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Institute's website.

► Financial reporting

The Institute comments on IASB Proposed Policy On Technical Corrections:

The policy sets out the types of issue that a technical correction addresses the initial identification of technical corrections and the technical corrections due process. The Institute made a submission to the IASB which supported the development of a policy to deal with technical corrections.

► Banking

The Hong Kong Monetary Authority issues consultation papers on new capital adequacy standards in Hong Kong:

On 6 October 2005 the HKMA issued four consultation papers on new capital adequacy standards in Hong Kong. The consultations, which closed at the end of October 2005, covered the following subjects:

- Validating risk rating systems under the Internal Ratings-based Approach
- Weighting framework for credit risk (the Basic Approach)
- Supervisory policy manual on operational risk management
- Latest work programme for implementing Basel II in Hong Kong

This was the fourth round of consultations from the HKMA on the implementation of the Basel II capital adequacy standards in Hong Kong. The new standards are expected to take effect from 1 January 2007.

► Insolvency and corporate restructuring

Draft subsidiary legislation under the Bankruptcy (Amendment) Ordinance

2005: Under this Ordinance, which was passed by the Legislative Council in July 2005, the Official Receiver's Office may appoint private sector insolvency practitioners to act as trustees in bankruptcy. The Institute has been invited to comment on the draft subsidiary legislation, and the Institute's Insolvency Practitioners Committee is considering the proposals.

► Taxation

The Institute comments on Revenue (Profits Tax Exemption For Offshore Funds)

Bill 2005: This Bill has been reviewed by the Institute's Taxation Committee. The Institute expressed its support, in principle, for legislation to exempt offshore funds from profits tax and highlighted concerns over certain technical matters in the Bill. More broadly, it pointed out that while the Bill should provide greater certainty for funds that operated primarily outside of Hong Kong, it might be of less assistance to some smaller, locally-operated funds, because under the Bill, the residence of a fund was determined by the location of its central management and control and not, for example, by the residence of the investors in the fund.

IASB updates

► Fair comment

The International Accounting Standards Board (IASB) has issued a discussion paper on management commentary for consultation. This is the first step in the possible development by the IASB of a standard or guidance covering management commentary. This concept is known as “management discussion and analysis” in North America and as “operating and financial review” in the United Kingdom.

The discussion paper proposes that management commentary should supplement and complement financial statement information, providing an analysis of the entity through the eyes of management. The IASB’s discussion paper seeks views on whether such information should be provided within financial statements or as an adjunct. The location of such commentary will determine whether or not it should be audited – and consequently how much flexibility management will have in writing it.

The Institute’s Financial Reporting Standards Committee has invited comments on the IASB’s discussion paper. Details are available on the Institute’s website and the deadline for comments is 12 April 2006.

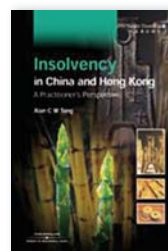
► Measurement matters

The Institute has released an exposure draft on measurement bases for financial accounting. This follows an IASB discussion paper, prepared by the Canadian Accounting Standards Board, on the same subject. The paper considers the merits of different measurement approaches, including historical cost, current cost, fair value, net realisable value and value in use. It also considers deprival value, which combines several measurement bases in a single model.

► IFRIC update

The International Financial Reporting Interpretations Committee (IFRIC) has issued IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies. This clarifies the requirements under IAS 29 relating to how comparative amounts in financial statements and deferred tax items should be restated in an economy with hyperinflation.

Book reviews



Insolvency in China and Hong Kong

(published 8 December)

► By Alan Tang

Tang, a partner at Grant Thornton, provides a historical backdrop to the development of insolvency law and practice and analysis of new ideas in the field.



Applying International Accounting Standards

► By Keith Alfredson, Ken Leo, Ruth Picker, Paul Pacter and Jennie Radford

This is the most up-to-date volume to cover the complexities of International Financial Reporting Standards, from their conceptual framework to practical application.

Quick links

- Institute homepage:
www.hkicpa.org.hk
- IASB homepage:
www.iasb.org



PHOTOGRAPH BY COLIN BEERE

Better practice over the border

By David Cho and Carl Poon

A look at the features, and common pitfalls, of contract processing and import processing arrangements in China.

Guangdong is the “world factory” in the eyes of many foreign investors. However, processing industries must operate under onerous PRC regulations governing tax, customs and foreign exchange. There are many pitfalls, so companies must keep a constant eye on the compliance status of their processing trade operations.

As local administration structures vary from one area to the next, different practical problems will arise. Some important considerations include the level of unit consumption and wastage in relation to

the disposal of scrap materials; procedures pertaining to customs and foreign exchange; regulations for verification or cancellation of production contracts; value-added tax (VAT) refunds; and regulations governing imports of bonded equipment. The choice of location for processing trade activities can itself lead to certain advantages or disadvantages.

Where regulatory restrictions on contract processing prevent products from being sold domestically, there will be no VAT refund on local purchases. It's hardly surprising that many foreign investors are considering changing their investment



mode, from a contract processing arrangement to an import processing arrangement.

Contract processing arrangements

Under a contract processing arrangement, the domestic enterprise or foreign investment enterprise (FIE) only acts as the processor for the foreign consignor. The foreign consignor provides raw materials to the processor at no charge. The processor will use the raw materials and return the finished goods to the foreign consignor for a fee. Under this system, the foreign consignor holds the title on raw materials and finished goods throughout the production process.

In general, the domestic enterprise should first enter into a processing agreement with both the foreign consignor and an import/export (I/E) agent. The agreement should then be submitted to the local Ministry of Commerce (MOC) for

its approval. Once the approval is obtained, the domestic enterprise shall apply for a Processing Special Operation Permit with the local State Administration for Industry and Commerce for the purposes of carrying out contract processing.

Apart from this processing agreement, the domestic enterprise shall also register a production contract which estimates the raw materials to be used and finished goods to be manufactured for a period of time, generally a six-month period, with the local MOC. It must also obtain approval for the importation of bonded raw materials, free from customs duty and import VAT.

All raw materials should be imported through the I/E agent. Domestic sales are not permitted under the contract processing arrangement.

Import processing arrangements

Under an import processing arrangement, a FIE purchases raw materials from suppliers and holds legal title on them throughout the production process. The FIE will then sell the finished goods to its customers.

This arrangement allows the FIE to import bonded raw materials for export sales purposes. As with the contract processing arrangement, the FIE should register its production contract with the local MOC. Raw materials imported under the production contract would be bonded provided that all the finished goods are exported.

Under the import processing arrangement, the FIE is permitted to conduct domestic sales. Customs duty and import VAT should be paid upon receipt of imported raw materials which are used for the manufacture of goods for domestic sale.

Common pitfalls

In light of this situation and based on our practical experience, foreign investors should be aware of the following considerations:

Selection of locality and form of processing trade: Customs formal-

ties, foreign exchange verification and cancellation, taxation administration, and the applicable preferential treatments on processing trade are quite different between the contract processing and import processing trades and can vary from one location to another. It is highly recommended that a full comparison of locales be made before reaching a decision.

Disposal of scraps: Under PRC customs and tax regulations, any scrap material sold domestically without obtaining any prior approval from the local government authorities can lead to penalties, in the form of back-payment of duties and tax. Hence, attention must be made with regard to their disposal.

Assessment of unit consumption rate and wastage rate: It's common to find that the unit consumption and wastage rates assessed by the relevant customs offices differ from the actual operational levels. This may give rise to problems when verifying or cancelling production contracts. In these cases, penalties could be imposed by customs offices. A process of negotiation will often be the most appropriate solution.

Change in investment mode: A switch in the investment mode from contract processing to import processing requires a detailed evaluation of the PRC customs and tax implications in connection with the transfer of bonded equipment, bonded materials and inventory.

In summary, foreign investors who contemplate carrying out or have carried out processing trade activities in the PRC should evaluate the prevailing PRC tax, customs and business regulatory matters, which are constantly changing. Foreign investors should therefore seek counsel from their business advisors, where appropriate.

David Cho is partner, and **Carl Poon** is PRC Tax and Business Advisory Services director, Moores Rowland Mazars Tax Services Ltd.

It won't

Wash

John Broome argues that money laundering and terrorist financing are separate issues requiring separate solutions.

Criminals have always needed to hide the source of their illicit funds. Until the late 1980s, money laundering was only a concern for law enforcers. Then, the international financial community began to realise the huge sums involved had the potential to undermine financial markets, encourage corruption in the financial sector, lead to irrational investment decisions, distort money flows and undermine governments. Quite suddenly, money laundering became an urgent issue in financial circles.

Global response

The G7 group of nations responded by creating the Financial Action Task Force (FATF) in 1989. The FATF comprised developed economies, largely those in the Organisation for Economic Cooperation and Development. Its charter set out international practices to reduce and prevent money laundering. These would form the basis of national legislation, financial industry regulation and international cooperation. The FATF published its original *Forty Recommendations on Money Laundering* in 1990.

The FATF was intended to be a short-term task force, bringing together international experts from the legal, financial and law enforcement sectors. But over time, its role grew. It began to examine the



PHOTO-ILLUSTRATION BY PAM CHOI

extent to which members met standards, sponsored regional bodies to spread its message, and in 1996 it revised its *Forty Recommendations*. New members were added, despite the lack of coherent membership criteria. Finally the FATF began to assess non-members' compliance with the FATF recommendations in a process called the Non Cooperative Countries and Territories (NCCT) initiative.

While the NCCT initiative was based on transparent criteria drawn from the *Forty Recommendations*, they were not applied objectively or equally. The process unquestionably produced results, but its political nature seriously undermined FATF's claim to be an expert, independent standard-setting body. The FATF had become legislator, judge, jury and executioner.

FATF hijacked

The terrorist attacks of 11 September 2001 changed everything. The attacks on the United States were the catalyst, fundamentally changing the way the international community dealt with money laundering and terrorist financing. The "war on terrorism" was characterised not only by military action but also tougher regulation. New offences were created, even though many laws already existed to cover the criminal activities of terrorists. Governments and legislators had to be seen to be responding.

In the immediate aftermath of the attacks, someone somewhere decided that the way to prevent terrorism was to locate and confiscate terrorist funding. It was a rerun of the 1980s approach to narcotics, but this time chasing the money trail of terrorists rather than drug barons. It was quickly reflected in legislation in the United States and Britain – and in the Security Council of the United Nations.

The FATF got caught up in this frenzied response. A special meeting was convened in Washington in October 2001 and the U.S. put forward eight special

“The resources devoted to dealing with money laundering have increased marginally, but only to the extent that links are found with terrorist financing issues.”

recommendations dealing with the financing of terrorism. These recommendations were adopted with little warning to participating delegations – and with little debate. The FATF did not have anti-terrorism or national security expertise and this is evident in some of the recommendations.

New ground for the FATF

The best example of the fuzzy thinking surrounding the adoption of the special recommendations is in Special Recommendation II. It requires that “each country should criminalise the financing of terrorism, terrorist acts and terrorist organisations. Countries should ensure that such offences are designated as money laundering predicate offences.”

Most terrorist activity is funded by legitimate money not criminal proceeds. The idea that a terrorist act like a bombing could be a predicate offence to the earlier provision of funds to pay for the bomb making equipment is self-evident nonsense. The funding of a terrorist act involves the provision of funds to be used for a subsequent offence. It's not money laundering and it does not involve money laundering unless the funds are derived from an earlier criminal act and are being laundered to be used for terrorist purposes.

The FATF was used in the absence of any other relevant international framework to discuss terrorist financing and to put into action existing laws relating to criminal proceeds. While the methods used to move funds might be similar, they involve very

small sums, which are almost certainly unidentifiable by a financial institution without specific intelligence information provided by government agencies.

The result is that the FATF, like many other bodies, has been overtaken by the terrorism agenda. Terrorism is a very serious issue. But unlike money laundering it does not threaten the viability or operation of the global financial system. Even the September 2001 attacks, which some thought were a direct assault on the U.S. economy or even the global economy, did not undermine the financial system. In fact they demonstrated how resilient it is.

Organised crime and criminal money laundering still provide a much greater threat to our citizens than terrorism. It causes more social dislocation, and far greater financial and personal loss; the resources devoted to terrorism are quite disproportionate to its impact. That's not to suggest the response to terrorism is unimportant. On the contrary, it's a complex issue which will not be dealt with by focusing on its financing.

The resources devoted to dealing with money laundering have increased marginally, but only to the extent that links are found with terrorist financing issues. Financial institutions are not identifying transactions that are possibly linked to terrorism. They do not know what to look for. We need to rethink our approach to combating terrorism and realise that money laundering is still a problem of much greater proportion to many nations as it directly reflects the extent of crime and corruption within their societies.

John Broome is professional fellow at the Centre for Transnational Crime Prevention, Faculty of Law, University of Wollongong in Australia. He is author of *Anti-Money Laundering International Law and Practice*, published by Sweet and Maxwell Asia.

納稅人的義務

章家壽
深圳市地方稅務局副局長



在重新修訂並頒佈施行的《中華人民共和國稅收徵收管理法》及其實施細則中，涉及納稅人的義務主要有十個方面：

1. 納稅人自領取營業執照之日起三十日內須辦理稅務登記。稅務登記內容發生變化，或在申辦註銷營業登記之前，須到稅務機關辦理稅務變更或註銷登記。辦理註銷稅務登記前，須繳清應繳納的稅款並繳銷剩餘的發票。
2. 納稅人持稅務登記證在銀行開設賬戶後十五日內須向稅務機關書面報告。賬戶發生變動亦須在十五日內書面報告。
3. 納稅人須按稅法規定向稅務機關如實地提供與納稅有關的信息資料，不得拒絕提供或提供虛假信息資料。
4. 納稅人須向稅務機關報送財會制度、財務處理辦法和會計核算軟件，並須按稅法規定至少十年內保管賬簿、憑證及資料，不得偽造、變造、損毀。
5. 納稅人在經營活動中，須向稅務機關領取發票，並按稅法規定保管、使用和開具發票。不得拒絕開具發票或使用假發票。
6. 納稅人須按稅法規定按期如實申報納稅，即使在沒有應稅收入或在免稅期間也須辦理納稅申報。
7. 納稅人的經營活動屬於關聯企業之間的業務往來須按獨立企業之間的業務往來進行。否則，稅務機關有權對因關聯企業之間業務往來而減少的應納稅額進行合理調整。
8. 納稅人經營的公司發生合併或分立，須向稅務機關報告。公司合併或分立時應繳清稅款，否則，合併或分立後的納稅人承擔連帶責任。
9. 納稅人須接受稅務檢查，如實反映經營和收入情況，提供相關資料，不得拒絕檢查或隱瞞情況。
10. 納稅人將經營權利或經營場所發包或出租給他人經營，須在三十日內向稅務機關報告承包或承租人的情況，否則承擔連帶責任。

Responsibilities of taxpayers

By Zhang Jiashou

In addition to clarifying the legal right of taxpayers (as outlined in issue 4, September 2005), China's revised Law on the Administration of Taxation Collection further defines the obligations of taxpayers in ten major areas.

Zhang Jiashou is vice director of the Administration of Local Taxation of Shenzhen Municipality.