



## TechWatch 47 & 48

The latest standards  
and regulatory  
announcements

### ► Financial reporting

#### Forthcoming operative dates of standards

The following HKFRSs are effective for annual periods beginning on or after 1 January 2007:

- Amendment to HKAS 1 *Presentation of Financial Statements* – Capital Disclosures
- HKFRS 7 *Financial Instruments: Disclosures*

#### IASB latest draft of an exposure draft on SME project

The IASB has posted on its website the latest version of an exposure draft (ED) prepared by its staff in the process of developing an IFRS for small and medium-sized entities (SMEs). This IASB project is ongoing and the draft ED is a report on the progress of the project. Further changes, some of which could be substantial, will be made to this draft ED before the IASB publishes it for public comment. The IASB has discussed earlier drafts of this draft ED at public meetings and this draft reflects the cumulative, tentative decisions made by the conclusion of its meeting in July 2006. Those tentative decisions have been reported in the IASB Update.

The draft ED is being made publicly available purely for information – to give interested parties an update on the project. The IASB has not approved and does not request comments on this draft ED and its staff will not consider or respond to any comments. The IASB expects to publish an ED on the SME project for public comment later this year.

#### Institute issues HK(IFRIC)-Int 10

The Institute has issued HK(IFRIC)-Int 10 *Interim Financial Reporting and Impairment* with effect for annual periods beginning on or after 1 November 2006.

HK(IFRIC)-Int 10 is converged with the equivalent IFRIC interpretation. It addresses the apparent conflict between the requirements of HKAS 34 *Interim Financial Reporting* and those in other standards on the recognition and reversal in financial statements of impairment losses on goodwill and certain financial assets. HK(IFRIC)-Int 10 states that any such impairment losses recognized in an interim financial statement must not be reversed in subsequent interim or annual financial statements.

### **Comments on IASB ED of proposed amendments to IAS 23**

The IASB exposure draft of proposed amendments to IAS 23 *Borrowing Costs* proposes to require an entity to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The option of immediately recognizing those borrowing costs as an expense would be removed as a result.

The Institute's submission to the IASB, in general, supports the proposed change as the change will improve financial reporting by removing an option, resulting in information that is more comparable between entities.

### **► Ethics**

#### **Section 441 of the Code of Ethics for Professional Accountants**

Outgoing auditors of listed issuers are reminded that the Institute issued in May 2005 a Professional Ethics Statement 1.207A – *Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong*, now known as section 441 of the Code of Ethics for Professional Accountants.

Section 441 establishes a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.

### **► Corporate finance**

#### **Implementation progress of the new sponsors regulatory regime**

The Securities and Futures Commission (SFC) informed the market of the implementation progress of the new sponsors regulatory regime on 5 September 2006.

On 10 April 2006, the SFC released the consultation conclusions to the *Consultation Paper on the Regulation of Sponsors and Compliance Advisers*, which introduced the Guidelines for Sponsors and Compliance Advisers ("Sponsor Guidelines"), outlining the specific eligibility and ongoing requirements for corporate finance advisory firms wishing to act as sponsors and compliance advisers.

The Sponsor Guidelines, which have been incorporated as part of the Fit and Proper Guidelines issued by the SFC, will become effective on 1 January 2007. The SFC has recently published on its website a set of frequently asked questions to clarify and elaborate certain issues in relation to the Sponsor Guidelines.

On 5 September 2006, the SFC also issued two circulars to existing intermediaries holding Type 6 regulated activity licences to remind them of the forthcoming implementation of the Sponsor Guidelines. These circulars are "Intermediaries licensed or registered for Type 6 regulated activity – sponsor regime" and "Securities and Futures (Financial Resources) (Amendment) Rules 2006 for Sponsors."

#### **Consultation conclusions on possible reforms to the prospectus regime**

On 22 September 2006, the SFC announced the release of the consultation conclusions on the reforms to the prospectus regime. This initiative is designed to modernize the regime governing the public offering of shares and debentures in the Companies Ordinance (Cap. 32), in order to encourage capital raising and the issuance of securities in Hong Kong, while ensuring satisfactory standards of investor protection.

*Extracts from TechWatch 47 and 48. The entire publications are available as a PDF on the Institute's website. Since October, members opting for e-communications with the Institute receive the latest TechWatch in e-circular format at the beginning of each month.*

#### **Quick link**

##### **► TechWatch:**

[www.hkicpa.org.hk/  
professionaltechnical/  
techwatch/techwatch.php](http://www.hkicpa.org.hk/professionaltechnical/techwatch/techwatch.php)

# Let's get technical

*This column is dedicated to answering questions submitted by members regarding Institute standards*

**Q.** I have been applying acquisition accounting to a common control combination and now wish to apply merger accounting. Is there any reason why I should not change my accounting policy?

**A.** Common control combinations are outside the scope of HKFRS 3 *Business Combinations*. There is no specific accounting standard addressing the appropriate accounting treatment for common control combinations after the withdrawal of SSAP 27 *Accounting for Group Reconstructions* in November 2005. Accordingly, an entity selects an appropriate accounting policy in accordance with the requirements set out in HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and merger accounting might be considered as an appropriate accounting policy for common control combinations.

Despite the above, since you have been applying acquisition accounting to a common control combination, a change from using acquisition accounting to using merger accounting is a change in accounting policy. Accordingly, further consideration would have to be given before merger accounting can be applied. HKAS 8 permits an entity to change its accounting policy only if the change:

- a. is required by a standard or an interpretation; or
- b. results in the financial statements providing reliable and more relevant

information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Given that there is no new standard or interpretation requiring merger accounting to be used for a common control combination, the change from using acquisition method to merger accounting can only be made on a voluntary basis under the above (b). It should be noted that, even though Accounting Guideline 5 *Merger Accounting for Common Control Combinations* sets out the principles and procedures for applying merger accounting, it does not require merger accounting to be used for a common control combination.

In the case that you decide to make a voluntary change from using acquisition accounting to using merger accounting, you are required to make the disclosures as required under HKAS 8 paragraph 39. This includes the disclosure of the reasons why applying merger accounting would provide more reliable and more relevant information and the effect of the change on the financial statements.

*Please note that the answers only address general issues and provide general guidance. The answers do not constitute professional or legal advice. You need to base your decisions on frameworks, standards and other documents approved by the Council of the Institute, after taking account of your specific circumstances.*

## Members helping members

*Do you want to help your fellow members?*

*Try answering this question from a member and send an email to [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk). Answers received by 20 November will be considered for inclusion in the January issue of A Plus.*

This month's question:

**Q.** I am a practising accountant and most of my clients prepare their financial statements in accordance with the Institute's Small and Medium-sized Entity Financial Reporting Standard. As an auditor, where can I find guidance about how I audit such financial statements? I presume that I can apply simpler audit procedures to match the simpler reporting requirements?

Here is the answer to the question we asked members to help with in the September edition of *A Plus*:

**Q.** My firm has been engaged to conduct an internal control review for the purpose of Chapter 3A of the Main Board Listing Rules for a company that is seeking a listing on the Stock Exchange of Hong Kong. Which standard or practice note should I refer to?

**A.** Chapter 3A of the Main Board Listing Rules requires a sponsor to submit to the Stock Exchange a declaration that the listing applicant has established procedures, systems and controls (including accounting and management systems) which are adequate having regard to the obligations of the new applicant and its directors to comply with the Listing Rules and other relevant legal and regulatory requirements, and which are sufficient to enable the new applicant's directors to make a proper assessment of the financial position and prospects of the listing applicant and its subsidiaries, both before and after listing.

Reporting accountants are often requested by sponsors to undertake engagements to provide a reasonable basis for them to make proper judgement as to whether they would be able to make the declaration required by the Listing Rules. It should be noted that the Stock Exchange imposes the requirements for making a declaration on sponsors, and therefore only sponsors are in a position to determine the scope of work that is required. It is important for reporting accountants, the listing applicant and sponsors to reach an understanding and agreement as to the sponsors' requirements and the scope of work that the reporting accountants would perform.

The scope of work that might be performed by reporting accountants depends on many factors, including:

- The level of expertise that the sponsors have in respect of assessing the new applicant's internal controls
- The type of assistance and hence the type of engagements that the sponsors are requesting
- The level of expertise of the reporting accountants in respect of reporting on internal controls
- The level of risks that the reporting accountants are willing to take
- Whether the listing applicant has in fact got systems and controls already in place (noting that some listing applicants only come into existence shortly before listing)

Broadly speaking, the standard to be followed depends on the types of engagement that your firm has agreed with the listing applicant and the sponsor. If your firm will undertake an assurance engagement, you should refer to HKSAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information*. If your firm will undertake an agreed-upon procedures engagement, you should refer to HKSRS 4400 *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*.

The Institute has not issued a standard or practice note on reporting on internal controls for the purpose of the Listing Rules. Because the obligation to make a declaration rests with the sponsors, it is considered inappropriate for the Institute to provide guidance until there is a clearer understanding of the needs of the sponsors and the type of assistance that reporting accountants are able to provide with respect to ethical and risk considerations. Of course, any guidance ultimately depends on the criteria that the Stock Exchange considers appropriate for the purpose of the Listing Rules.

The Institute is monitoring the development in this area and will study the practicality of issuing some form of guidance where appropriate.

*You can submit questions on technical issues by sending an email to [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk). The standard setting team will answer these questions in accordance with the policy on handling members' technical questions which is posted on the Institute's website.*

