In 2008, it issued a [Risk-based Approach Guidance for Accountants](#) to help accountants apply such an approach in relation to their obligations to combat ML/TF.

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

20. Library Resources

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

In addition, members can [login](#) to the [e-Library](#) and access e-journals and e-books on a wide range of business subjects.

21. Other Publications

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

- (i) Publications in August 2010 by Hong Kong Exchanges and Clearing:
 - a number of [listing decisions](#) (see LD101-1 & LD101-2, LD102-1 & LD102-2)

- **Financial Statements Review Programme Report 2010**, which summarises key observations and findings from its review of 100 financial reports released by listed issuers in 2008 and 2009.

- (ii) An article under the SFC Dr. Wise's column, **No More Gifts to Take Your Mind off the Product**, discusses the new measure of the ban on intermediaries offering gifts to promote specific investment products.

- (iii) The August issue of **GAA Accounting**, featuring a chartered accountant who became a CEO of a gold mine in West Africa, the future of audit following the crisis, and articles from leading accounting institutes around the world.

- (iv) Articles on corporate governance by Deloitte:
 - **Corporate governance considerations in initial public offerings**

 - **Risk intelligent decision-making: ten essential skills for surviving and thriving in uncertainty**

 - **Global economic outlook: global slowdown or false alarm?**

 - **Dodd-Frank Wall Street Reform and Consumer Protection Act — abstracts and observations**

- (v) **Through the Lens of the Investor: IFAC Business Reporting Series Article Three** by IFAC