



## TECH HIGHLIGHT

The Hong Kong Institute of CPAs published issue 33 of Techwatch on 1 June. The following subjects are all included in the publication, which can be viewed in full on the Institute's website.



# Techwatch 33

## ▶ Financial reporting updates

The Institute changes the name of Financial Reporting Interpretations, to HK(IFRIC) Interpretations and HK(SIC) Interpretations respectively. It also issues new interpretations on determination of the length of lease term, and on land leases in Hong Kong (see right).

The Institute invites comments on:

- Proposed amendments to IFRS 6 and IFRS 1
- IFRIC Draft Interpretations: D16 Scope of IFRS 2 and D17 IFRS 2 – Group and Treasury share transactions

## ▶ Audit and assurance

The Institute invites comments on the following Audit Report Exposure Drafts:

- Proposed HKSA 700: “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements”
- Proposed ISA 705: “Modifications to the Opinion in the Independent Auditor’s Report”
- Proposed ISA 706: “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report”

The Institute comments on IAASB Exposure Drafts of proposed revisions to ISAs on documentation, audit materiality and accounting estimates.

## ▶ Ethics

The Institute issues a standard, in conjunction with the Stock Exchange of Hong Kong Ltd. and the Securities and Futures Commission, to seek improvement in information made available in audit resignation letters – effective 1 June 2005.

## ▶ Corporate finance

The Stock Exchange of Hong Kong issues new disclosure requirements relating to initial listing documents and circulars, arising from new Hong Kong Financial Reporting Standards and the adoption of International Financial Reporting Standards.

The Institute comments on the proposal to give statutory backing to listing rules.

## ▶ Taxation

Summary of meeting with The Inland Revenue Department on tax implications of Hong Kong interpretation 3: “Revenue – Pre-completion Contracts For The Sale Of Development Properties.”

## Financial reporting interpretations

HKFRS Interpretations and HKAS Interpretations have been renamed as HK(IFRIC) Interpretations and HK(SIC) Interpretations respectively. Local interpretations developed by the Institute are renamed as HK Interpretations.

The changes address the concern that the existing names of the interpretations give a misleading impression that each type is linked to a particular category of Standards. The changes distinguish the interpretations in Hong Kong that are based on the equivalent international interpretations (IFRIC and SIC Interpretations) and those that are developed locally by the Institute.

Following the name changes, the Institute re-issued the following HK Interpretations as part of Update No. 14:

- HK Interpretation 1: The appropriate policies for infrastructure facilities (previously SSAP-Int 22)
- HK Interpretation 2: The appropriate policies for hotel properties (previously SSAP-Int 23)
- HK Interpretation 3: Revenue – Pre-completion contracts for the sale of development properties (previously SSAP-Int 24)

Update 14 also included a new interpretation on how to determine the length of the lease term of a Hong Kong land lease, for the purpose of applying the amortisation (depreciation) requirements under HKAS 16 and HKAS 17, as appropriate. This interpretation concludes that the lease term of a Hong Kong land lease should be determined by reference to the legal form and status of the lease. Renewal of a lease term is assumed only when the lessee has a renewal option and it is reasonably certain at the inception of the lease that the option will be exercised. Options for extending the lease term that are not at the discretion of the lessee shall not be taken into account by the lessee in determining the lease term. It became effective on 24 May 2005.

### Quick links

- ▶ Homepage  
<http://www.hkicpa.org.hk>
- ▶ For full details of Hong Kong standards and updates  
<http://www.hkicpa.org.hk/ebook/main.php>
- ▶ Mandy Tam, Legco representative  
<http://www.mandytam.com>

## Disciplinary findings

Mok Wah Chiu, Christopher CPA of C.W. Mok & Co. and H.I. Lee & Co. (a firm now de-registered).

**Complaint:** Non-compliance with Statements of Auditing Standards 400 “Audit evidence” and 230 “Documentation” in the audits the financial statements of four companies. Complaint raised by the Practice Review Committee based on the findings of a second practice review on Mr. Mok’s practices.

**Decision:** Reprimanded, fined HK\$100,000 and ordered to pay costs. DC(105)

### Quick links

- ▶ Further information is available at  
[http://www.hkicpa.org.hk/professionalcompliance/disciplinary/press\\_release.php](http://www.hkicpa.org.hk/professionalcompliance/disciplinary/press_release.php)





# Trust Services: A better way to evaluate IT controls

The Sarbanes-Oxley Act of 2002 requires internal control assessments using a suitable framework in a company's annual report. This article looks at the options that are open to companies performing the required assessment.

By Martin J. Coe

Section 404 of the Sarbanes-Oxley Act requires public companies to include in their annual reports an assessment by management of their internal controls over financial reporting. This includes: a statement of management responsibility for establishing and maintaining adequate internal control, an assessment of the effectiveness of those controls as of the end of the most recent fiscal year, a statement identifying the framework that was used to evaluate those controls and a statement that the external auditor issued an attestation report on management in-

ternal control assessment.

The United States' Securities and Exchange Commission rules say management must base its internal control evaluation on a suitable, recognised control framework established by a body or group that followed due-process procedures. The rules do not mandate the use of a particular framework but say a suitable one must:

- Be free of bias
- Permit reasonably consistent qualitative and quantitative measurements
- Include all relevant factors that



nual internal control evaluation and disclosure requirements. The COSO framework defines internal control, describes its components and provides criteria against which CPAs can evaluate control systems. In a survey of CEOs and CFOs, 72 percent said they used COSO to assess the effectiveness of their IT internal control structure. One reason for its popularity is that its objectives have been mapped to COSO in a publication entitled IT Control Objectives for Sarbanes-Oxley (available at [www.isaca.org](http://www.isaca.org)). However, since COSO does not provide specific criteria for IT controls, some companies may find a supplemental framework necessary.

#### COBIT ([www.isaca.org](http://www.isaca.org))

The Information Systems Audit and Control Foundation developed the control objectives for information and related technology (COBIT). Now in its third edition, COBIT is increasingly accepted as good practice for control over IT and related risks. The objective is a generally applicable and accepted standard for IT security and control practices that provides a reference framework for management, users, auditors and security practitioners. It has been mapped to popular enterprise resource planning (ERP) systems such as SAP, Oracle and PeopleSoft.

#### Trust Services ([www.aicpa.org/trustservices](http://www.aicpa.org/trustservices))

The foundation of the AICPA/CICA Trust Services framework is a set of principles and criteria CPAs can use to

## COMPLIANCE COSTS GROWING

Meeting the requirements of section 404 of the Sarbanes-Oxley Act of 2002 will cost public companies an average 62 percent more than first anticipated. The increase stems from a 109 percent rise in internal costs, a 42 percent jump in external costs and a 40 percent increase in the fees charged by external auditors, according to the Financial Executives International 2004 Survey ([www.fei.org](http://www.fei.org)).



assess the reliability of a company's IT systems. The criteria constitute professional guidance as well as serve as best practices for system reliability. While COBIT provides a comprehensive framework for assessing IT controls, clients may seek a narrower framework that would complement the overall COSO model many clients were using. To this end, Trust Services focuses on the controls that are in place to ensure the company systems carry out business processes reliably.

might alter a conclusion about the effectiveness of the internal controls

- Be relevant to an evaluation of internal control over financial reporting

The three most suitable and widely spread frameworks are COSO, COBIT and the American Institute of CPAs' Trust Services framework.

#### COSO ([www.coso.org](http://www.coso.org))

The framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) satisfies the SEC criteria. Companies may use it to meet management's an-

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## TECH FEATURE

# Financial reporting in China

▶▶▶ *Part 2*



In the June issue of *A Plus*, we set out the key developments of the new accounting and auditing regulations issued by the PRC Ministry of Finance (MOF) over the past 18 months. This month, we present a companion overview of the guidance from the China Securities Regulatory Commission (CSRC) and the Chinese Institute of Certified Public Accountants (CICPA).

### CSRC Revisions to Form and Content Standard #2

**Effective:** December 2004

**What it is:** The CSRC details the additional disclosures required on various corporate governance matters.

**Key disclosures:**

- + The nature, amount, reason and financial impact resulting from correction of material accounting errors.
- + The relationship between major shareholders who are related, and a graphical representation of ownership.
- + Details of any investments owned jointly by the listed company and its related parties.
- + Policies regarding payment of dividends, including reasons for not distributing profits and their intended use, and proposed capitalisation of capital reserves, if any.
- + How independent directors have performed their duties (such as meeting attendance) and details of recommendations or objections made at board meetings.
- + Details of significant events of subsidiaries, for example, court cases and arbitrations.

### CICPA Special Committees

**Established:** 2004

**What it is:** The CICPA established the following special committees, to improve the self-regulatory structure and practices of the accountancy profession in China.

- + **Auditing Standards Committee:** This committee was formed to propose and develop independent auditing standards, including an exposure draft and comments prior to final adoption.
- + **Discipline Committee:** Formed to discipline CPA firms and CPAs who violate regulations.
- + **Discipline Appeal Committee:** Formed to consider appeals against a punishment made by the Discipline Committee and affirm or modify the decision.

- + **Right-protecting Committee:** Formed to protect the rights of the members and the profession.

### CICPA Technical Bulletin No. 8

**Issued:** 19 February 2004

**What it is:** The CICPA Technical Expert Team issued this bulletin addressing five key issues.

**Key issues covered:**

- + **Impairment losses of assets:** Provides guidance, in the form of four questions and answers, relating to a provisional regulation on asset impairment that was issued in 2003. There is additional clarification stating that it must be applied by all listed companies.
- + **Deconsolidation:** Describes how to account for "surplus reserves" (a special reserve under PRC law) when an investor no longer has a majority interest.
- + **Dividends:** The accounting method used when a parent acquires the minority interest in a subsidiary to which dividends are owed.
- + **Receivables and payables:** Provides guidelines on offsetting in the balance sheet in the case of receivables from and payable to the same party.
- + **Capital surplus:** This sets out three questions relating to "surplus reserves".

### CICPA Exposure Drafts on Independent Auditing Standards

**Key proposals:**

- **No. 1:** Objective and general principles governing an audit of financial statements.
- **No. 5:** Audit evidence.
- **No. 29:** Understanding the entity and its risk environment and assessing the risks of material misstatement.
- **No. 30:** Procedures in response to assessed risks of material misstatement.

All of the above are based on the related International Standards on Auditing (ISA).