



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

Members' Handbook

1. Handbook Updates No. 77 & No. 78

- (i) **Update No. 77** contains amendment to HKFRS 1 (Revised) *First-time Adoption of HKFRSs – Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters*, which relieves first-time adopters of HKFRSs from providing the additional disclosures introduced in March 2009 by *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7). It thereby ensures first-time adopters benefit from the same transition provisions which Amendments to HKFRS 7 provides to current HKFRS preparers.

The Institute has taken this opportunity to incorporate relevant amendments to HKFRS 1 (Revised) and HKFRS 7 *Financial Instruments: Disclosures* for greater clarity.

- (ii) **Update No. 78** contains consequential amendments to HKFRSs which were previously set out in the appendix to the standards as they were not yet effective. The Institute has taken this opportunity to incorporate amendments applicable on 1 January 2010 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

Financial Reporting

2. HKFRS Insights on Amendments to HKAS 17 Leases - Classification of Leases of Land and Building

The Institute issued the *Improvements to HKFRSs 2009* in May 2009 which included amendments to HKAS 17 *Leases – Classification of Leases of Land and Building*.

Details of the amendments are described below:

- The amendments removed the specific guidance in paragraphs 14 and 15 of HKAS

17 which stated that land held under a lease should be classified as an operating lease unless title to the land is expected to pass at the end of the lease term.

- A new paragraph 15A is added in the amendments to HKAS 17 which indicates that entities should use judgment to decide whether the lease transfers the significant risks and rewards of ownership of the land.
- Paragraphs BC8A to BC8F are added in the Basis for Conclusions, which indicate that the Board considers that the present value of the residual value of a property in a lease with a term of several decades or more would be negligible and that in such circumstances classifying the lease as a finance lease would be consistent with the economic position of the lessee.

If the market is in effect behaving as if the land interest were substantially the same as a freehold interest, then the lessee of such a lease is in effect exposed to substantially all the risks and rewards of ownership of the land. In such circumstances, classification of the interest as being held under a finance lease is consistent with the substance of the interest and the economic position of the lessee.

If the registered holder of the land interest is regarded as the lessee under a finance lease, then, unless the property is leased out by the registered holder to another party under a finance lease, HKAS 2 *Inventories*, HKAS 16 *Property, Plant and Equipment* and HK Interpretation 4 *Leases-Determination of the Length of Lease Term in respect of Hong Kong Land Leases*; or HKAS 40 *Investment Property* would be applicable to account for that interest by the holder.

Preparers of financial statements should, based on the circumstances of their transactions, assess to what extent the present value of the minimum lease payments (i.e. the transaction price of the leasehold land) amounts to substantially all of the fair value of the land as if it is freehold.

Any change in classification of the interest in land which arises as a result of these amendments to HKAS 17 requires retrospective adoption unless the entity does not have the information necessary to apply the amendments retrospectively. In such cases, the entity is required to recognize the asset (and any unpaid lease premium liability) at fair value on the date it adopts the amendments, with a corresponding adjustment to retained earnings and this amount should be considered as deemed cost going forward. The effective date of the amendments is annual periods beginning on or after 1 January 2010. Earlier application is permitted.

For practical guidance, members may refer to:

- [Financial Reporting Update](#) by KPMG
- [The Question and Answer](#) by the Institute

Audit & Assurance

3. AASC Minutes

This [AASC minutes](#) on 15 December 2009 covers:

- AASC Work Plan for 2009 – Status Report
- Proposed Work Plan for 2010
- IAASB Consultation Papers
- HKICPA's Alert on Bank Confirmations
- To consider implications of ED of PN 610 *Guidance on the Determination of Realized Profits and Losses in the context of Distributions under the Hong Kong Companies Ordinance* on PN 600.1 Reports by Auditors under the Hong Kong Companies Ordinance
- Status of Practice Notes
- Consultation Paper on Auditor Communications by International Organization of Securities Commissions

International Meetings

4. International Accounting Standards Board

The IASB met on 2 and 10 February 2010 (additional meeting) and 15-19 February 2010, and discussed the following topics:

- Presentation of other comprehensive income
- Financial instruments with characteristics of equity
- Financial instruments: hedge accounting
- Leases
- Financial instruments: classification and measurement
- Insurance contracts
- Derecognition
- Revenue recognition
- Financial statement presentation
- Fair value measurement
- Consolidation
- Rate-regulated activities
- Post-employment benefits
- Joint ventures
- Right of offset

Click to view the IASB Update on the meetings on [2 and 10 February](#) and [15-19 February](#). The IASB next meets in March 2010.

5. International Financial Reporting Interpretations Committee

The IFRIC next meets in March 2010. Click [here](#) for the next meeting's details.

6. International Auditing and Assurance Standards Board

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

7. International Ethics Standards Board for Accountants

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

Useful Resources

8. Publications

The following are publications on various topics:

- (i) Clarified ISAs
 - [FAQ](#) by IAASB
- (ii) Effective dates of IFRSs
 - [Briefing Sheet](#) by KPMG
- (iii) Accounting for income taxes
 - [Searching for clarity in uncertain tax positions](#) by Ernst & Young
 - [Tax Accounting Update](#) by PwC
- (iv) Financial reporting news
 - [Quarterly update on financial reporting standards and developments](#) by Grant Thornton

Comment Due Dates

29 March 2010: IASB Exposure Draft of *Measurement of Liabilities in IAS 37*

31 March 2010: Statement of Intent on HKFRS for Private Entities

7 June 2010: IASB Exposure Draft of *Financial Instruments: Amortised Cost and Impairment*

Specialist Practices, Business Members and Advocacy

Insolvency & Corporate Restructuring

1. Institute Comments on Corporate Rescue Proposals

As reported in [TechWatch No. 85](#), the HKSAR Government issued a consultation document to seek views on the introduction of a statutory corporate rescue procedure, known as "provisional supervision". The proposals were based on those previously contained in a corporate rescue bill introduced into the Legislative Council ("LegCo") in 2001, with some modifications. The 2001 bill had been allowed to lapse after coming up against stumbling blocks in LegCo.

The Institute's submission urged the government to give priority to the introduction of a corporate rescue procedure in Hong Kong. The submission also made technical and detailed suggestions to help facilitate the rescue process. These included seeking greater flexibility in terms of the length of the moratorium on creditor actions, and recommending that other possible sources of funding for employees' entitlements be explored, to boost the chances for troubled companies to be turned around.

The proposals on insolvent trading in the consultation document were less stringent than in the 2001 bill, in that they excluded non-director senior management from their scope and imposed a higher threshold for liability. The submission agreed that insolvent trading provisions would be a useful means of encouraging directors to initiate rescue action early, rather than going deeper into debt and reducing the chances of a successful rescue, as well as, potentially, affecting other businesses.

Johnson Kong, chairman of the Institute's Restructuring and Insolvency Faculty Executive Committee, explained to reporters at a press briefing on 9 February 2010 that the global financial crisis had highlighted the need for

Hong Kong to introduce a flexible, cost effective corporate rescue framework to help companies facing temporary financial difficulties.

Click for the [press release](#) and the [full submission](#).

Taxation

2. 2010 Annual Meeting with the Inland Revenue Department

The annual meeting between representatives of the Institute's Taxation Committee and the Inland Revenue Department ("IRD") took place on 5 February 2010. Among the items discussed at the meeting, the Institute would like to highlight the following items for immediate attention:

➤ Filing deadlines for 2009/10

At the meeting, the IRD confirmed the following due dates for lodging profits tax returns for the year of assessment 2009/10:

- (i) "N" Code – 3 May 2010 (no extension)
- (ii) "D" Code – 16 August 2010 (no change)
- (iii) "M" Code – 15 November 2010 (no change)
- (iv) "M" Code (current year loss cases) – 31 January 2011 (no change)

➤ Electronic filing of profits tax returns

The IRD will expand the tax filing service under eTAX with effect from April 2010 for a corporation or partnership which satisfies certain conditions. Please click for more [details](#). For those filing electronically, there will be a two-week extension for lodging profits tax returns for the year of assessment 2009/10. The extended due dates are as follows:

- (i) "N" Code – 17 May 2010
- (ii) "D" Code – 30 August 2010

(iii) "M" Code – 29 November 2010

(iv) "M" Code (current year loss cases) – 31 January 2011 (same as paper returns)

➤ Discussions with the State Administration of Taxation ("SAT")

The Institute asked the IRD for an update of its discussions with the SAT on cross border issues, including matters relating to the Mainland - Hong Kong Double Taxation Arrangement ("DTA"). The following is a summary of the issues raised by the Institute and discussed between the IRD and SAT:

- (i) Certificate of resident status – It has been clarified with SAT that the existing administrative procedures adopted between the Mainland and Hong Kong would continue to apply even after the issue of Guoshuifa [2009] No.124 ("Circular No. 124"), which was clearly stated in Article 44 of Circular No. 124. The SAT agreed to reinforce the dissemination of the current administrative procedures to local tax authorities. Nevertheless, Circular No.124 also included other procedures not covered by the current administrative procedures, such as prior approval for treaty benefits and prior registration requirements etc., and these procedures would then be applicable to the DTA between the Mainland and Hong Kong. One point to note regarding the completion of the forms for record or for approval of "Non-resident's claim for treatment under Double Taxation Agreement" (i.e. Annex 1 & 2 to Circular No. 124): SAT has agreed to accept a resident certificate in lieu of the chop or stamp by the IRD on the forms.

It is also noted that some companies incorporated in Hong Kong are requested by the Mainland local tax authorities to provide the certificate of resident status even after submission of their certification of incorporation. The SAT advised that local tax authorities

would only make the request in case of doubt.

Hong Kong raised the point that sometimes local tax authorities do not provide referral letters to the taxpayers despite repeated requests. Hong Kong will therefore consider to issue the resident certificates in the absence of referral letters in exceptional justifiable cases.

- (ii) Beneficial ownership – In October 2009, the SAT issued Guoshuihan [2009] No. 601 (“Circular No. 601”) on the interpretation of beneficial ownership in the implementation of DTA provisions. The SAT may, in the light of experience on the implementation of the circular, consider to amend and fine-tune the circular at a later stage.
- (iii) Anti-avoidance rules – The recent tax cases on capital gains happened in Chongqing and Xinjiang were discussed. The SAT understood Hong Kong’s concern and confirmed that currently local tax authorities have to seek approval before applying the anti-avoidance rules under Article 47 of the Corporate Income Tax (“CIT”) Law. The approval procedures have been centralised under the scrutiny of the SAT.
- (iv) Treaty withholding rate on dividends – According to Article 3 of Guoshuihan [2009] No. 81 (“Circular No. 81”), a non-resident investor has to hold the shares of a Mainland company for a continuous period of 12 months before the outbound dividends could be eligible for treaty benefits. This requirement, however, is not stipulated in the DTA between the Mainland and Hong Kong. The SAT said that as the circular applies to all treaty partners, it would not be appropriate to change it for time being. The SAT might consider IRD’s request for exemption of the 12-month look back period some time

later.

Other issues discussed by IRD with SAT include:

- (v) Joint seminar on transfer pricing – the IRD and the SAT would jointly host a seminar in the first half of 2010 on the issue of transfer pricing and reference would also be made to Guoshuifa [2009] No. 2 on transfer pricing guidelines.
- (vi) 183 days rule regarding employment income – The SAT considered that the 183 days rule is an international standard and there is no strong reason for any amendment.
- (vii) Source of rental income – According to Article 7 of the Implementation Regulations of the CIT Law, the source of any rental income is located at the place where the payer is situated. The SAT confirmed that the provisions on source of rental income provided in Article 6 of the DTA override the domestic law.
- (viii) Business Tax – Under the current Business Tax regulation, a non-resident service provider providing services to a Mainland company has to pay Business Tax in the Mainland. The SAT confirmed that the exemption provisions stated in Articles 3 and 4 of Caishui [2009] No. 111 are applicable to Hong Kong residents.

The minutes of past annual meetings are contained in [Tax Bulletins](#) on the Institute’s website and full minutes of the 2010 annual meeting will be published in due course.

3. 2010-11 Budget Speech

The [budget speech](#) was delivered on 24 February 2010. Click for the [budget highlights](#) and [budget tax measures](#).

In its [press release](#) and in media interviews conducted by Ayesha Macpherson, chair of the Taxation Committee, the Institute expressed the view that, given the signs of economic recovery, the financial secretary could afford to have been

less cautious in the budget and take more definite steps to address Hong Kong's long-term tax competitiveness.

While the Institute indicated support for various measures in the budget, such as the efforts to promote further development of the asset management industry by extending stamp duty and profits tax concessions, and the extension of tax deductions for the acquisition of intellectual property to trademarks, copyright and registered designs, the Institute had put forward a number of other proposals in its budget [submission](#), where it was considered more should be done. These included:

For business -

- Giving “super deductions” (i.e., more than 100%) for research and development expenditure to encourage more innovation.
- Reducing the corporate profits tax rate to 16% in 2010-11, with further progressive reductions to 15% over time.
- Improving clarity in determining the source (i.e., location) of profits and employment income.
- Shortening the time frame for finalising tax assessments for a particular year of assessment.
- Introducing a group loss relief system and loss carry-back provisions.

For individuals -

- Allowing deductions for private medical insurance, subject to a HK\$12,000 annual cap per person.
- Increasing annual allowances under salaries tax by 20 percent for children, dependent parents, grandparents, siblings and disabled dependants.

4. Exchange of Tax Information Rules Introduced into LegCo

Following the [amendments](#) to the Inland

Revenue Ordinance (“IRO”) in January to allow a more extensive exchange of information article to be included in double tax agreements (“DTAs”) between Hong Kong and other jurisdictions, the related [Inland Revenue Rules](#) have been introduced into LegCo.

The rules put in place domestic safeguards in addition to those provided by individual DTAs, to protect the privacy and confidentiality of information exchanged. These rules require LegCo's approval by means of “positive vetting”, in contrast to the negative vetting procedure (i.e., a form of tacit approval, unless objections are received, normally within a period of one month) commonly adopted for subsidiary legislation.

5. IRD News

- [Departmental Interpretation and Practice Notes \(“DIPN”\) 43 \(Revised\)](#) on profits tax exemption for offshore funds. Paragraph 15 and Appendix B have been revised to clarify that for the purpose of determining the location of a company's central management and control, the mere fact that the majority of the directors of the management board of the company are resident in Hong Kong would not of itself adversely affect the application of an offshore funds tax exemption.
- [Circular on filing of return of stock borrowing transactions](#). This is to remind the borrowers under stock borrowing and lending agreements registered with Stamp Office of the requirement to file a return of stock borrowing transactions under the prescribed conditions.
- [FAQ on Tax Treatment for Reinstatement Costs](#).
- [FAQ on Departmental Interpretation and Practice Notes No. 42](#).
- [LegCo question](#) on arrangement for avoidance of double taxation.
- [Advanced ruling case no. 41](#) relating to section 18E of the IRO.

Legislation & Other Initiatives

6. Consultation Conclusions on Review of the Trustee Ordinance

Consultation conclusions in relation to the **consultation** on amending the Trustee Ordinance, conducted last year, are now available. The Institute's **submission** supported a number of the technical changes proposed in the consultation paper. Following the outcome of the consultation, the changes to the legislation that the government proposes to introduce in 2010/11 include:

- Introduce a statutory duty of care for trustees.
- Retain the list of default authorised investments for trustees in the Second Schedule, but make it less prescriptive.
- Provide trustees with default powers to delegate, employ agents, nominees and custodians, and to take out insurance.
- Introduce provision for trustees to receive remuneration.
- Subject certain trustee exemption clauses for professional trustees to statutory control.
- Provide beneficiaries with the right to remove trustees by way of a court-free process under certain conditions.
- The government also sought views on several other issues. Amongst these, was a proposal to consider legislating for the role of a protector of a trust. As views on this were divided, the government has concluded that this is not the right time to pursue this suggestion.

7. Consultation on Class Actions

The Law Reform Commission of Hong Kong recently concluded a **consultation** on introducing a comprehensive regime for class actions or multi-party litigation in Hong Kong. This refers to instances where a collection or group of potential litigants shares characteristics

sufficient to allow them to be dealt with collectively in a court case.

In a **submission** on the paper, the Institute pointed out that class action regimes were still not the norm in jurisdictions similar to Hong Kong, such as the United Kingdom, New Zealand, and Singapore, and that there would be concern were a United States-style of class action procedure to be introduced into Hong Kong. As there are different possible approaches and procedures in relation to these kinds of actions, the submission suggested that it would be better to wait and see what form they took in other jurisdictions, how they worked in practice and what would suit Hong Kong best. Were class actions to be introduced, the Institute would also favour a step-by-step approach, looking initially at consumer cases, which seem to lend themselves more to this form of legal action. As regards cases relating to securities/initial public offerings, the submission argued that without addressing liability reform first, a multi-party litigation procedure could simply result in exacerbating existing inequities in the system.

8. Latest Notices on Combating Money Laundering/Terrorist Financing

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

- **Government notice 505**: New list of relevant persons and entities specified under the United Nations Sanctions (Democratic People's Republic of Korea) Regulation. The regulation was amended under an amendment regulation published as **legal notice 5 of 2010** in the gazette.
- **Government notice 337**: Updated list of terrorists and terrorist associates specified under the United Nations (Anti-Terrorism Measures) Ordinance.
- **Financial action task force on money laundering ("FATF") statement**: Draws the attention of FATF members to jurisdictions with deficiencies that pose

money laundering and terrorist financing risks to the international financial system.

- **US executive order 13224**: Changes to the list relating to “Blocking property and prohibiting transactions with persons who commit, threaten to commit or support terrorism”.

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

9. New Books in the Library

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

10. Other Publications

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

- (i) Articles on corporate governance by Deloitte
 - **Asia Pacific economic outlook: China, India, Japan, South Korea**
 - **A Climate for Change? SEC Issues Interpretive Guidance on Disclosures Related to Climate Change**
- (ii) Tips for small business - articles for SMEs by ICAEW
 - **Q&A: Capitalise on the economic recovery**
 - **Overseas outsourcing**
- (iii) **IFAC Global Leadership Survey**
- (iv) International initiative on **eXtensible Business Reporting Language (XBRL)**