



TechWatch

News at a glance

Issue 104 • June 2011

TechWatch updates you on technical developments in financial reporting, auditing, regulation and business. The Institute welcomes your comment, by email 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

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Peter Tisman (Editor), Elena Chai, Mary Lam, Sharon Yeung

Financial Reporting, Auditing and Ethics

New!

1. Guidance on the Determination of Realized Profits and Losses - AB 4

Members are reminded that the Institute has issued **Accounting Bulletin ("AB") 4 Guidance on the determination of realized profits and losses in the context of distributions under the Hong Kong Companies Ordinance** in May 2010 to provide guidance on the determination of distributable profits under the Hong Kong Companies Ordinance.

For ease of reference, a **staff summary** has been prepared to provide an overview of the guidance set out in AB 4.

2. SMP and SME Resource Centre

Some latest publications and guidance regarding Code of Ethics (Hong Kong specific and International specific) are updated in a new section "HKICPA Code of Ethics for Professional Accountants" in the SMP and SME Resource Centre.

Click [here](#) to view the updated information at the SMP and SME Resource Centre.

Financial Reporting

3. Invitation to Comment on IFRS Foundation Report of the Trustee's Strategy Review

The Institute has issued an **Invitation to Comment** on IFRS Foundation Report of the Trustee's Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation's Second Decade, with comments requested by **30 June 2011**.

In this paper, the Trustees set out a series of recommendations for the organization's second decade. These recommendations address four areas:

- the IFRS Foundation's mission, specifically the public interest served by the Foundation's work;
- governance;
- the process and procedures used by the Foundation and the IASB; and
- the organization's financing.

In making the recommendations contained in the Strategy Review paper, the Trustees have put forward proposals that affect the different components of the IFRS Foundation. These include actions for:

- the Trustees specifically as the non-executive body responsible for the oversight of the entire gamut of the IFRS Foundation's activities;
- the Foundation in general (which includes the standard-setting function, an education programme, publication and content-related services, IFRS XBRL development, and general operations); and
- the operations, procedures and strategy of the IASB, but not its technical activities.

Consistently with their Constitutional responsibilities, the Trustees set out in this document a vision related to all three organizational components and identify where specific action is required, where appropriate. The Trustees do not comment on the technical content of the IFRSs or possible technical items for the IASB's agenda.

The Trustees acknowledge that they are making these recommendations at a time when a number of major economies are considering the adoption of IFRSs for their domestic economies (including Japan and the United States). For the purpose of the review, the Trustees assumed that these major economies will make a positive decision, in some form, on the adoption of global standards. Failure of such commitment on this basis would lead to the reconsideration of some elements of this strategy review document and could lead to modifications in this

suggested geographical distribution of the membership of the IFRS Foundation Trustees and the IASB.

In making these recommendations, the Trustees also note that the IFRS Foundation Monitoring Board is undertaking its own review of the Foundation's governance arrangements. The Monitoring Board's review focuses primarily on institutional aspects of governance, particularly the composition and the respective roles and responsibilities of the Monitoring Board, Trustees and IASB. While addressing the issue of governance (in a manner consistent with the Monitoring Board's proposals), this paper addresses broader issues of the IFRS Foundation's mission and operations, the Trustees' activities, the IASB's due process, and financing.

The Trustees are committed to co-ordinating the conclusion of their review with the IFRS Foundation Monitoring Board, in order to arrive at an integrated set of proposals on the basis of the proposals and the final decisions reached by the Monitoring Board following its separate public consultation.

4. Institute Comments on Consultation Documents

- (i) The IASB ED of *Offsetting Financial Assets and Financial Liabilities*

The Institute made a [submission](#) to IASB on its ED of *Offsetting Financial Assets and Financial Liabilities* and the Institute is overall supportive of the IASB decision to use, as a basis for the converged requirements, the existing guidance for offsetting financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*. However, with the more detailed criteria and guidance contained in the proposals, including those related to derivatives and cash collateral, the reporting under IFRS, particularly for banks and clearing houses, may be impacted greatly as the clarifications will affect how the offsetting requirements are interpreted in

practice today. The Institute understands that the intention of the IASB was not necessarily to change the current offsetting requirements for IFRS preparers, but rather to clarify some of the existing criteria. However, it is noted that the proposed stringent requirements may have unintentional consequences as they would pose a number of practical issues that we would like the IASB and the US FASB to reconsider and amend the effects of the "clarification" in the final Standard including:

- 1) Requirement to simultaneously settle at the same moment

The Institute does not believe that such simultaneity can exist as it is not operational in practice due to processing constraints even with a clearing house. In addition, the Institute considers the proposed simultaneous settlement criterion, based on the moment in time at which an asset and liability are settled, is narrow and rules-based as well as operationally challenging.

- 2) Right of set-off must be legally enforceable in all circumstances

The Institute considers that if an entity has a legal right to set-off under its contract, the position of the two parties with a netting arrangement is unclear and may be subject to judicial determination by the courts. This issue is particularly important for emerging countries where an international ISDA ("International Swaps and Derivatives Association") contract could be interpreted differently locally based on local rules and regulations which are influenced by the political environment. In such circumstances, the clarification that the right of set-off must be unconditional does not resolve the issue as to whether that right is legally enforceable in the event of bankruptcy.

3) Offsetting of cash collateral against underlying derivative financial instruments

The ED states that an entity shall not offset financial assets, including cash, pledged as collateral or the obligation to return collateral obtained and the associated financial assets and financial liabilities. Under the proposals, the margin accounts are described as a form of collateral for the counterparty or clearing house. However, in effect, the cash collateral operates as deposit accounts with or from the counterparty that are used in the normal course of events to settle payments or receipts under derivatives or other transactions within the scope of the same master agreement. It is not clear from the ED why offsetting is prohibited on cash margin arrangements.

(ii) IVSC ED of Technical Information Paper 1 The Discounted Cash Flow Method - Real Property and Business Valuations

The Institute made a [submission](#) to IVSC ED of Technical Information Paper 1 The Discounted Cash Flow ("DCF") Method - Real Property and Business Valuations and the Institute generally agrees with the principles-based approach adopted in the proposed guidance.

In the view of the Institute, the purpose of valuation guidance is to provide the underlying principles that should be considered in undertaking a valuation, rather than to stipulate a specific technique. Prescriptive technical information paper at an international level would not take account of differences in legal frameworks and market mechanisms between countries which should be left to the local valuation standard setters. The Institute therefore supports the view that it is not the role of the IVSC guidance to expressly identify particular approaches that would be acceptable or unacceptable.

From a financial reporting perspective, it is considered that the underlying DCF method described in the Technical Information Paper ("TIP") is generally consistent with that in IFRS, except for that relating to investment value which is not consistent with the IFRS fair value concept of an exit price from the market participants' perspective. The Institute considers that it is conceptually not appropriate for the TIP to state that the cash flows for future periods are constructed using "actual" income and "actual" expenditure in paragraph 8 as the concept of the cash flow model is developed based on forecast information. It is recommended that the word "actual" should be replaced with "contractual/estimated expected" if the International Valuation Professional Board means to refer to cash flows that are known or are reasonably predictable at the time the valuation is performed.

The Institute supports that the TIP provides examples of key components that should normally be provided for the DCF model in the valuation report. It is believed that it is important for the valuation report to provide clear guidance in relation to its reliability stating the inputs and assumptions adopted and the reasonableness thereof including an indication of the availability of data or the possible range of such data in the context of the current market conditions.

Finally, the Institute considers that more practical implementation guidance would be welcomed by emerging economies in Asia as entities in those economies might find it difficult to apply the principles in practice due to the immaturity of the market. The Institute encourages the IVSC to work closely with local valuation standard setters such as The Royal Institution of Certified Surveyors in the UK and the Hong Kong Institute of Surveyors in Hong Kong in developing local practical guidance on real property and business valuations so as to ensure it is consistent with the underlying principles in the TIP when addressing specific legal and market conditions of different jurisdictions.

Audit & Assurance

5. Invitations to Comment on Consultation Documents

- (i) IAASB ED on Proposed International Standard on Assurance Engagements ("ISAE")

The Institute has issued an [Invitation to Comment](#) on IAASB ED on Proposed ISAE 3000 (Revised) *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, with comments requested by 1 August 2011.

The Explanatory Memorandum to the ED provides background information and explanation of the proposed revised ISAE.

Proposed ISAE 3000 is a principles-based standard that can be applied effectively to a broad range of assurance engagements. Such engagements may range from assurance on statements about the effectiveness of internal control, for example, to direct engagements such as performance or "value for money" audits, to possible future engagements addressing integrated reporting or corporate social responsibility reporting. It reflects those requirements that, in the IAASB's view, enable consistent high quality engagements while being sufficiently flexible to apply to the broad range of relevant engagements.

Consistent with extant standard, the proposed ISAE recognizes that two levels of assurance are possible for engagements: reasonable assurance and limited assurance. It also introduces additional guidance designed to help readers better understand these two levels of assurance.

In accordance with the Institute's International Standards Convergence Due Process, comments are invited from any interested party and the Institute would like to hear from both those who do agree and those who do not agree with the proposals contained in the IAASB ED.

- (ii) IFAC's IAASB Consultation Paper on Enhancing the Value of Auditor Reporting: Exploring Options for Change

The Institute has issued an [Invitation to Comment](#) on IFAC's IAASB Consultation Paper on Enhancing the Value of Auditor Reporting: Exploring Options for Change, with comments requested by 16 August 2011.

The purpose of this Consultation Paper is to determine whether there are common views among key users of audited financial statements and other parties to the financial reporting process about the usefulness of auditor reporting, and to explore possible options to enhance the quality, relevance and value of auditor reporting.

The Consultation Paper describes issues with current financial reporting, including a perceived "information gap," identified by some stakeholders. It then sets out possible options for change and seeks input as to whether such options might be effective in enhancing auditor reporting and the communicative value of the auditor's report. IAASB is also seeking information about the potential implications of changes in auditor reporting, as well as about possible implementation challenges.

The IAASB is consulting across a broad range of users globally to better understand the extent to which these views are held for audits of financial statements of various types of entities and across different jurisdictions, and to explore options for change that may help achieve reporting that better meets users' information needs, thereby to enhance the value and relevance of auditor reporting. The IAASB wants to better understand these views as well as the views of others, including users of audited financial statements of small and medium sized entities and public sector organizations, preparers, auditors and other key participants in the financial reporting process.

6. Institute Comments on IAASB Proposed ISRE 2400 (Revised)

The Institute made a [submission](#) to IAASB on ED of the Proposed ISRE 2400 (Revised) *Engagements to Review Historical Financial Statements* and the Institute supports the proposed plan to revise ISRE 2400 which will help the users or preparers of financial statements better understand the basis for a review engagement.

International Meetings

7. International Accounting Standards Board

The IASB met on 4 May, 11-12 May, and 17-19 May 2011, and discussed the following topics:

- Annual improvements
- Insurance contracts
- IFRS 9: Financial instruments - hedge accounting
- IFRS 9: Financial instruments - impairment
- IFRS Interpretations Committee
- Offsetting financial assets and financial liabilities
- Leases
- Revenue recognition

Click to view the IASB Update on the meetings on [4 May](#), [11-12 May](#) and [17-19 May](#). The IASB next meets in June 2011.

8. IFRS Interpretations Committee

The IFRS Interpretations Committee met on 5-6 May 2011, and discussed the following topics:

- Accounting for stripping costs in the production phase of a surface mine

- Contingent pricing of property, plant and equipment and intangible assets
- IFRS Interpretations Committee tentative agenda decisions
- Issues considered for Annual Improvements
- IFRS Interpretations Committee work in progress

Click to view the IFRIC Update on the meeting on [5-6 May](#). The IFRS Interpretations Committee next meets in July 2011.

9. International Auditing and Assurance Standards Board

The IAASB next meets in June 2011. Click [here](#) for the next meeting's details and previous meeting summary.

10. International Ethics Standards Board for Accountants

The IESBA next meets in June 2011. Click [here](#) for the next meeting's details and previous meeting summary.

Useful Resources

11. Publications

The following are publications on various topics:

- (i) Progress report on convergence:
 - [Report](#) by the IFRS Foundation
- (ii) Upcoming changes in IFRS:
 - [IFRS update for financial year ending 30 June 2011](#) by Ernst & Young
- (iii) Illustrative financial statements:
 - [Illustrative interim condensed consolidated financial statements](#) by Ernst & Young
 - [Disclosure checklist](#) by Ernst & Young

(iv) Single model for consolidation:

- [Investor perspective article May 2011](#) by the IFRS Foundation
- [HKFRSs/IFRSs update](#) by BDO

Comment Due Dates

30 June 2011: IFRS Foundation Report of the Trustee's Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation's Second Decade

1 August 2011: IAASB ED on Proposed ISAE 3000 (Revised) *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*

16 August 2011: IFAC's IAASB Consultation Paper on Enhancing the Value of Auditor Reporting: Exploring Options for Change

Specialist Practices, Business Members and Advocacy

Professional Accountants in Business

12. Proposed Predictive Analytics Guidance from IFAC

The Professional Accountants in Business Committee of the International Federation of Accountants ("IFAC PAIBC") has issued an exposure draft of an international good practice guidance, entitled [Predictive business analytics: Forward-looking measures to improve business performance](#). The guidance is designed to help PAIBs anticipate future events, forecast possible outcomes, and select actions and decisions to improve the performance of their organizations, in response to changing market and industry dynamics.

Click [here](#) to submit your comment to the IFAC PAIBC by **29 July 2011**.

Corporate Finance

13. Consultation Conclusions on Ex-entitlement Trading and Shareholder Approval

On 20 May, Hong Kong Exchanges and Clearing Limited ("HKEx") published its [consultation conclusions](#) on ex-entitlement trading and shareholder approval.

Given that a majority of the respondents supported the view that shares should be traded ex-entitlement only after shareholder approval (see [TechWatch no. 102](#) (item 17) for the Institute's submission), HKEx has amended the listing rules to:

- prevent shares from trading ex-entitlement before shareholder approval;
- require the record date to be set at least three business days after the date of shareholder approval (i.e. at least one cum-trading day will be provided);

- require a minimum of one cum-trading day after the general meeting; and
- apply the changes to all conditional entitlements that are subject to shareholder approval.

The rule amendments ([amendments to main board listing rules](#) and [amendments to GEM listing rules](#)) will come into effect on 20 June 2011. However, they do not apply to entitlements with timetables announced before the effective date of the rule amendments.

14. Legislative Amendment on Structured Products

The [Securities and Futures and Companies Legislation \(Structured Products Amendment\) Ordinance 2011](#) ("the Amendment Ordinance") was gazetted on 13 May 2011. The Amendment Ordinance transfers the regulation of public offers of structured products in the form of shares or debentures from the prospectus regime of Companies Ordinance ("CO") to the regime for public offers of investments under the Securities and Futures Ordinance ("SFO").

Following the commencement of the Amendment Ordinance on 13 May 2011:

- The issue of advertisements and offer documents for structured products (be they in the form of shares or debentures, or any other legal form) must be authorized by the SFC, unless otherwise exempted by the SFO.
- The safe harbours in the 17th schedule to the CO are no longer available to structured products in the form of shares and debentures; instead the exemptions in section 103 of the SFO apply.

15. Areas for Improvement in Selling Practices of Securities Sector

The SFC and the Hong Kong Monetary Authority jointly engaged an external service provider to carry out a "mystery shopping"

exercise between July and November 2010 to look into the selling practices of intermediaries regarding unlisted securities and futures products. The exercise primarily focused on three key areas, namely the "know-your-client" procedures, explanation of product features and disclosure of risks, and suitability assessment.

Findings of the mystery shopping programme

which were released on 24 May, indicated a need for licensed corporations to review their systems and controls to ensure full compliance when selling investment products to the public. The deficiencies, in terms of the selling practices of the selected licensed corporations, included:

- insufficient understanding of the recommended products;
- inadequate or inaccurate explanations of the features and/or disclosure of risks of the recommended products;
- inaccurate descriptions of the SFC's requirements or practices; and
- failure to take into account all the relevant personal circumstances of the client when making the suitability assessment.

Taxation

16. Institute Comments on Proposed Tax Deductions for Intellectual Property Rights

The Institute has issued a [submission](#) on the [Inland Revenue \(Amendment\) \(No.2\) Bill 2011](#). The bill relates to profits tax deductions for capital expenditure incurred on the purchase of three commonly-used types of intellectual property rights ("IPR"), namely copyrights, registered designs and registered trademarks. In principle, the Institute welcomes the proposals but believes they do not go far enough and that the proposed anti-avoidance provisions are too restrictive. The Institute's comments cover, amongst other things, the scope of deductions, period for write-off of IPR expenditure and the anti-avoidance provisions.

17. Double Taxation Agreements Come into Effect

Orders to implement double taxation agreements ("DTAs") with Liechtenstein, France, Japan and New Zealand, and the Protocol to the Agreement with Luxembourg, were gazetted on 13 May 2011.

18. IRD Warning about a Fraudulent Website

IRD has **alerted** the public to a fraudulent website using the domain name www.irdhongkong.com, which looks similar to the official website of IRD (www.ird.gov.hk).

19. Advance Ruling on Section 14

The IRD has published an **advance ruling** relating to service fee income and section 14 of the Inland Revenue Ordinance on chargeability to tax.

20. More LegCo Questions on Processing Trade Operations

Questions in respect of processing trade operations and section 39E of the Inland Revenue Ordinance continue to be raised in LegCo. Click for the detailed questions raised on [11](#) and [25](#) May.

Legislation & Other Initiatives

21. Companies Registry Update

Details of the latest updates on **third party software interface with e-Registry** have been posted on the Companies Registry ("CR")'s website, as follows:

- (i) data specification for e-Forms NC1, NC1G and NC2; and the XML data file samples for e-Forms NC1 and NC1G, for the Third Party Software Interface, have been updated.
- (ii) a **testing environment** for software developers or customers' IT staff to perform necessary tests of their XML data interface file, in accordance with the **third party software interface specifications**, has been set up.

22. Latest Notices on AML/CFT

Members may wish to note that the following notices in relation to combating money laundering/terrorist financing:

- **Government notice 2552**: Updated list of relevant persons and entities specified under the United Nations Sanctions (Eritrea) Regulation.
- **Government notice 2553**: Updated list of relevant persons and entities specified under the United Nations Sanctions (Somalia) Regulation.
- **US executive order 13224**: The list relating to "Blocking property and prohibiting transactions with persons who commit, threaten to commit or support terrorism".

For more AML-related circulars from the Office of the Commissioner of Insurance, click [here](#).

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

23. 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.

24. Other Publications

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

- (i) In May 2011, HKEx published:
 - two listing decisions in relation to:
 - Guernsey as an acceptable jurisdiction of an issuer's incorporation ([LD10-2011](#))

- Alberta, Canada as an acceptable jurisdiction of an issuer's incorporation ([LD11-2011](#))
 - amendments to IPO checklists relating to standard comments on:
 - distributorship business ([CF100M](#), [CF100G](#), [CF069M](#), [CF045G](#), [SC001M](#) and [SC001G](#))
 - Pre-IPO investments ([CF100M](#), [CF069M](#) and [SC001M](#))
 - [Report](#) on initial public offering ("IPO") applications, delisting and suspensions (as at 31 May 2011)
- (ii) In May 2011, SFC published:
- May 2011 issue of [InvestEd Intelligence](#) – this issue advises investors to choose their investment advisers carefully and get the most out of them in the course of investing; discusses what investors should note when diversifying their investments overseas and explains why trading of derivative warrants ends before they expire.
 - May 2011 issue of [Enforcement Reporter](#) – this issue reports that the SFC has recently reached two other agreements on Lehman Brothers-related products, and a recent development regarding the SFC's seeking of orders to disqualify listed company directors. It also gives an account of how recent decisions by the courts and the Securities and Futures Appeals Tribunal upheld the SFC's further action against market manipulators.
- (iii) Hong Kong tax cases volume 8, which covers seven cases from July to November 2009, has been published by the government. Details of how to purchase it can be found [here](#).
- (iv) Articles on corporate governance by Deloitte:
- [Audit committee brief – Looking toward 2015 and beyond: Will your organization's internal audit function be ready?](#)
 - [Annual meeting preparations](#)
 - [Asia-Pacific economic outlook: China, India, Malaysia, Taiwan, and Vietnam](#)
 - [Global economic outlook Q2 2011: Navigating a world of turmoil](#)
- (v) [Environment: Green and growth go together](#) by OECD