



# STANDARDS & TECHNICAL

## NEWS AT A GLANCE

TechWatch is a publication designed to alert members to topics and issues that impact on CPAs and their working environment. We welcome your comments and feedback. Comments and suggestions on TechWatch should be addressed to Patricia McBride, Director, Standard Setting by [email](#).

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## **Spotlight**

### **1. Handbook Updates 27 & 28**

**Update 27** encloses the revised Practice Review Statements 1.400 *Explanatory Foreword* and 1.401 *Review Procedures and Conduct of Members*. These statements are revised following the commencement of the revised Practice Review Programme on 13 March 2006.

The revised Programme adopts a risk-based approach and will comply with the provisions in Statement of Membership Obligations 1 (“SMO 1”) *Quality Assurance* issued by the International Federation of Accountants. Under SMO 1, practice review also covers a review of practice units’ system of quality control, which is required to be established under Hong Kong Standard on Quality Control 1 *Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*.

The revised Practice Review Statement 1.401 includes the prescription of the scope of practice review and procedures to be adopted during the performance of practice review, and the conduct members are expected to follow during a practice review under the revised Programme. It applies whenever a practice review is conducted.

**Update 28** encloses the following:

- Revised Guidance on Implementing HKFRS 4 *Insurance Contracts*
- AG 7 *Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars*
- HKSIR 300 *Accountants’ Report on Pro Forma Financial Information in Investment Circulars*

Further details are set out in the “Financial Reporting” and “Audit & Assurance” sections below.

## **CPD & Events**

### **2. Technical Update Evening (TUE)**

The **new TUE programme** covering the period from April to July 2006 features a number of important auditing and financial reporting topics:

- 606 (11 Apr) Issues in Preparing Financial Statements
- 608 (18 Apr) Issues in Preparing Financial Statements (Re-run)
- 607 (25 Apr) Improving Audit Documentation
- 611 (2 May) Introduction to Financial Instruments (Re-run)
- 610 (9 May) Improving Audit Documentation (Re-run)
- 612 (16 May) Issues in Preparing Financial Statements (Re-run)
- 613 (23 May) Proposed changes to HKAS 1
- 614 (6 June) New Standards on Pro Forma Financial Information
- 615 (27 June) ED of Discussion Paper “Requests for Special Purpose Reports”
- 616 (11 July) Commonly asked Financial Reporting Questions

To secure your seats, please register early by completing the **registration form** and returning it to the Institute.

### 3. **Professional Development Activities April To June 2006**

The Institute is committed to provide an all rounded CPD programme to suit the varying needs of members. Highlights for the months of April to June are:

#### Quality Assurance Workshop

- To compliment the issuance of the *Guide to Quality Control* (see article 14 below), a number of one-day training workshops, entitled “**Quality Assurance Workshop**”, have been organised by the Institute. The first six sessions to be held in early April have all been fully subscribed. Additional sessions are now being offered on **10, 11, 12 and 13 April 2006**. Enrol now to secure a seat in these popular Quality Assurance Workshops. Click [here](#) for details and registration.

#### IFRS Training

- **HKAS 32 and 39** (1 & 2 June)

#### Other CPD events

- **Intellectual Property Issues in Merger and Acquisition Transactions** (3 Apr)
- **Warrant Market – Risk & Opportunity** (7 Apr)
- **Update on Codes on Takeovers and Mergers and Share Repurchases** (11 Apr)
- **Breakthrough Tough Negotiations** (22 Apr)
- **Listing Documentation – Legal Issues** (13 May)
- **Privacy Guidelines: Monitoring & Personal Data Privacy at Work** (15 May)
- **國內民事訴訟和仲裁實務** (19 May)
- **Influencing and Assertiveness Skills** (20 May)

Please view the full programme [here](#) and enroll before they are full.

#### **Financial Reporting**

### 4. **New Guidance On Pro Forma Financial Information**

The Institute issues **Accounting Guideline (AG) 7 Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars**, which is effective for engagements where the investment circular is dated on or after 1 April 2006.

AG 7 provides guidance for preparation and presentation of pro forma financial information for inclusion in investment circulars. The guidance is intended primarily for the purpose of assisting directors of listed issuers or listing applicants in preparing and presenting pro forma financial information under the Stock Exchange Listing Rules. Major areas covered by AG 7 are the nature and presentation of pro forma financial information and adjustments in pro forma financial information.

Please also see article 9 below for details of new Hong Kong Standard on Investment Circular Reporting Engagements 300 relating to reporting on pro forma financial information and an update on the Institute’s Accountants’ Report Project.

## 5. Revised Guidance On Implementing HKFRS 4 Insurance Contracts

The Institute issues **revised Guidance on Implementing HKFRS 4 Insurance Contracts** (“Revised Guidance”). The Revised Guidance applies when an entity adopts HKFRS 7 *Financial Instruments: Disclosures*.

HKFRS 7 amends and supersedes the disclosures about risk that were previously required by HKAS 32 *Financial Instruments: Disclosure and Presentation*. These changes necessitate consequential amendments to HKFRS 4 *Insurance Contracts*, which previously required disclosure of ‘the information about interest rate risk and credit risk that HKAS 32 would require if the insurance contracts were within the scope of HKAS 32’. The changes affect only the disclosure section of the guidance.

## 6. Institute Invites Comment On IASB Proposed Amendments To IAS 1

The Institute issues an **Invitation to Comment** on an IASB exposure draft of Proposed Amendments to IAS 1 *Presentation of Financial Statements*, with comments requested by **3 July 2006**.

The proposed amendments are aimed at enabling entities to present more clearly the financial information, in particular income and expenses, that is already required to be presented in accordance with the IASB’s standards. Under the proposals, an entity would present all income and expenses separately from changes in its equity that arise from transactions with its owners. Entities would have a choice of presenting income and expenses in a single statement or in two statements. An entity would also be required to include in its set of financial statements a statement showing its financial position (or balance sheet) at the beginning of the previous period.

## 7. All SSAPs And SSAP Interpretations Will Be Removed From The Members’ Handbook

Statements of Standard Accounting Practice (SSAPs) and SSAP Interpretations are all replaced by new Hong Kong Accounting Standards and HK(SIC) Interpretations with effect from accounting periods beginning on or after 1 January 2005. Accordingly, the Institute will remove all SSAPs and SSAP Interpretations from Volume II of the Members’ Handbook in May 2006. These will be stored in the archive section of the e-Handbook for members’ reference.

## 8. FRSC Meeting Summary – 15 February 2006

This **FRSC meeting summary** covers:

- Application of S141D to a subsidiary of an overseas company
- Proposed AG 6 *Preparation of Historical Financial Information for Inclusion in Investment Circulars*
- Proposed AG 7 *Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars*
- ED 26 – Improvements to International Public Sector Accounting Standards
- The recent visit of Sir David Tweedie

## **Audit & Assurance**

### **9. New Reporting Standard On Pro Forma Financial Information And An Update On The Accountants' Report Project**

The Institute issues [Hong Kong Standard on Investment Circular Reporting Engagements \(HKSIR\) 300 Accountants' Report on Pro Forma Financial Information in Investment Circulars](#), which is effective for engagements where the investment circular is dated on or after 1 April 2006.

HKSIR 300 establishes standards and provides guidance to reporting accountants who are engaged to issue an accountants' report on pro forma financial information in investment circulars. The standards and guidance are intended primarily for the purpose of reporting under the Stock Exchange Listing Rules. HKSIR 300 contains in its appendices an example accountants' report and examples of management representation clauses.

Please also see article 4 above regarding details of new Accounting Guideline 7 on preparation of pro forma financial information.

The Institute issued for public consultation in 2004, under the Accountants' Report Project, an exposure draft of a suite of seven proposed professional pronouncements in relation to listing engagements, aiming at bringing Hong Kong's reporting standard in line with international best practices. One of the professional pronouncements, HKSIR 400 *Comfort Letters and Due Diligence Meetings on Financial and Non-financial Information* was issued in 2005. The Institute has now completed the second phase of its work in finalising two pronouncements, i.e., HKSIR 300 and AG 7. The Institute will proceed to finalise the remaining four proposed pronouncements in consultation with the Stock Exchange and the Securities and Futures Commission, as these pronouncements are likely to involve changes in the Listing Rules.

### **10. Audit Report – Reference To Hong Kong Standards On Auditing**

As reported in [TechWatch 40](#), auditors are reminded that they should apply Hong Kong Standards on Auditing (HKSAs) to all audits of financial statements for periods beginning on or after 15 December 2004, i.e., starting with December 2005 year-end audits.

In this regard, the Institute's Auditing and Assurance Standards Committee, at its March 2006 meeting, recommended that practising members, in their Audit Report for financial statements for periods beginning on or after 15 December 2004, should indicate that they have conducted their audit in accordance with HKSAs instead of Statements of Auditing Standards.

### **11. New Example Report On The Calculation Of The Fund Expense Ratio Under MPF**

As reported in [TechWatch 40](#), the following sections of the Code on Disclosure for MPF Investment Funds, issued by the Mandatory Provident Fund Schemes Authority (MPFA) in June 2004, should be noted by auditors:

- Section G2.7 requires that Fund Expense Ratio (FER) of both constituent funds and Approved Pooled Investment Funds (APIFs) should be first calculated for any financial period that commences after 31 December 2004.
- Section E4.2 requires that approved trustees and operators of APIFs should ensure that the calculation of the FER is checked by the auditor of the financial statements of the relevant scheme or APIF. Calculations and source data should be documented and retained by approved trustees or operators of APIFs for inspection by the MPFA.



It has been agreed between the Institute and the MPFA that the requirement under section E4.2 would be an agreed-upon procedures engagement in accordance with HKSRS 4400 *Engagements To Perform Agreed-upon Procedures Regarding Financial Information* issued by the Institute. An **example report** by the auditors on the requirement of section E4.2 of the Code has been developed by the Institute in consultation with MPFA.

## 12. **Institute Comments On Improving The Clarity Of IAASB Standards**

The Institute's **submission** to the IAASB on the ED of Improving the Clarity of IAASB Standards stressed that the IAASB should not approach the development of objectives on a piecemeal ISA-by-ISA basis. It should all be done in one go, so that the IAASB and those who comment on the ISAs know whether the objectives provide the basis for a complete body of auditing standards.

The Institute strongly recommends the following actions to be taken by the IAASB on the Clarity Project:

- The Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services contains the overarching objective of an audit, as explained in ISA 200, and all the audit objectives embodied in the suite of the ISAs to show how these objectives contribute to the overarching objective; and
- The adequacy of the objectives of all existing ISAs be evaluated prior to the release of any ISA in a revised format to ensure that all objectives are complete, consistent and contribute to meeting the overarching objective of an audit.

The Institute is concerned that unless the IAASB addresses all of the objectives at the start of the project, it may find difficulty in establishing objectives for those standards that focus on processes. Further, by identifying all the objectives at the beginning, the IAASB may find that material contained in a number of standards addresses a single objective and some restructuring may be appropriate.

## 13. **AASC Meeting Summary – 27 January 2006**

This **AASC meeting summary** covers:

- List of items for attention of IAASB at its March 2006 Meeting in Hong Kong
- Draft Discussion Paper on Issues arising from Requests for Assurance, Agreed-upon Procedures and Compilation Reports
- Revised Q&As on Audit Issues – Related Party Transactions
- Proposed Reply to the Stock Exchange of Hong Kong on the proposed Type of Reporting for Share Option Scheme Adjustments
- Proposed Working Group for Real Estate Investment (REIT) Listings

### **Quality Assurance**

## 14. **Institute Publishes A Guide To Quality Control**

The Institute has published a **Guide to Quality Control**. The guide outlines objectives of good control and risks associated with poor quality control, and focuses on the development of quality control policies and procedures for CPA firms. It will assist CPAs and CPA firms in understanding, developing and documenting quality control policies and procedures in accordance with Hong Kong Standard on Quality Control 1 *Quality Control for Firms That Perform Audits and Reviews of*

*Historical Financial Information, and Other Assurance and Related Services Engagements.* The guide also contains sample quality control manuals and practice aids to suit different sizes of CPA firms, and other reference materials that may be helpful in addressing specific issues.

To compliment the issuance of the guide, a number of Quality Assurance training workshops have been organised by the Institute (see article 3 above). Participants of the workshops will be given a copy of the guide.

To purchase your copy of the guide, complete the [order form](#) and sent it, together with payment, to the Institute or visit the Institute's Member Services Counter on 4th Floor, Lippo Centre, Tower Two, 89 Queensway, Hong Kong.

## 15. **Second Communication Paper On The Revised Practice Review Programme**

The Institute issued a [Second Communication Paper on the Revision of Practice Review Programme & Practice Review Questionnaire](#) on 13 March 2006. The paper serves to provide more detailed information on the key components of the revised Practice Review Programme and its implementation following the first Communication Paper issued on 30 July 2005 on the adoption of a risk-based approach to the Programme.

The first paper provided information about the progress on the revision and invited feedback on the proposed self-assessment questionnaire developed for the revised Programme. The feedback received has been taken into account in the development of the revised Programme, as set out in the Second Communication Paper.

### **Professional Liability Reform**

## 16. **Need For Professional Liability Reform**

The Institute made a [submission](#) commenting on the Department of Justice LC Paper No. [CB\(2\)1371/05-06\(01\)](#) on Limitation of Liability and attended the meeting of the LegCo Panel on Administration of Justice and Legal Services on 27 March 2006 to emphasise the urgency and importance of professional liability reform.

In the submission, the Institute urges a reconsideration of the Administration's decision to suspend further studies into professional liability reform proposals for the remainder of the Chief Executive's term of office. The Institute's submission rebuts statements in the Department of Justice's paper and stresses that professional liability reform is too important to Hong Kong to defer until some unspecified future time.

### **Taxation**

## 17. **Financial Secretary Delivers Budget Speech 2006/07**

The Financial Secretary ("FS"), Mr. Henry Tang, delivered his third [Budget Speech](#) on 22 February 2006.

As regards the overall fiscal position, the budget figures revealed a fairly robust performance by the economy in 2005/06. The FS forecast a consolidated budget surplus of HK\$4.1 billion for 2005/06, compared with an estimated deficit of HK\$10.5 billion forecast in last year's budget. The overall surplus is the result of an estimated HK\$5.8 billion surplus on the operating account and a deficit of \$1.7 billion on the capital account. A consolidated budget surplus of HK\$5.6 billion is now forecast for 2006/07, compared with a deficit of HK\$1.2 billion for the same period



forecast in last year's budget. The fiscal reserves are expected to stand at HK\$300.8 billion as at 31 March 2006 and to be maintained in the range of HK\$300 billion to HK\$390 billion over the next five years, equivalent to 15 to 17 months of government expenditure.

The positive outturn for 2005/06 has meant that the government is expecting to achieve the three fiscal targets set by the FS in his 2004 budget, three years ahead of schedule. These are:

- Operating expenditure below H\$200 billion in 2004/05 and 2005/06 (2005/06 is estimated to be HK\$194.7 billion while in 2004/05 it was \$196.9 billion. However, operating costs are expected to grow to \$230.7 billion by 2010/11).
- Fiscal balance in both the operating and consolidated accounts, which is expected to be the case starting from 2005/06.
- Public expenditure to be kept at below 20% of gross domestic product ("GDP"). This was achieved in 2004/05 and will be maintained. It is forecast to fall to 16.1% in 2010/11 from 18.2% in 2006/07.

Real growth in GDP was 7.3% in 2005 following 8.1% growth in 2004. 4% - 5% growth is expected for 2006 while the trend growth rate over the period 2007 – 2010 is projected to be 4% in real terms. Inflation is forecast to be 2.3% in 2006 compared with 1.1% in 2005.

As regards specific revenue measures and concessions in the budget, these included:

- Salaries tax:
  - The marginal rates of the second, third and top salaries tax bands lowered by 1% each, to 7%, 13% and 19%, respectively, from 2006/07, while the rate applicable to the first HK\$30,000 of assessable income will remain at 2%.
  - Extending the salaries tax relief for home loan mortgage interest (of up to HK\$100,000 per annum) to ten years from seven years. The proposal will cost the government some HK\$1.2 billion in 2006/07 and is in line with a proposal contained in the Institute's budget submission (see below).
  - No changes were proposed to the tax allowances or to the standard rate of salaries tax, which will remain at 16%.
- Profits tax: No change. The rates will remain at 17.5% for corporations and 16% for unincorporated businesses.
- Property tax and rates: No changes. The rate of property tax will remain at 16% and rates will stay at 5% of the rateable value. In relation to the latter, the FS indicated that rateable values increased by 9.2% in the latest revaluation exercise.
- Financial services:
  - The levy on trading in securities, futures and options contracts will be reduced by 20%.
  - The FS also encouraged LegCo to complete its scrutiny of the Financial Reporting Council (FRC) Bill as soon as possible, so that the establishment of the FRC could proceed.

- Separately, the Revenue (Profits Tax Exemption for Offshore Funds Bill) was passed by LegCo on 1 March 2006. This legislation implements a measure announced in the 2004/05 Budget Speech.
- Amongst other important tax matters mentioned in the budget were:
  - Goods and services tax (GST) – The FS announced that a nine-month public consultation would be launched in the middle of 2006. He pointed out that, were a decision to proceed to be made, implementation would still take another three years.
  - The FS specifically ruled out two measures supported by the Institute, and by other professional bodies and chambers of commerce, namely, group loss relief and loss-carry back arrangements. Of the former, he said that group relief is too easily abused, and he ruled out loss-carry back because of the pressure this could place on tax revenue during periods of economic downturn.

The Institute's president, Mr. Paul Chan, hosted a press briefing immediately after the Budget. While **commenting** that the proposed Budget was prudent but overly conservative in relation to granting tax breaks to the middle class and enhancing the competitiveness of Hong Kong, the Institute noted that the budget should also provide a map for Hong Kong's future economic development. The president urged the government to take stock of the economic impact of the financial and commercial services sectors, tourism and logistics, and to consider whether these sectors can continue to provide the engine for Hong Kong's growth and prosperity over the next decade.

The decision not to implement group relief, which is available in a number of developed markets around the world, is a point of concern for the Institute. The Institute has advocated its adoption for some years. With the introduction of new international accounting standards, which require, in some cases, asset revaluations to be reflected in the profit and loss account, "unrealised" profits may now become subject to tax and this may put companies under cash flow pressure. Meanwhile, unlike a number of other developed jurisdictions, Hong Kong has no group tax relief or loss carry-back provisions to help alleviate the problem.

Earlier in the year, the Institute published a set of **27 proposals** for the 2006 budget (see **TechWatch 40**). The FS' proposal on GST is in line with the Institute's budget submission, which pointed to the need to move ahead with consultation and specify a timetable for implementation of a GST (see **TechWatch 20 and 40**). The Institute believes that, given the structural fiscal problem previously identified by the Task Force on Review of Public Finances, and the narrowness of the Hong Kong's tax base, the government should focus on broadening the tax base, rather than continuing to rely on increases in direct taxes as a primary source of any future requirements for additional revenue.

The FS stated that the government is studying alternative arrangements for healthcare financing, and will conduct a public consultation later in the year, and that, in finalising an overall package, the proposal to provide a tax deduction for contributions to private medical insurance schemes would be considered. The funding of healthcare was also raised in the Institute's budget submission. The submission emphasised that it was critically important to determine how to maintain a financially sustainable public health care system over the long term.

To promote environmental protection, the FS reiterated the need to impose green taxes in accordance with the "polluter pays" principle. He confirmed that the Product Eco-responsibility Bill would be introduced into LegCo in 2006 to provide a legal framework for producer responsibility schemes covering, inter alia, tyres and plastic bags. The Institute has previously proposed implementing a more coordinated green tax policy in Hong Kong and adopting the "user/polluter pays" principle with polluters.

## International Meetings

### 18. International Accounting Standards Board Meeting

The IASB met in London on 21 to 24 February 2006 and discussed the following topics:

- Short-term convergence: income taxes
- Business Combinations II
- Short-term convergence: proposed amendments to IAS 20
- Financial instruments puttable at fair value
- Accounting standards for small and medium-sized entities
- Revenue recognition
- Amendments to IAS 37
- Conceptual Framework
- Fair value measurement
- Insurance

Click [here](#) to view the February 2006 IASB Update of the Board Decisions on IFRS. The IASB next meets on 27 to 31 March 2006.

### 19. International Financial Reporting Interpretations Committee Meeting

The IFRIC met in London on 2 and 3 March 2006 and discussed the following topics:

- Service Concession Arrangements
- IAS 18 *Revenue* – Sales of Real Estate
- IAS 19 *Employee Benefits* – The Effect of a Minimum Funding Requirement on the Asset Ceiling
- IAS 32 *Financial Instruments: Presentation* – Classification of a Financial Instrument
- IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Determination of the Carrying Amount of the Investment in a Subsidiary in the Separate Financial Statements of the Parent
- Customer Loyalty Programmes
- IAS 39 *Financial Instruments: Recognition and Measurement* – Aspects of Derecognition in the Context of Securitisation
- IAS 39 *Financial Instruments: Recognition and Measurement* – Whether Inflation Risks Qualify as Separable Components for Hedging Purposes
- IFRIC Relationship with National Standard-Setters and National Interpretative Groups
- IFRIC Agenda Decisions
- Tentative Agenda Decisions

Click [here](#) to view the March 2006 IFRIC Update of the newsletter of the IFRIC. The IFRIC next meets on 12 and 13 May 2006.

**20. International Auditing & Assurance Standards Board Meeting**

The IAASB met on 6 to 10 March 2006 in Hong Kong at the Harbour-Plaza Hotel in Hung Hom, Kowloon. Click [here](#) for the audio recording of the IAASB meeting.

The welcoming dinner hosted by the Institute for the IAASB delegates and accompanying persons were successfully held on 6 March 2006, attended by the Institute president, vice presidents and members. A special meeting of the Institute’s Auditing and Assurance Standards Committee was held with the IAASB Deputy Chairman and Technical Director on 10 March 2006 to discuss topics of common interest.

**For Your Information**

**21. Award Of Contracts For Preliminary Examination In Bankruptcy Cases**

A notice of the award of contracts for preliminary examination in bankruptcy cases has been posted on the [website of the Official Receiver's Office](#).

**22. XBRL Progress Updates**

The Securities and Futures Commission releases [HK XBRL News Issue 02](#). In this issue, the XBRL Preparatory Working Group's activities in the past few months was reviewed and the key findings of the two surveys conducted in 2005 were summarised.

**Comment Due Dates**

DATE	SUBJECT
10 April 2006	<a href="#">IAASB Exposure Draft</a> of ISA 550 (Revised) on Related Parties
12 April 2006	<a href="#">IASB Discussion Paper</a> on Management Commentary
28 April 2006	<a href="#">IASB Discussion Paper</a> on Measurement Bases for Financial Accounting – Measurement on Initial Recognition
4 May 2006	<a href="#">IASB Exposure Draft</a> of IFRS 8 <i>Operating Segments</i>
3 July 2006	<a href="#">IASB Exposure Draft</a> of Proposed Amendments to IAS 1 <i>Presentation of Financial Statements</i>
<b>Please send comments to <a href="mailto:commentletters@hkicpa.org.hk">commentletters@hkicpa.org.hk</a></b>	