



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:
Ben Lo, Katherine Leung

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

Financial Reporting, Auditing and Ethics

New!

1. Financial Reporting Seminar – Valuation for HKFRS 2 *Share-based Payment*

The Institute will hold a Financial Reporting Seminar – Valuation for HKFRS 2 *Share-based Payment* on 20 August 2012 and the seminar comprises:

- Introduction to HKFRS 2
- Regulatory framework in Hong Kong and financial reporting impact
- Introduction to different option schemes
- Discussion on common option valuation methodology
- Case studies

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

Members' Handbook

2. Handbook Updates No. 118 to 120

(i) **Update No. 118** relates to the issuance of :

- *Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*
- HKSA 610 (Revised) *Using the Work of Internal Auditors*, which aims at enhancing the external auditor's performance by providing a more robust framework for evaluating and using the work of an entity's internal audit function. Related changes have been made to HKSA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* to explain how the internal

audit function and its findings can usefully inform the external auditor's risk assessments. Both HKSA 610 (Revised) and HKSA 315 (Revised) are effective for audits of financial statements for periods ending on or after 15 December 2013.

- HKSRS 4410 (Revised) *Compilation Engagements*, which clarifies the practitioner's role and responsibilities in a compilation engagement and matters that need to be considered when accepting such engagements, and emphasizes the importance of quality control. HKSRS 4410 (Revised) is effective for compilation engagement reports dated on or after 1 July 2013.
- HKAPG 1000 *Special Considerations in Auditing Financial Instruments*, which provides important practical assistance to auditors when addressing valuation and other considerations pertaining to financial instruments.

(ii) **Update No. 119** relates to the issuance of *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to HKFRS 10 *Consolidated Financial Statements*, HKFRS 11 *Joint Arrangements* and HKFRS 12 *Disclosure of Interests in Other Entities*).

The amendments clarify the transition guidance in HKFRS 10 and provide additional transition relief in HKFRS 10, HKFRS 11 and HKFRS 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. Furthermore, for disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before HKFRS 12 is first applied.

The effective date of the amendments is annual periods beginning on or after 1 January 2013, which is aligned with the effective date of HKFRS 10, 11 and 12.

- (iii) **Update No. 120** relates to the issuance of handbook improvements to HKFRSs.

Amendments to HKFRSs and related basis for conclusions and implementation guidance, which are applicable on 1 January 2012, have been incorporated into the relevant HKFRSs for greater clarity.

Financial Reporting

3. FRSC Minutes

FRSC minutes on 8 May 2012 cover:

- Report on the various international meetings in Kuala Lumpur
- IFRS Regional Policy Forum 2013 in Hong Kong
- Outreach activities for HKFRS 10 *Consolidated Financial Statements*
- Annual Accounting Update Conference 2012
- Report on the HKICPA/IASB Outreaching Roundtable Meeting
- Proposed visit from Vietnam MoF

4. Invitations to Comment on Consultation Documents

- (i) IASB Request for Information ("RFI") of *Comprehensive Review of the IFRS for SMEs*

The Institute has issued an **Invitation to Comment** on IASB RFI of *Comprehensive Review of the IFRS for SMEs*, with comments requested by **28 September 2012**.

When the *IFRS for SMEs* was issued in July 2009, the IASB said it would assess the first two years' experience entities have had in implementing it. The IASB also said that, after the initial review, it expected to consider amendments to the *IFRS for SMEs* approximately once every three years.

The IASB's SME Implementation Group ("SMEIG") worked closely with IASB staff to develop the RFI. The SMEIG approved and submitted its final draft to the IASB for review with a recommendation for issuing the RFI.

The RFI asks specific questions on particular sections of the *IFRS for SMEs*, as well as general questions about respondents' experience with it. Respondents are encouraged to raise any other issues that they want to put forward. The document does not contain any preliminary views of the IASB or the SMEIG.

- (ii) IASB RFI of *Post-Implementation Review: IFRS 8 Operating Segments*

The Institute has issued an **Invitation to Comment** on IASB RFI of *Post-Implementation Review: IFRS 8 Operating Segments*, with comments requested by **12 October 2012**.

The IASB began its review of IFRS 8 *Operating Segments* by publishing for comment a RFI on the effect of implementing the standard. The review seeks feedback on whether the standard is functioning as intended, as well as more practical information on the challenges and costs associated with implementing the standard.

In 2007, the Trustees of the IFRS Foundation, responsible for governance and oversight of the IASB, introduced a requirement for the IASB to conduct a post-implementation review of each new standard or major amendment of a standard, two years after the effective date. The Standard on Operating Segments is the first to be reviewed under this new process. The IASB will use this review to refine its methodology for undertaking future reviews, with its Business Combination Standard being the next review planned.

In addition to the RFI, the IASB is also undertaking a broad range of outreach activities internationally to gather further

feedback on the effect of implementing IFRS 8.

(iii) IVSC Discussion Paper *Valuation in the Extractive Industries*

The Institute has issued an **Invitation to Comment** on International Valuation Standards Council ("IVSC") Discussion Paper *Valuation in the Extractive Industries*, with comments requested by **14 September 2012**.

The IVSC has formally launched a new project designed to provide greater valuation guidance to the mining, oil and gas industries. In a Discussion Paper being distributed to industry participants, the IVSC is seeking input on the form and scope of valuation guidance needed in the extractive industries, and consults on current practice on the types of assets being recognized and valued, valuation methodologies employed, and the recognition of intangible assets and goodwill in practice.

The IVSC had previously issued Guidance Note 14 *The Valuation of Properties in the Extractive Industries* ("GN 14"). However, this guidance was not included in the revamped valuation standards issued in July 2011 on the basis of the outdated IFRS standards referenced in the guidance, the IASB's project on extractive activities and a number of valuation issues that were causing difficulty in the sector that were not referenced in GN14.

Audit & Assurance

5. AASC Minutes

This **AASC minutes** on 22 May 2012 mainly covers:

- AASC Work Plan 2012 – Status Report
- Amended "Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements"

- HKSRS 4410 (Revised) "Compilation Engagements"
- HKSA 610 (Revised) "Using the Work of Internal Auditors" and HKSA 315 (Revised) "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment"
- Annual Auditing Update Conference 2012
- Publications of research findings for members

6. Invitation to Comment on IFAC's IAASB Invitation to Comment: *Improving the Auditor's Report*

The Institute has issued an **Invitation to Comment** on IFAC's IAASB Invitation to Comment: *Improving the Auditor's Report* ("ITC"), with comments requested by **7 September 2012**.

This ITC sets out the indicative direction of the IAASB's future standard-setting proposals to improve how and what auditors report in accordance with International Standards on Auditing. The ITC features a revised auditor's report that illustrates the application of the IAASB's suggested improvements. The ITC also provides the IAASB's rationale for the suggested improvements, together with a discussion of their potential value and impediments, and in what areas feedback is sought.

At the heart of the suggested improvements is the need for transparency on matters specific to the audited financial statements and the audit that was performed. A proposed new section in the auditor's report, "Auditor Commentary," is envisaged to be the mechanism by which auditors may call attention to matters that are, in the auditor's judgment, likely to be most important to the users' understanding of the audited financial statements or the audit. There are also suggested improvements with respect to new statements regarding going concern and other information in documents containing the audited financial statements, the description of the responsibilities of the auditor and key

features of the audit itself, and enhancement to the format of the report.

7. Legislative Council Election Financial Assistance Scheme Notes for Candidate and Independent Auditor of Candidate of Legislative Council Elections (2012)

The Institute prepared Legislative Council ("LC") Election Financial Assistance Scheme Notes in [English version](#) and [Chinese version](#) to provide guidance to: (a) the LC election candidate or list of LC election candidates ("candidate") seeking financial assistance from the Government under the Financial Assistance Scheme (the "Scheme"); and (b) the auditor of the candidate; in order that:

- (i) the candidate will establish proper internal controls in relation to the accounting requirements to ensure that his/her election return (with the account of the declared election expenses) complies with section 37(1)(a) and (2)(b)(i) and (v) of the Elections (Corrupt and Illegal Conduct) Ordinance (Cap. 554); and
- (ii) the auditor of the candidate will be able to plan and perform appropriate procedures for a reasonable assurance engagement as required by the Electoral Affairs Commission (Financial Assistance for Legislative Council Elections and District Council Elections)(Application and Payment Procedure) Regulation (Cap. 541N).

Ethics

8. Ethics Committee Minutes

This [EC minutes](#) on 13 December 2011 covers:

- Revised Section 500 "Professional Ethics in Liquidation and Insolvency" of the Hong Kong Code of Ethics for Professional Accountants
- Ethics Circular 1
- IESBA ED on proposed changes to the Code of Ethics for Professional Accountants related to provisions addressing a breach of a requirement of the IESBA Code

9. Invitation to Comment on IFAC's IESBA ED on Proposed Change to the Definition of "Those Charged with Governance"

The Institute has issued an [Invitation to Comment](#) on IFAC's IESBA ED on Proposed Change to the Definition of "Those Charged with Governance", with comments requested by **28 September 2012**.

The objectives of the change are to more closely align the definition of "those charged with governance" in the IESBA *Code of Ethics for Professional Accountants* ("IESBA Code") with that in ISA 260, *Communication with Those Charged with Governance*, and to eliminate any confusion as to how it is defined. The IESBA is of the opinion that the proposals do not call for any change in systems or common practice, should they be approved.

The change specifically aims to clarify that a subgroup, such as an audit committee, may assist the governing body in meeting its responsibilities. In those cases, the auditor shall determine with whom within the entity's governance structure to communicate.

The IESBA proposes that the change be effective one year after approval of the final change to the IESBA Code. Subject to comments received on exposure, the IESBA expects to finalize the revision to the IESBA Code in the second half of 2012.

International Meetings

10. International Accounting Standards Board

The IASB met on 16-21 July 2012, and discussed the following topics:

- Accounting for macro hedging
- Financial Instruments: Classification and Measurement
- Financial Instruments: Impairment
- Revenue Recognition

- IAS 28 *Investments in Associates and Joint Ventures*
- Insurance Contracts
- Investment Entities
- Leases
- Due Process
- Work plan

Click to view the IASB Update on the meetings on **16-21 July**. The IASB next meets in September 2012.

11. IFRS Interpretations Committee

The IFRS Interpretations Committee met on 10 July 2012 and discussed the following topics:

- IFRS 10 *Consolidated Financial Statements*, IAS 28 *Investments in Associates and Joint Ventures* – Accounting for the loss of control of a group of assets or a subsidiary between an investor and its associate or joint venture
- IAS 19 *Employee Benefits* – Accounting for contribution-based promises – Reconsideration of Draft Interpretation D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions*
- IFRS Interpretations Committee agenda decisions
- IFRS Interpretations Committee tentative agenda decisions
- IFRS Interpretations Committee work in progress

Click to view the IFRIC Update on the meeting on **10 July**. The IFRS Interpretations Committee next meets in September 2012.

12. International Auditing and Assurance Standards Board

The IAASB next meets in September 2012. 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 2012. Click [here](#) for the next meeting's details and previous meeting summary.

Useful Resources

14. Publications

The following are publications on various topics:

- (i) New and revised pronouncements:
 - [Overview](#) by Deloitte
- (ii) Applying IFRS for SMEs:
 - [Talking SMEs](#) by Ernst & Young
- (iii) Annual improvements 2009-2011 Cycle:
 - [Update](#) by PwC
- (iv) Definition of the public interest:
 - [Policy position paper](#) by IFAC
- (v) Transition guidance amendments for IFRS 10, IFRS 11 and IFRS 12:
 - [IFRS Developments](#) by Ernst & Young

Comment Due Dates

15 August 2012: IVSC ED of a Practical Guide on *The Role of the Professional Valuer in the Audit Process*

3 September 2012: IFRS Interpretations Committee ED of *Put Options Written on Non-controlling Interests*

7 September 2012: IFAC's IAASB Invitation to Comment: *Improving the Auditor's Report*

14 September 2012: IVSC Discussion Paper
Valuation in the Extractive Industries

28 September 2012: IASB Request for
Information of *Comprehensive Review of the
IFRS for SMEs*

28 September 2012: IFAC's IESBA ED on
Proposed Change to the Definition of "Those
Charged with Governance"

12 October 2012: IASB Request for Information
of *Post-Implementation Review: IFRS 8
Operating Segments*

Specialist Practices, Business Members and Advocacy

Professional Accountants in Business

15. Directors' Practice Notes on Continuing Professional Development by HKIoD

The Hong Kong Institute of Directors ("HKIoD") has released the first issue of its **Directors' Practice Notes**, which is on the topic of continuing professional development for directors. The practice notes are intended to be a regular series that provides guidance for directors and recommendations of best practice. Click [here](#) for details.

Corporate Finance

16. Institute Comments on SFC Proposals to Enhance Regulatory Regime for Sponsors

As reported in [TechWatch no. 116](#) (item 11), the Securities and Futures Commission ("SFC") issued a **consultation paper** to seek views on proposals to enhance the regulatory regime of sponsors. At the request of market participants, the submission deadline was extended from 6 July to end of July 2012.

The Institute's **submission** indicates that while the Institute is supportive of a number of the proposals in the consultation paper, it has some important reservations, such as:

- The proposal of making the draft prospectus, submitted together with a listing application, publicly available on the Stock Exchange website will subject a listing applicant's business to an undue level of public scrutiny prior to the final stages of its initial public offering process. This could deter companies from seeking a listing in Hong Kong, diminish Hong Kong's attractiveness as a fund-raising centre and adversely affect the development of the Hong Kong financial market.

- The Institute recommends that, instead of introducing sponsors' liability for untrue statements in a prospectus, on an ad hoc basis, this be considered, together with other relevant issues, in the context of a more comprehensive review of Hong Kong's whole prospectus regime.

The submission also points out some areas of ambiguity that require clarification or further guidance to be provided by the SFC. These include:

- The level of detailed due diligence work to be performed by a sponsor in connection with the expert report/opinion and the records that a sponsor is expected to keep as documentary evidence in support of the due diligence work it has undertaken.
- The requirement for sponsors to identify and disclose to the Stock Exchange non-compliance with other legal or regulatory requirements applicable to a listing applicant. The scope of this proposal seems to exceed the boundaries of a sponsor's responsibilities. It is also unclear what specific action the Stock Exchange is supposed to take upon receipt of such information.

17. Consultation Conclusions and Supplemental Consultation on Regulating the OTC Derivatives Market

The Hong Kong Monetary Authority ("HKMA") and the SFC jointly published [Consultation Conclusions on the Proposed Regulatory Regime for the Over-the-counter \("OTC"\) Derivatives Market in Hong Kong](#) on 11 July.

The conclusions paper summarizes the comments in response to the public consultation conducted in October-November 2011. In general, the respondents were supportive of the proposed regulatory regime and recognized the need for Hong Kong to develop and implement measures in line with G20 Leaders' objectives of improving transparency, regulatory monitoring and reducing counterparty and systemic risk in the OTC derivatives market.

Taking into consideration the responses received, the HKMA and SFC have fine-tuned some of the features of the regime and have set out proposals for taking forward the OTC derivatives reform initiative.

On the same date, the HKMA and SFC also issued a [Supplemental Consultation Paper](#) on the proposed scope of the new regulated activities to be introduced under the proposed OTC derivatives regulatory regime, and the proposed oversight of systemically important players. The consultation period will end on **31 August 2012**.

18. Proposals to Enhance the Regulatory Framework for Electronic Trading

The SFC has released a [consultation paper](#) on proposals to enhance the regulatory framework for electronic trading, which includes internet trading, direct market access ("DMA") and algorithmic trading, with comments requested by **24 September 2012**.

Key proposals include:

- general requirements on all forms of electronic trading in respect of responsibility for orders, management and supervision, adequacy of system and record keeping;
- specific requirements on the provision of internet trading and DMA services, in particular, requiring that an intermediary put in place effective risk management and supervisory controls to monitor orders, including automated pre-trade controls and regular post-trade monitoring; and
- specific requirements on algorithmic trading related to testing of the algorithmic trading system and trading algorithms, user qualification and risk management controls.

19. Consultation on Listing Rule Changes Consequential on Statutory Backing of Price Sensitive Information Disclosure

The Hong Kong Exchanges and Clearing ("HKEx") has published a [consultation paper](#)

to seek views on rule changes to complement the introduction of a statutory obligation to disclose inside information, with comments requested by **3 October 2012**.

The Securities and Futures (Amendment) Ordinance 2012 implements a statutory obligation on listed corporations to disclose price sensitive information (referred to as "inside information", under the Securities and Futures Ordinance). See [TechWatch no. 115](#) (item 23) for further detail.

In connection with the implementation of the statutory disclosure regime, changes to the Listing Rules are needed to minimize duplication and overlaps with the new law. The main change will be to remove the existing continuing disclosure obligations which will become part of the statutory regime. In addition, a range of amendments will be made consequential on the removal of these core provisions.

Taxation

20. IRD Issued a New Practice Note on Intellectual Property Rights

The IRD has issued [a new Departmental Interpretation and Practice Notes \("DIPN"\) No.49](#), on profits tax deductions for capital expenditure on relevant intellectual property rights and the taxation of royalties derived from licensing of intellectual property rights.

21. Announcements by the IRD

Members should be informed of the following:

- [DIPN 5](#) has been revised to make reference to DIPN No. 49, concerning the amended Inland Revenue Ordinance Section 16E (see paragraph 29).
- [DIPN 21](#) has been revised to make reference to DIPN No. 49 concerning the taxation of royalties derived from licensing of intellectual property rights (see paragraph 45(g)).
- [A list of qualifying debt instruments](#) as at 30 June 2012.

- [An updated list](#) of recognized stock exchanges outside Hong Kong.
- As from 1 August, [small tax bills](#) and [other government bills](#) of up to \$5000, have become payable at over 1000 convenience stores.

22. Double Taxation Agreement with Malta Takes Effect

The double taxation agreement between [Hong Kong and Malta](#) came into effect on 18 July 2012. Click for [more details](#).

Legislation & Other Initiatives

23. Update on Companies Bill Clause 399 – Proposed Criminal Sanctions against Auditors

It was reported in [TechWatch no. 117](#) (item 21) that the Institute made several submissions to the Bills Committee, met with legislators from different parties and wrote to all legislators to explain its concerns on clause 399 of the Companies Bill.

Subsequent to the above lobbying efforts, clause 399 was discussed and passed at the Legislative Council ("LegCo") on 12 July. The Institute gained the support to exclude junior staff from liability for the criminal offence under this clause from a large majority of the legislators. As a result, LegCo voted against the government's proposed Committee Stage Amendment to the clause. However, the Institute's proposal to remove the provision relating to "recklessly" omitting a required statement from an audit report was not able to gain sufficient support.

The Institute will form a working group with a view to producing practice guidance on the conduct of audits and audit reporting, in light of the potential implications of clause 399. The aim is to issue practice guidance before the new Companies Ordinance ("CO") is brought into effect.

For further details, refer to the various alerts and other relevant documents/materials on this

subject, posted on the [Clause 399](#) page of the Institute's website.

24. Companies Registry Update

- (i) The Companies Registry ("CR") has issued [Companies Registry External Circular No. 5/2012](#) to **announce** the passage of the Companies Bill by the LegCo on 12 July 2012. The new CO aims to achieve four main objectives, namely, to enhance corporate governance, ensure better regulations, facilitate business and modernize the law. A summary of the major initiatives introduced in the new CO to achieve these objectives is set out at the annex to the CR circular. The new CO is expected to commence operation in 2014.
- (ii) The CR released statistics for the first half of 2012 on 15 July 2012. Refer to the relevant [press release](#) and the [statistics](#) section of the CR website for details.

25. Latest Notices on AML/CFT

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

- **United Nations (anti-terrorism measures) (amendment) ordinance 2012:** The amendment ordinance was gazetted on 13 July. It has taken immediate effect and, inter alia,
 - amended the United Nations (Anti-Terrorism Measures) Ordinance ("UNATMO") including:
 - (a) repealing the definition of "funds" and replacing the term "funds" by "property"; and
 - (b) expanding the prohibition on assistance for terrorists and terrorist associates, to cover also the collection of property or soliciting financial (or related) services for terrorists and terrorist associates.

- made consequential amendments to the Anti-money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO") to ensure that the definition of "terrorist financing" under the AMLO continues to tally with sections 7 and 8 of the UNATMO.

➤ Following the amendments to UNATMO and AMLO, revised guidelines on anti-money laundering and counter-terrorist financing have been gazetted. These can be found at:

- **Government notice 4719:** For authorized institutions
- **Government notice 4720:** For authorized insurers, reinsurers, appointed insurance agents and authorized insurance brokers carrying on or advising on long term business
- **Government notice 4721:** For money service operators

➤ **Government notice 4429:** An updated list of terrorists and terrorist associates specified under the UNATMO.

➤ **Government notice 4430:** An updated list of relevant persons specified under the United Nations Sanctions (Afghanistan) Regulation 2012.

➤ **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 [Anti-money Laundering Bulletin 1](#), "Requirements on anti-money laundering, anti-terrorist financing and related matters", and the [supplement](#) on suspicious transaction reporting.

Useful Resources

26. 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.

27. Other Publications

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

(i) HKEx has published:

- listing decisions in relation to
 - disclosure requirements for listing applicants engaged in the pawn loan business in the PRC (**HKEx-LD33-2012**)
 - whether directors' conduct, while at the predecessor company of a listing applicant, affected their suitability to be directors of the listing applicant and the listing applicant's compliance with the management experience requirement (**HKEx-LD34-2012**)
 - whether a listed company would have sufficient operations or assets to warrant its continued listing under rule 13.24, after a series of proposed transactions (**HKEx-LD35-2012**)
- a guidance letter in relation to Hong Kong depository receipts – market practice of pre-lease and pre-cancellation (**HKEx-GL39-12**)
- **Status report** on new product and market development initiatives (as of 30 June 2012)
- **report** on IPO applications, delisting and suspensions (as at 31 July)
- July 2012 issue of **Exchange**

(ii) The SFC has published:

- **Dual Filing Update** (issue no. 6, July 2012), a newsletter that highlights major deficiencies that the SFC noted in its review of listing application materials
- **Fund Management Activities Survey 2011** and the relevant **news release**
- July 2012 issue of **InvestEd Intelligence** offers practical guidance on how to ascertain key risks before investing, introduces the new RMB Qualified Foreign Institutional Investor A-share exchange-traded fund and the Financial Dispute Resolution Centre, and clarifies that it is not compulsory to accept a mandatory offer in a takeover transaction
- June 2012 edition of the **Code of Conduct for Persons Licensed by or Registered with the SFC**

(iii) Articles on corporate governance by Deloitte:

- **Audit committee brief - the promise and perils of information technology**
- **2012 Proxy season: looking back as we move forward**

(iv) **Mainland China Trust Survey 2012** by KPMG