

PREFACE TO HONG KONG FINANCIAL REPORTING STANDARDS

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and October 2004)*

This Preface is issued to set out the objectives and due process of the Council of the Hong Kong Institute of Certified Public Accountants (HKICPA) (formerly known as Hong Kong Society of Accountants (HKSA)) (hereafter referred as the "Council") in respect of setting Hong Kong Financial Reporting Standards (HKFRSs) and to explain the scope, authority and timing of application of HKFRSs. For the purpose of this Preface, the term "Hong Kong Financial Reporting Standards" includes all Statements of Standard Accounting Practice (SSAPs), Hong Kong Accounting Standards (HKASs) and Interpretations approved by Council and currently in issue. It also sets out the relationship between HKFRSs and International Financial Reporting Standards (IFRSs) and the scope and authority of Accounting Guidelines and Accounting Bulletins. The Preface supersedes the Preface approved in October 2003 and revised in September 2004 and the Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines issued in September 1978 (reviewed March 1984 and amended December 1991 and June 2000).

1. Pursuant to section 18A of the Professional Accountants Ordinance (Chapter 50), Council may, in relation to the practice of accountancy, issue or specify any standards of accounting practices required to be observed, maintained or otherwise applied by members of the HKICPA. Approval of HKFRSs and related documents, such as the *Framework for the Preparation and Presentation of Financial Statements (Framework)*, exposure drafts, and other discussion documents, is the responsibility of Council.
2. Council has mandated the Financial Accounting Standards Committee (FASC) to develop accounting standards to achieve convergence with the IFRSs issued by the International Accounting Standards Board (IASB). Within this remit, Council permits the FASC to work in whatever way it considers most effective and efficient and this may include forming advisory sub-committees or other forms of specialist advisory groups to give advice in preparing new and revised HKFRSs.
3. The Urgent Issues and Interpretations Sub-Committee (UII) is a sub-committee formed under the auspices of the FASC. The role of the UII is to prepare interpretations of HKFRSs for consideration by the FASC and, in the context of the *Framework*, to provide timely guidance on newly identified financial reporting issues not specifically addressed in HKFRSs or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop. It thus promotes the rigorous and uniform application of HKFRSs.
4. The HKICPA's Standard-Setting Steering Board (SSSB) is responsible for reviewing and advising on the HKICPA's overall strategy, policies and processes for setting accounting standards. One of the SSSB's main objectives is to give advice to the FASC on priorities and on major standard-setting projects.

Objectives of Council

5. In 2001, Council adopted the policy of achieving convergence of HKFRSs with IFRSs. Council's objectives in this respect are:
 - (a) to develop, in the public interest, a single set of high quality, understandable and enforceable accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the capital markets and other users of the information to make economic decisions;
 - (b) to promote the use and rigorous application of those standards;
 - (c) to promote, support and enforce compliance with those standards by members of the HKICPA whether as preparers or auditors of financial information; and
 - (d) to bring about convergence of accounting standards with IFRSs.

Scope and authority of HKFRSs

6. Council achieves its objectives primarily by developing and publishing HKFRSs and promoting the use of those standards in general purpose financial statements and other financial reporting. Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. In developing HKFRSs, Council takes into consideration the need to achieve convergence of HKFRSs with IFRSs and the need to maintain consistency with the legal framework.
7. HKFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. They may also set out such requirements for transactions and events that arise mainly in specific industries. HKFRSs are based on the *Framework*, which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the *Framework* is to facilitate the consistent and logical formulation of HKFRSs. The *Framework* also provides a basis for the use of judgement in resolving accounting issues.
8. HKFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organised in corporate or in other forms. They include organisations such as mutual insurance companies and other mutual cooperative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants. Although HKFRSs are not designed to apply to not-for-profit activities in the private sector, public sector or government, entities with such activities may find them appropriate.

9. HKFRSs apply to all general purpose financial statements. Such financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective of financial statements is to provide information about the financial position, performance and cash flows of an entity that is useful to those users in making economic decisions.
10. A complete set of financial statements includes a balance sheet, an income statement, a statement showing either all changes in equity or changes in equity other than those arising from capital transactions with owners and distributions to owners, a cash flow statement (unless exempt), and accounting policies and explanatory notes. In the interest of timeliness and cost considerations and to avoid repeating information previously reported, an entity may provide less information in its interim financial statements than in its annual financial statements. *SSAP 25 Interim Financial Reporting* prescribes the minimum content of complete or condensed financial statements for an interim period. The term 'financial statements' includes a complete set of financial statements prepared for an interim or annual period, and condensed financial statements for an interim period.
11. In some cases, HKFRSs permit different treatments for given transactions and events. Usually, one treatment is identified as the 'benchmark treatment' and the other as the 'allowed alternative treatment'. The financial statements of an entity may appropriately be described as being prepared in accordance with HKFRSs whether they use the benchmark treatment or the allowed alternative treatment.
12. Council's objective is to require like transactions and events to be accounted for and reported in a like way and unlike transactions and events to be accounted for and reported differently, both within an entity over time and among entities. Consequently, Council intends not to permit choices in accounting treatment. Also, Council has reconsidered, and will continue to reconsider, those transactions and events for which HKFRSs permit a choice of accounting treatment, with the objective of reducing the number of those choices.
13. Statements approved by Council include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual standard should be read in the context of the objective stated in that standard and this Preface.
14. Interpretations of HKFRSs are to give authoritative guidance on newly identified financial reporting issues not specifically addressed in HKFRSs or issues where unsatisfactory or conflicting interpretations have developed or seem likely to develop in the absence of such guidance.
- 14A. Entities shall apply interpretations if their financial statements are described as being prepared in accordance with HKFRSs (see paragraph 14 of HKAS 1 (issued 2004)).
- 14B. Interpretations apply to current and future reporting periods from the date of issue or other specified effective date. Transitional provisions that apply on initial application of an interpretation are specified in the interpretation.

- 14C. An interpretation becomes inoperative and is withdrawn when a HKFRS or other authoritative document issued by Council that overrides or confirms a previously issued interpretation becomes effective. Those interpretations that would be affected by an authoritative HKICPA document are identified in the Exposure Draft of that document.
15. HKAS 1 *Presentation of Financial Statements* includes the following requirement:

"An entity whose financial statements comply with HKFRSs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with HKFRSs unless they comply with all the requirements of HKFRSs. "

This requirement extends to HKFRSs currently in issue.

16. Any limitation of the scope of a HKFRS is made clear in the standard.

Obligation for members of the HKICPA to observe HKFRSs or justify departures

17. Council is committed to promoting and supporting compliance with HKFRSs by members of the HKICPA whether as preparers or auditors of financial information.
18. Council therefore expects members of the HKICPA who assume responsibilities in respect of financial statements to observe HKFRSs.
19. Where this responsibility is evidenced by the association of members' names with such financial statements in the capacity of directors or other officers, the onus will be on them to ensure that the existence and purpose of HKFRSs are fully understood by non-member fellow directors and other officers. Members of the HKICPA should also use their best endeavours to ensure that HKFRSs are observed and that significant departures found to be necessary are adequately disclosed and explained in the financial statements.
20. Where members of the HKICPA act as auditors or reporting accountants, they should be in a position to justify significant departures, to the extent that their concurrence with the departures is stated or implied. They are not, however, required to refer in their report to departures with which they concur, provided that adequate disclosure has been made in the notes to the financial statements.
21. Council may enquire into apparent failures by members of the HKICPA to observe HKFRSs or to ensure adequate disclosure of significant departures there from.

Compliance with a basis or standard of accounting other than HKFRSs

22. Where a member of the HKICPA assumes responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, the member should observe that other basis or standard of accounting. Accordingly, paragraphs 19 to 21 of this Preface shall apply, as if the references to HKFRSs in those paragraphs are to the other basis or standard of accounting, to members of the HKICPA who assume responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, as they apply to members of the HKICPA who assume responsibility in respect of financial statements prepared under HKFRSs.

Due process

23. HKFRSs and Interpretations of HKFRSs are developed through a due process that involves members and member practices of the HKICPA, listed companies in Hong Kong, the stock exchange, regulatory and legal authorities, academics and other interested individuals and organisations.
24. The FASC consults the SSSB on major projects, agenda decisions and work priorities. The UII assists the FASC in identifying potential agenda items for which timely guidance can be provided. Due process for projects normally, but not necessarily, involves the following steps:
- (a) the staff are asked to identify and review all the issues associated with an exposure draft or a draft interpretation issued by the IASB for possible adoption in Hong Kong or any other topics and to consider the application of the *Framework* to the issues, if needed;
 - (b) study of pronouncements of the IASB and other standard setting bodies and accepted industry practices about the issues;
 - (c) consulting the SSSB about the advisability of adding the topic to the FASC or UII's agenda;
 - (d) formation of an advisory group to give advice to the FASC on the project;
 - (e) publishing for public comment a discussion document;
 - (f) publishing for public comment an exposure draft or a draft interpretation;
 - (g) publishing within an exposure draft a basis for conclusions;
 - (h) consideration of all comments received within the comment period on discussion documents, exposure drafts and draft interpretations and, when appropriate, preparing a comment letter to the IASB;

- (i) following publication of the finalised IFRS or Interpretation of IFRS, consideration of the changes made, if any, by the IASB;
 - (j) approval of a standard or an Interpretation by Council; and
 - (k) publishing within a standard a basis for conclusions, if appropriate, explaining how the conclusions were reached and to give background information that may help users of HKFRSs to apply them in practice.
- 24A. On occasion, the FASC may consult and raise issues specific to Hong Kong proactively with the IASB.

Coordination with International Due Process

25. Council understands that close co-ordination between the FASC's and IASB's due processes is important to the success of achieving convergence of HKFRSs with IFRSs.
26. In its due process statements, the IASB states that it is exploring ways in which it can integrate its due process more closely with national due process (such as that operated in Hong Kong by the FASC).
27. In particular, the IASB states that it is exploring the following procedures for projects that have international implications:

IASB and national standard setters would co-ordinate their work plans so that when IASB starts a project, national standard setters would also add it to their own work plans so that they can play a full part in developing an international consensus. Similarly, where national standard setters start projects, IASB would consider whether it needs to develop a new IFRS or revise its existing IFRSs. Over a reasonable period, IASB and national standard setters should aim to review all standards where significant differences currently exist, giving priority to the areas where the differences are greatest;

National standard setters would not be required to vote for IASB's preferred solution in their national standards, since each country remains free to adopt IASC standards with amendments or to adopt other standards. However, the existence of an international consensus is clearly one factor that members of national standard setters would consider when they decide how to vote on national standards;

IASB would continue to publish its own Exposure Drafts and other documents for public comment;

National standard setters would publish their own exposure documents at approximately the same time as IASB Exposure Drafts and would seek specific comments on any significant divergences between the two exposure documents. In some instances, national standard setters may include in their exposure documents specific comments on issues of particular relevance to their country or include more detailed guidance than is included in the corresponding IASB document; and

National standard setters would follow their own full due process, which they would, ideally, choose to integrate with IASB's due process. This integration would avoid unnecessary delays in completing standards and would also minimise the likelihood of unnecessary differences between the standards that result.

Council supports the integration of its standard setting process with that of the IASB as outlined above by adopting these procedures.

Timing of application of HKFRSs

28. HKFRSs apply from a date specified in the document. New or revised HKFRSs set out transitional provisions to be applied on their initial application.
29. Council has no general policy of exempting transactions occurring before a specific date from the requirements of new HKFRSs. When financial statements are used to monitor compliance with contracts and agreements, a new HKFRS may have consequences that were not foreseen when the contract or agreement was finalised. For example, covenants contained in banking and loan agreements may impose limits on measures shown in a borrower's financial statements. Council believes the fact that financial reporting requirements evolve and change over time is well understood and would be known to the parties when they entered into the agreement. It is up to the parties to determine whether the agreement should be insulated from the effects of a future HKFRS, or, if not, the manner in which it might be renegotiated to reflect changes in reporting rather than changes in the underlying financial condition.
30. Exposure drafts are issued for comment and their proposals are subject to revision. Until the effective date of a HKFRS, the requirements of any HKFRS that would be affected by proposals in an exposure draft remain in force.

Relationship with IFRSs

31. Although Council has a policy to achieve convergence of HKFRSs with IFRSs, Council may consider it appropriate to include additional disclosure requirements in a HKFRS or, in some exceptional cases, to deviate from an IFRS. Each HKFRS issued by Council contains information about the extent of compliance with the equivalent IFRS. Where the requirements of a HKFRS and an IFRS differ, the HKFRS should be followed by entities reporting within the area of application of the HKFRSs.

Scope and application of Accounting Guidelines

32. Accounting Guidelines are those guidelines that have been approved for issue by Council.

33. Accounting Guidelines have effect as guidance statements and indicators of best practice. They are persuasive in intent. Unlike HKFRSs, Accounting Guidelines are not mandatory on members of the HKICPA but are consistent with the purpose of HKFRSs in that they help define accounting practice in the particular area or sector to which they refer. Therefore, they should normally be followed and members of the HKICPA should be prepared to explain departures if called upon to do so.

Scope and application of Accounting Bulletins

34. Accounting Bulletins are informative publications issued by the FASC on subjects of topical interest and are intended to assist members of the HKICPA or to stimulate debate on important accounting issues. They do not require the approval of Council and they do not have the same authority as either HKFRSs or Accounting Guidelines.