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- (i) Auditing And Assurance Standards Committee Meeting Summary – July 2003
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Accounting & Financial Reporting

1. FASC Meeting – 10 September 2003

The FASC met on 10 September 2003 and discussed the following items:

- 9 Proposed HKFRS 1, First-Time Adoption of Hong Kong Financial Reporting Standards
- 9 Investment Property – further consideration of provisions re transfers between classes of assets
- 9 Proposed SSAP 37, Accounting and Reporting by Retirement Benefit Plans, and proposed replacement of Statement 2.302
- 9 Proposed Preface to Hong Kong Financial Reporting Standards – continued discussion on the ED
- 9 Report from the Urgent Issues & Interpretations Sub-Committee meetings held on 25 June and 23 July 2003

A copy of the September meeting summary is attached to this issue of TechWatch. The meeting summary has also been posted on the HKSA website at:

< <http://www.hksa.org.hk/professionaltechnical/accounting/fascupdate> >.

Audit & Assurance

2. Eight New Auditing Practice Notes Issued

As part of the HKSA International Convergence Programme, the HKSA has issued the following eight new Practice Notes adopting the equivalent International Auditing Practice Statements:

- z PN 1000 “Inter-Bank Confirmation Procedures” providing practical assistance to external independent auditors and also internal auditors and inspectors on inter-bank confirmation procedures.
- z PN 1001 “IT Environments – Stand-Alone Personal Computers” providing guidance when stand-alone PCs are used in the production of information that is material to the financial statements of the entity.
- z PN 1002 “IT Environments – On-Line Computer Systems” providing guidance when on-line computer systems are used in the production of information that is material to the financial statements of the entity.
- z PN 1003 “IT Environments – Database Systems” providing guidance when database systems are used in the production of information that is material to the financial statements of the entity.
- z PN 1009 “Computer-Assisted Audit Techniques” providing guidance on the use of Computer-Assisted Audit Techniques involving a computer of any type or size. This PN replaces Auditing Guideline (AG) 3.262 “Computer-assisted audit techniques (CAATs)” which has been withdrawn.
- z PN 1010 “The Consideration of Environment Matters in the Audit of Financial Statements” providing guidance when environment matters are significant to the financial statements of the entity.
- z PN 1012 “Auditing Derivative Financial Instruments” providing guidance when derivatives activities are material to the financial statements of the entity.

- z PN 1013 “Electronic Commerce – Effect on the Audit of Financial Statements” providing guidance where an entity uses a public network, such as the internet, for electronic commerce.

The eight new Practice Notes are unchanged from the Exposure Drafts.

3. New Practice Note On Review Of Lottery Accounts

The HKSA has issued Practice Note 852 “Review of lottery accounts” to provide guidance to CPAs in conducting a review of the lottery accounts under a new condition of the Lottery Licence issued by the Television Entertainment Licensing Authority of the Government (TELA). The new condition of the TELA Lottery Licence requires a report by the CPA on the lottery accounts and will become effective on 3 December 2003.

The Practice Note was developed at the request of and in consultation with the TELA.

4. Proposed New Guidance On The Securities And Futures Commission’s Power To Access Audit Working Papers Under Section 179 Of the Securities And Futures Ordinance

The HKSA has issued an Exposure Draft of General Guidance 1.307 “Production of audit working papers to the Securities and Futures Commission under section 179 of the Securities and Futures Ordinance” for consultation until 21 January 2004

< http://www.hksa.org.hk/professionaltechnical/assurance/exposuredraft/ed-gg1.307_cover.pdf >.

The proposed General Guidance was developed in consultation with the Securities and Futures Commission (SFC) to provide guidance to auditors of listed companies in respect of the power conferred upon the SFC under section 179 of the Securities and Futures Ordinance. This power requires the auditors of listed companies to produce their audit working papers to assist the SFC in its investigations of listed companies where the SFC suspects that persons involved in the management of the affairs of the listed companies have engaged in defalcation, fraud, misfeasance or other misconduct.

5. Review Of Interim Financial Information Performed By The Auditor – HKSA Comments On IAASB ED

The HKSA has made the following points in a submission to the IAASB on the captioned IAASB Exposure Draft:

- z the proposed ISA should be issued as an International Standard on Assurance Engagements (ISAE) instead of an International Standard on Auditing (ISA);
- z the applicability of other ISAs to “Review” engagements;
- z there is not a need to have two Standards (the proposed ISA and extant ISA 910) covering a similar subject; and
- z it would be preferable for auditors to express the same conclusion on both a condensed set of interim financial information and a complete set of interim financial information.

The HKSA submission and the IAASB’s Exposure Draft can be viewed at:

< http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/IAASB_ED_IntFin.pdf >.

6. The Auditor's Responsibility To Consider Fraud In An Audit Of Financial Statements And Audit Planning – HKSA Comments On IAASB EDs

The HKSA has made a submission to the IAASB expressing support of the captioned IAASB EDs. Both EDs have been developed to align the guidance on fraud and audit planning with the guidance in the new Audit Risk Standards. The proposed revised ISA on fraud deals only with the auditor's responsibility to consider fraud in an audit of financial statements and proposes that the specific guidance with respect to error will be moved to other ISAs. The proposed revised ISA on audit planning discusses the requirement for the auditor to develop an "overall audit strategy" and an "audit plan" to replace the concepts of "overall audit plan" and an "audit program".

Upon finalization of the IAASB EDs, the AASC intends to adopt them as local standards so that Hong Kong Auditing and Assurance Standards maintain conformity with current International Auditing and Assurance Standards.

The HKSA submission and the IAASB EDs can be viewed at: < http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/IAASB_ED_fraud_planning.pdf >.

7. AASC Meetings – 22 July and 4 September 2003

The meeting summaries of the AASC meetings held in July 2003 and September 2003 are attached to this issue of TechWatch. The meeting summaries have also been posted on the HKSA website at: < <http://www.hksa.org.hk/professionaltechnical/assurance/aasc/index.php> >.

Ethics

8. New Independence Rules

The HKSA has issued new Professional Ethics Statement 1.203A "Independence for assurance engagements" and Professional Ethics Guidance 1.308 of the same title, which is closely modelled on section 8 of the IFAC Code of Ethics for Professional Accountants. The Statement sets out the principles of independence for assurance engagements while the Guidance provides examples on the application of the principles to specific situations.

The finalization of the rest of the proposed HKSA Code of Ethics has been postponed pending finalization of the IFAC Exposure Draft of the revised IFAC Code issued in July 2003.

The new independence requirements set out a conceptual framework on independence that focuses on the factors that pose a threat to independence for all assurance engagements and the safeguards that firms should put in place to preserve their independence. It identifies five categories of threat to independence – self-interest, self-review, advocacy, familiarity and intimidation threats. Each has its own level and nature of risks attached that need to be balanced against possible safeguards. It identifies three categories of safeguards to mitigate threats.

The examples of situations on how the conceptual approach to independence is to be applied to specific circumstances and relationships include a discussion of "provision of non-assurance services to assurance clients". Ten categories of non-audit services are identified, including preparation of accounting records and financial statements, tax services, valuation services, internal audit services, IT systems services, litigation support services, legal services, corporate finance, provision of staff assignment and recruiting senior management. There is no specific banning based on the types of services, but rather, based on the principles set out in the new Statement, a firm should not accept an appointment where the threat to independence is so significant that no safeguard could reduce the threat

to an acceptable level. There are specific examples that this will be so including specific types of legal, corporate finance and valuation services, and accounting records and financial statement preparation for listed audit clients.

The new Guidance also provides specific guidance on the rotation of the lead engagement partner as a safeguard to mitigate the familiarity threat that may arise as a result of using the same senior personnel on an assurance engagement of a listed entity over a long period of time. It states that such a safeguard involves the rotation of the lead engagement partner after a pre-defined period, normally no more than seven years. It also states that a partner rotating after a pre-defined period should not resume the lead engagement partner role until a further period of time, normally two years, has elapsed.

The new Statement and Guidance are applicable to audits of financial statements for accounting periods beginning on or after 1 January 2004, and to other assurance engagements (including reporting engagements performed by reporting accountants) when the assurance report is dated after 31 December 2004. A transitional period of two years is permitted in respect of the rotation of the lead engagement partner and one year for the provision of non-assurance services to assurance clients.

Because of the issuance of the new Statement and Guidance, the existing independence requirements in Statement 1.203 have been withdrawn. The ethical requirements on conflicts of interest in Statement 1.203 are retained for the time being pending the finalization of the IFAC ED which contains a section on conflicts of interest. As a result, the revised Statement 1.203 has been retitled "Conflicts of interest".

Corporate Governance

9. HKSA Comments On SCCLR's Phase II Corporate Governance Review

The Society expressed general support for the SCCLR's proposals in relation to board procedures and board structure, directors' qualifications and training and directors' remuneration, and the various proposals to enhance the effectiveness and transparency of company general meetings. The SCCLR's key proposals were summarised in the August 2003 issue (Issue No. 16) of TechWatch.

The Society indicated support in principle for a number of the proposals in the consultation paper that were based on Listing Rule requirements. However, it was subject to the view that it would be preferable to give broader statutory backing to the Listing Rules, rather than incorporating corresponding provisions in the Companies Ordinance in a more piecemeal way.

As regards the SCCLR's proposal that there should be mandatory rotation of both the lead and concurring audit partners every five years, it was noted that the international references quoted in the consultation paper, i.e. the Sarbanes-Oxley Act (2002) and the IFAC (International Federation of Accountants) Code of Ethics for Professional Accountants ("IFAC Code") were directed primarily at the audit of listed companies. The Society took it, therefore, that the SCCLR's proposal on rotation of audit partners was also intended to be applicable only to the audit of listed entities. In any case, the submission indicated that extending the requirement to require rotation of audit partners to the audit of private companies would be going too far, since there was no public interest involved and the issues of perception surrounding independence also centred on listed companies.

As regards the proposal itself, the Society suggested that the current requirements under the IFAC Code, i.e. a rotation period of no more than 7 years, might be a more appropriate starting point for Hong Kong rather than the 5-year period suggested by the SCCLR. The situation could be subject to review in 2 - 3 years' time. The Society considered that although rotation of the lead engagement partner might, on the one hand, help to reduce any perceived threat to independence, there could, on the other hand, be adverse consequences. The efficiency and effectiveness of the audit might be affected, particularly in the case of complex corporations, where the acquisition of specialist knowledge might be beneficial in

understanding and reporting on the business.

The Society also considered that the proposed “time-out” period of five years (i.e. the minimum period of absence before a “rotated” audit partner can again work on the client’s audit) would be too long and could prove challenging, not only for small and medium-sized firms, but also for larger firms in the case of audits of specialised industries. Accordingly, the Society recommended that a “time-out” period of not less than two years, as recommended in the IFAC Code, should be adopted.

The Society agreed with most of the other proposals in relation to audit, nomination and remuneration committees. However, it was considered to be overly restrictive to propose a total ban on a retired partner of the firm auditing the company’s accounts from even acting as the chairman or member of an audit committee, of the company. In order to address the question of independence, the Society suggested that a “sanitisation” period of say, 2 – 3 years, would be sufficient in most cases. So as to further strengthen the perception of independence, as a further pre-condition, any retired partner considered for membership of the audit committee should have no more financial interest in the audit firm.

The Society also expressed concern about the proposal to introduce a wider duty on directors or auditors of a subsidiary undertaking of a company to volunteer information to the auditors of the company (i.e. the holding company) where the normal standards of directors’ or auditors’ care and skill would require them to recognise that such information was needed; and that criminal sanctions should be applied to breaches of this wider duty where the director or auditor knows that the information concerned is material to the audit (of the holding company). The reasons for not supporting such proposals are detailed in the submission.

The Society continued to be concerned about the considerable unfairness to professionals in Hong Kong, which often arises as a result of application of the current system of joint and several liability. The Society believes that a good case has been made for the introduction of a form of proportionate liability to address these concerns.

A number of significant jurisdictions have already introduced or are committed to the introduction of a system of proportionate liability, most notably Australia. The Australian Government published on 8 October 2003 the CLERP (Audit Reform and Corporate Disclosure) Bill 2003, which would amend the relevant legislation to ensure that proportionate liability applies to damages for economic loss for misleading or deceptive conduct. It was the Society’s view that the Government of the HKSAR should take steps to introduce a well-thought-out system of proportionate liability to avert the possibility of a professional crisis, which would not be in the public interest and would be damaging to Hong Kong’s position as a major regional financial centre.

The HKSA submission can be assessed at
< <http://www.hksa.org.hk/professionaltechnical/corporategov/index.php> >.

10. Proposals For Reform Of Listing Regulations

The Financial Services and the Treasury Bureau (FSTB) has recently issued a consultation paper on proposals to enhance the regulation of listing. The publication consultation will end on 31 December 2003.

This consultation is to follow up the recommendations of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure published in March 2003. The full text of the Expert Group’s report is available at < <http://www.info.gov.hk/info/expert/expertreport-e.htm> >.

The major issues under consultation are summarised as below:

A. Statutory Backing to the Listing Rules

The basic question is whether statutory backing should be given to the Listing Rules? If so, then views are sought on aspects of the implementation:

- ¾ Which part of the Listing Rules should be given statutory backing?
- ¾ How statutory backing should be best achieved – through a mix of primary legislation, subsidiary legislation, non-statutory codes and guidelines?
- ¾ What sanctions should be introduced for breaches of statutory listing requirements – the types of statutory sanctions, the types and levels of civil sanctions, criminal sanctions for severe breaches?

B. Regulatory Structure Governing the Listing Function

Questions are raised as to how to administer/enforce the statutorily backed rules and which agency should do so? Views are sought as to whether and how:

- ¾ the existing regulatory structure should be improved after certain requirements of the Listing Rules are provided with statutory backing?
- ¾ the existing safeguards to address the conflict of interests of the Stock Exchange should be improved to enhance the integrity of the regulatory structure governing the performance of listing functions?

Public views are also sought on the following four possible models of regulatory structure outlined in the consultation document:

- Model A: Transfer of listing functions to a new division set up under the Securities and Futures Commission (SFC)
- Model B: Transfer of listing functions to a new subsidiary of the Hong Kong Exchanges and Clearing Limited (HKEx)
- Model C: Transfer of listing functions to a new statutory authority independent of both the SFC and the HKEx
- Model D: Expanding the 'dual filing' system

The consultation paper is available on the FSTB's website at < <http://www.info.gov.hk/fstb/fsb/consult/doc/erl-e.pdf> >.

Relevant HKSA committees are currently reviewing the consultation paper with a view to coordinating submission to the FSTB. If members have comments on the consultation paper, these may be submitted to the HKSA's Corporate Governance Committee, c/o Mary Lam, Assistant Director (Business and Practice) by 28 November 2003.

Professional Accountants In Business

11. CFO Forum On Improving Corporate Governance In Hong Kong

A stimulating CFO luncheon forum was held on 29 September 2003 at the Ritz Carlton Hotel. The guest speaker was Mr. Paul Chow Man-yiu, new Chief Executive of the Hong Kong Exchanges and Clearing Limited, who spoke on the need to improve corporate governance in Hong Kong.

Mr. Chow gave an overview of existing state of corporate governance and the corporate governance framework in Hong Kong. He pointed to certain weaknesses in the framework, including insufficient legislation to govern listed companies, many of which incorporated overseas, over-reliance on non-statutory listing rules and codes of best practice; the need to update the Companies Ordinance and insufficient power in the hands of regulators.

In outlining the characteristics of the local market, Mr. Chow believed that, as most listed companies were controlled by major shareholders/family controlled, corporate governance should focus more on protecting minority shareholders from abuse by the major shareholder through e.g. connected transactions. As such, the kind of solutions adopted in the United States, which related more to reinforcing management's accountability to the shareholders as a whole and on shareholder empowerment, might not represent the best approach for the Hong Kong market.

He also invited the audience to consider a number of issues as to possible future directions for the market in Hong Kong, e.g.

- ¾ a more merit-based approach to listing as compared to a more disclosure-based listing system – i.e. tending towards *caveat emptor* or buyer beware, on the basis of adequate and extensive information?
- ¾ tiering listed companies to focus on problematic cases? But then, what should be the criteria for tiering, e.g. rule breaches?
- ¾ sponsors to share responsibility?

To wrap up his presentation, Mr. Chow briefly mentioned the current corporate governance reforms in Hong Kong, covering the initiatives of the Stock Exchange, the SFC, the Standing Committee on Company Law Reform and the Financial Services and the Treasury Bureau. All of the reforms aimed to bring Hong Kong up to current international standards. A lively Q&A session followed the presentation.

12. HKCSI Issues A Statistical Card On Service Industries

The Hong Kong Coalition of Service Industries (HKCSI), the service policy think tank of the Hong Kong General Chamber of Commerce, has produced a statistical datacard on service industries in Hong Kong, which includes general economic data, information on the composition of imports and exports of goods and services, and on the number of establishments and persons engaged in the main service industries. The statistical datacard may be accessed at the HKCSI's website at: < <http://www.hkcsi.org.hk/publications/statistics/stat2003.pdf> >.

Corporate Restructuring & Insolvency

13. Insolvency Interest Group Beijing-Hong Kong Seminar

As part of the ongoing efforts to improve liaison on cross-border insolvency cases, 29 representatives from the Society's Insolvency Interest Group (IIG) attended a seminar on Corporate Restructuring, Merger & Acquisition and Liquidation on 24 October 2003, which was held in Beijing, in conjunction with the 7th Beijing-Hong Kong Economic Cooperation Symposium. The seminar was sponsored by the Beijing Municipal Bureau of Commerce, the Beijing Municipal Judicial Bureau, Beijing Municipal Investment Promotion Bureau and by the HKSA, and speakers included representatives from both the Beijing and Hong Kong delegations. Further details on the seminar will be contained in an Insolvency Interest Group report to be included in the Hong Kong Accountant.

14. The Companies (Amendment) Bill 2003

The Companies (Amendment) Bill has been introduced to the Legislative Council (LegCo) to make various amendments to the Companies Ordinance (Cap. 32) (“CO”) relating to prospectuses, group accounts (including the definition of “subsidiary”), the regulation of overseas companies (referred to in the Bill as “non-Hong Kong companies”) and shareholder remedies¹. A copy of the Bill may be accessed at the LegCo website at: < http://www.legco.gov.hk/yr02-03/english/bills/brief/b59_brf.pdf >.

The HKSA made a submission to the Bills Committee expressing its views on the main proposals of the Bill as follows:-

On shareholder remedies

- While supporting the proposals to remove some of the practical obstacles for initiating derivative actions by shareholders, the Society also warned of the need to prevent the possible abuse of what may be commercially sensitive information. As such, the Society believes that there is a need to restrict the disclosure/use of information obtained following an order by the court authorising a member contemplating action against the company to inspect any records of the company. The use/disclosure of any information so obtained should be limited to the purposes for which it was sought, unless the court orders otherwise.
- The Society also suggested that consideration be given to specifying a minimum shareholding requirement for a shareholder to be able to apply for an order for inspection, in order to deter frivolous and obstructive actions.

On regulation of non-Hong Kong companies

- In regard to the restriction to prevent bodies corporate other than solicitor corporations or corporate accountancy practices under the Professional Accountants from accepting service of process/notice on behalf a non-Hong Kong company, it was suggested that, in keeping with the spirit of this restriction, permission should be extended to include a body corporate controlled by a CPA or solicitor firm, as CPA firms and firms of solicitors may set up separate company secretarial companies.
- There is also a need to retain a statutory grace period for the appointment of a replacement authorised representative (AR) of a non-Hong Kong company where an AR is terminated or quits, otherwise such a company could easily become technically in breach of the continuing obligation to keep the details of an AR registered at all times.
- The Society disagreed with the proposal to remove the obligation on the officers of a non-Hong Kong company to notify the Companies Registry when liquidation proceedings are commenced against the company. There is a need to retain such an obligation on officers, as well as on the company itself, because the company itself, being overseas, may have less incentive to comply with Hong Kong filing requirements than locally-based officers. In addition, reference to “officer” in this case should be extended to a (provisional) liquidator.

¹ The proposed amendments in the Bill relating to shareholder remedies were contained in the Consultation Paper on Proposals made in Phase I of the Corporate Governance Review published by the Standing Committee on Company Law Reform (SCCLR) (see TechWatch No.1).

On group accounts

- The Society expressed support of the proposed amendment to the definition of “subsidiary” which has been developed in consultation with the Society.

Other provisions contained in the Bill were considered to be reasonable. These include provisions to simplify the registration and issue of prospectus for certain offers, on which the Society commented at the consultation stage (see TechWatch No. 14).

A copy of the Society’s submission on the Bill may be accessed at the Society’s website at:
< http://www.hksa.org.hk/professionaltechnical/whatsnew/docs/company_amend_bill_2003.pdf >.

15. The Companies Registry On-line Public Search System Services (CROPS) Available Until End Of January 2004

The Companies Registry has advised that its existing On-line Public Search System (CROPS) services will be extended to the end of January 2004, pending the implementation of its new information system, which will be known as the Integrated Companies Registry Information System.

16. The Companies Registry’s Website Now Contains Statistical Information On The Number Of Summons Issued By The Department

The Companies Registry has informed the Society that its website has incorporated statistical information on the number of summonses issued by the Companies Registry, which may be accessed at:
< <http://www.info.gov.hk/cr/key/index.htm> > under “Summonses Issued”.

Taxation

17. Annual Meeting Between HKSA And IRD Coming Up In Early 2004

Representatives of the Society will be holding the next regular annual meeting with the Commissioner of Inland Revenue in early-January 2004 to discuss matters of common concern in relation to tax practice and procedure. Members of the Society have been invited by a circular dated 23 October 2003 to forward any suggestions for agenda items, together with an explanation of the issue, to John Tang, Assistant Director (Business and Practice) at < johntang@hksa.org.hk > by 18 November 2003. Please note, however, that the annual meeting focuses on matters of broader concern and it is generally not a suitable forum for taking up specific cases with the IRD.

18. CEPA – CPAs As One Of The Designated Professionals To Certify Documents

Certified Public Accountants (CPAs) are amongst the designated professionals who can certify supporting documents that need to be submitted by an applicant for a Certificate of Hong Kong Service Supplier under the Mainland/Hong Kong Closer Economic Partnership Arrangement (CEPA). The supporting documents include copies of the business registration certificate and tax documents. These documents must be certified by a “designated professional” which is defined to include CPAs, and Hong Kong practising lawyers who are China-appointed attesting officers. Further information may be obtained from the Inland Revenue Department via its website at: < <http://www.info.gov.hk/ird/eng/tax/cepa/cepa.htm> >, its enquiry website address at < taxinfo@ird.gov.hk > or enquiry hotline 187 8088.

Comment Key Dates

| <u>Date</u> | <u>Subject</u> |
|--|---|
| 28 November 2003 | FSTB Consultation Paper on Proposals to Enhance the Regulation of Listing, which may be accessed on the FSTB's website at: < http://www.info.gov.hk/fstb/fsb/consult/doc/erl-e.pdf >. [FSTB deadline: 31 December 2003] |
| 21 January 2004 | ED of General Guidance 1.307 "Production of audit working papers to the Securities and Futures Commission under section 179 of the Securities and Futures Ordinance, which may be accessed at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/ed-gg1.307.pdf >. |
| Please send comments to < commentletters@hksa.org.hk > | |

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Mr. Peter Tisman, Deputy Director (Business & Practice)
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Appendices

(i) Auditing and Assurance Standards Committee Meeting summary – July 2003

The Society's Auditing and Assurance Standards Committee (Committee) met on 22 July 2003.

Members present at the meeting were: Wong Tak Wai, Alvin (Chairman), Charles Chow (Deputy Chairman), Richard George (Deputy Chairman), Deborah Annells, Albert Au, Andrew Bennett, Kim Chong, Charles Grieve, Raymond Li, Man Mo Leung, Phyllis Mo, Shum Man To, and Paul F. Winkelmann.

Secretariat staff present at the meeting were: Stephen Chan, Elaine Chan and Steve Ong.

The agenda items were:

1. Minutes of the June 2003 (248th) Meeting
2. Meeting Summary of the June 2003 (248th) Meeting for publication
3. Documents approved by Council
4. Document for the Committee's ratification
5. PN 840 "The audit of solicitors' accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules" – clarification obtained from the Law Society on paragraph 19(b)
6. Retention of working papers – views of the Professional Risk Management Committee
7. PN 870 – proposed changes to the scope of assessment of Certification Authorities under the Electronic Transactions Ordinance
8. Audited financial statements included in Circulars and Takeover Documents
9. Working Group on China audit matters
10. Date of next meeting

1. Minutes of the June 2003 (248th) Meeting

The Committee approved the Minutes of the 248th Meeting subject to some changes.

2. Meeting Summary of the June 2003 (248th) Meeting for publication

The Committee approved the Meeting Summary of the 248th Meeting subject to some changes.

3. Documents approved by Council

The Committee noted that Council had approved the HKSA Submissions on IAASB Exposure Drafts on Assurance Engagements and Proposed Amendments to IAPS 1005 "The Special Considerations in the Audit of Small Entities", and the issuance of an Exposure Draft of proposed PN 852 "Review of lottery accounts".

[The HKSA Submissions on IAASB Exposure Drafts are available on-line at:

< <http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/ED100703.pdf> >, < <http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/ED100703b.pdf> > and

the Exposure Draft of proposed PN 852 is available on-line at:

< <http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/ed-pn852.pdf> >]

4. Document for the Committee's ratification

The Committee ratified the issuance of the HKSA Invitation to Comment on the IAASB Exposure Draft of Proposed ISA on Review of Interim Financial Information Performed by the Auditor of the Entity, which had been endorsed by the Committee by circulation.

[The HKSA Invitation to Comment is available on-line at: < http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment_fi.pdf >]

5. PN 840 "The audit of solicitors' accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules" – clarification obtained from the Law Society on paragraph 19(b)

The Committee noted that a clarification had been obtained from the Law Society that the Law Society takes the view that whilst contraventions of Practice Direction J "Interest on Clients' Account" (which provides for the payment of interest on client account) are regarded as matters which adversely affect any client account or any trust money held by the firm, those providing the accountant's report should exercise common sense and apply the "de minimis" rule particularly if the amount of the contravention is less than a realistic administration fee which could have been charged under the same Practice Direction.

The Committee agreed that a further letter should be sent to the Law Society seeking its confirmation that in providing the above clarification, whether it was envisaged by the Law Society that its view as expressed to the HKSA in mid 2002 (that any contraventions of Practice Direction J were regarded as matters which affect adversely any client account or trust money held by the firm to a material extent) would be superseded, such that paragraph 19(b) of the extant PN 840 would need to be amended accordingly.

6. Retention of working papers – views of the Professional Risk Management Committee (PRMC)

The Committee noted the views of the PRMC that it would be appropriate for the HKSA to provide guidance in respect of the need for firms to develop a policy regarding the retention of working papers (not only audit working papers), that it would not be appropriate for the HKSA to prescribe the minimum period of retention of working papers, and that guidance could be provided to include the requirements of the US Securities and Exchange Commission engagements, the Hong Kong Inland Revenue Ordinance requirements and the statutory six year "limitation of actions" period.

The Committee considered that practice review requirements would be an important factor in deciding on the required length of record retention period and that the PRMC should be asked to reconsider whether the statutory six year "limitation of actions" period would be the appropriate benchmark for the required minimum retention period.

7. PN 870 – proposed changes to the scope of assessment of Certification Authorities under the Electronic Transactions Ordinance

The Committee considered the preliminary proposals by the Information Technology Services Department (ITSD). The Committee expressed concern that a number of the ITSD's proposals would only work if the ITSD provides in its Code of Practice the relevant benchmarks against which the assessor can measure the Certification Authority's policies and procedures and report on its compliance.

8. Audited financial statements included in Circulars and Takeover Documents

The Committee noted that Counsel advice obtained indicates that the clarification wording on auditors' responsibility to third parties for auditors' report is not an option for an auditor in respect of a prospectus issued pursuant to section 40 of the Companies Ordinance, or in respect of a "relevant communication" under section 391 of the Securities and Futures Ordinance which concerns securities or futures contracts, or which may affect the price of securities or the price for dealings in securities contracts.

It was agreed that the HKSA should monitor the developments in this area in other jurisdictions such as the UK before deciding whether to issue any further guidance in this area.

9. Working Group on China audit matters

The Committee received a report on the latest composition of the Working Group and progress of the work of the Working Group. So far the Working Group had identified a list of the risk areas in respect of the audit of mainland enterprises and had deliberated on the different forms of guidance that might take.

10. Date of next meeting

The next Committee meeting would be held on 4 September 2003.

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(ii) Auditing and Assurance Standards Committee
Meeting summary – September 2003

The Society's Auditing and Assurance Standards Committee (Committee) met on 4 September 2003.

Members present at the meeting were: Wong Tak Wai, Alvin (Chairman), Charles Chow (Deputy Chairman), Richard George (Deputy Chairman), Deborah Annells, Albert Au, Andrew Bennett, Patrick Cheng, William Crowe, Charles Grieve, Raymond Li, Man Mo Leung, Phyllis Mo, Paul F. Winkelmann and Desmond Yuen.

Secretariat staff present at the meeting were: Stephen Chan and Steve Ong.

The agenda items were:

1. Minutes of the July 2003 (249th) Meeting
2. Meeting Summary of the July 2003 (249th) Meeting for publication
3. Document for the Committee's ratification
4. IAASB Exposure Draft on Quality Control: Proposed New ISQC 1 "Quality Control for Audit, Assurance and Related Services Practices" and Proposed Revised ISA 220 "Quality Control for Audit Engagements"
5. IFAC Exposure Draft of Proposed Statements of Membership Obligations
6. PN 840 "The audit of solicitors' accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules" – clarification obtained from the Law Society on paragraph 19(b)
7. Corporate Governance Review by The Standing Committee on Company Law Reform – A Consultation Paper on Proposals made in Phase II of the Review – "Corporate Reporting"
8. Government's Proposal on the Monitoring of Charitable Fund-raising Activities
9. Working Group on China audit matters – progress report
10. Date of next meeting

1. Minutes of the July 2003 (249th) Meeting

The Committee approved the Minutes of the 249th Meeting subject to some changes.

2. Meeting Summary of the July 2003 (249th) Meeting for publication

The Committee agreed that meeting summaries should be prepared in such a way that they serve to inform readers of the discussions of the meetings. The Meeting Summary of the 249th Meeting should be revised to meet this objective.

3. Document for the Committee's ratification

The Committee ratified the issuance of the HKSA Invitation to Comment on the IAASB Exposure Draft of Proposed Revised ISA 240 on The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements and Proposed Revised ISA 300 on Planning the Audit, which had been endorsed by the Committee by circulation.

[The HKSA Invitation to Comment is available on-line at: <
http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment1015.pdf>].

4. IAASB Exposure Draft on Quality Control: Proposed New ISQC 1 “Quality Control for Audit, Assurance and Related Services Practices” and Proposed Revised ISA 220 “Quality Control for Audit Engagements”

The Committee considered the two submissions of comments received on the Exposure Draft in response to the Committee’s Invitation to Comment.

The Committee discussed the proposed requirements on the rotation of audit partners and senior engagement personnel and had the following comments:

- x It would be appropriate to eliminate the flexibility for partner rotation for listed entities due to the size of the firm as set out in paragraph 8.153 of the IFAC Code of Ethics.
- x Although the IOSCO Principles for Auditor Independence require that standards of auditors’ independence should address specifically the need to ensure appropriate rotation of the audit engagement team such that senior members of a team do not remain in key decision-making positions for extended periods, the definitions of senior member and key decision-making positions must be clearly laid down first before the IOSCO Principles might be considered for adoption.

The Committee considered that the Exposure Draft would lead firms to reflect on whether their quality control policies and procedures are robust and comprehensive, and would help to both clarify and reinforce the roles and responsibilities of engagement partners and teams and engagement quality control reviewers in delivering quality audit, assurance and related services. This is important in strengthening the public’s trust in the profession.

After the meeting, a further review was carried out by the secretariat on the proposed requirements for firms to establish policies and procedures setting out criteria against which audits of non-listed entities, and assurance and related services engagements should be evaluated for the purpose of determining whether the engagement partner is rotated after a specified period (paragraphs 25(b) and (c) of the proposed ISQC 1). In the final submission, the HKSA expressed a few observations and reservations on the proposed requirements.

[The HKSA submission is available on-line at: <
http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/IAASB_ED_QC.pdf >]

5. IFAC Exposure Draft of Proposed Statements of Membership Obligations

The Committee noted that IFAC had released an ED of 7 proposed Statements of Membership Obligations (SMO) for consultation until 30 November 2003.

The Committee considered the proposed SMO 3 on “Auditing Standards and other International Auditing and Assurance Standards Board (IAASB) pronouncements”. It was agreed that further clarifications should be sought from the IAASB on the requirements of paragraph 2(b) of the proposed SMO as to whether the statement would allow member bodies to adopt only the basic principles and essential procedures (black lettering paragraphs) without the guidance paragraphs and still meet their membership obligations.

6. PN 840 “The audit of solicitors’ accounts under the Solicitors’ Accounts Rules and the Accountant’s Report Rules” – clarification obtained from the Law Society on paragraph 19(b)

The Committee noted that the Law Society in its letter dated 15 July 2003 clarified that it takes the view that whilst contraventions of Practice Direction J “Interest on Clients’ Account” (which

provides for the payment of interest on client account) are regarded as matters which adversely affect any client account or any trust money held by the firm, those providing the accountant's report should exercise common sense and apply the "de minimis" rule particularly if the contravention is less than a realistic administration fee which could have been charged under the same Practice Direction.

A further clarification was obtained from the Law Society on 13 August 2003 that it would not envisage reports or qualifications of accountant's report merely on a failure to account for very small amounts of interest particularly if those amounts of interest are less than a realistic administration fee. It went on to say that the purpose of the accountant's report is to identify breaches of the Solicitors' Accounts Rules or Practice Directions that adversely affect any client account or trust money.

The Committee agreed that in view of the clarifications obtained from the Law Society, paragraph 19(b) of PN 840 would need to be amended.

7. Corporate Governance Review by The Stirling Committee on Company Law Reform – A Consultation Paper on Proposals made in Part II of the Review – "Corporate Reporting"

The Committee considered Chapter 5 of the Consultation Paper on "Corporate Reporting" and supported the proposals on auditors' functions and auditing standards, auditors' remuneration, outgoing auditors, auditors' independence, rotation of audit firms and auditors' duties.

The majority view of the Committee did not support the proposal to widen the duty of the auditors of a subsidiary undertaking of a company so as to require them to volunteer information to the auditors of the holding company for the following reasons:

- x the proposal contains elements of uncertainty and ambiguity which would cause practical difficulties for the auditors of a subsidiary undertaking to comply with, in particular it is not clear what is the intended threshold of the criteria of "where the normal standards of auditors' care and skill require them to recognize that such information is needed and "information material to the audit (of the holding company)"
- x in performing an audit of the subsidiary undertaking, the auditors would consider materiality at the subsidiary undertaking level, but such materiality level would not be appropriate for the audit of the holding company or group accounts. It would be impossible for the auditors of a subsidiary undertaking to determine what is considered material to the audit of the holding company or the group; and
- x the auditors of the holding company at present already have an effective channel to receive material information on a subsidiary undertaking through any qualifications/modifications in the audit report of the subsidiary undertaking.

The Committee considered that the current requirements were adequate and recommended that further research should be carried out before reaching a conclusion on the proposal to widen the duty of the auditors of a subsidiary undertaking.

The Committee supported the proposal of mandatory rotation of both lead and concurring audit partners every five years for audits of listed entities, as this seemed to be the international trend. However, it did not support the proposal of a "time-out" period of five years as it was considered too long. The Committee considered that a shorter "time-out" period would be more appropriate given that a period of five years could prove challenging not only for small and medium-sized firms, but also for larger firms in the case of audits of specialized industries. Accordingly, the Committee recommended that the "time-out" period of two years mentioned in the IFAC Code of

Ethics should be adopted.

The Committee also supported the SCCLR's recommendation of a detailed review of the final rules of the Sarbanes-Oxley model with regard to other partners to determine their relevance and applicability in Hong Kong.

The Committee's comments were incorporated into the HKSA submission dated 17 October 2003. It is stated in the HKSA submission that the current requirements under the IFAC Code of Ethics may be a more appropriate starting point for Hong Kong (i.e. a rotation period of no more than 7 years) subject to review in 2-3 years' time to see if it is necessary to shorten the maximum period to 5 years or some other duration.

[The HKSA submission is available on-line at: <
http://www.hksa.org.hk/professionaltechnical/corporategov/SCCLR_II.pdf >]

8. Government's Proposal on the Monitoring of Charitable Fund-raising Activities

The Committee noted from the Social Welfare Department's (SWD) letter to the Society that the Government had decided not to pursue legislative changes for the purpose of expanding the Permit System under the Summary Offences Ordinance to cover all types of fund-raising activities. The Government would instead be working on a voluntary system to monitor charitable fund raising activities.

The Committee reviewed the draft "Reference Guide for Charities on Best Practice for Fund-raising Activities" and was concerned that the proposed audit requirement for individual events or drives involving appeal to the public as set out in the draft Reference Guide would not be consistent with the current practice in PN 850 "Review of flag day accounts", which was agreed between the HKSA and the SWD in 1999. It was agreed that a meeting should be arranged to meet with the SWD to discuss this concern.

9. Working Group on China audit matters – progress report

The Committee endorsed the Working Group's recommendations that the proposed guidance is to be issued in the form of Questions and Answers in The Hong Kong Accountant and the topics of sales, off-book transactions and debtors should form the first series of the Questions and Answers.

10. Date of next meeting

The next Committee meeting would be held on 28 October 2003.

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(iii) Financial Accounting Standards Committee
Meeting summary – September 2003

The Society's Financial Accounting Standards Committee (Committee) met on 10 September 2003.

Present at the Committee's meeting were: Messrs. Roger Best (Chairman), Carlson Tong (Deputy Chairman), Paul F. Winkelmann (Deputy Chairman), Chan Lok Sang, Choy Chung-foo (represented by Mr. Vingle Yuen), William Crowe, Raphael Ding, Tommy Fung, Robert Gibson, Philip Hilliard, Andrew Huke, Quinn Y.K. Law, Nigel Reid (represented by Mr. Paul Hebditch), Tommy Tam, Ms. Olivia Cheung, Ms. Susanna Lau, Mr. Simon Riley (HKSA Deputy Director, Accounting) and Ms. Elsa Ho (HKSA Assistant Director, Accounting).

The Committee discussed the following items:

- 9 Proposed HKFRS 1, First-Time Adoption of Hong Kong Financial Reporting Standards
- 9 Investment Property – further consideration of provisions re transfers between classes of assets
- 9 Proposed SSAP 37, Accounting and Reporting by Retirement Benefit Plans, and proposed replacement of Statement 2.302
- 9 Proposed Preface to Hong Kong Financial Reporting Standards – continued discussion on the ED
- 9 Report from the Urgent Issues & Interpretations Sub-Committee meetings held on 25 June and 23 July 2003

Proposed HKFRS 1, First-Time Adoption of Hong Kong Financial Reporting Standards

The Committee received and considered revised draft copies of the following documents that had taken into account the comments made by the Committee at its last meeting:

- x Proposed HKFRS 1
- x Guidance on Implementing HKFRS 1
- x Basis for Conclusions on HKFRS 1

Subject to a few minor changes, the Committee agreed to recommend the above documents be issued as final statements to become effective for financial statements covering accounting periods beginning on or after 1 January 2004.

The Committee discussed whether an accountants' report could be considered as the first set of financial statements prepared under HKFRSs. The Committee generally considered that, under the current regime, financial information prepared for the first time in accordance with HKFRSs published in an investment circular should not be considered as first time adoption of HKFRSs. The Committee acknowledged that this is an issue that needs to be addressed at some point in time but not necessarily in HKFRS 1. Since the HKSA Accountants' Report Task Force (ARTF) is currently reviewing the guidance on preparing financial information in circulars, the Committee would work together with the ARTF to develop appropriate guidance.

Investment Property – further consideration of provisions re transfers between classes of assets

The Committee received a paper proposing replacement provisions for ED/SSAP 13 (revised) re transfers between categories of assets together with the comments received thereon. The replacement provisions include a proposal to require the revaluation reserve of an investment property to be derecognised at the date of transfer to inventory carried at lower of cost and NRV or PPE carried at cost.

The Committee considered that, since ED/ SSAP 13 (revised) was merely an interim measure prior to the full adoption of IAS 40, it should not propose any changes to the existing practice unless such

changes were unavoidable from the adoption of a new requirement under IAS 40. The Committee was of the view that a “death bed accounting” approach on transfers (i.e. the investment property is revalued, the revalued amount is taken as the deemed cost in the new category in all cases, and the existing reserve, if any, should be frozen until it is realised on disposal, amortisation or impairment), rather than the approach set out in the paper, should be adopted in ED/SSAP 13 (revised) because that approach is more commonly applied at present.

Proposed SSAP 37, Accounting and Reporting by Retirement Benefit Plans, and proposed replacement of Statement 2.302

The Committee received and considered the following documents that were referred for its consideration by the Expert Panel on Insurance (EPI):

- x A marked up draft of proposed SSAP 37 based on IAS 26, Accounting and Reporting by Retirement Benefit Plans
- x A marked up and a clean copy of a draft appendix to the proposed SSAP that is based on the existing Statement 2.302, Financial Statements of Retirement Schemes
- x A draft Invitation to Comment on the proposed SSAP.

The Committee endorsed the above documents to be sent to the MPF Authority for comments before releasing them for public consultation.

Proposed Preface to Hong Kong Financial Reporting Standards – continued discussion on paragraph 31 (pages 5-7 of covering memo)

The Committee continued its discussion on paragraph 31 of ED, Preface to Hong Kong Financial Reporting Standards, concerning the relationship of HKFRSs with IFRSs.

The Committee agreed to remove paragraph 31 as members considered that the guidance in paragraph 31 was unnecessary and had already been covered by paragraph 30 of the ED. Subject to this and a few other wording changes, the Committee then agreed to recommend that the proposed Preface be issued as a final Statement concurrently with the proposed HKFRS 1.

Report from the Urgent Issues & Interpretations Sub-Committee meetings held on 25 June and 23 July 2003

The Committee received the meeting notes of the Urgent Issues and Interpretations Sub-Committee (UIISC), which summarised its views on the following referral issues from the Committee:

- x Inconsistency between paragraph 4 of Interpretation 20 and the equivalent paragraph of SIC-21 (“Issue 1”);
- x Classification of properties, including hotels and service apartments (“Issue 2”);
- x Treatment of revaluation reserve upon a transfer from investment property carried at valuation to owner-occupied properties carried at revalued amount under SSAP 17 (“Issue 3”);
- x Treatment of transport infrastructure facilities (“Issue 4”).

As regards issue 1, the Committee agreed with UIISC that there is a need to bring Interpretation 20 in line with SIC-21. However, the Committee had sympathy with the concern raised that many enterprises had already used Interpretation 20 for preparing their interim results and it might be difficult to justify changing Interpretation 20 so close after its issue. After considering a few alternatives about the timing of the change, the Committee agreed that the change should be deferred and be included as part of the Hong Kong Convergence project.

As regards issue 2, the Committee supported the view of the UIISC that the issue could not be resolved unless the IASB removed the reference to rental earning objective in the definition of an investment property. The Committee noted that a number of accounting firms had drawn this issue to the attention of the IASB.

As regards issue 3, the Committee noted the view of the UIISC that the revaluation reserve should follow the asset upon a transfer. Further details of the Committee's consideration of this issue appear in the "Investment Property" item above.

As regards issue 4, the Committee noted that there was no consensus at the last meeting of the UIISC as to the treatment of transport infrastructure facilities. Given the apparent unwillingness of the IFRIC to attend to the matter, the Committee agreed to refer the matter back to the UIISC for further consideration to issue Hong Kong specific guidance on this matter.

Date of Next Meeting

The Committee's next meeting is tentatively scheduled to be held on 15 October 2003.

This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. Except where indicated otherwise, all conclusions reported are tentative and may be changed at future meetings.

The IASB publishes summaries of its meetings and projects. These can be found on the IASB's website at < <http://www.iasb.org.uk> >.

The Committee welcomes comments on its technical agenda. Please e-mail us at < commentletters@hksa.org.hk >.