

# Let's get technical

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

**Q.** For an engagement in relation to Solicitors' Accounts Rules, is there any guidance on what client account means and what are the possible qualifications in the report?

**A.** In accordance with rule two of the Solicitors' Accounts Rules, client account is defined as current or deposit account at a bank in the name of the solicitor in the title of which the word "client" appears.

The Institute has issued Practice Note 840 *The Audit of Solicitors' Accounts Under the Solicitors' Accounts Rules and the Accountant's Report Rules* (PN 840), which can be found in volume III of the members' handbook. The purpose of this practice note is to give members guidance on the audit of firms' accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules. PN 840 deals exclusively with the aspects of the rules that concern clients' monies held by law firms.

A list of key questions based on the Solicitors' Accounts Rules is attached as appendix 1 of PN 840. Any "no" answers to these key questions would normally suggest that the Solicitors' Accounts Rules have not been complied with. An accountant would make further investigation if necessary to enable him to sign the accountant's report. He would issue a qualified opinion in the report where he has come across any breaches of the Solicitors' Accounts Rules during the course of his work.

## 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 18 November will be considered for inclusion in the January 2009 issue of A Plus.*

**Q. Should two parties be regarded as related if they are subject to significant influence from the same source?**

*Here is the answer to the question we asked members to help with in the September 2008 edition of A Plus:*

**Q. After my company issued a compound financial instrument, it seems to me that the exercise of the conversion option would be more advantageous to holders. In this respect, should the classification of the liability and equity of a compound financial instrument be revised if there is a change in the likelihood that a conversion option will be exercised in a subsequent accounting period?**

**A.** Paragraph 28 of HKAS 32 *Financial Instruments: Presentation* requires the issuer of a non-derivative financial instrument to evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. This evaluation should be done in accordance with the substance of the contractual arrangement and the definition of a financial liability, financial asset and an equity component. If such components are identified, the issuer should account for the components separately as financial liabilities, financial assets or equity instruments.

Based on paragraph 30, separation of the instrument into liability and equity components is made upon initial recognition of the instrument and is not subsequently revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected and the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, the instrument's maturity or some other transaction.

As part of the requirements in HKAS 32 dealing with the separation of a convertible instrument, paragraphs 31 and 32 provide guidance as follows:

- i. The carrying amount of the liability component (that is, a contractual arrangement to deliver cash or another financial asset) is the first to be determined by measuring the fair value of a similar liability (including any embedded non-equity derivative features such as an issuer's call option to redeem the bond early) that does not have any associated equity component.
- ii. The carrying amount of the equity instrument (that is, a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity) is determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Following the guidance listed above, the sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value of the instrument as a whole as the equity component is assigned the residual amount after deducting from the total fair value of the instrument. Thus, no gain or loss arises from initially recognizing the components of the instrument separately.

You can find more guidance in example 9 (paragraphs IE34–IE36) and example 10 (paragraphs IE37–IE38) of illustrative examples accompanying HKAS 32.

*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.*

