



STANDARDS & TECHNICAL

NEWS AT A GLANCE

TechWatch is a publication designed to alert members to topics and issues that impact on CPAs and their working environment. We welcome your comments and feedback. Comments and suggestions on TechWatch should be addressed to Stephen Chan, Executive Director by [email](#).

ISSUE 39 • November/December 2005

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*Season's Greetings from The Hong Kong Institute of Certified Public Accountants
Wishing you a Merry Christmas and a Peaceful and Prosperous New Year*

聖誕快樂 新年進步

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TechWatch is prepared by the Hong Kong Institute of CPAs and is intended for general guidance only. Professional advice should be taken before applying the content of this publication to your particular circumstances. While the Institute endeavours to ensure that the information in this publication is correct, no responsibility for loss to any person acting or refraining from action as a result of using any such information can be accepted by the Institute.

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Previous issues of TechWatch

Spotlight

1. Handbook Updates No. 22 & 23

Update 22 encloses the new Accounting Guideline *Merger Accounting for Common Control Combinations* and amendments to the following Standards:

- HKAS 1 *Presentation of Financial Statements*
- HKAS 16 *Property, Plant and Equipment*
- HKAS 27 *Consolidated and Separate Financial Statements*
- HKAS 40 *Investment Property*
- HKFRS 3 *Business Combinations*

Update 23 encloses the new Code of Ethics for Professional Accountants.

Further details are set out in the “Financial Reporting” and “Ethics” sections below.

CPD & Events

2. Technical Update Evening (TUE)

The last session of this year’s **TUE programme** is “21 Replacement Hong Kong Auditing Standards (Re-run)” to be held on 16 December 2005. To secure your seats, please register by completing the **registration form** and returning it to the Institute.

The first TUE programme for 2006 will be available soon. Please watch for it on the Institute’s website.

3. Professional Development Activities January And February 2006

The Institute is committed to provide an all rounded CPD programme to suit the varying needs of members. Highlights of January and February 2006 are:

[IFRS Training Seminars](#)

- **HKFRS 3 and HKAS 27, 28 and 31** (16 Jan 06)
- **HKAS 32 and 39** (19 Jan 06)
- **HKAS 16, 17 and 40 and Interpretations 1, 2 and 4** (23 Feb 06)

Other CPD events

- Workshop on **Due Diligence (Re-run)** (7, 14 and 21 Jan 06)
- **Study Mission to Qingyuan and Guangzhou** (8 - 10 Jan 06)
- Seminar on **PRC Contract Law** (18 Jan 06)
- Seminar on **How to Prepare and Conduct a Case for Clients before the Board of Review** (27 Feb 06)

View the full comprehensive programme **here**. Act now to secure a seat.

4. New CPD Requirements Effective From 1 December 2005

The new CPD requirements detailed in **Statement 1.500** (August 2005) have become effective from 1 December 2005. Go to the Institute’s webpage under **Mandatory CPD Requirements** for more information.

International Submissions

5. IASB Submissions

(a) IASB proposed amendments to IFRS 3 and IASs 27, 37 and 19

(i) Proposed amendments to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements*

- To measure 100% of the fair value of the acquiree, even if the business combination is less than 100%.
- To recognise goodwill as the difference between the fair value of the acquiree, as a whole, and the fair value of the identifiable assets acquired and liabilities assumed.
- In a business combination achieved in stages, to remeasure the acquirer's non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss.
- To account for acquisitions or reductions of additional non-controlling equity interests after the business combination as equity transactions rather than by using acquisition accounting.
- To include in gain or loss arising on loss of control the parent's share of gains or losses related to the former subsidiary that were previously recognised in equity and remeasure any remaining non-controlling interest to its fair value.

(ii) Proposed amendments to IAS 37 *Non-financial Liabilities*

- To eliminate the terms "contingent liabilities" and "contingent assets" and use the term "contingency" to refer to uncertainty about the amount of a liability or an asset, rather than uncertainty about whether a liability or an asset exists.
- When the amount that will be required to settle a liability (unconditional obligation) is contingent on one or more uncertain future events, to recognise the liability independently of the probability that the uncertain future event(s) will occur (or fail to occur). The uncertainty is incorporated in the measurement.
- To include items previously described as contingent assets that satisfy the definition of an asset within the scope of IAS 38 *Intangible Assets* rather than IAS 37 (except for the rights to reimbursement).

(iii) Proposed amendments to IAS 19 *Employee Benefits*

- To recognise voluntary termination benefits when employees accept the entity's offer of those benefits.
- To recognise involuntary termination benefits when the entity has communicated its plan of termination to the affected employees and the plan meets specified criteria, unless they are provided in exchange for employees' future services. In such cases, to recognise the liability for those benefits over the future service period.

The Institute's **submission** to the IASB states that in general, the Institute considers that the proposed amendments in these Exposure Drafts are technically sound. However, the Institute is concerned about the practicability of some of the proposals, in particular their measurement aspects.

(b) IASB Proposed Policy on Technical Corrections and Draft Technical Correction 1

The IASB Proposed Policy on Technical Corrections sets out the types of issue that a technical correction addresses; the initial identification of technical corrections; and the technical corrections due process.

The IASB Draft Technical Correction (DTC) 1 *Proposed amendments to IAS 21 – Net Investment in a Foreign Operation* proposes to require exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements irrespective of the currency of the monetary item and irrespective of whether the monetary item results from a transaction with the parent or with any of its subsidiaries. It also proposes to clarify that an investment by an associate of the reporting entity in a foreign operation is not part of the reporting entity's net investment in that foreign operation.

The Institute's **submission** to the IASB states that in general, whilst the Institute supports the IASB's proposed amendments under DTC 1, the Institute does not consider it appropriate to treat the amendments as a Technical Correction. The Institute therefore requests the IASB to issue the changes as Amendment to IAS 21 in order to avoid creating an inappropriate precedent for a Technical Correction. The Institute also requests the IASB to review the definition of a Technical Correction and to restrict its application to changes to standards only where there is an ambiguity.

In response to the concerns identified by the Institute, and many other commentators, the IASB decided at its recent meeting not to pursue its proposed technical correction policy and to amend standards through its usual Exposure Draft process.

6. IAASB Submission

The Institute's **submission** to the IAASB on the EDs of proposed ISA 701 *The Independent Auditor's Report on Other Historical Financial Information* and ISA 800 *The Independent Auditor's Report on Summary Audited Financial Statements* states that:

- (a) In relation to the proposed ISA 701, the Institute believes that further debate among a wide range of stakeholders is needed as to whether it is possible or, indeed, right to give a "true and fair/fairly presents" opinion on anything other than full financial statements.
- (b) In relation to the proposed ISA 800, the Institute questions whether the auditor is in a position to comment on the appropriateness of either the summary financial information or of the summarisation process in the absence of an accounting standard or appropriate regulation.

7. International Ethics Standards Board Submission

The **International Ethics Standards Board (IESB) Exposure Draft** proposes to classify a firm as a network firm of another firm if the two share a common brand name or if they share significant professional resources or revenues, profits, costs or expenses. The proposed revised definition focuses not only on how the firms operate, but also on how they present themselves.

The Institute's **submission** supports the IESB's initiative to clarify the definition of network firm and considers that the proposed revision to the definition should be principle-based, such that a firm would be considered as a network firm if it gives the public at large a perception that it belongs to a larger structure.

Financial Reporting

8. Amendments To Standards Arising From Companies (Amendment) Ordinance 2005

The Institute amends **HKAS 27 Consolidated and Separate Financial Statements**, **HKFRS 3 Business Combinations** and the appendix on the notes on legal requirements in Hong Kong in **HKAS 1 Presentation of Financial Statements** as a result of Companies (Amendment) Ordinance 2005 (“CAO”).

The CAO redefines a subsidiary for the purpose of group accounts to include a subsidiary undertaking as defined in the new Twenty-third Schedule to the Companies Ordinance and includes a true and fair overriding provision. The changes brought about by the CAO will remove the legal restraint that prevents an entity from consolidating a controlled entity that does not meet the legal definition of a subsidiary with effect for annual periods beginning on or after 1 January 2006.

The Institute sought legal advice on whether an entity could restate the comparative amounts in its financial statements prepared for annual periods beginning on or after 1 January 2006 following the implementation of the CAO. The legal opinion concludes that comparative amounts should be restated in the above circumstance.

In the light of the above, HKAS 27 and HKFRS 3 are amended:

- (a) to limit the application of the special provisions for Hong Kong incorporated companies currently existed in these two Standards to annual periods beginning before 1 January 2006 only; and
- (b) in the case where the special provisions for Hong Kong incorporated companies had previously been applied, to require restatement of the comparative amounts in the financial statements prepared for annual periods beginning on or after 1 January 2006 as if the special provisions for Hong Kong incorporated companies had not been applied.

9. New Transitional Provisions In HKAS 16 And HKAS 40

The Institute includes new transitional provisions in **HKAS 16 Property, Plant and Equipment** and **HKAS 40 Investment Properties** for entities that had previously taken advantage of the exemption under SSAP 13 *Accounting for Investment Properties* and SSAP 17 *Property, Plant and Equipment* from compliance with their requirements.

SSAP 13 and SSAP 17 exempted charitable, government sub-vented and not-for-profit organisations whose long-term financial objective is other than to achieve operating profits (e.g., trade associations, clubs and retirement schemes) from compliance with their requirements. The new transitional provisions permit those entities that had previously taken advantage of the exemption under SSAP 13 and SSAP 17 to deem the carrying amount of an item of property, plant and equipment (PPE) or an investment property immediately before the application of HKAS 16 and HKAS 40, as appropriate, as the cost of that item of PPE or investment property. These transitional provisions address the particular concern raised by some of the exempted entities that it might be difficult, if not impossible, for them to trace back the original cost of an asset.

10. Institute Issues Accounting Guideline 5 And Withdraws SSAP 27

The Institute issues **Accounting Guideline (AG) 5: Merger Accounting for Common Control Combinations** and withdraws SSAP 27 *Accounting for Group Reconstructions*.

AG 5 sets out the basic principles and procedures of merger accounting when recognising a common control combination. AG 5, however, does not address the treatment for common control combinations that take place after the balance sheet date but before the date of approval of financial statements by the directors (subsequent combinations).

The Institute is of the view that, for statutory reporting purposes, subsequent combinations should be treated as a non-adjusting event but, for other reporting purposes, the treatment will depend on the relevant framework. The Institute therefore considers that the guidance on such does not have to form a necessary part of AG 5. As far as financial statements to be included in investment circulars are concerned, such guidance is expected to be included in the HKSIR series.

11. Institute Invites Comments On Two IASB Discussion Papers

(a) Management Commentary

The Institute has issued an [Invitation to Comment](#) on the IASB Discussion Paper on Management Commentary with comments requested by **12 April 2006**.

The Discussion Paper is a first step in the possible development by the IASB of a standard or guidance covering Management Commentary (also known as Management's Discussion & Analysis in the USA and Canada and Operating and Financial Review in the UK). It proposes that management commentary should supplement and complement financial statement information, provide an analysis of the entity through the eyes of management, and have an orientation to the future. It also seeks views as to whether such information should be provided within the financial statements or as an adjunction to the financial statements.

(b) Measurement Bases for Financial Accounting – Measurement on Initial Recognition

The Institute has issued an [Invitation to Comment](#) on IASB Discussion Paper on Measurement Bases for Financial Accounting – Measurement on Initial Recognition with comments requested by **28 April 2006**.

The Discussion Paper analyses possible bases for measuring assets and liabilities on initial recognition. These measurement bases include historical cost, current cost, fair value, net realisable value and value in use. It also considers deprival value, which combines several measurement bases in a single model. The Discussion Paper evaluates the possible bases against criteria derived from the IASB *Framework for the Preparation and Presentation of Financial Statements*, as well as developments in finance theory, the application of present value and statistical probability principles and measurement practices.

This Discussion Paper is a first step in revising the measurement aspects of the IASB *Framework for the Preparation and Presentation of Financial Statements*, and is likely to affect many Standards in future.

12. FRSC Meeting Summaries – 12 October and 9 November 2005

The [FRSC meeting summary](#) of 12 October 2005 covers:

- Exposure Draft of proposed Amendments to IFRS 3 *Business Combinations*
- Concern raised by the Education Manpower Bureau in respect of the accounting of fixed assets held by aided schools under HKAS 16 (with no exemption from compliance)

- Amendments to HKAS 27 *Consolidated and Separate Financial Statements*, HKFRS 3 *Business Combinations* and the appendix on the notes on legal requirements in Hong Kong in HKAS 1 *Presentation of Financial Statements* consequent on the change in the definition of subsidiary
- Proposed Accounting Guideline on Merger Accounting
- Draft Q&As on the HKFRS application issues raised at the last annual update
- Feedback after attending the IASB Conference with World Standard Setters
- Next Financial Reporting Standards Forum
- Submission on the IASB Proposed Policy on Technical Corrections

The [FRSC meeting summary](#) of 9 November 2005 covers:

- Concern raised over the impact of fair value treatment of investment properties on earnings and EPS
- Concern raised by the Education Manpower Bureau in respect of the accounting of fixed assets held by aided schools under HKAS 16 (with no exemption from compliance)
- Amendments to HKAS 27 *Consolidated and Separate Financial Statements*, HKFRS 3 *Business Combinations* and the appendix on the notes on legal requirements in Hong Kong in HKAS 1 *Presentation of Financial Statements* consequent on the change in the definition of subsidiary
- Proposed Accounting Guideline on Merger Accounting
- Next Financial Reporting Standards Forum
- Submission on the IASB EDs of proposed amendments to IFRS 3, IASs 27, 37 and 19
- Submission on the IASB Draft Technical Correction 1
- Accounting for owner-used properties in Hong Kong

Audit & Assurance

13. Institute Invites Comments On IAASB ED Of Improving The Clarity Of IAASB Standards

The Institute has issued an [Invitation to Comment](#) on the IAASB Exposure Draft (ED) of Improving the Clarity of IAASB Standards, with comments requested by **10 February 2006**. This ED is important to all those interested in auditing standards because it sets the style and format for future auditing standards.

The IAASB is now seeking comments on four standards, which have been redrafted in the proposed new style. The key elements of the new drafting style include:

- Basing the standards on objectives, as opposed to procedural considerations;
- Use of the word “shall” to identify requirements that the professional accountant is expected to follow in the vast majority of engagements;

- Eliminating the present tense to describe actions by the professional accountant, which some had regarded as ambiguous in terms of obligation; and
- Structural improvements to enhance the overall readability and understandability of the standards.

14. **Innovation And Technology Fund – Revised Example Report By Auditors**

The Innovation and Technology Commission, in consultation with the Institute, issued the revised **Notes** for Auditors of Recipient Organisations in early November 2005. The revised Notes include a revised example report by auditors.

15. **AASC Meeting Summary – 26 October 2005**

This **AASC meeting summary** covers:

- Invitations to Comment on IAASB EDs of ISA 701 *The Independent Auditor's Report on Other Historical Financial Information* and ISA 800 *The Independent Auditor's Report on Summary Audited Financial Statements*
- New/Other IAASB Auditing Standards not yet adopted in Hong Kong
- Working Group on Audit Report – Progress Report
- ED of guidance for auditors regarding preliminary announcements of annual results
- Proposed PN 900 *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard*
- Mainland Audit Issues
- Working Group on Types of Reporting – Progress Report

Ethics

16. **New Code Of Ethics For Professional Accountants**

The Institute has issued a new **Code of Ethics for Professional Accountants** (“new Code”), adopting the IFAC Code of Ethics for Professional Accountants issued by the International Federation of Accountants (“IFAC Code”). Certain existing Professional Ethics Statements have been incorporated into the new Code as additional local ethical requirements.

The new Code establishes a conceptual framework for all professional accountants to ensure compliance with the five fundamental principles of professional ethics. These are integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour. Under the framework, all professional accountants will be required to identify threats to these principles and, if there are threats, apply safeguards to ensure that the principles are not compromised. The framework applies to all professional accountants – those in public practice as well as those in businesses.

The effective date of the new Code of 30 June 2006 is the same as that of the IFAC Code. Earlier application of the new Code is encouraged.

Corporate Governance

17. Results Of The 2005 Best Corporate Governance Disclosure Awards Announced

The Institute's 2005 Best Corporate Governance Disclosure Awards ("the Awards") was successfully concluded with the presentation ceremony for the Awards held at a luncheon on 29 November 2005. The guest of honour, the Secretary for Financial Services and the Treasury, Mr. Frederick Ma, presented the awards to the winners.

The results of the Awards were announced at a **press conference** held prior to the luncheon. Chairmen, finance directors, chief financial officers and other senior representatives of the award winners also briefly addressed the audience on the subject of corporate governance in their companies/organisations at the press conference.

<u>Significant Improvement Award</u>	
Hang Seng Index Category	Hutchison Whampoa Limited
Non-Hang Seng Index Category	Standard Chartered PLC
<u>Hang Seng Index Category</u>	
Diamond	CLP Holdings Limited
Platinum	HSBC Holdings plc
Gold	Li & Fung Limited
Special Mention	MTR Corporation Limited
Special Mention	Swire Pacific Limited
<u>Non-Hang Seng Index Category</u>	
Diamond	Hong Kong Exchanges and Clearing Limited
Platinum	Hysan Development Company Limited
Gold	Standard Chartered PLC
<u>Growth Enterprise Market Category</u>	
Diamond	Media Partners International Holdings Inc.
<u>Public Sector/Not-For-Profit Organisations Category</u>	
Diamond	Airport Authority Hong Kong
Platinum	Securities and Futures Commission

This was the sixth consecutive year that the Awards competition has been held. The annual reports reviewed in this year's competition revealed that companies were already prepared for the new requirements in respect of corporate governance practices and disclosures under the revised listing rules and the new Code on Corporate Governance Practices and Corporate Governance Report, most of which took effect after the reporting period covered by the Awards. A number of this year's award winners had voluntarily measured their practices against these new standards and were able to measure up to and even, in some areas, exceed them.

The Significant Improvement Award (SIA) was again a major focus of the competition, as fostering improvements is one of the principal objectives of the Awards.

Senior representatives from the winning companies and organisations also attended the Awards presentation luncheon. During the presentation ceremony, a video and slide presentation of the winning annual reports, and short video-taped interviews with the CEO / CFO of the SIA winners were shown to the audience.

A **Judges' Report** for the 2005 Awards has been produced. In addition to containing the results, it provides the judges' commentaries on the winning annual reports, and the observations of the judges and reviewers on the general standard of corporate governance disclosures and practices in Hong Kong, as reflected in the annual reports entered in the competition.

Banking

18. Example Disclosure Note On Regulatory Reserve

Section 9 of Schedule 7 to the Banking Ordinance requires authorized institutions ("AIs") to maintain adequate provisions "for depreciation or diminution in the value of its assets (including provision for bad and doubtful debts), for liabilities which will or *may* fall to be discharged by it and for losses which will or *may* occur" (i.e., an expected loss model). HKAS 39 *Financial Instruments: Recognition and Measurement*, on the other hand, requires that an impairment loss be recognized only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition (i.e., an incurred loss model). There is a conceptual difference between the regulatory concept of provisions and the accounting concept of impairment loss.

The Hong Kong Monetary Authority ("HKMA") has set out in its **Guidance to AIs "Impact of the New Hong Kong Accounting Standards on AIs' Capital Base and Regulatory Reporting"**, issued in April 2005, that AIs should generally hold a regulatory reserve in excess of individual and collective impairment allowance recognized under HKAS 39. AIs may earmark an agreed portion of retained earnings as regulatory reserve subject to the HKMA's consent. Alternatively, AIs may appropriate the agreed amount of earnings to a separate "regulatory reserve".

The Institute has developed, in consultation with the HKMA, an **example disclosure note on regulatory reserve** to describe the nature and purpose of the regulatory reserve to meet the disclosure requirement in HKAS 1 *Presentation of Financial Statements*.

19. Commencement Of Banking (Amendment) Ordinance 2005

The Secretary for Financial Services and the Treasury has appointed 2 December 2005 as the commencement date for sections 5 and 8-15 of the Banking (Amendment) Ordinance 2005, which covers the following areas:

- Increasing the maximum ratio to which the capital adequacy ratio of a licensed bank may be varied by the HKMA from 12% to 16%;
- Limiting the criminal liability of managers of authorized institutions to certain cases;
- Introducing a defence of "reasonable excuse" in certain reporting to the HKMA; and
- Introducing new sections to allow the HKMA to disclose to the public details of disciplinary decisions against certain individuals or executive officers of registered institutions (i.e., institutions which are granted a certificate of registration under the Securities and Futures Ordinance).

Further details are available from the **HKMA's circular dated 18 November 2005**.

Your Questions/Staff Answers

Please note that the staff answers only address general issues and provide general guidance. The staff answers do not constitute professional or legal advice. You need to base your accounting policies or any of your actions on Frameworks, Standards and other documents approved by the Council of the Institute, after taking account of your specific circumstances.

Q. After the withdrawal of SSAP 27 Accounting for Group Reconstructions, can an entity account for a business combination that takes place subsequent to the balance sheet date but before the approval of financial statements by the Board of Director (“subsequent combination”) in its consolidated financial statements prepared using the principles of merger accounting?

A. The recently issued Accounting Guideline 5 *Merger Accounting on Common Control Combinations* does not address the treatment for subsequent combinations. However, it is the staff view that, for statutory reporting purposes, a subsequent combination must be treated as a non-adjusting event (as defined in HKAS 10 *Events after the Balance Sheet Date*) in the consolidated financial statements prepared using the principles of merger accounting. For other reporting purposes, the treatment will depend on the relevant framework on which the consolidated financial statements are based.

Q. If I am dealing with an accounting problem that is addressed in an Exposure Draft, can I use the requirements of that Exposure Draft to tell me what to do? What about an auditing problem?

A. If you are dealing with an issue that is not covered by Hong Kong Financial Reporting Standards (comprising all HKFRSs, HKASs and Interpretations issued by the Institute), you must follow the requirements of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop an accounting policy. As a result of applying the requirements of HKAS 8, you may find that the proposals in an exposure draft are an appropriate policy. However this is a matter of professional judgement.

In relation to an auditing problem, you are again required to use your professional judgement to determine whether the proposals in an exposure draft are appropriate to your circumstances. However, there is no need to refer to the exposure draft in your report.

Comment Due Dates

DATE	SUBJECT
10 February 2006	IAASB Exposure Draft – Improving the Clarity of IAASB Standards
12 April 2006	IASB Discussion Paper on Management Commentary
28 April 2006	IASB Discussion Paper on Measurement Bases for Financial Accounting – Measurement on Initial Recognition
Please send comments to commentletters@hkicpa.org.hk	