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Accounting Profession in Hong Kong; Professional Accounting in Foreign Country Series

Byrne & Co., Hong Kong

Susan Sgromo

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The Accounting Profession in Hong Kong

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES



AICPA

American Institute of Certified Public Accountants

The Accounting Profession in Hong Kong

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES

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NOTICE TO READERS

The Professional Accounting in Foreign Countries series is designed to be educational and used as reference material for the members of the Institute and others interested in the subject. It is not intended to establish standards.

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The International Practice Committee gratefully acknowledges the contributions made to the development of this series by former committee chairman Harvey D. Moskowitz; former committee members Dale D. Baker, R. Harry Beattie, J. Stanley Blumin, Campbell E. Corfe, Perry D. Harbour, W. Edward Hastings, Konrad W. Kubin, Walter F. O'Connor, W.C. Brian Peoples, Bruce D. Robertson, Martin Rotheim, and Anthony L. Smith; and former staff aide James F. Flynn. The committee would also like to acknowledge the fine editorial efforts of Carrie Vaccaro and Gene Smith and the production work of Robert DiCorcia, David Chipps and Mary Hendrickson.

The Accounting Profession in Hong Kong

PROFESSIONAL ACCOUNTING IN FOREIGN COUNTRIES SERIES

Prepared by
Byrne & Co.,
Certified Public Accountants,
Hong Kong

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AICPA

American Institute of Certified Public Accountants

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American Institute of Certified Public Accountants, Inc.
1211 Avenue of the Americas, New York, N.Y. 10036-8775
1234567890 TI 898

Library of Congress Cataloging-in-Publication Data
(Revised for vol. 7)

The Accounting profession in Hong Kong.

Contents: [1] Canada/prepared by Fuller Jenks
Landau — [2] Netherlands/prepared by Ernst &
Whinney— [3] Sweden/prepared by Pannell Kerr
Foster— [etc.]

1. Accounting. 2. Comparative accounting.
I. American Institute of Certified Public Accountants.
II. Professional accounting in foreign countries series.
HF561L.A34 1987 657 87-150526
0-87051-004-5

Preface

This booklet is one of a series on professional accounting in foreign countries. The material is current as of December 1987. Changes after this date in the standards of either the United States or Hong Kong may alter the comparisons detailed in this publication.

Included are descriptions of the accounting profession, auditing standards, and accounting principles in Hong Kong. The booklet also presents brief descriptions of the various forms of business organizations, taxes, and requirements for stock exchange listings and securities offerings. Checklists comparing Hong Kong auditing standards and accounting principles with those generally accepted in the United States are appendixes to the text.

This booklet is not intended to be a comprehensive discussion of auditing standards and accounting principles in Hong Kong but is designed instead to focus primarily on differences with those of the United States.

John Graves
Director
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The Accounting Profession

REQUIREMENTS FOR ENTRY INTO THE PROFESSION

Domestic Functions and Licensing Requirements

1. Anyone may use the title “accountant” and offer accounting and tax services. In Hong Kong, the only professional body is the Hong Kong Society of Accountants (herewith referred to as the “Society”). Qualified members are described as the professional accountants who are entitled to use either designation of Associate or Fellow of the Hong Kong Society of Accountants. To qualify as a professional accountant, a person should be twenty-one years old, of good character, a member of an approved institute or have passed either the Society’s Professional Examinations or the Joint Examination with effect from 1982 onwards and acquired the necessary practical experience.

2. Each company incorporated under the provisions of the Companies Ordinance shall appoint an auditor who must be a professional accountant holding a practicing certificate issued by the Society. This practicing certificate bestows upon the holder the title of Certified Public Accountant. To qualify for issuance of a practicing certificate, which requires annual renewal, the professional accountant should not have less than four years of full-time approved accounting/audit experience (or thirty months in cases of post-qualification experience), should be ordinarily resident in Hong Kong, and should possess the local experience and knowledge of local law and practice as the Council may

2 The Accounting Profession in Hong Kong

consider as necessary. A person shall be treated as *ordinarily resident* if he or she has been present in Hong Kong for not less than 180 days in the preceding twelve months.

3. In Hong Kong, the Certified Public Accountant may also act as liquidator, receiver or trustee of a company in bankruptcy. He or she may also act as company secretary, registrar, and share valuer.

Foreign Reciprocity

4. Under the Professional Accountants Ordinance, the Society has authority to admit as professional accountants full members of the following “Approved Institutes”:

- American Institute of Certified Public Accountants
- Australian Society of Accountants
- Canadian Institute of Chartered Accountants
- The Chartered Association of Certified Accountants
- The Chartered Institute of Public Finance and Accounting
- The Institute of Chartered Accountants in Australia
- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Ireland
- The Institute of Chartered Accountants of Scotland
- The Institute of Cost and Management Accountants
- New Zealand Society of Accountants

The Society has absolute discretion to admit full members of other accounting bodies accepted as having a standard similar to an approved institute.

ROLES AND RESPONSIBILITIES OF STANDARD-SETTING BODIES

Professional Standards Promulgated by Each Body

5. The Society is the only professional accounting body in Hong Kong and is responsible for setting all professional standards. The Society is responsible for the determination and publication

of auditing and accounting standards and guidelines. Auditing standards prescribe the basic principles and practices that members of the Society are expected to follow in the conduct of an audit. Auditing guidelines provide guidance on—

- Procedures by which the auditing standards may be applied.
- The application of the auditing standards to specific items appearing in the financial statements of entities.
- Technique currently being used in auditing.
- Audit problems relating to particular commercial or legal circumstances or to specific industries.

6. The Society prepares and promulgates Statements of Standard Accounting Practice (SSAPs). The SSAPs define standard practice on particular aspects of accounting. Before auditing and accounting standards and guidelines are issued, they are usually preceded by exposure drafts, and members are invited to comment on the contents of such drafts.

7. The Society is a member of the International Federation of Accountants and of the International Accounting Standards Committee and consequently supports the objectives of these bodies. The Society publishes all international accounting standards and uses its best endeavors to ensure their compliance in all material respects for published financial statements, to persuade government and authorities controlling the securities market and the business and industrial community that published financial statements should comply with international accounting standards in all material respects and to ensure that auditors satisfy themselves that the financial statements comply with international accounting standards. The Society has also agreed to incorporate the principles of international auditing guidelines into its own auditing standards and guidelines.

Ethics Requirements

8. Besides following the relaxation of the previous restrictions on advertising, the Society has adopted statements of professional ethics similar to those of the Institute of Chartered Accountants in England and Wales. The statements cover a wide range of matters including the following: independence, publicity, adver-

tising, obtaining professional work, changes in a professional appointment, fees, and clients' monies.

9. In the statements and accompanying guidelines, particular emphasis is placed on the requirements that a member of the Society must have integrity, be objective and competent, follow technical and professional standards, act with courtesy and consideration, follow the ethical guidance and generally maintain the good reputation of the profession and the Society.

PROFESSIONAL PUBLIC ACCOUNTING ORGANIZATIONS

10. As previously mentioned, the only professional public accounting organization in Hong Kong is the Hong Kong Society of Accountants.

Requirements for Membership

11. Reference is made in paragraph 1 to the description of the requirements for membership in the Society.

Rights of Membership

12. Only members of the Society holding the practicing certificate can undertake audits of financial statements of companies incorporated under the Companies Ordinance or other statutes. Membership in the Society is almost always the minimum qualification necessary for employment in financial positions in senior local government, as well as in commerce and industry.

Number of Members

13. The number of members in the Society is approximately 3,800, of which 974 are holders of practicing certificates, and there are 459 registered firms of certified public accountants or public accountants.

CPE Requirements

14. The Society, through its CPE committee and its director for CPE, is committed to giving guidance to its members regarding the form of CPE, as well as providing structured CPE as seminars and lectures. Although the Society has not made CPE compulsory, members are encouraged to stay abreast of developments in the profession and to maintain a certain level of technical knowledge.

2

Auditing Requirements

STATUTORY AUDITING AND REPORTING REQUIREMENTS

Purpose of the Statutory Audit

15. Auditors have a statutory responsibility to report to the members of the company whether in their opinion the financial statements give a true and fair view of the state of the company's affairs and of the profit or loss and changes in financial position for the year, and whether such statements comply with the Companies Ordinance (or other relevant legislation). There is also a professional responsibility to report if the financial statements do not comply in any material respect with the Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants, except in the opinion of the auditor when such non-compliance is justified.

Entities That Are Required to Be Audited

16. The Companies Ordinance requires that every company incorporated under the Companies Ordinance must appoint an auditor whose report shall be attached to the financial statements requiring approval by the company's board of directors.

Appointment and Qualifications of Auditors

17. Every company shall, at each annual general meeting of the company, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting of the company. When, at the annual

general meeting of a company, no auditors are appointed or reappointed, the court may, on the application of any member of the company, appoint a person to fill the vacancy.

18. The first auditors of a company may be appointed by the directors at any time before the first annual general meeting of the company, and auditors so appointed shall hold office until the conclusion of that meeting. If the directors fail to exercise their power to appoint an auditor, such power may be exercised by the company at the general meeting.

19. The appointment of a firm of auditors shall be deemed to be the appointment of the partners for the time being of that firm.

20. Special notice shall be given for a resolution at a general meeting concerning the removal of auditors or the appointment of auditors other than the retiring auditors. On receipt of this notice, the company must notify the auditors who have been proposed to be removed or not reappointed and, where applicable, to notify the persons proposed to be appointed auditors. The auditors who have been proposed to be removed or not reappointed may present a written representation to the company and request that this representation be circulated to members to whom notice of the general meeting and the resolution are to be or have been sent. These same auditors are also entitled to attend and be heard at the general meeting.

Auditing and Reporting Responsibilities

21. It is the auditor's responsibility to report to the members of the company whether the financial statements presented by the company's management are properly prepared in accordance with the Companies Ordinance, and whether the statements present a true and fair view of the state of the affairs of the company, its profit or loss and changes in financial position. If the entity reported upon is a bank, insurance, shipping, security or commodity trading company, the auditor's opinion will also make reference to the relevant ordinances and, where applicable, the industry guidelines issued by the Society.

22. The responsibility of maintaining proper books and records and preparing a proper set of financial statements rests with management.

23. The auditor also has a professional responsibility to note in the report all significant departures from statements of standard accounting practice in preparing the financial statements unless the auditor concurs with such departures. If the auditor considers that the departure is not justified and that the true and fair view shown by the financial statements is therefore impaired, in addition to referring to the notes and disclosing the necessary information in the report, the auditor should, unless it is impracticable, express a qualified opinion and quantify the financial effect of the departure.

24. Under the Companies Ordinance, the auditor is also required to report by exception if he or she is unable to satisfy himself or herself that—

- Proper books of account have been kept.
- Proper returns adequate for the purposes of his or her audit have been received from branches not visited.
- The financial statements are in agreement with the books and the returns received from branches.
- He or she has obtained all the necessary information and explanations.

25. The financial statements are usually accompanied by a directors' report, which is required under the Companies Ordinance, and may include a chairman's statement and other information supplementary to the financial statements. To indicate that the auditor is neither responsible for nor reporting on such report or statements, it is usual for the auditor to be specific in his or her report as to the financial statements on which he or she is reporting by identifying the page numbers of such financial statements. Although the auditor is not responsible for the above-mentioned directors' report, he or she should ensure that the information contained therein is not materially misleading before completion of the audit report.

Filing of Reports

26. For public companies, the audit report and the certified true copy of the financial statements are required to be filed together with the Companies Registrar. Members of the general public may inspect such financial statements upon payment of a fee. Private companies are exempted from such filing requirements.

27. The auditor's report and the financial statements are also required to be submitted to the Inland Revenue Department in support of tax returns.

SUMMARY OF SIGNIFICANT AUDITING STANDARDS AND COMPARISON WITH U.S. GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)

Standards Issued

28. The Society has issued auditing standards and auditing guidelines regarding audit approach and reporting. Auditing standards prescribe the basic principles and practices that members are expected to follow in the conduct of an audit. Auditing guidelines give guidance on the procedures and techniques being applied during the audit. (A list of the auditing standards and auditing guidelines currently in issue is detailed in appendix A.)

29. Although the substance in U.S. auditing standards tends to be more codified, Hong Kong standards tend to allow more room for professional judgment. Other differences between Hong Kong and the U.S. auditing standards and procedures are described in the following paragraphs. In accordance with the Society's issued auditing guideline on Representations by Management, an auditor should obtain from his or her client a representation letter on each audit engagement, but there are no auditing standards/guidelines on representations by management.

30. In Hong Kong, although the general audit practice is to obtain written representation from the client's solicitors and legal advisors, there is no auditing standard or guideline concerning written representations from management's legal counsel.

31. At present, there is no local standard or guideline on audit sampling. The auditor may apply either statistical or non-statistical methods.

32. There is currently no standard or guideline requiring an auditor to search for errors or irregularities that would have a material effect on the financial statements. However, the auditor should recognize the possibility of material irregularities that, unless adequately disclosed, could distort the results and position of the financial statements. Therefore, the auditor should plan the audit so that he or she has a reasonable expectation of detecting material errors or irregularities.

33. There is also no standard or guideline requiring the auditor to perform procedures to identify and disclose related party transactions and to determine the impact on the financial statements of an illegal act; however, a discussion paper on related party transactions has been issued.

34. The principal auditor in Hong Kong is fully responsible for his or her opinion on the group accounts' consolidated financial statements and, for this reason, need not refer in his or her report to the fact that the financial statements of some subsidiaries or associated companies have been audited by other auditors. Because the shareholders of the holding company are entitled to know that the financial statements of some of the companies in the group have been audited by other auditors and also to know the materiality of those companies to the group, the appropriate information is usually disclosed in the accounting notes.

35. Auditing standards in Hong Kong do not require that the auditor's report state whether the financial statements are presented in accordance with generally accepted accounting principles. However, when expressing a *true and fair* opinion, the auditor should be satisfied that all relevant statements of standard accounting practice have been complied with, except in situations in which, for justifiable reasons, they should not be applied.

36. Auditing standards in Hong Kong do not require an auditor's report to express an opinion on consistency; however, this fundamental concept is assumed unless the contrary is stated.

37. Auditing standards in Hong Kong require either a *subject to* or disclaimer rather than an *except for* qualification when there is audit scope limitation.

General Standards

38. The Society has set forth guidance on professional ethics that includes the matter of independence and its contents, which are similar to those of the U.S. standard. The auditing guideline on quality control advocates adequate training and competence.

39. In Hong Kong, an auditor can provide other types of services apart from an audit. However, a practice should not participate in the preparation of the accounting records of a public company audit client other than in exceptional circumstances. In all cases in which a practice is involved in the preparation of accounting records of an audit client, particular care must be taken to ensure that the client accepts full responsibility for such records and that objectivity in carrying out the audit is not impaired.

40. Although the Society has not issued an explicit auditing guideline on due care on the performance of work, it has always emphasized the need for due care in the performance of work.

Standards of Fieldwork

41. The Society has issued an auditing standard and guidelines concerning many areas covered by the U.S. Standards of Fieldwork as follows:

- *Planning, Controlling and Recording*

The auditor should adequately plan, control and record the work.

- *Accounting System*

The auditor should ascertain the entity's system of recording and processing transactions as well as assess its adequacy as a basis for the preparation of financial statements.

- *Internal Control*

If the auditor wishes to place reliance on any internal controls, he or she should ascertain and evaluate those controls and perform compliance tests on their operation,

- *Audit Evidence*

The auditor should obtain relevant and reliable audit evidence sufficient to enable him or her to draw reasonable conclusions therefrom.

- *Review of Financial Statements*

The auditor should carry out a review of the financial statements as is sufficient, in conjunction with the conclusions drawn from the other audit evidence obtained, to give him or her a reasonable basis for an opinion on the financial statements.

Standards of Reporting

42. The Society has issued an auditing standard on reporting that applies to all reports in which the auditor expresses an opinion on financial statements intended to give a true and fair view of the state of affairs, profit or loss and, where applicable, changes in financial position of the entity. The standard is not intended to override the statutory exemptions granted in respect of certain types of entity; rather, it is intended to apply to the audit reports relating to such entities in other respects.

43. In Hong Kong, the auditor is not required to make reference in the audit report regarding consistency of application of and conformity with the statements of standard accounting practice. If noncompliance with the SSAP results in impairment of a true and fair position of the financial statements, the auditor should consider expressing a qualified opinion. The auditor should ensure disclosures of significant departures and, to the extent of concurrence with the departures either stated or implied, be prepared to justify them.

44. Auditing guidelines on the auditor's report on financial statements, forms of qualifications in auditors' reports and audit report examples have been issued to give guidance on how to apply the standard on reporting and how to prepare a qualified report. (An illustrative auditor's report is included in appendix C.)

Qualifications in Audit Reports

45. Auditing guidelines on forms of qualifications in auditors' reports outline the circumstances under which a qualified report

is to be issued and explain the form of qualification required. An uncertainty that is considered material but is not fundamental requires a *subject to* opinion. If the impact of the uncertainty on the financial statements is so great as to render them, as a whole, meaningless, a disclaimer of opinion should be issued.

46. If a qualified opinion is issued due to disagreement, an *except for* opinion will be required for a material but not fundamental item. If the impact of the disagreement on the financial statements is so great as to render them totally misleading, an adverse opinion should be issued.

Dating of Auditing Reports

47. Statement of Standard Accounting Practice 9, *Accounting for Post Balance Sheet Events*, states that the date on which the financial statements are approved by the Board of Directors should be disclosed in the financial statements. In Hong Kong, the date of the auditor's report should be as near as possible to the date of the actual signing. The auditor should never date a report earlier than the date on which the financial statements were approved by the Board of Directors.

3

Accounting Principles and Practices

SOURCES OF ACCOUNTING PRINCIPLES

48. Accounting principles are set forth in statements of standard accounting practice issued by the Hong Kong Society of Accountants (see appendix B for the list of SSAPs). The Companies Ordinance Tenth Schedule sets forth the minimum statutory disclosure requirements for financial statements.

FORM AND CONTENT OF FINANCIAL STATEMENTS

Presentation of Statements

49. The directors of a company are required by the Companies Ordinance to submit every calendar year a directors' report and audited financial statements to the members (shareholders) for their approval at the annual general meeting. The directors are also required to file with the Registrar of Companies, together with the annual return, a certified true copy of the balance sheet that is laid before the company in meeting during the period to which the return relates. The filing should be made within forty-two days after the annual general meeting for the year. Private companies are exempted from such filing. (Illustrative Financial Statements are presented in appendix C.)

50. The directors' report attached to the financial statements shall be approved by the Board of Directors and signed for on behalf of the board either by the chairman of the meeting at which the financial statements are approved or by the secretary of the company. The directors' report shall include the following:

- The principal activities of the company and of its subsidiaries in the course of the financial year and any significant changes in those activities in that year
- The amount of dividend recommended by directors
- The proposed transfer to reserves
- Total amount of donations in excess of 1,000 Hong Kong dollars (including those made by subsidiaries)
- Significant changes in fixed assets of the company (or any of its subsidiaries)
- Details of issues of shares or debentures, stating the reason for making the issue, the class and amount and the consideration received for the issue
- Names of directors who held office at any time during the period
- Particulars of any significant contract with the company, its holding company, its subsidiary companies or its fellow subsidiary companies during the period, in which a director was materially interested
- Particulars of any significant contract (including the name of any director interested in the contract) with an individual, firm or corporation for the management of the whole or a substantial part of the company's business irrespective of whether a director has an interest in the contract
- Particulars of directors' rights to acquire shares or debentures, in the company or any other corporate body, under any arrangement to which the company, its holding, subsidiary or fellow subsidiary company is a party
- Any other matters material for the appreciation of the company's state of affairs

51. For private companies to which S.141D, a section of the Hong Kong Companies Ordinance, applies, certain disclosure requirements under the Companies Ordinance as to financial

statements are waived. All the members of a private company must agree in writing that S.141D shall apply with respect to a financial year of that company.

52. The Tenth Schedule of the Companies Ordinance states the particular items in the case of a limited company that should be disclosed separately in the balance sheet and profit and loss account. It requires disclosure separate of fixed assets, current assets, current liabilities, share capital, and assets that are neither fixed nor current. The net current assets/current liabilities are shown to disclose the working capital of the company. *Current assets* are generally defined as those that are expected to be realized within twelve months of the balance sheet date, and *current liabilities* are those that are expected to fall due within the same period. For private companies applying S.141D, the provisions concerning the balance sheet are stated in the Eleventh Schedule of the Companies Ordinance.

53. The Companies Ordinance does not require a statement of changes in financial position. However, Statement of Standard Accounting Practice 4, *Statement of Changes in Financial Position*, requires that, to ensure a true and fair view, such a statement, both for the period under review and for the corresponding previous period, should be included in the audited financial statements. Companies exempted from this requirement include the following:

- Those with turnover or gross income of less than HK\$1,000,000 per annum
- Those who have obtained exemption S.141D of the Companies Ordinance
- Specialized industries (banks, insurance and shipping companies)
- Nonprofit-making entities

Types of Statements Prepared

54. Limited companies incorporated under the Companies Ordinance must prepare their financial statements in compliance with the provisions of the Companies Ordinance and SSAPs. The financial statements should contain a balance sheet, a profit and

loss account, a statement of changes in financial position and the accompanying notes.

55. Private companies using the application of S.141D of the Companies Ordinance on their financial statements need only contain the balance sheet with the relevant accounting notes.

56. At the end of its financial year, when a company has subsidiaries, it is required by the Companies Ordinance to present the group accounts before the company in the general meeting. Although the Companies Ordinance accepts alternative forms of presentation of the group accounts, Statement of Standard Accounting Practice 7, *Group Accounts*, states that group accounts in the form of consolidated financial statements are the best means of achieving the objective of group accounts, which is to give a true and fair view of the profit or loss and of the state of affairs of the group. A separate profit and loss account of the holding company is not required, provided the financial statements disclose how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the holding company.

57. A company may elect not to present consolidated financial statements if the company is itself a wholly-owned subsidiary of another company that presents a consolidated financial statement (including foreign companies).

58. When a subsidiary has not been included in the consolidated financial statements, the following details need to be disclosed:

- The reasons for exclusion
- Net aggregate amount attributable to the holding company of profit less losses of such subsidiaries dealt with and not dealt with in its financial statements
- Any qualification in audit reports on the financial statements of the subsidiaries or notes on the financial statements that, if not made, would have been the subject of qualifications, so far as not covered by the holding company's financial statements

59. In addition, in respect of any subsidiaries omitted from consolidated financial statements, the consolidated balance sheet must show—

- Shares in and amounts due to and from such subsidiaries, and
- Number, description, and amount of shares and debentures in the company held by subsidiary companies or their nominees.

60. Apart from the above disclosure requirements, when a subsidiary is excluded from consolidation on the grounds of dissimilar activities, the group accounts should include separate financial statements that should include the following:

- Details of the holding company's interest
- Particulars of intra-group balances
- The nature of transactions with the rest of the group
- A reconciliation with the amount included in the consolidated financial statements for the group's investment in the subsidiary, which it is recommended be stated under the equity method of accounting

61. When a subsidiary is excluded from consolidation on the grounds of lack of effective control, it is recommended that it be dealt with in the consolidated financial statements under the equity method of accounting.

SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES AND COMPARISON WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

62. The fundamental accounting concepts in Hong Kong are *going concern*, *accruals*, *consistency*, and *prudence*. Significant Hong Kong accounting principles are discussed in the following paragraphs. (The lists of SSAPs and statements of accounting guidelines issued by the Society is detailed in appendix B.)

63. Although there is no specific pronouncement regarding the historical cost basis of recording assets and liabilities in Hong Kong, such is the predominant practice.

Alternative Accounting Methods

64. There also exists in Hong Kong alternative accounting methods that permit inventories, investments, tangible fixed assets,

and intangible fixed assets (other than goodwill) to be stated at values other than cost as follows:

- *Market value.* Tangible fixed assets may be revalued and stated at the revalued amount of the latest valuation. Short-term investments shall be stated at market value if the market value falls below cost.
- *Equity method.* For the investing group, investments in associated companies must be valued under the equity method whereby the amount of the investing group's interests in associated companies includes the cost of the investment less any amounts written off and the investing group's share of the post-acquisition retained profits and reserves of associated companies.
- *Other.* Fixed assets may be valued based on directors' valuation or estimation, which is to be disclosed in the notes on the financial statements.

65. Where assets are revalued and the effect is given to the revaluation in the financial statements, depreciation should be based on the revalued amount, to eliminate the existing accumulated depreciation against the book cost, and to substitute the revalued amount for the net book amount. Any deficit or surplus arising on a revaluation must be handled through the *revaluation reserve*. In the case of assets revalued during the financial year, the name and qualification of the valuer and the bases of valuation used must be disclosed in the financial statements.

66. Work in progress should be stated at the lower of cost and net realizable value. Cost is the expenditure incurred during the normal course of business in bringing the product or service to its present location and condition.

67. The valuation of long-term contract work in progress includes cost plus any attributable profit, less any foreseeable losses and progress payments received and receivable. If the outcome of the contract cannot be estimated, the completed contract method is used.

Fixed Assets

68. All fixed assets with a limited useful economic life are required to be depreciated over their useful economic life. The

depreciation should be allocated to the profit and loss account on a systematic basis for each accounting period during the useful life of the asset. The useful lives of major depreciable assets should be reviewed periodically and depreciation rates for current and future accounting periods adjusted if current expectations are significantly different from previous estimates.

69. In Hong Kong, land cannot be owned but is instead based on a long-term lease basis. As a result, there is a policy which allows leasehold land with remaining terms in excess of fifty years not to be depreciated. Leasehold land with terms under fifty years must be amortized.

Goodwill

70. Statement of Accounting Guideline 2.204, on *Goodwill*, recommends various ways for treating goodwill. Goodwill may stay as a permanent intangible asset, unless there is a permanent impairment in value. It may also be written off over a defined period or at the time of acquisition either to a reserve or a profit and loss account as an extraordinary item.

Related Party Disclosure

71. Unlike the U.S. practice, there is no special requirement to disclose related party transactions in the financial statements in Hong Kong. However, there is a discussion paper on the audit implication of related party transactions. In any case, the requirement of a *true and fair view* may require consideration of the impact of certain types of transactions.

Segment Reporting

72. In Hong Kong, there is no statutory requirement to disclose information in the financial statements for each industry segment, but there is an accounting guideline on the subject.

Effects of Inflation

73. There is no requirement at present to disclose the effects of inflation on the financial statements or to present the financial statements under any current cost accounting method.

Receivables

74. Although there is no statement of standard accounting practice in respect of provisions for doubtful receivables, it is general practice to make adequate provision for all doubtful items in accordance with the concept of prudence.

Liabilities

75. Provision is made for all known liabilities. Revenue and profits are not anticipated but are only recognized when realized (in the form of either cash or other assets, the ultimate cash realization of which can be assessed with reasonable certainty).

Accounting for Leases

76. The Hong Kong Society of Accountants has issued SSAP 14 on leases and hire purchase contracts. It states the method of accounting for operating leases and finance leases as well as the disclosure requirements in the financial statements.

Research and Development Costs

77. There is no local standard concerning accounting for research and development costs. The various treatments in practice depend on the nature of the research and development taken.

Pension Costs

78. Once again, there is no local accounting standard on pension costs, but for companies having established a pension scheme (plans), appropriate pension costs will be provided in the financial statements. There is no statutory requirement to make relevant disclosures.

Deferred Taxes

79. An accounting standard (SSAP 12) has been issued dealing with the matters concerning deferred taxes.

Foreign Currency Translation

80. The Hong Kong Society of Accountants has issued SSAP 11, *Foreign Currency Translation*. It states the method of translation

for an entity's foreign operations in its own financial statements and the financial statements of its foreign subsidiaries for consolidation purposes.

81. For individual companies, transactions denominated in a foreign currency should be translated into the reporting currency at the rate applicable on the date of transactions. At balance sheet date, monetary assets and liabilities denominated in a foreign currency should generally be translated using closing rates. Apart from the situation set out in the following paragraph, no subsequent translation should normally be made once nonmonetary assets have been translated and recorded. Exchange differences arising from the translation set out are dealt with in the profit and loss account.

82. When a company has used foreign currency borrowings or forward contracts to finance or provide a hedge against its foreign currency assets, provided the conditions stated below apply, the foreign currency assets should be denominated in the appropriate foreign currencies and the carrying amounts translated at the end of each accounting period at closing rates for inclusion in the company's financial statements. Any exchange differences arising should be taken to reserves, and the exchange gains or losses arising on the borrowings or the forward contracts should then be offset as a reserve movement, against those exchange differences. Following are the conditions that must apply:

- In any accounting period exchange gains or losses arising on the borrowings or the forward contracts should be offset only to the extent of exchange differences arising on the foreign currency assets.
- The foreign currency borrowings or the forward contracts are designated and effective as a hedge against the foreign currency assets.

83. When preparing group accounts, the closing rate/net investment method of translating the financial statements is used. Under this method, the amounts in the balance sheet of a foreign enterprise should be translated into the investing company's reporting currency using the closing rate of exchange. Exchange differences should be recorded as a movement on reserves.

84. The profit and loss account of a foreign enterprise accounted for under the closing rate/net investment method should be translated either at the closing rate or at an average rate for the period. Any exchange difference should be recorded as a movement on reserves.

85. In cases when the trade of the foreign enterprise is more dependent on the economic circumstances of the investing company's reporting currency than on its own reporting currency, the temporal method should be used. SSAP 11 defines the temporal method of translation as requiring translation of all assets, liabilities, revenue and expenses at the exchange rate ruling at the date on which the amount recorded in the financial statements was established. At the balance sheet date, monetary assets and liabilities are re-translated at the closing rate and any resulting exchange difference is taken to the profit and loss account.

86. The following disclosures are required for foreign currency translation:

- The methods used in the translation of the financial statements of foreign enterprises and the treatment of exchange differences
- The net amount of exchange gains and losses on foreign currency borrowings, identifying separately those offset in reserves and those incorporated in the profit and loss account
- The net amount of exchange gains or losses on forward contracts, together with any associated discount or premium on these contracts offset in reserves
- The net movement on reserves arising from exchange differences

4

Business Environment

FORMS OF BUSINESS ORGANIZATION

87. The forms of business organization existing in Hong Kong include the sole proprietorship, the partnership, the limited liability company, and the unlimited liability company.

Entities With Corporate Attributes

88. A company may be registered as—
- A limited company, that is, a company limited by shares for which the liability of a member to contribute is limited to the amount of the unpaid capital on his shares in the company.
 - A company limited by guarantee for which the liability of a member is limited to the amount the member has undertaken to contribute in the event of the company being wound up. The articles shall state the number of members with which the company proposes to be registered.
 - An unlimited company in which the liability of a member is unlimited. The articles shall state the number of members with which the company proposes to be registered and if the company has a share capital, the amount of share capital with which the company proposes to be registered.

89. Limited companies limited by shares are additionally distinguished into public and private companies. A private company, by its articles, restricts the right of transfer of its shares, limits the number of its members to fifty, and prohibits any invitation to the public to subscribe for any shares or debentures

in the company. A public company is not necessarily a listed company, but a listed company will always be a public company.

90. A limited company must hold an annual general shareholders' meeting once a year and no later than fifteen months after the previous meeting.

91. Extraordinary general meetings may be convened if requisition is made by members holding not less than one-tenth of the paid-up capital of the company or the total voting rights of all the members at the date of requisition.

92. Certain matters (such as the change in the issued share capital, a change in the company's name or alterations to the memorandum or articles of association) can only be effected with the approval of the members.

93. Although the liability of a member of a limited company is limited, a director will be penalized if he fails to carry out his obligations as stated in the Companies Ordinance, such as the keeping of proper books and records, the presentation of audited financial statements to the members in the general meeting, and the filing of the annual return with the Companies Registrar. A director faces unlimited liability when a company has traded fraudulently with the knowledge of such director.

94. The Companies Ordinance requires a company to set up a share premium account (for shares issued at a premium) and a capital redemption reserve (for shares redeemed out of profit). These are reserves not available for distribution as cash dividends. In general, a revaluation reserve will be established whenever there is any revaluation of fixed assets.

Branch of a Foreign Company

95. A foreign corporation that establishes a place of business in Hong Kong shall, within one month of the establishment of the place of business, deliver to the Companies Registrar registration of—

- A certified copy of the charter, statute or memorandum and articles of association of the company or other instrument constituting or defining the constitution of the company and,

if the instrument is not written in English, a certified translation thereof.

- A list of the directors and secretary of the company giving details, such as name, residential address and nationality, and so forth.
- Names and addresses of the company's authorized representative resident in Hong Kong and also the address of the principal place of business of the company in Hong Kong.
- A memorandum of appointment of power of attorney or other document under the company seal authorizing someone to act as the company's representative. The document should be in English; if not, a certified translation thereof.
- A certified copy of the company's certificate of incorporation, together with a certified translation, if not in English.
- A certified copy of the latest financial statements of the company except where the company is deemed equivalent to a private company.

96. In case there is any alteration to the above-mentioned documents, the company shall deliver to the Companies Registrar for registration a return containing the prescribed particulars of the alteration. The foreign entity shall confirm to the Companies Registrar, at least once in every calendar year and at intervals of not more than fifteen months, that there has been no alteration in the documents as stated above, apart from those of which he or she has been advised.

97. A foreign entity shall also deliver annually to the Companies Registrar certified copies of—

- Its balance sheet as at the end of its last financial year.
- Its profit and loss account for the said year.
- Its group accounts, if applicable.
- Its directors' report in respect of the said year.
- The auditor's report on the financial statements.

98. The annual confirmation as to changes and copies of audited financial statements are not required to be filed if the company would be a private company if incorporated under the

Ordinance or, in the opinion of the Registrar, has the same general characteristics as a private company and is not required by the law of its place of incorporation to publish its accounts or deliver copies to any person in whose office they may be inspected as of right by members of the public. The Registrar has issued circulars specifying the information required to enable him to determine whether a foreign entity is equivalent to a private company for these purposes.

Partnership Entities

99. There are two types of partnerships in Hong Kong—the partnership governed by the Partnership Ordinance and the limited partnership governed by the Limited Partnership Ordinance.

100. For partnerships other than limited partnerships, each partner is liable jointly and severally with the other partners for all debts and obligations of the firm incurred while he or she is a partner. The Partnership Ordinance requires partners to render true accounts and full information of all matters affecting the partnership. There are no specific accounting, auditing and disclosure rules regarding partnerships.

In case of a limited partnership, the number of partners shall not exceed 20 and must consist of one or more general partners who shall be liable for all debts and obligations of the firm, and one or more limited partners whose liabilities are limited to the amount of contribution they have made. A limited partner shall not take part in the management of partnership business; otherwise, he or she shall be liable for all debts and obligations of the firm incurred while he or she takes part in the management as a general partner.

Other Forms of Business Organization—Sole Proprietor

101. A *sole proprietor* is an individual engaged in a business or profession on his or her own. As with any other form of business organization, a sole proprietor must be registered with the business registration office of the Inland Revenue Department. The financial statements of a sole proprietor need not be audited or publicly disclosed.

REQUIREMENTS FOR PUBLIC SALES OF SECURITIES AND REQUIREMENTS FOR LISTING SECURITIES ON STOCK EXCHANGES

Registration Requirements for Public Sale

102. An offer to sell new securities must be accompanied by a prospectus complying with the Third Schedule of the Companies Ordinance. The prospectus must be filed with the Registrar of Companies. A prospectus must be accompanied by the following reports:

1. A report by the auditors of the company and of any guarantor corporation referred to in the prospectus with respect to—
 - Profits and losses of the last five years and assets and liabilities of the latest financial statements of the company and of any guarantor corporation
 - The rates of dividends paid by the company in respect of each class of shares in the company for the last five financial years
2. If the proceeds of the issue of securities are to be applied directly or indirectly in the purchase of any business, a report by accountants (who shall be named in the prospectus) on—
 - The profits or losses of the business for the last five financial years
 - The assets and liabilities of the business at the last date to which the financial statements of the business were made up
3. A valuation report with respect to the company's interests in land or buildings if such assets exceed 10 percent of the value of the company's assets or a value of not less than HK\$3 million is placed on the company's interests in land or buildings as reflected in the most recent financial statements

Requirements for Listing Securities on Major Stock Exchanges

Requirements for Listed Companies

103. Listed companies have to comply with Securities (Stock Exchange Listing) Rules and the rules governing the official listing

of securities set by the Stock Exchange. The Securities (Stock Exchange Listing) Rules fall into two main sections: the application for listing, and the prescribed undertaking. There are also a number of supplementary and transitional provisions that give the Commissioner for Securities the power to direct the Stock Exchange to suspend dealings in securities and otherwise to ensure the maintenance of an orderly market. The rules set by the Stock Exchange include those governing admission of securities to listing, the application and requirements, the Listing Agreement and the necessary contents of certain reports in a prospectus.

Preparation and Filing of Listing Application

104. An application made by a company to a stock exchange for the listing of any securities issued or to be issued by that company shall comply with the rules and requirements of the Stock Exchange and any provision of law applicable and shall contain such particulars and information that, according to the particular nature of the company and the securities for the listing for which application is being made, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities and financial position of the company at the time of the application and its profits and losses and of the rights attaching to such securities.

105. A copy of the application for listing shall be submitted to the Commissioner. The Stock Exchange also specifies certain documents that must be submitted to its listing department whenever an application for listing is made.

106. Once a company is listed, it must send to the Exchange, the Commissioner for Securities, every member of the company, and every holder of securities (not being bearer securities) issued by the company the following:

- A copy of the company's financial statements together with the directors' report and auditors' report not less than twenty-one days before the company's annual general meeting and no later than six months after the end of the financial year
- An interim report (unaudited) in respect of the first six months of each financial year, not later than four months from the end of that period of six months. The interim report should be

advertised in the newspapers, and a copy should be sent to the Commissioner for Securities and the Exchange with details of the names and dates of the newspapers that contained the reports. Apart from the company's financial statements and the interim report, a listed company must submit details of notifiable transactions to the Commissioner for Securities, the Exchange, and every member of the company.

Impact on Accounting Requirements

107. The Securities (Stock Exchange Listing) Rules and the rules governing the official listing of securities set out the information that should be disclosed in the interim reports and the financial statements included in the prospectus.

TAXES

Principal Types

108. Hong Kong has four separate and distinct taxes on income and profits:

- Property tax
- Salaries tax
- Interest tax
- Profits tax

109. The Inland Revenue Ordinance and Inland Revenue Rules cover the law for the four taxes. Following are certain fundamental principles common to all four taxes:

- There is no total income concept; each of the taxes is assessed without regard for what the taxpayer's income may be under other headings. However, there are exceptions to this rule in that an individual may, in appropriate circumstances, elect for personal assessment, which has the effect of bringing all sources of his or her income into a single assessment for which he or she must make a separate total income return.

Accordingly, unless an individual elects for personal assessment, he or she does not make a return of total income but makes

separate returns and declarations for each of the four taxes under which he or she has sources of income. The individual's total sources of income are therefore not immediately brought to the attention of the Inland Revenue Department.

- Except for salaries tax and personal assessment, tax is levied at a fixed standard rate and is non-progressive.
- The extent of exposure to tax is not governed by residency status, neither of individuals nor companies. Residency status has a limited application in certain special instances, otherwise the extent of liability under each of the taxes is limited to income that arises in or is derived from Hong Kong and certain other sources deemed by the Inland Revenue Ordinance to arise in Hong Kong.
- There is no provision in the Inland Revenue Ordinance that renders taxable all items of income not specifically charged elsewhere in the Ordinance. The logical feature of the four-tax system is that any item of income that does not fall within one of the tax categories is not subject to tax.
- There is no tax on capital gains. Tax will be charged on the profits of speculative transactions, if they can be proved to be part of normal trading or to constitute a speculative or risky transaction in the nature of trade.
- Except in respect of interest tax, there are no withholding taxes on either dividends or any other source of income, whether paid to residents or non-residents. However, there are instances when an assessment on a non-resident may be made on or through an agent in Hong Kong who is entitled to retain the tax out of payments due to the non-resident.

Year of Assessment

110. The year of assessment is the year to March 31st. Each tax has its own rules regarding what income and deductions form the basis for a given year of assessment.

Property Tax

111. Property tax is chargeable at the rate of 16.5 percent effective from year of assessment 1987/88 to the owner of land

or buildings situated in Hong Kong on the net assessable value of such land or buildings. Not all land and buildings in Hong Kong fall within the scope of property tax, as in the cases of certain areas in the New Territories, until such time as the Governor by proclamation in a public notice declares them to be chargeable.

112. The assessable value is the actual rental income. There can be irrecoverable rental if such irrecoverability can be proved to the satisfaction of the assessor. Net assessable value is arrived at after deduction of—

- Rates paid by the owner, and
- 20 percent of the assessable value after deduction of the above-mentioned rate paid, if any.

The 20 percent is a fixed allowance for repairs and outgoings. There are various forms of exemption and relief from property tax, for example—

- When the owner is the Hong Kong Government or a Commonwealth Government.
- When the owner carrying on a trade, profession or business in Hong Kong brings the income from the property into its profits tax computation, or the land and buildings are occupied for the purpose of producing profits subject to profits tax.

Salaries Tax

113. Salaries tax is imposed upon income that arises in or is derived from Hong Kong from any office or employment of profit and from pensions. Tax is levied on the actual income received for that year of assessment. The tax is the lesser of—

- Assessable remuneration less expenses wholly, exclusively, and necessarily incurred, depreciation allowances, allowable charitable donations, losses computed under salaries tax rules and personal allowances, charged at progressive rates of tax from 5 percent to 25 percent.
- The same net income before personal allowances, charged at the standard rate, which currently is 16.5 percent effective from year of assessment 1987/88.

114. Salaries tax is collected by direct assessment based on a return made at the end of the year of assessment. There is a system of provisional salaries tax for the current year of assessment, which is based on the previous year's agreed assessment, and is combined with the final assessment for the immediately preceding year of assessment. Provisional salaries tax is normally payable in two installments. There is no *pay-as-you-earn* system.

1987 Amending Legislation

115. In his 1987 Budget Speech, the Financial Secretary foreshadowed legislation for the automatic granting of time apportionment commencing from the year of assessment 1987/88 when, in a year of assessment, an employee renders services outside Hong Kong for a period of more than sixty days in total. If the services are rendered outside Hong Kong for sixty days or less, all of the salary income will be subject to salaries tax and no time apportionment will be permitted.

Interest Tax

116. Interest tax is a withholding tax by deduction at source. Interest is broadly defined by the Inland Revenue Ordinance and specifically includes the portion of an annuity that is deemed to be interest and also certain profits on the redemption on maturity or presentment of a certificate of deposit or bill of exchange. Interest tax is applicable to payments of interest having a source in Hong Kong. Effective from year of assessment 1987/88 the rate of interest tax is 16.5 percent, and there are no allowable deductions in arriving at an interest tax liability.

Profits Tax

117. Individuals, corporations, bodies of persons and partnerships are liable to profits tax in respect of assessable profits from a trade, profession or business carried on in Hong Kong and giving rise to a source of profits in Hong Kong currently at the following rates (effective from year of assessment 1987/88):

Corporation	18%
Individual and partnership	16.5%

118. The taxability of profits in Hong Kong is to be ascertained by determining whether—

- A business is being carried on in Hong Kong.
- The profits arise in or are derived from Hong Kong.

119. Section 15 of the Inland Revenue Ordinance specifies certain types of receipts deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business that is carried on in Hong Kong.

120. The general rule for deductibility of expenditure is stated in S.16(1) of the Inland Revenue Ordinance to include all outgoing and expenses to the extent to which they are incurred during the basis period for the year of assessment in the production of profits chargeable to profits tax. Apart from this general rule as to deductibility, S.16 provides a number of circumstances when a certain expenditure is specifically deductible.

Depreciation Allowances

121. Depreciation allowances represent the statutory means of allowing for exhaustion of capital expenditure and in effect replace the depreciation charge in the financial statements.

122. *Industrial building allowance.* Qualifying expenditure—must be capital expenditure incurred for the construction of an industrial building or structure occupied for the purposes of a trade. An initial allowance (20 percent of the capital expenditure) is given by way of deduction against taxable income. Annual allowance (4 percent of the capital expenditure)—is granted for any year of assessment at the end of the basis period for which the building was in use as an industrial building. A balancing allowance or charge arises when—

- The relevant interest in the building is sold.
- The building is demolished, destroyed or ceases to be used.
- In general, a leasehold interest comes to an end provided that all those events take place when the building is an industrial building.

123. *Commercial rebuilding allowance.* It is a single allowance for each year of assessment of three-quarters percent of the qualifying expenditure. A *commercial building* is defined as any building or structure used by the person entitled to the relevant interest on which the expenditure was incurred in his or her

trade, profession or business, and that does not qualify as an industrial building or structure. The claimant does not have to incur the capital expenditure personally; it is sufficient that the taxpayer holds the relevant interest in relation to which the expenditure was originally incurred.

124. *Plant and machinery.* Plant and machinery attract the largest allowances of all assets qualifying for depreciation allowances. In order to qualify for capital allowance, capital expenditure must be incurred by a person carrying on a trade, profession or business for the purposes of producing profits chargeable to profits tax or by an employee the use of which is essential to the production of income assessable to salaries tax.

Initial allowance (55 percent of the qualifying expenditure)—it is not necessary for the asset to be brought into use in the basis period; it is sufficient that the expenditure is incurred while a trade, profession or business is carried on.

Annual allowance—is available when at the end of a basis period for a year of assessment, a person owns and has had use of the assets for the purpose of producing profits assessable to profits tax. Allowance is granted annually in respect of each of three classes of assets at the rates of 10, 20 and 30 percent. Items qualifying for the same rate of annual allowance are grouped under one *pool*. Annual allowance is calculated by applying the relevant percentage on the reducing value of the asset, such as the qualifying expenditure less—

- The initial allowance given on that expenditure.
- Previous annual allowance given.

Sale and Leaseback and Leveraged Lease

125. There are restrictions on the availability of capital allowances in certain situations.

Sale and leaseback. Plant or equipment acquired by a lessor after March 13, 1986, under a sale and leaseback arrangement will not be entitled to depreciation allowances unless the price of such acquisition is not greater than the original price paid by the

vendor and no depreciation allowances on such plant and machinery have been previously allowed to the vendor.

Leveraged leases. Depreciation allowances will not be available for plant and machinery other than a ship or aircraft if all of the following apply:

- The plant is acquired by the lessor after March 13, 1986.
- The plant is, while the lease is in force, used wholly or principally outside Hong Kong by a person other than the lessor.
- The whole or a predominant part of the cost of the acquisition or construction of the plant is financed directly or indirectly by a nonrecourse debt.

126. When a leveraged lease involves a ship or aircraft, depreciation allowances will not be available if—

- The ship or aircraft is acquired by the lessor after March 13, 1986;
- The lessee is not a person deemed to carry on business as owner of the ship and aircraft under Hong Kong tax law; and
- The whole or a predominant part of the cost of the acquisition or construction of the ship or aircraft was financed directly or indirectly by a nonrecourse debt.

Balancing Charge or Allowance

127. Under the pooling system, balancing charge or allowance does not normally arise whenever there is a disposal. Sale proceeds are deducted from the reducing value of the relevant class of assets.

128. A balancing charge arises when, at the end of a basis period for a year of assessment, the reducing value of a class of assets is a negative figure because the disposal proceeds from the pool for that period have exceeded the reducing value brought forward plus additions of the whole *pool* of assets to which the disposed items belong. The negative amount then becomes a balancing charge for the year of assessment related to the basis period, and the reducing value carried forward is nil.

129. At the end of the basis period when cessation takes place, the reducing value of each class of assets is reduced by the sale

proceeds. If this is a positive balance, it becomes a balancing allowance; if a negative balance, it becomes a balancing charge.

Tax Returns

130. An assessor has the power under the Inland Revenue Ordinance to require any person to complete and submit any return that may be specified by the Board of Inland Revenue within a reasonable time. This applies to returns in respect of each of the four income taxes and also for those who elect for personal assessment. Normally, one month is allowed for the submission of returns of income.

131. In the case of profits tax returns, there is an automatic extension arrangement available to tax representatives, provided they submit suitably detailed lists of affected clients when invited to do so. The automatic extensions are as follows:

- For accounting periods ending in December—extended to July 31st
- For accounting periods ending between January 1st and March 31st—extended to October 31st

132. These can be further extended by individual application specifying good grounds, but extension is entirely at the discretion of the assessor. Apart from these arrangements, profits tax returns must be submitted within one month of issue, which is normally around April 1, following the year of assessment.

133. Any person in receipt of taxable income is obliged to inform the Commissioner in writing that he has such income, and such notification must be made within four months after the end of the basis period for assessment of that income, unless he has already received a specified return form for completion.

134. Under the Ordinance, employers have a number of obligations to report information regarding the commencement and cessation of employment of employees and of their remuneration, in order to ensure effective policing and collection of salaries tax.

135. When profits tax returns are filed, they are accompanied by certified true copies of the financial statements of the company

for the relevant period forming the basis period. Should there be corporations, an Auditors' Report must be submitted together with the audited financial statements.

Personal Assessment

136. Because the tax system in Hong Kong does not involve a computation of total income upon which tax is charged, and only salaries tax carries an entitlement to deduct personal allowances and to be charged at progressive rates of tax, there can be circumstances when assessment under a total income computation would produce a smaller overall tax liability than the separate combined taxes. The personal assessment provisions provide an opportunity for an individual to elect for total income assessment involving the personal allowances and progressive tax rates that otherwise apply only to salaries tax.

137. An election can only be made by an individual who is either a permanent or temporary resident of Hong Kong. The election must be made in writing.

OTHER MATTERS OF IMPORTANCE

Anti-Avoidance Provisions

138. Section 61A of the Inland Revenue Ordinance applies to any transaction entered into after March 13, 1986, which has the effect of conferring a tax benefit on the relevant person and having regard to the seven stated matters. It would be concluded that the person or one of the persons who entered into the transaction did so for the sole or primary purpose of enabling the relevant person to obtain a tax benefit.

139. Following are the seven stated matters:

- The manner in which the transaction was entered into or carried out
- The form and substance of the transaction
- The tax result that except for Section 61A would have been achieved by the transaction

- Any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction
- Any change in the financial position of any person who has, or has had, any connection with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction
- Whether the transaction has created rights or obligations that would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question
- The participation in the transaction of a corporation resident or carrying on business outside Hong Kong

140. When a transaction would be concluded as a Section 61A transaction, the Assistant Commissioner shall assess the liability to tax of the relevant person who has been conferred with the tax benefit—

- As if the transaction or any part thereof had not been entered into.
- In such other manner as the Assistant Commissioner considers appropriate to counteract the tax benefit that would otherwise be obtained.

141. Section 61A should only attack tax-motivated transactions and should not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their tax affairs.

APPENDIX A

Statements of Auditing Standards and Guidelines Currently in Effect

Statements of Auditing Standards in Issue

- 3.101 *Audit Approach*
- 3.102 *Reporting*

Statements of Auditing Guidelines in Issue

- 3.210 *Planning, Controlling and Recording*
- 3.211 *Quality Control*
- 3.220 *Accounting Systems*
- 3.230 *Audit Evidence*
- 3.231 *Auditing Stocks and Work in Progress*
- 3.232 *Verification of Debtor Balances: Confirmation by Direct Communication*
- 3.233 *Representations by Management*
- 3.234 *Contingent Liabilities Arising From Pending Legal Matters*
- 3.240 *Internal Controls*
- 3.250 *Review of Financial Statements*
- 3.251 *The Auditor's Considerations in Respect of Going Concern*
- 3.252 *Events After the Balance Sheet Date*
- 3.260 *Auditing in an EDP Environment—General Principles*
- 3.261 *The Effects of an EDP Environment on the Study and Evaluation of the Accounting System and Related Internal Controls*
- 3.262 *Computer-Assisted Audit Techniques (CAATS)*
- 3.270 *Engagement Letters*
- 3.280 *Group Financial Statements—Reliance on the Work of Other Auditors*
- 3.290 *Audit Approach to Companies Applying Section 141D of Companies Ordinance*

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- 3.310 *The Auditor's Report on Financial Statements*
- 3.320 *Forms of Qualifications in Auditors' Reports*
- 3.330 *Audit Report Examples*
- 3.401 *Industry Guideline—Banks and Deposit-Taking Companies*
- 3.402 *Industry Guideline—Insurance Companies*
- 3.403 *The Audit of the Accounts of Commodities Dealers*
- 3.404 *The Audit of the Accounts of Dealers in Securities*
- 3.405 *The Audit of Solicitors' Accounts*

APPENDIX B

Lists of Statements of Standard Accounting Practice and Accounting Guidelines Issued by the Hong Kong Society of Accountants

Statements of Standard Accounting Practice

- SSAP 1 *Disclosure of Accounting Policies*
- SSAP 2 *Extraordinary Items and Prior Year Adjustments*
- SSAP 3 *Stock and Work in Progress*
- SSAP 4 *Statements of Changes in Financial Position*
- SSAP 5 *Earnings Per Share*
- SSAP 6 *Depreciation Accounting*
- SSAP 7 *Group Accounts*
- SSAP 8 *Accounting for Contingencies*
- SSAP 9 *Accounting for Post Balance Sheet Events*
- SSAP 10 *Accounting for the Results of Associated Companies*
- SSAP 11 *Foreign Currency Translation*
- SSAP 12 *Accounting for Deferred Tax*
- SSAP 13 *Accounting for Investment Properties*
- SSAP 14 *Accounting for Leases and Hire Purchase Contracts*

Statements of Accounting Guidelines

- Statement 2.201 *Preparation and Presentation of Accounts From Incomplete Records*
- Statement 2.202 *The Effect of International Accounting Standards*
- Statement 2.203 *Accounts of Securities Companies*

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Statement 2.204 *Goodwill*

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Statement 2.206 *Reporting Financial Information by Segment*

APPENDIX C

Illustrative Auditors' Report and Financial Statements

The following financial statements are intended for illustrative purposes only. The statements presented are not intended to include all information that Hong Kong law requires.

AUDITORS' REPORT

We have audited the accounts set out on the following pages in accordance with approved auditing standards.

In our opinion, the accounts give a true and fair view of the state of affairs of the company and of the group at 30th June, 1986 and of the results and changes in financial position of the group for the year ended on that date and comply with the Companies Ordinance.

Peat, Marwick, Mitchell & Co.

Certified Public Accountants

Hong Kong, 26th September, 1986

CONSOLIDATED PROFIT & LOSS ACCOUNT

For the year ended 30th June, 1986

(Expressed in thousands of Hong Kong dollars)

	<u>Note</u>	<u>1986</u>	<u>1985</u>
Turnover	13	<u>1,611,525</u>	<u>746,701</u>
Operating profit	14	495,242	265,964
Share of profits less losses of associated companies		26,965	21,752
Taxation	15(a)	<u>(69,920)</u>	<u>(16,008)</u>
Profit after taxation		452,287	271,708
Minority interests		<u>(124,899)</u>	<u>(46,090)</u>
Net profit attributable to shareholders	16	<u>327,388</u>	<u>225,618</u>
Retained profits at 1st July 1985 & 1984			
As previously stated		90,308	76,858
Prior years adjustments	11	<u>133,933</u>	<u>94,085</u>
As restated		<u>224,241</u>	<u>170,943</u>
		551,629	396,561
Transfer to general reserves		300,000	60,000
Dividends	12	<u>171,630</u>	<u>112,320</u>
Retained profits carried forward	8	<u>79,999</u>	<u>224,241</u>
Earnings per share		<u>59.7¢</u>	<u>41.8¢</u>

Note: The calculation of earnings per share is based on earnings of \$327,388,000 (1985—\$225,618,000) and the weighted average of 548,025,000 shares in issue (1985—540,000,000 shares) during the year.

The earnings per share figure for 1985 has been restated to reflect the capitalization issue referred to in note 7.

The notes on pages 50 to 64 form part of these accounts.

BALANCE SHEETS**At 30th June, 1986***(Expressed in thousands of Hong Kong dollars)*

	<i>Note</i>	<i>The Company</i>		<i>The Group</i>	
		<u>1986</u>	<u>1985</u>	<u>1986</u>	<u>1985</u>
Assets Employed:					
Fixed assets	2	—	—	3,293,062	2,942,360
Interest in subsidiary companies	3	1,891,359	1,897,038	—	—
Interest in associated companies	4	196,194	208,483	397,011	420,829
Loans and investments	5	12,085	3,427	25,467	27,145
Net current assets/ (liabilities)	6	<u>(259,128)</u>	<u>(248,232)</u>	<u>868,269</u>	<u>980,561</u>
		<u>1,840,510</u>	<u>1,860,716</u>	<u>4,583,809</u>	<u>4,370,895</u>
Financed By:					
Share capital	7	572,100	432,000	572,100	432,000
Reserves	8	<u>1,077,224</u>	<u>1,151,937</u>	<u>2,411,212</u>	<u>2,210,755</u>
Shareholders' funds		1,649,324	1,583,937	2,983,312	2,642,755
Minority interests	9	—	—	552,797	623,898
Deferred liabilities	10	<u>191,186</u>	<u>276,779</u>	<u>1,047,700</u>	<u>1,104,242</u>
		<u>1,840,510</u>	<u>1,860,716</u>	<u>4,583,809</u>	<u>4,370,895</u>

*Approved by the Board of Directors on 26th September, 1986.*CHEN Tseng Tao Thomas *Director*YIN Shang Shing *Director**The notes on pages 50 to 64 form part of these accounts.*

CONSOLIDATED STATEMENT OF CHANGES
IN FINANCIAL POSITION

For the year ended 30th June, 1986

(Expressed in thousands of Hong Kong dollars)

	<u>1986</u>	<u>1985</u>
Source of Funds:		
Group profit before taxation less minority interests	397,308	241,626
Adjustments for items not involving the movement of funds:		
Minority interest in the retained profits of the year	124,899	46,090
Depreciation	759	748
Profit retained in associated companies	(22,738)	(18,151)
Profit on disposal of fixed assets	(642)	(2,965)
Profit on disposal of unlisted investments	—	(1,071)
Profit on disposal of listed investments	—	(208)
Loss on disposal of associated companies	19,519	—
Provision write-back on unlisted investments	—	(30,411)
Provision write-back on listed investments	3,815	(7,627)
Provision write-back on development properties	(32,000)	—
Provision write-back on completed properties for resale	(3,061)	—
Provision write-back on associated companies	<u>(7,074)</u>	<u>(10,785)</u>
Total generated from operations	480,785	217,246
Funds from other sources:		
Shares issued	179,760	—
Investment by minority shareholders	—	488,477
Proceeds from disposal of fixed assets	1,300	15,662
Proceeds from disposal of unlisted investments	—	1,411
Proceeds from disposal of listed investments	—	550
Proceeds from disposal of associated companies	3,170	—
Decrease in interest in associated companies	25,790	683,165

	<u>1986</u>	<u>1985</u>
Decrease in unlisted investments	—	16,926
Decrease in installment loans	<u>10,707</u>	<u>5,698</u>
	701,512	1,429,135
Application of Funds:		
Dividends paid to shareholders	130,650	69,120
Dividends paid to minority shareholders	9,695	5,651
Tax paid	21,799	25,483
Addition to fixed assets	408,628	54,692
Decrease in investment by minority shareholders	167,242	—
Decrease in deferred liabilities	56,542	734,524
Increase in unlisted investments	1,134	—
Increase in interest in associated companies	—	1,211
Changes in composition of the Group	<u>—</u>	<u>773,341</u>
	<u>(94,178)</u>	<u>(234,887)</u>
Representing		
Increase (decrease) in working capital:		
Development properties and stocks	(75,134)	(493,331)
Debtors, deposits and prepayments	187,217	(69,553)
Creditors	(110,161)	103,963
Movement in net liquid funds:		
Cash and bank balances	10,118	552
Bank loans and overdrafts	38,782	219,161
Short term loan	(145,000)	4,500
Short term listed investments	—	(179)
	<u>(94,178)</u>	<u>(234,887)</u>
Note:		
Summary of the effect of companies becoming subsidiaries		
Development properties	—	2,146,052
Debtors & prepayments	—	17
Cash	—	2
Bank overdraft	—	(2,535)
Creditors & accruals	—	(76,986)
Deferred liabilities	—	<u>(1,429,969)</u>
Net tangible assets acquired	—	636,581
Increase in minority interest	—	(8)
Increase in associated companies	—	<u>136,768</u>
Changes in composition of the Group	<u>—</u>	<u>773,341</u>

NOTES ON THE ACCOUNTS

1 Principal Accounting Policies

a. *Basis of consolidation*

The consolidated accounts incorporate the audited accounts of the Company and all its subsidiary companies made up to 30th June, 1986 and include the Group's share of the results for the year and retained post acquisition profits and reserves of associated companies. The results of subsidiary companies acquired or disposed of during the year are dealt with in the consolidated profit and loss account from the effective dates of acquisition or to the effective dates of disposal, respectively. Goodwill arising on consolidation represents the excess of the consideration paid over the net tangible assets of the companies acquired at the date of acquisition and is deducted from reserves.

All material intercompany transactions, including intercompany sales of properties, have been eliminated on consolidation.

b. *Associated companies*

Associated companies are companies, other than subsidiaries, in which the Group's interest is held for long term purposes and is substantial, or is effectively that of a partner in a joint-venture or consortium, and, in both situations, actively participates in management policy decisions through representation on the Board of Directors.

c. *Investment properties*

1. Land and buildings held for rental purposes are included as fixed assets.
2. Investment properties owned by the Group are stated at cost throughout the course of development until the completed developments achieve a mature state of income generation. Thereafter, they are valued on rotation at intervals of not more than three years by independent firms of professional valuers. In the intervening periods, valuations of these properties are undertaken by the Directors. Differences between valuation and carrying value are credited or charged to capital reserves.
3. Profits on sale of investment properties in the ordinary course of business are included in the operating profit of the group.

d. *Development properties*

1. Properties developed or under construction and properties acquired for future development projects with the intention of resale are classified under current assets at the lower of cost or market value.
2. When properties are developed for resale, income is recognized either when the sale agreement is entered into or when the occupation permit is issued, whichever is later. Profit or loss arising from

outright sales of an entire development project prior to completion are recognized when the contract is signed.

3. Property development expenditure, inclusive of interest and professional fees, is included as cost of development.
4. Deposits and installments received on properties sold prior to their completion are carried under current liabilities.

e. *Listed investments*

Listed investments included under current assets are stated at the lower of cost or market value.

f. *Translation of foreign currencies*

Foreign currency balances at the year end are translated into Hong Kong dollars at approximately the market rates of exchange ruling at the balance sheet date. Foreign currency transactions during the year are translated into Hong Kong dollars at the rates of exchange prevailing at the transaction dates. Differences on foreign currency translation are dealt with in the profit and loss account.

g. *Depreciation*

1. No amortization is provided for investment properties. This is not in accordance with Statement of Standard Accounting Practice No. 6 as it is currently stated but follows the recommendation of the Exposure Draft issued by the Hong Kong Society of Accountants on 13th December, 1985. Had depreciation been provided on investment properties, the additional charge would have been \$21,548,000 (1985—\$21,696,000).
2. Depreciation on other fixed assets has been provided on cost on a straight-line basis over the estimated useful lives of the assets as follows:

Furniture and equipment	10%–20% P.A.
Motor vehicles	20% P.A.

h. *Changes in accounting policies*

The accounting policy adopted in (a) above in respect of the accounting for results in associated companies is in accordance with Statement of Standard Accounting Practice No. 10 issued by the Hong Kong Society of Accountants which became effective in the current fiscal year. The accounting policy in respect of depreciation of investment properties adopted in (g) above is in accordance with the Exposure Draft issued by the Hong Kong Society of Accountants on 13th December, 1985. Both of these represent changes in accounting policies from those adopted in the previous years. The comparative figures for 1985 have been restated to reflect these changes. The effect of these changes resulted in the increase in reserves by \$62,086,691 (\$39,348,220 for 1985) and an increase in the current year's profit by \$44,287,113 (\$39,847,698 for 1985).

2 Fixed Assets—The Group
(Expressed in thousands of Hong Kong dollars)

	Investment Properties in Hong Kong on Long Lease				Land and Building Under Construc- tion	Equipment, Furniture, and Motor Vehicles	Total
	Office and Commercial	Hotel and Residential	Industrial				
Cost or valuation:							
At 1st July, 1985	2,242,997	512,352	185,000	—	5,370	2,945,719	
Additions:							
Land and Building	5,044	5,841	—	393,324	—	404,209	
Furniture and Fixtures	1,735	1,608	—	—	1,076	4,419	
Transfer from completed property for resale	2,239	—	—	—	—	2,239	
Disposals	—	(654)	—	—	(41)	(695)	
Transfer to development property	—	(98,000)	—	—	—	(98,000)	
Revaluation Surplus	27,449	7,803	4,000	—	—	39,252	
At 30th June, 1986	<u>2,279,464</u>	<u>428,950</u>	<u>189,000</u>	<u>393,324</u>	<u>6,405</u>	<u>3,297,143</u>	
Accumulated Depreciation:							
At 1st July, 1985	—	—	—	—	3,359	3,359	
Charge for the year	—	—	—	—	759	759	
Written back on disposal	—	—	—	—	(37)	(37)	
At 30th June, 1986	—	—	—	—	<u>4,081</u>	<u>4,081</u>	

Net book value						
At 30th June, 1986	2,279,464	428,950	189,000	393,324	2,324	3,293,062
At 30th June, 1985	2,242,997	512,352	185,000	—	2,011	2,942,360
Representing:						
1986 Professionals valuation	140,000	400,000	—	—	—	540,000
1986 Directors' valuation	2,139,464	28,950	189,000	—	—	2,357,414
Cost less provision	—	—	—	393,324	2,324	395,648
	2,279,464	428,950	189,000	393,324	2,324	3,293,062

3 Interest in Subsidiary Companies (Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>	
	1986	1985
Unlisted shares		
At cost	62,941	62,940
At Directors' valuation	66,984	66,984
	129,925	129,924
Amount due by subsidiary companies less provision	2,431,019	2,613,648
Amount due to subsidiary companies	(669,585)	(846,534)
	1,891,359	1,897,038

4 Interest in Associated Companies
(Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>		<i>The Group</i>	
	1986	1985	1986	1985
Unlisted investments at cost	12,611	12,630	57,565	63,973
Convertible loan stock less provision	—	7,908	—	7,908
Amount due by associated companies	221,753	279,740	323,456	394,485
Share of undistributed post-acquisition reserves	—	—	71,708	47,432
Less: Provision	(36,366)	(88,118)	(33,618)	(79,586)
	197,998	212,160	419,111	434,212
Less: Amount due to associated companies	(1,804)	(3,677)	(22,100)	(13,383)
	196,194	208,483	397,011	420,829

5 Loans and Investments
(Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>		<i>The Group</i>	
	1986	1985	1986	1985
Unlisted investments at cost	1,787	1,788	7,335	7,335
Advances	37,820	4,162	48,513	14,484
Provision for diminution in value	39,607	5,950	55,848	21,819
	(27,522)	(2,523)	(38,172)	(13,172)
	12,085	3,427	17,676	8,647
Installment loans	—	—	7,791	18,498
	12,085	3,427	25,467	27,145

6 Net Current Assets (Liabilities)
(Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>		<i>The Group</i>	
	<u>1986</u>	<u>1985</u>	<u>1986</u>	<u>1985</u>
Current Assets				
Projects under development for sale	—	—	1,759,612	1,760,481
Completed properties for sale	—	—	39,928	38,359
Stocks	—	—	865	691
Listed investments in Hong Kong at market value	—	—	14,315	18,130
Debtors, deposits and prepayments	51	1,235	205,458	18,241
Cash and bank balances	289	157	12,200	2,082
	<u>340</u>	<u>1,392</u>	<u>2,032,378</u>	<u>1,837,984</u>
Current Liabilities				
Bank loans and overdrafts	90,000	96,824	227,065	267,620
—secured	30,000	20,000	40,111	38,338
—unsecured	—	55,000	200,000	55,000
Short term loan	—	—	308,575	233,808
Deposits received	25,012	4,360	206,122	169,522
Creditors and accrued expenses	36	—	67,816	19,695
Taxation	114,420	73,440	114,420	73,440
Proposed dividend	259,468	249,624	1,164,109	857,423
	<u>(259,128)</u>	<u>(248,232)</u>	<u>868,269</u>	<u>980,561</u>

7 Share Capital
(Expressed in thousands of Hong Kong dollars)

	<u>The Company</u>
	<u>1986</u> <u>1985</u>
Authorized: 800,000,000 (1985—600,000,000) ordinary shares of \$1 each	<u>800,000</u> <u>600,000</u>
Issued and Fully Paid: 572,100,000 (1985—432,000,000) ordinary shares of \$1 each	<u>572,100</u> <u>432,000</u>

On 14th November, 1985 the issued share capital of the company was increased to \$540,000,000 by applying \$108,000,000 from the general reserves of the company in payment in full for 108,000,000 shares of \$1.00 each on the basis of one bonus share for four shares held on 31st October, 1985. These shares rank pari passu with the existing shares.

In addition, 32,100,000 shares of \$1.00 each were issued at a premium of \$4.60 each on 26th March, 1986 in part consideration for the acquisition of land.

8 Reserves
(Expressed in thousands of Hong Kong dollars)

	<u>The Company</u>	<u>The Group</u>
	<u>1986</u> <u>1985</u>	<u>1986</u> <u>1985</u>
Capital Reserves		
On consolidation	—	2,407
On asset revaluation	—	1,612,938
On acquisition of loan to a subsidiary	72,686	72,685
Others	—	55
Share Premium	147,660	147,660
Share of post acquisition capital reserves of associated companies	—	19,851
	<u>220,346</u>	<u>1,782,911</u>
		<u>1,630,212</u>

General reserves				
At 1st July	591,723	531,723	356,302	504,014
Goodwill written off	—	—	—	(207,712)
Capitalization on bonus issue	(108,000)	—	(108,000)	—
Transfer from profit and loss account	300,000	60,000	300,000	60,000
At 30th June	<u>783,723</u>	<u>591,723</u>	<u>548,302</u>	<u>356,302</u>
Retained profits	<u>73,155</u>	<u>487,529</u>	<u>79,999</u>	<u>224,241</u>
	<u>1,077,224</u>	<u>1,151,937</u>	<u>2,411,212</u>	<u>2,210,755</u>

Statement of Retained Profits

		<i>The Group</i>
		<u>1986</u>
Group companies	31,386	198,367
Associated companies	48,613	25,874
	<u>79,999</u>	<u>224,241</u>

Movements in Reserves

		<i>The Company</i>	<i>The Group</i>
Capital Reserves			
At 1st July, 1985			1,724,797
—As previously reported	72,685		(94,585)
—Prior year adjustments (note 11)	—		
As restated	<u>72,685</u>		<u>1,630,212</u>

8 Reserves (cont.)

	<u>The Company</u>	<u>The Group</u>
Revaluation of investment properties		
—surplus	—	39,252
—released on asset transferred to development properties	—	(54,814)
—decrease in minority interests' share	—	20,601
Premium on issue of Ordinary Shares	147,660	147,660
On acquisition of loan to a subsidiary	1	—
At 30th June, 1986	<u>220,346</u>	<u>1,782,911</u>

General Reserves

At 1st July, 1985	591,723	356,302
Capitalization on bonus issue	(108,000)	(108,000)
Transfer from profit and loss account	<u>300,000</u>	<u>300,000</u>
At 30th June, 1986	<u>783,723</u>	<u>548,302</u>

9 Minority Interests*(Expressed in thousands of Hong Kong dollars)*

	<u>1986</u>	<u>1985</u>
Share of equity in subsidiary companies	225,144	134,340
Advance by minority shareholders to projects under development	<u>327,653</u>	<u>489,558</u>
	<u>552,797</u>	<u>623,898</u>

10 Deferred Liabilities
(Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>		<i>The Group</i>	
	<u>1986</u>	<u>1985</u>	<u>1986</u>	<u>1985</u>
Bank loans—secured	170,000	210,000	582,982	619,099
Other Long Term Loans—secured	—	35,000	50,500	209,191
Other Creditors	21,186	31,779	238,312	36,314
	191,186	276,779	871,794	864,604
Secured bank loans in respect of MTR Island Line projects guaranteed by minority shareholders	—	—	175,906	239,638
	<u>191,186</u>	<u>276,779</u>	<u>1,047,700</u>	<u>1,104,242</u>

Liabilities payable within one year are included under current liabilities. The remaining balances of the Group are repayable within periods as follows:

	<i>1986</i>			<i>1985</i>		
	<u><i>Bank</i></u>	<u><i>Other</i></u>	<u><i>Bank</i></u>	<u><i>Other</i></u>	<u><i>Bank</i></u>	<u><i>Other</i></u>
	<u><i>Borrowings</i></u>	<u><i>Borrowings</i></u>	<u><i>Borrowings</i></u>	<u><i>Borrowings</i></u>	<u><i>Borrowings</i></u>	<u><i>Borrowings</i></u>
(i) of more than 1 year, but not exceeding 2 years	758,888	51,501	79,040	230,901		
(ii) of more than 2 years, but not exceeding 5 years	—	237,001	719,488	51,502		
(iii) of more than 5 years	—	310	—	23,311		
	<u>758,888</u>	<u>288,812</u>	<u>798,528</u>	<u>305,714</u>		

11 Prior Year Adjustments
(Expressed in thousands of Hong Kong dollars)

	<i>The Group</i>	
	<u>1986</u>	<u>1985</u>
Retained profits		
—Adjustment of share of Associated Companies' post acquisition profits	34,623	16,472
—Adjustment of provision for depreciation previously provided for investment properties	<u>99,310</u>	<u>77,613</u>
	<u>133,933</u>	<u>94,085</u>
Capital reserves		
—Adjustment of share of Associated Companies' post acquisition reserves	19,851	19,851
—Adjustment of asset revaluation surplus arising from the change of accounting policy in respect of investment properties	<u>(114,436)</u>	<u>—</u>
	<u>(94,585)</u>	<u>19,851</u>

12 Dividends
(Expressed in thousands of Hong Kong dollars)

	<i>The Company</i>	
	<u>1986</u>	<u>1985</u>
Interim dividend paid of 10 cents per share (1985—9 cents on 432,000,000 shares)	57,210	38,880
Proposed final dividend of 20 cents per share (1985—17 cents on 432,000,000 shares)	<u>114,420</u>	<u>73,440</u>
	<u>171,630</u>	<u>112,320</u>

13 Turnover
(Expressed in thousands of Hong Kong dollars)

An analysis of the Group's turnover and contribution to gross profit from the principal activities is as follows:

	1986		1985	
	Turnover	Contribution to Gross Profit	Turnover	Contribution to Gross Profit
Property development	1,220,977	302,053	419,914	153,094
Rental	277,441	239,269	249,227	218,899
Hotel	36,438	15,956	33,171	13,618
Others	76,669	23,440	44,389	27,055
	<u>1,611,525</u>	<u>580,718</u>	<u>746,701</u>	<u>412,666</u>

14 Operating Profit
(Expressed in thousands of Hong Kong dollars)

Operating profit has been arrived at after charging:
Interest on bank loans and overdrafts
Interest on other loans repayable within 5 years

Less: Interest capitalized as cost of property development

	The Group	
	1986	1985
	52,172	110,659
	94,634	48,249
	<u>146,806</u>	<u>158,908</u>
	<u>66,742</u>	<u>26,703</u>
	<u>80,064</u>	<u>132,205</u>

14 Operating Profit (cont.)

	<i>The Group</i>	
	<u>1986</u>	<u>1985</u>
Depreciation	759	747
Auditors' remuneration		
—current year	1,293	1,206
—underprovision in previous year	582	200
Loss on sale of associated companies	19,519	—
and crediting:		
Net rental revenue	239,269	218,899
Profit on sale of listed investments	—	208
Profit on sale of unlisted investments	—	1,071
Dividends from listed investments	869	977
Dividends from unlisted investments	2,408	4,040

15 Taxation

(Expressed in thousands of Hong Kong dollars)

	<i>The Group</i>	
	<u>1986</u>	<u>1985</u>
a. Taxation in the profit and loss account represents:		
Estimated liability at 18.5% on the assessable profits for the year	67,471	18,671
Overprovision for previous year	(240)	(5,053)
Share of liability of associated companies	2,689	2,390
	<u>69,920</u>	<u>16,008</u>

	<i>The Company</i>		<i>The Group</i>	
	<u>1986</u>	<u>1985</u>	<u>1986</u>	<u>1985</u>
b. The liability to taxation represents:				
Estimated liability to profits tax for the year	36	—	67,471	18,671
Add: Balance of profits tax provision relating to previous years	—	—	345	1,024
	<u>36</u>	<u>—</u>	<u>67,816</u>	<u>19,695</u>

16 Net Profit Attributable to Shareholders

Net profit attributable to shareholders includes an amount of \$57,257,000 (1985—\$654,217,000) which has been dealt with in the accounts of the Company.

17 Directors' Remuneration (Expressed in thousands of Hong Kong dollars)

Directors' remuneration disclosed in accordance with the provision of section 161 of the Companies Ordinance is as follows:

	<u>1986</u>	<u>1985</u>
Fees	79	68
Other emoluments	1,859	1,686
	<u>1,938</u>	<u>1,754</u>

18 Contingent Liabilities
(Expressed in thousands of Hong Kong dollars)

Contingent liabilities at 30th June, 1986 not provided for in the accounts of the Company were as follows:

	<i>The Company</i>	
	<u>1986</u>	<u>1985</u>
Guarantees given to banks and financial institutions for credit facilities made available to: Associated companies	<u>80,707</u>	<u>108,261</u>
Subsidiary companies	<u>638,337</u>	<u>738,953</u>

19 Capital Commitments
(Expressed in thousands of Hong Kong dollars)

	<i>Company</i>		<i>Group</i>	
	<u>1986</u>	<u>1985</u>	<u>1986</u>	<u>1985</u>
Contracted but not provided for	—	—	3,342	—
Authorized but not contracted for	—	—	74,457	—
	—	—	<u>77,799</u>	—

20 Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

APPENDIX D

Checklist for Comparison of Generally Accepted Auditing Standards (GAAS) in the United States to Auditing Standards in Hong Kong

<u>General Questions</u>	<u>Answer</u>	<u>Comments</u>
1. Is a primary purpose of an audit:		
a. to attest to information used by investors, creditors, etc. . . . ?	Yes	
b. to satisfy statutory requirements (for example, the Companies Act)?	Yes	1b. The primary purpose of an audit is to satisfy statutory requirements as it is stated in the Hong Kong Companies Ordinance S.129C that the auditors' report shall be attached to the financial statements laid before the company in general meeting.
c. for tax purposes?	No	

Notes:

Checklist should be completed from the perspective of performing a local audit, *not* a referral audit. AU numbers refer to sections in the *Codification of Statements on Auditing Standards*, unless otherwise noted.

<u>General Questions</u>	<u>Answer</u>	<u>Comments</u>
<p>2. A. The United States has ten generally accepted auditing standards including general standards, standards of field work, and standards of reporting. Those standards and their interpretations constitute U.S. generally accepted auditing standards which have been published in <i>Codification of Statements on Auditing Standards</i>. Do generally accepted auditing standards exist in your country?</p>	<p>Yes</p>	<p>2A. The Hong Kong Society of Accountants has issued auditing standards that prescribe the basic principles and practices that members are expected to follow in the conduct of an audit. Auditing guidelines are also issued to give guidance on—</p> <ul style="list-style-type: none"> • Procedures by which the auditing standards may be applied. • The application of the auditing standards to specific items appearing in the financial statements of entities. • Techniques currently being used in auditing. • Audit problems relating to particular commercial or legal circumstances or to specific industries. <p>However, auditing guidelines do not prescribe all those procedures and practices that should be followed in conducting an individual audit engagement.</p>
<p>B. If so, are they published?</p> <p>C. If auditing standards exist in your country, are they similar to U.S. standards?</p> <p>D. If not, what are they?</p>	<p>Yes Yes N/A</p>	<p>2C. We have auditing standards that are similar to U.S. standards.</p>
<p>3. Who is responsible for promulgating auditing standards (for example, the profession, a governmental body, etc.)?</p>	<p>The Profession</p>	<p>3. The professional body—Hong Kong Society of Accountants</p>

<u>U.S. Generally Accepted Auditing Standards</u>	<u>Required by Government Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
4. Do auditors confirm receivables? (AU 331)	Yes. Auditing Guideline 3.292	✓			
5. Do auditors observe inventory counts? (AU 331)	Yes. Auditing Guideline 2.231	✓			
6. Do auditors receive written representations from management? (AU 333)	Yes. Auditing Guideline 3.283	✓			
7. Do auditors receive written representations from management's legal counsel? (AU 337)	Not specifically required.	✓			
8. A. Do auditors prepare and maintain working papers? (AU 339)	Yes. Auditing Guideline 3.210	✓			
B. If so, do they include a written audit program outlining procedures to be performed? (AU 339)	Not specifically mentioned but the guideline stated above requires audit work to be evidenced.	✓			8B. Written audit programs are usually included in the audit working papers.
9. Do auditors study existing internal controls as a basis for reliance thereon in determining the nature, extent, and timing of audit tests to be performed? (AU 320)	Yes. Auditing Guideline 3.240	✓			
10. A. Do auditors communicate material weaknesses in internal accounting control to senior management or the client's board of directors? (AU 323)	Yes. Auditing Guideline 3.240	✓			

<u>U.S. Generally Accepted Auditing Standards</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
B. If so, is the communication documented? (AU 323)	Yes, Auditing Guideline 3.240	✓			
11. In obtaining evidential matter, does the auditor apply either statistical or nonstatistical procedures? (AU 350)	No	✓			11. The auditor may apply statistical or nonstatistical sampling methods.
12. Is the auditor responsible for planning his examination to search for errors or irregularities that would have a material effect on the financial statements? (AU 327)	No	✓			12. From: Explanatory Foreword of Statement 3.0, Auditing Standards and Guidelines: "The auditor's duties do not require him specifically to search for errors or irregularities unless required by the specific terms of his engagement. However, the auditor should recognize the possibility of material irregularities which, unless adequately disclosed, could distort the results or state of affairs shown by the financial statements. The auditor should, therefore, plan his audit so that he has a reasonable expectation of detecting material misstatements in the financial statements resulting from irregularities or fraud."

13. A. Does the auditor perform procedures to identify related party transactions and their effect on the financial statements? (AU 334)

No auditing guideline has been issued but there is an exposure draft on this subject.

B. If so, list the procedures.

13A. Difficult to determine—disclosures are very limited.

13B. Procedures employed:

- Obtaining management representations concerning the names of all related parties, including details of the affiliation of directors and officers with other entities
- Scrutinizing the register of members to identify substantial shareholders to the extent that these have not made use of nominees to hold the shares
- Reviewing minutes of board meetings and general meetings, with particular reference to any declaration of interest by a director
- Reviewing the previous year's audit file and discussing the situation with the auditors of other group companies or with predecessor auditors
- Company information obtained from management with the auditors' own knowledge of the entity and its related parties

<u>U.S. Generally Accepted Auditing Standards</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
14. Does the auditor consider the adequacy of cut-off procedures to ensure that movements into and out of inventories are properly identified in the accounting records? (AU 313)	Yes. Auditing Guideline 3.231	✓			
15. A. Are specific auditing procedures applied to transactions occurring after the balance sheet date? (AU 560) B. Are other auditing procedures applied to ascertain the occurrence of subsequent events that require adjustment to or disclosure in the financial statements? (AU 560)	Yes. Auditing Guideline 3.252	✓			15A,B. The auditors will review transactions after the balance sheet date and scrutinize books and records written up after the balance sheet date to ensure that proper disclosure or adjustment has been made in the financial statements where applicable for all post balance sheet date events.
16. The concept of "joint auditors" in certain countries (e.g., U.K., Canada, and Australia) is that two auditors or audit firms jointly audit the financial statements of a company and issue a single report signed by the two firms. This practice is not generally followed in the U.S. Does the concept of "joint auditors" exist in your country?	Yes. Foreword of Statement 3.0 of Auditing Standards and Guidelines.	✓			16. The concept of "joint auditors" exists in HK in the same way as it does in UK, Canada, and Australia.

17. When a principal auditor is reporting on financial statements that include one or more subsidiaries, divisions, branches, or investees: (AU 543)
- A. Must the principal auditor assume responsibility for the work of the other auditor as it relates to the principal auditor's opinions?
- Yes. Auditing Guidelines 3.310, 3.280 ✓
- B. May the principal auditor decide not to assume that responsibility by making reference to the other auditor and indicating the division of responsibility?
- No. Auditing Guidelines 3.310, 3.280 ✓
- 17A. In order to ensure that the other auditor has carried out a proper audit, the principal auditor will send out a questionnaire to the other auditor for completion or may examine his or her audit working papers.
- 17B. Even though some auditors do mention in the audit report that the audits of some subsidiaries/associated companies are carried out by other auditors, the principal auditor on signing the audit report will give his or her opinion on the financial position of the group, such as assume responsibility for the work of the other auditors.
18. A. Is there a standard form of auditor's report? (AU 509)
- Yes. Auditing Guideline 3.330 ✓

U.S. Generally Accepted Auditing Standards	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
<p>B. List the circumstances that require a departure from the standard report and indicate the type of report required. (AU 509)</p>	<p>Yes. Auditing Guideline 3.102</p>	✓			<p>18B.</p> <ul style="list-style-type: none"> • <i>Nature of circumstances</i> <ul style="list-style-type: none"> — Uncertainty — Disagreement • <i>Material but not fundamental</i> <ul style="list-style-type: none"> — “Subject to” opinion — “Except for” opinion • <i>Fundamental</i> <ul style="list-style-type: none"> — Disclaimer of opinion — Adverse opinion
<p>19. A. Does the auditor’s report express an opinion on the consistency of application of accounting principles? (AU 420)</p>	No			✓	<p>19A,B. The auditor is not required to express an opinion on the consistency of application of accounting principles. However, any change in significant accounting principles and its effect on the financial statements are required to be disclosed in the notes to the financial statements.</p>
<p>20. A. Is the auditor’s report dated as of the last day of fieldwork? (AU 530)</p>	No	✓			<p>20A,B. The date of the audit report will normally be as near as possible to the date of actual signing and should be as close as possible to the date of approval of the financial statements by the directors. The auditor can never date his report earlier than the date on which the financial statements are approved by the directors.</p>
<p>B. If not, what date is used?</p>					

- | | | |
|--|---------------------------------------|--|
| <p>21. To express an opinion, must the auditor be independent? For the purpose of this checklist, independence is defined as being free of financial interest in the client. (Code of Professional Conduct, Rule 101)</p> <p>22. Please describe any standards for Hong Kong for which there are no corresponding U.S. standards.</p> | <p>Yes. Professional Ethics 1.203</p> | <p>21. Professional independence is a concept fundamental to the accountancy profession.</p> |
| <p>22. The standards are as follows:</p> <ul style="list-style-type: none"> • Standards for certain specialized industries unique to Hong Kong (for example, banks and deposit-taking companies, insurance companies, commodities dealers, solicitors, dealers in securities) • Audit approach to companies applying section 141D of the Companies Ordinance under which some disclosure requirements are waived for certain private companies | <p>✓</p> | <p>22. The standards are as follows:</p> <ul style="list-style-type: none"> • Standards for certain specialized industries unique to Hong Kong (for example, banks and deposit-taking companies, insurance companies, commodities dealers, solicitors, dealers in securities) • Audit approach to companies applying section 141D of the Companies Ordinance under which some disclosure requirements are waived for certain private companies |

APPENDIX E

Checklist for Comparison of Generally Accepted Accounting Principles (GAAP) in the United States to Accounting Principles in Hong Kong

<u>General Questions</u>	<u>Answer</u>	<u>Comments</u>
1. Are there generally accepted accounting principles in Hong Kong? If so, are they codified?	Yes	1. There are generally accepted accounting principles in Hong Kong, and they are codified in Statements of Standard Accounting Practice.
2. Who is responsible for promulgating accounting principles (for example, the profession, a governmental body, etc.)?	The Profession	2. The professional body Hong Kong Society of Accountants is responsible for promulgating Statements of Standard Accounting Practice.
U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Not Done
3. Are assets and liabilities recorded on the historical cost basis?	No	Minority Practice
	Predominant Practice	Comments
	✓	

- | | | |
|--|---|----------|
| <p>4. Are interest costs, incurred while activities that are necessary to get an asset ready for its intended use are in progress, capitalized as part of the historical cost of an asset? (I67)</p> | <p>Yes. In accordance with Accounting Guideline 2.205 issued by the Hong Kong Society of Accountants.</p> | <p>✓</p> |
| <p>5. A. Is a general revaluation (either upward or downward) of assets permitted? (D40)</p> | <p>Yes. SSAPs 6 and 13.</p> | <p>✓</p> |
| <p>B. If so, define the basis.</p> | <p>See Comment.</p> | <p>✓</p> |
-
- 5A. It is generally permitted to revalue assets; however, there is no specific accounting standard on the subject.
- 5B. The basis is not specifically mentioned in the SSAPs. The revaluation is normally based on a valuation conducted by a professional valuer. SSAP 6 (Depreciation Accounting) states that deficit or surpluses on revaluation should be treated as movements on a separate revaluation reserve on an individual basis. A deficit arising on revaluation of an indi-

Note:

References are to sections in the *FASB Current Text*, unless otherwise noted.

<u>U.S. Generally Accepted Accounting Principles</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
6. Are nonmonetary transactions that culminate an earnings process accounted for on the basis of the fair market value of the assets involved when that value is determinable within reasonable limits? (N35)	No	✓			vidual asset (to the extent not covered by reserve arising on a previous revaluation of the same asset) should be charged to the profit and loss account. SSAP 13 (Accounting for Investment Properties) states that changes in the value of investment properties should be treated as movements on an investment property revaluation reserve unless the total of this reserve is insufficient to cover a deficit on a portfolio basis, in which case the amount in deficit should be charged to the profit and loss account.
7. Is revenue recognized when it is earned and its realization is reasonably assured (rather than when money is received)? (Statement of Financial Accounting Concepts No. 5)	No	✓			

8. Are costs recorded when incurred rather than when money is paid? (Statement of Financial Accounting Concepts No. 5) ✓
8. The accrual concept is regarded as one of the fundamental accounting concepts.
9. A. Are consolidated financial statements required when one company has control over another company? (C51) ✓
- B. Is control usually indicated by ownership of over fifty percent of the outstanding voting shares? If not, how is control indicated? ✓
10. A. Are there instances when an entity would not be consolidated even though control is present? (C51) ✓
- B. If so, list them.
- 10B.
- When the activities of the subsidiaries are so dissimilar as to those of other companies within the group
 - When the subsidiaries operate under severe restrictions which significantly impair control by the holding company over the subsidiaries' assets and operations for the foreseeable future
 - When control is intended to be temporary
 - Elective if controlling company itself is 100% owned by another company
- Yes. SSAP 1. ✓
- Yes. SSAP 7. ✓
- Yes. SSAP 7. ✓
- Yes. SSAP 7. ✓

<u>U.S. Generally Accepted Accounting Principles</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
11. If consolidation is not otherwise appropriate, is the equity method used for unconsolidated subsidiaries, corporate joint ventures, and other investees, if the investments give the investor the ability to exercise significant influence over the investees' operating and financial policies? (182)	Yes. SSAP 7.				<p>—When a subsidiary is excluded from consolidation on the grounds of lack of effective control it is recommended that it be dealt with in the consolidated financial statements under the equity method of accounting.</p> <p>—When a subsidiary is excluded from consolidation due to dissimilarity in nature of business, the group accounts should include separate financial statements for that subsidiary.</p> <p>—When excluded on the basis of temporary control or severe restrictions which impair control, the investment in subsidiary is presented in the balance sheet at lower of cost or market.</p>

- | | | | |
|---|--|---|--|
| 12. Are there two methods of accounting for business combinations: the pooling of interests method and the purchase method? (B50) | No | ✓ | 12. Hong Kong does not have an accounting standard regarding accounting for merger and acquisition. It does, however, prescribe procedures to use in allocating purchase consideration for purchased subsidiaries (p. 29 of SSAP 7). |
| 13. Is the method used to account for a business combination disclosed? (B50) | No | ✓ | |
| 14. A. Do criteria exist for treatment of business combinations as poolings of interests? (B50)
B. If so, list the criteria. | No | ✓ | |
| 15. A. Is goodwill arising from a business combination accounted for as an asset? (I60) | Yes. Accounting Guideline 2.204 on Goodwill. | ✓ | 15A. There are various treatments of goodwill—
• As a permanent intangible asset except when there is a permanent impairment in the value.
• Amortization over a defined period.
• Write it off at the time of acquisition either to reserves or to the profit and loss account as an extraordinary item. |
| B. If so, is it amortized as a charge to income over the period estimated to be benefited? | Yes. Accounting Guideline 2.204 on Goodwill. | ✓ | |

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
16. Are the following disclosures made for related party transactions: (R36)	No		✓		16a-d. Not very common although some major accounting firms encourage such disclosures. There is a paper presently under discussion concerning audit implications in respect of related party transactions.
a. the nature of the relationship?	No		✓		
b. a description of the transactions for the periods presented?	No		✓		
c. the amounts of the transactions for the periods presented?	No		✓		
d. the amounts due to or from related parties at the balance sheet date?	No		✓		
17. Is an estimated loss from a loss contingency accrued only if it is probable that an asset has been impaired or a liability incurred and the amount of loss can be reasonably estimated? (C59)	Yes. SSAP 8.	✓			17. Provision is made for all known liabilities whether the amount of these is known with certainty or can only be estimated.
18. If a loss contingency is not accrued because both conditions for accrual listed in question 17 are not met, is disclosure of the contingency required when there is at least a reasonable possibility that a loss may have been incurred? (C59)	Yes. SSAP 8 and Tenth Schedule of the Companies Ordinance.	✓			

<p>19. Are guarantees of the indebtedness of others or other loss contingencies disclosed in financial statements even though the possibility of loss may be remote? [In the U.S., guarantees are usually disclosed as loss contingencies even if the possibility of loss is remote.] (C59)</p>	<p>Yes. SSAP 8 and Tenth Schedule of the Companies Ordinance.</p>	<p>✓</p>
<p>20. Are the following items disclosed in an enterprise's financial statements for each industry segment: (S20)</p>	<p>20. Listed companies only—requirement to disclose segment turnover and contribution to trading results (turnover less expenses) only—also geographically.</p>	<p>✓</p>
<p>a. sales to outsiders and intersegment sales?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>b. operating profit or loss?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>c. identifiable assets and related depreciation, depletion, and amortization expense?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>d. capital expenditures?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>e. equity in net income and net assets of unconsolidated subsidiaries and other investees?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>f. effect of a change in accounting principle?</p>	<p>Yes. Accounting Guideline 2.206.</p>	<p>✓</p>
<p>21. A. Are there any requirements to disclose the effects of inflation? (C27)</p>	<p>No</p>	<p>✓</p>
<p>B. If so, list the disclosures required.</p>		

<u>U.S. Generally Accepted Accounting Principles</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
22. Are assets segregated into current and noncurrent classifications with a total for current assets presented? (B05)	Yes. In accordance with Companies Ordinance.	✓			22. See paragraph 52 of text.
23. A. Are noncurrent assets those not expected to be realized within one year or the current operating cycle? (B05)	No	✓			23A. Though not statutorily defined, noncurrent assets are generally defined as those not expected to be realized within one year or the current operating cycle. See paragraph 52 of text.
B. If not, how are noncurrent assets defined?					
24. A. Is an allowance established for uncollectible receivables? (C59)	No	✓			24A. In general accepted accounting practice, an allowance is established for receivables where collection is deemed doubtful.
B. If so, what is the basis (e.g., percentage of sales, aging of receivables, etc.) for calculating the allowance?					
25. Are receivables and payables, not arising in the normal course of business or subject to normal trade terms, recorded at an amount which takes imputed interest into account? (I69)	No			✓	

26. A. Is inventory stated at the lower of cost or market (or net realizable value)? (178) Yes. SSAP 3. ✓
 B. If not, how is inventory stated?
 C. Is the basis disclosed? Yes. SSAP 1. ✓
27. Does cost for inventory purposes include: (178)
a. materials? Yes. SSAP 3. ✓
b. direct labor? Yes. SSAP 3. ✓
c. factory overhead? Yes. SSAP 3. ✓
d. if the answer to *c.* is yes, is an allocable share of all factory overhead included? Yes. SSAP 3. ✓
28. A. Are the following cost methods permitted for reporting purposes: (178)
a. first-in, first-out (FIFO)? Yes. SSAP 3. ✓
b. last-in, first-out (LIFO)? Yes. SSAP 3. ✓
c. average cost? Yes. SSAP 3. ✓
 B. Are the same methods permitted for tax purposes? Yes ✓
29. Is the inventory costing method used disclosed? (178) Yes. SSAPs 1 and 3. ✓
- ✓
- 28A, B. Statement of Standard Accounting Practice 3 on Stocks and Work-in-Progress requires disclosure of policies which have been used in calculating cost. Management must exercise judgment to ensure that the methods chosen provide the fairest practicable approximation to actual cost. "Last-in, first-out" costing method does not usually satisfy such approximation. Taxation authorities do not usually approve the replacement method.

<u>U.S. Generally Accepted Accounting Principles</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
30. A. Are fixed assets depreciated over their estimated useful lives by systematic charges to income? (D40)	Yes. SSAP 6.	✓			
B. If so, is an accumulated depreciation account used?	Yes	✓			30B. A provision for depreciation account is used.
31. Are disclosures made of: (D40)					
a. depreciation expense for the period?	Yes. SSAP 6 and Tenth Schedule of Companies Ordinance.	✓			
b. balances of major classes of depreciable assets?	Yes. SSAP 6 and Tenth Schedule of Companies Ordinance.	✓			
c. the methods used to compute depreciation for the major asset classes?	Yes. SSAP 6 and Tenth Schedule of Companies Ordinance.	✓			
d. accumulated depreciation, either by major class of assets or in total?	Yes. SSAP 6 and Tenth Schedule of Companies Ordinance.	✓			

<p>32. A. Do criteria exist for classifying leases as operating leases? (L10)</p> <p>B. If so, list the criteria and disclosure requirements.</p>	<p>Yes. SSAP 14.</p>	<p>✓</p>	<p>32A,B. The standard gives the definition of operating lease as a lease other than a finance lease, and a finance lease is one that transfers substantially all the risks and reward of ownership of an asset to the lessee.</p> <p>33A,B. See above.</p>
<p>33. A. Do criteria exist for classifying leases as other than operating leases for the lessor and lessee? (L10)</p> <p>B. If so, list the criteria, type of lease, and disclosure requirements.</p>	<p>Yes. SSAP 14.</p>	<p>✓</p>	
<p>34. Are liabilities segregated into current and noncurrent classifications with a total for current liabilities presented? (B05)</p>	<p>No special requirement or pronouncement although Companies Ordinance requires appropriate reclassification.</p>	<p>✓</p>	<p>34. The general practice is to segregate liabilities into current and noncurrent classifications. See paragraph 52 of text.</p>
<p>35. A. Are noncurrent liabilities those whose liquidation is not expected to require the use of current assets or the creation of current liabilities? (B05)</p> <p>B. If not, how are noncurrent liabilities defined?</p>	<p>No</p>	<p>✓</p>	<p>35A,B. Though not defined, noncurrent liabilities are generally regarded as those not falling due within twelve months from the balance sheet date.</p>

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
<p>36. For notes payable, is disclosure made of: (C59 and Statement of Financial Accounting Concepts No. 5)</p> <p>a. interest rates?</p> <p>b. maturities?</p> <p>c. assets pledged as collateral?</p> <p>d. covenants to reduce debt?</p> <p>e. minimum working capital requirements?</p> <p>f. dividend restrictions?</p>	<p>Yes. Companies Ordinance.</p> <p>Yes. Companies Ordinance.</p> <p>Yes. Companies Ordinance.</p> <p>Yes, if applicable.</p> <p>Yes, if applicable.</p> <p>Yes, if applicable.</p> <p>Yes. SSAP 3.</p>	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>			<p>36. For loans, any part of which has more than 5 years to run, disclosure is required of the repayment terms and the rate of interest in the financial statements.</p>
<p>37. A. For long-term construction-type contracts, are the percentage-of-completion and completed-contract methods used? (C04)</p> <p>B. If so, what are the criteria for determining the method to be used?</p>	<p>No special requirement or pronouncement.</p> <p>See Comment.</p>	<p>✓</p>		<p>✓</p>	<p>37A, B. Statement of Standard Accounting Practice 3 states use percentage-of-completion unless outcome is uncertain and therefore prudent not to recognize income. Losses always recognized immediately.</p> <p>38A. Various treatments exist.</p> <p>38B. Not disclosed, unless they are extraordinary or exceptional by their size and incidence.</p>
<p>38. A. Are research costs charged to expense when incurred? (R50)</p> <p>B. Are such costs disclosed?</p>	<p>No special requirement or pronouncement.</p> <p>See Comment.</p>	<p>✓</p>		<p>✓</p>	<p>38A. Various treatments exist.</p> <p>38B. Not disclosed, unless they are extraordinary or exceptional by their size and incidence.</p>

<p>39. A. Are development costs charged to expense when incurred? (R50) B. Are such costs disclosed?</p>	<p>No See Comment.</p>	<p>✓ ✓</p>	<p>39A. Various treatments exist. 39B. Not disclosed unless they are extraordinary or exceptional by their size and incidence.</p>
<p>40. A. In the U.S., events and transactions are presented in the income statement as extraordinary items when they are unusual in nature and are of the type that would not reasonably be expected to recur in the foreseeable future. Do similar criteria for identifying extraordinary items exist in your country? (117) B. If no, what are the criteria?</p>	<p>Yes. SSAP 2.</p>	<p>✓</p>	<p>40A. Extraordinary items are those items that derive from events or transactions outside the ordinary activities of the business and that are both material and expected not to recur frequently or regularly.</p>
<p>41. Are material events or transactions that are unusual in nature or expected to occur infrequently but not both (and thus do not meet the criteria for classification as extraordinary) shown as a separate component of income or expense? (122)</p>	<p>Yes. Tenth Schedule of the Companies Ordinance.</p>	<p>✓</p>	<p>41. Items which, though abnormal in size and incidence, are not extraordinary items since they derive from the ordinary activities of the business, may require separate disclosure to fulfill the requirements for the financial statements to show a true and fair view.</p>
<p>42. A. Are disclosures required for: a. extraordinary items? (117) b. material events or transactions not classified as extraordinary items? (122)</p>	<p>Yes. SSAP 2. Yes. SSAP 2.</p>	<p>✓ ✓</p>	

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
<p>c. disposal of a segment of a business? (I13)</p>	<p>Yes. SSAP 2.</p>	<p>✓</p>			<p>42c. It is not specifically stated in Statement of Standard Accounting Practice 2 that disposal of a segment of a business is required to be disclosed but since in most cases such event will constitute an extraordinary item, disclosure would normally be made.</p>
<p>B. Indicate the financial statement presentation of these items.</p>					<p>42B. To disclose: —profit before extraordinary items —extraordinary items (less tax-ation attributable thereto) —profit after extraordinary items Other material events or transactions could be disclosed as an exceptional item or otherwise in a footnote to the financial statements.</p>
<p>43. A. Are pension costs provided for covered employees over the term of employment? (P15)</p>	<p>No</p>				<p>43A. Not many enterprises establish pension schemes (plans) for their staff—there are no accounting standards in respect of accounting for employee pension costs.</p>
<p>B. If so, do they include charges for costs assigned under the actuarial method used to years prior to the plan's inception?</p>					<p>43B. Due to the absence of any standard, various treatments exist.</p>

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| <p>44. A. Are specific disclosures required relating to pension plans? (P15)
 B. If so, list them.</p> | No | ✓ |
| <p>45. A. When accounting income and taxable income differ, are deferred income taxes recorded for differences (as opposed to permanent differences)? (124)
 B. If so, are deferred taxes provided for all timing differences (as opposed to only those meeting certain criteria)?
 C. If deferred taxes are provided only for those timing differences meeting certain criteria, what are the criteria?</p> | Yes. SSAP 12. | ✓ |
| <p>B. If so, are deferred taxes provided for all timing differences (as opposed to only those meeting certain criteria)?</p> | Yes. SSAP 12. | ✓ |
| <p>46. A. Are deferred taxes determined on the basis of tax rates in effect at the time the difference originated? (124)
 B. If not, on what basis?</p> | Yes. SSAP 12. | ✓ |
| <p>47. A. Is specific information related to income taxes required to be disclosed? (128)
 B. If so, list the requirements.</p> | Yes. Tenth Schedule of the Companies Ordinance. | ✓ |
- 45A. The accounting standard (SSAP 12) requires deferred tax accounting using the liability method, if it is probable that a liability or asset will crystallize.
- 45B,C. For those expected to reverse and for which a liability or asset is expected to crystallize.
- 46B. Rate expected when timing rate reverses.
- 47A,B. It is required to disclose (a) Hong Kong tax and basis of computation and (b) overseas tax and any special circumstances affecting liability to taxation for the period or succeeding periods. Substantial additional disclosure is required in SSAP 12.

U.S. Generally Accepted Accounting Principles	Required by Government or Professional Pronouncement	Predominant Practice	Minority Practice	Not Done	Comments
48. A. Are operating losses reported on the income tax return allowed to be carried backward to earlier periods? (137)	No. Inland Revenue Ordinance.			✓	48A. Tax losses as agreed by the Inland Revenue Department (IRD) can only be used to set off assessable profit in future periods.
B. If so, are the tax effects of a loss carryforward included in the income in the period?					
49. A. Are operating losses reported on the income tax return allowed to be carried forward? (137)	Yes. Inland Revenue Ordinance.	✓			49A. Tax losses as agreed by the IRD can be used to set off assessable profit in future periods.
B. If so, are the tax effects of a loss carryforward included in the income in the period realized?					49B. Yes, they are currently included as a reduction of profits tax for the period—not considered an extraordinary item.
50. Are financial statements of a foreign entity prepared for consolidation purposes measured in the currency of the primary economic environment in which the entity operates? (F60)	Yes. SSAP 11.	✓			50. Under SSAP 11, when preparing group accounts for an investing company and its foreign subsidiaries, the closing rate method of translating the financial statements should normally be used. Under this method, amounts in the balance sheet of a foreign subsidiary should be translated into the investing company's reporting currency using the closing rate of exchange.

The profit and loss account of a foreign subsidiary should be accounted for under the closing rate method or at an average exchange rate for the period. In those circumstances when the trade of the foreign subsidiary is more dependent on the economic circumstances of the investing company's reporting currency than on its own reporting currency, the temporal method should be used; for example, all assets, liabilities, revenue and expenses are translated at the exchange rate ruling at the date on which the amount recorded in the financial statements was established. At the balance sheet date, monetary assets and liabilities are retranslated at the closing rate. See paragraphs 79 through 84 of text.

51. Transactions are translated at transaction rates. Generally many assets and liabilities are translated at closing rates. See paragraphs 79 through 84 of text.

52A. The following information is to be disclosed:



Yes. SSAP 11.

51. Are all elements of financial statements translated at current exchange rates? (F60)



Yes. SSAP 11.

52. A. Are translation adjustments reported separately? (F60)

<u>U.S. Generally Accepted Accounting Principles</u>	<u>Required by Government or Professional Pronouncement</u>	<u>Predominant Practice</u>	<u>Minority Practice</u>	<u>Not Done</u>	<u>Comments</u>
B. Are they accumulated in a separate component of stockholders' equity until ultimately realized?	Yes. SSAP 11.	✓			<ul style="list-style-type: none"> • The net amount of exchange gains and losses on foreign currency borrowings identifying separately the amount offset in exchange reserve under the cover principle and the net amount charged/credited to the profit and loss account • The net amount of exchange gains or losses on forward contracts, together with the associated discount or premium on these contracts offset in the exchange reserves under the cover principle • The net movement on reserves arising from exchange differences • Movements of reserve account
C. Is there an analysis of the changes during the period in the component of stockholders' equity relating to translation adjustments?	Yes. SSAP 11.	✓			52C. Where the translation adjustments are to be taken to reserve in accordance with the Standard. See paragraphs 79 through 84 of text.

53. A. Are gains and losses resulting from transactions, denominated in a currency other than that of the environment in which the entity operates, included in determining net income for the period in which the exchange rate changes? (F60) Yes. SSAP 11. ✓
- B. Is the aggregate transaction gain or loss included in determining net income for the period disclosed in the financial statements or notes? No ✓
54. Are gains or losses on foreign currency transactions that are intended to hedge a foreign currency commitment deferred and included in the related transaction? (F60) Yes. SSAP 11. ✓
55. What information is disclosed about foreign currency restrictions? No ✓
56. Are significant events arising subsequent to the balance sheet date reflected in the financial statements or notes thereto? Yes. SSAP 9. ✓
57. Please list any standards for Hong Kong for which there are no corresponding U.S. standards. 57. None.
- 53B. Not statutorily required to disclose the amount of exchange difference arising during the period but it will be disclosed if it is extraordinary or exceptional by its size and incidence. ✓
55. If the effect of the restriction is material to the financial statements it would be mentioned. ✓

Bibliography

The information in this booklet was compiled from many sources in Hong Kong. Significant references follow.

- Companies Ordinance (reprinted August 1984)
- Inland Revenue Ordinance
- Hong Kong Society of Accountants
 - Auditing Standards and Guidelines
 - Statements of Standard Accounting Practice and Accounting Guidelines
- Stock Exchange: Rules governing the official listing of securities
- Securities (Stock Exchange Listing) Rules 1986

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