Financial Reporting Update 2011

27 August 2011

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Effective for 2010 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• HKFRS 1 (Revised) *First-time Adoption of HKFRS*	➢ 1 Jul. 2009
• Amendments to HKFRS 1 *Additional Exemptions for First-time Adopters*	➢ 1 Jan. 2010
• Amendments to HKFRS 2 *Share-based Payment – Group Cash-settled Share-based Payment Transactions*	➢ 1 Jan. 2010
• HKAS 27 (Revised) *Consolidated and Separate Financial Statements*	➢ 1 Jul. 2009
• HKFRS 3 (Revised) *Business Combination*	➢ 1 Jul. 2009
• Amendments to HKAS 39 *Eligible Hedged Items*	➢ 1 Jul. 2009
• HK(IFRIC) 17 *Distributions of Non-cash Assets to Owners*	➢ 1 Jul. 2009
• HK(IFRIC) 19 *Extinguishing Financial Liabilities with Equity Instruments*	➢ 1 Jul. 2010
• Annual Improvements to HKFRSs 2009	➢ 1 Jan. 2010 & etc.
• Amendments to HK Interpretation 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*	➢ Not specified
• HK Interpretation 5 *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause*	➢ Immediate effect
• *HKFRS for Private Entities (or IFRS for SME)*	➢ Effective upon issue

Updated to HKICPA Update No. 107 of 14 July 2011

Effective for 2011 Dec. Year-End

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• Amendments to HKAS 32 *Classification of Rights Issues*	➢ 1 Feb.2010
• HKAS 24(Revised) *Related Party Disclosures*	➢ 1 Jan. 2011
• Amendments to HK(IFRIC) 14 *HKAS 19 —The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	➢ 1 Jan. 2011
• Amendment to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards – Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters*	➢ 1 Jul. 2010
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• AB 4 *Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance*

Effective after 2011 Dec. Year-End

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• Amendments of HKAS 12 *Deferred Tax: Recovery of Underlying Assets*	➢ 1 Jan. 2012
• HKFRS 9 *Financial Instruments (with financial liabilities)*	➢ 1 Jan. 2013
• HKFRS 10 *Consolidated Financial Statements*	➢ 1 Jan. 2013
• HKFRS 11 *Joint Arrangements*	➢ 1 Jan. 2013
• HKFRS 12 *Disclosure of Interests in Other Entities*	➢ 1 Jan. 2013
• HKFRS 13 *Fair Value Measurement*	➢ 1 Jan. 2013
• HKAS 1 (revised) *Presentation of Items of OCI*	➢ 1 Jul. 2012
• HKAS 19 (revised) *Employee Benefits*	➢ 1 Jan. 2013

Today's Agenda

Brief Recap of Amendments to HKFRS effective for 2010/11

Update of Amendments to HKFRS effective for 2011/12

Update of Amendments to HKFRS/IFRS effective after 2011/12

Effective for 2010 Dec. Year-End

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蘋果日報（2011.5.28）

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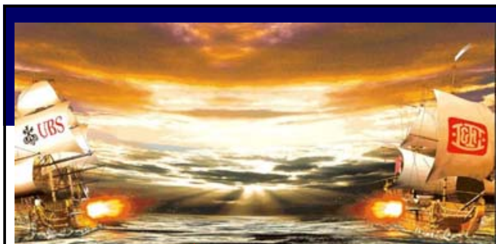

UBS Securities Asia Ltd. states that

- The accounting rule states <u>all payments to purchase a business</u> are to be <u>recorded at fair value</u> <u>at the acquisition date</u>, with *<u>contingent payments</u>* <u>classified as debt</u> (under balance of purchase consideration <u>payable</u>), *<u>subsequently remeasured through the consolidated profit and loss account</u>*. (25.5.2011)

Method of accounting

Application of the method

– Contingent consideration shall be measured at fair value

Li & Fung issued a clarification announcement on 27.5.2011 and stated:

- It is stated on page 11 of the Report that …… "L&F has recently adopted a new accounting rule, HKFRS 3 (revised). This potentially allows companies to convert earn-out payments to earnings".
- These statements *<u>are misleading</u>* …… It is not optional ……

UBS Securities Asia Ltd. states:

- Under the new accounting rule, *goodwill* associated with the acquired operation *will not be impaired* …… (See the appendix section for more detail)
- …… *goodwill* is *not tested annually for impairment* or *when there are indications of impairment*. (25.5.2011)

Method of accounting

– Non-controlli
measured at

– Goodwill can incorporate the goodwill of non-

Li & Fung clarified on 27.5.2011 that:

- It is also stated on page 23 of the Report that "goodwill is not tested annually for impairment or when there are indications of impairment".
- These statements *are all fundamentally incorrect*.

HKFRS 3 (revised 2007) states:

- The acquirer measures goodwill at the amount recognised at the acquisition date ***less any accumulated impairment losses***.
- **HKAS 36 *Impairment of Assets*** prescribes the accounting for impairment losses.

(HKFRS 3.63a)

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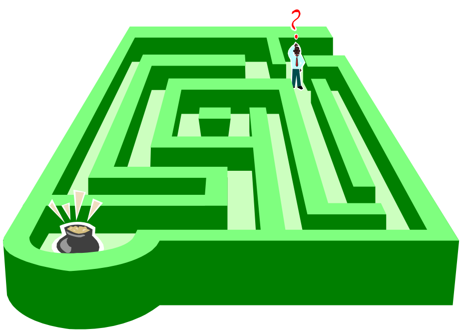
Classification of Rights Issues

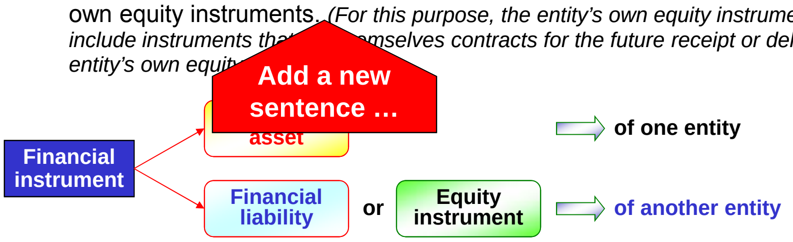
(Amendments to HKAS 32)



Definitions – Financial Instruments

Financial liability is any liability that is

- A contractual right
  - i) to <u>deliver</u> cash or another financial asset from another entity
  - ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially <u>unfavourable</u> to the entity
- A contract that will or may settled in the entity's own equity instruments and is
  - i) a <u>non-derivative</u> for which the entity is or may be obliged to <u>deliver</u> a <u>variable number</u> of the entity's own equity instruments; or
  - ii) a <u>derivative</u> that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. *(For this purpose, the entity's own equity instruments do not include instruments tha… mselves contracts for the future receipt or delivery of the entity's own equit…*



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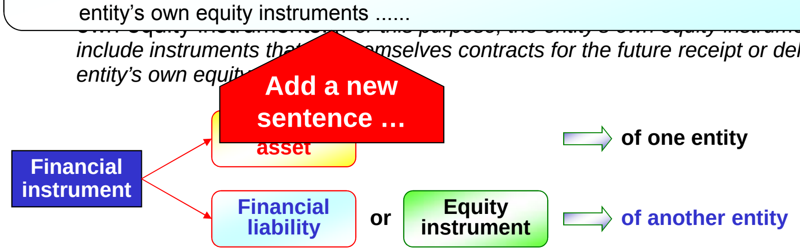
Definitions – Financial Instruments

Financial liability is any liability that is

- A contract that will or may be settled in the entity's own equity instruments and is:
  - i. a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For <u>this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also for these</u> purposes the entity's own equity instruments ......

include instruments tha… mselves contracts for the future receipt or delivery of the entity's own equit…



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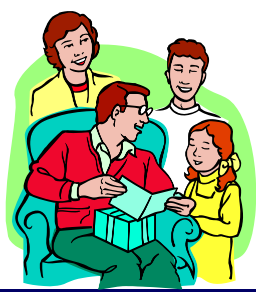
Related Party Disclosures
(HKAS 24)

Key Amendments

- Related party – Definition change
- Government-related entities – Definition and Exemption
- Commitment is included for disclosure



Definition of a Related Party

- A **related party** is a person or entity that is related to the entity that is preparing its financial statements (i.e. reporting entity).
  - a) A person or a close member of that person's family is related to a reporting entity if that person:
    - i. has control or joint control over the reporting entity;
    - ii. has significant influence over the reporting entity; or
    - iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

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Definition of a Related Party

- A **related party** is a person or entity that is related to the entity that is preparing its financial statements (i.e. reporting entity).
  - b) An entity is related to a reporting entity if any of the following conditions applies:
    - i. The entity and the reporting entity are members of the same group (which means that each parent, sub. and fellow sub. is related to the others).
    - ii. One entity is an associate or JV of the other entity (or an associate or JV of a member of a group of which the other entity is a member).
    - iii. Both entities are JV of the same third party.
    - iv. One entity is a JV of a third entity and the other entity is an associate of the third entity.
    - v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
    - vi. The entity is controlled or jointly controlled by a person identified in (a).
    - vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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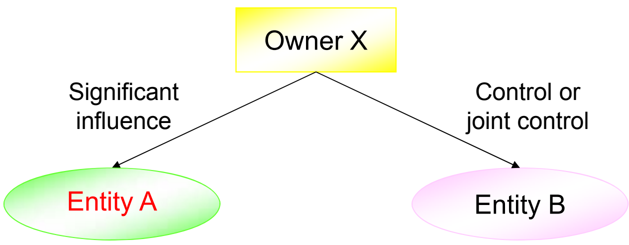
Definition of a Related Party – Key Changes

- Clearly separate the related party to 2 angles:
  1) Person (replaced "individual" as well), and
  2) Entity
- Eliminate inconsistencies in the definition and make it symmetrical:
  – When Entity A is identified as a related party in Entity B's financial statements, Entity B will also be identified as related party in Entity A's financial statements.
- Entities with only "common significant influence" (no matter from an entity or a person) are not related to each other
- However, whenever a person or entity has both
  – joint control over Entity X and
  – joint control or significant influence over Entity Y,
    ➢ Entity X and Y are related to each other.

Definition of a Related Party – Key Changes

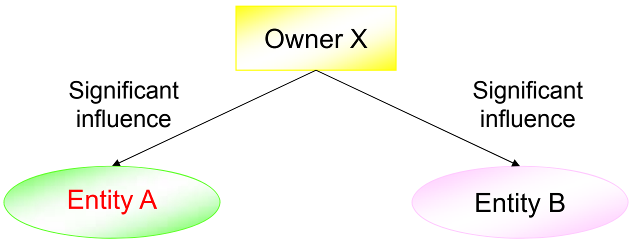
Example



- Entity A and Entity B are related to each other in both Entity A's and Entity B's financial statements
- Previously, they are not regarded as related parties.

Definition of a Related Party – Key Changes

Example



- Entity A and Entity B are not related to each other in both Entity A's and Entity B's financial statements

Definition of a Related Party – Key Changes

- Remove the term "significant voting power" in the definition of a related party
- Clarify that
  - An associate includes subsidiaries of the associate and
  - A joint venture includes subsidiaries of the joint venture
  - Two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity.
- Amended that
  - Close members of the family of an individual are (not may) those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include (not "they may include" as in previous HKAS 24):
    - a) the person's children and spouse or domestic partner;
    - b) children of the person's spouse or domestic partner; and
    - c) dependants of that person or that person's spouse or domestic partner.

Disclosures – Government

- A reporting entity is exempt from the disclosure requirements of HKAS 24.18 in relation to related party transactions and outstanding balances, including commitments, with:
  a) a government that has control, joint control or significant influence over the reporting entity; and
  b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.
  (HKAS 24.25)

Disclosures – Government

- If a reporting entity applies the exemption in HKAS 24.25 (last slide), it shall disclose the following about the transactions and related outstanding balances referred to in HKAS 24.25:
  a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);
  b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
     i. the nature and amount of each individually significant transaction; and
     ii. for other transactions that are collectively, but not individually, significant,
        – a qualitative or quantitative indication of their extent.
        Types of transactions include those listed in HKAS 24.21. (HKAS 24.26)

Individually Significant

Collectively significant

Improvements to HKFRSs 2010

Introduction

- Annual Improvement Project
  - A vehicle for making non-urgent but necessary amendments to IFRS (and consequentially HKFRSs)
  - Introduced by the IASB in 2007 and issued each year
  - Improvement to HKFRSs 2010 is the one finalised in 2010
- The project has amended
  - 8 HKFRSs and 1 HK(IFRIC) Interpretations

Summary

Amendments to

HKFRS 1	First-time Adoption of Hong Kong Financial Reporting Standards
HKFRS 3	Business Combinations
HKFRS 7	Financial Instruments: Disclosures
HKAS 1	Presentation of Financial Statements
HKAS 21, 28 & 31	Transition requirements for amendments arising as a result of HKAS 27 Consolidated and Separate Financial Statements
HKAS 34	Interim Financial Reporting
HK(IFRIC)-Int 13	Customer Loyalty Programmes

Amendments to HKFRS 3

Do you remember the following requirements?

Non-Controlling Interests

- The acquirer shall measure the identifiable assets acquired and the liabilities assumed
  - at their acquisition-date fair values. (HKFRS 3.18)
- For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either
  - at fair value or — New alternative ("full goodwill method")
  - at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. (HKFRS 3.19) — Existing practice

Amendments to HKFRS 3

As Amended ……

Non-Controlling Interests

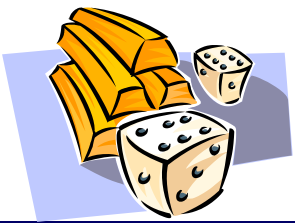
- For each business combination, the acquirer shall measure at the acquisition date components of non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either: *(Amended)*
  - a. fair value or *(No Change)*
  - b. the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets. *(Amended)*
- All other components of non-controlling interests shall be measured at *(Amended)*
  - their acquisition-date fair values,
    - unless another measurement basis is required by HKFRSs. (HKFRS 3.19)

e.g. preference share without any right on liquidation

Amendments to HKFRS 3

Share-based payment transaction under HKFRS 3

- The acquirer shall measure a liability or an equity instrument related to
  - share-based payment transactions of the acquiree or
  - the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the acquirer
    - in accordance with the method in HKFRS 2 *Share-based Payment* at the acquisition date.
      - (HKFRS 2 refers to the result of that method as the 'market-based measure' of the share-based payment transaction.) (HKFRS 3.30)



Amendments to HKFRS 3

Effective date

- An entity shall apply those amendments for annual periods beginning on or after 1 July 2010.
- Earlier application is permitted.
  - If an entity applies the amendments for an earlier period it shall disclose that fact.
- Application should be prospective from the date when the entity first applied this HKFRS. (HKFRS 3.64B)

Apply Prospectively

Amendments to HKFRS 3

Transition

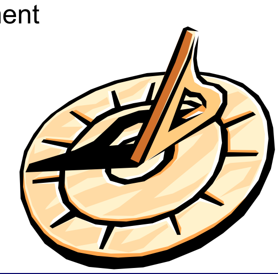
(for contingent consideration from a business combination that occurred before the effective date of revised HKFRS 3)

- Contingent consideration balances arising from business combinations whose acquisition dates preceded the date when an entity first applied HKFRS 3 as issued in 2008 shall not be adjusted upon first application of HKFRS 3.
- Paragraphs 65B–65E
  - shall be applied in the subsequent accounting for those balances (i.e. before effective date of revised HKFRS 3).
  - shall not apply to the accounting for contingent consideration balances arising from business combinations with acquisition dates on or after the date when the entity first applied HKFRS 3 as issued in 2008. (HKFRS 3.65A)

Amendments to HKFRS 3

Transition
(for contingent consideration from a business combination that occurred before the effective date of revised HKFRS 3)

- If a business combination agreement (those before effective date of revised HKFRS 3) provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall
  - include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment
    - is probable and
    - can be measured reliably. (HKFRS 3.65B)



Amendments to HKFRS 7

Nature and Extent of Risks

- Para. 32A is added for clarification of disclosure:
  - Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments.
  - The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks. (HKFRS 7.32A)

Amendments to HKFRS 7

Credit risk

Quantitative Disclosures

- An entity shall disclose by class of financial instrument:
  a) the amount that best represents its maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements (e.g. netting agreements that do not qualify for offset in accordance with HKAS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.
  b) a description of collateral held as security and of other credit enhancements, and their financial effect (eg a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).
  c) information about the credit quality of financial assets that are neither past due nor impaired.

Amendments to HKFRS 7

Effective date

- An entity shall apply those amendments for annual periods beginning on or after 1 January 2011.
- Earlier application is permitted.
  – If an entity applies the amendments for an earlier period it shall disclose that fact.
  (HKFRS 7.44L)

No specific transition stated

↓

Imply Retrospectively

Comparatives should be re-presented

Amendments to HKAS 1

Clarification of Statement of Changes in Equity

- HKAS 1.106(d) requires an entity to provide a reconciliation of changes in each component of equity.
- In *Improvements to HKFRSs* 2010, it clarified that entities may present the required reconciliations for each component of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements.
  - HKAS 1.106A is added and states that:
    - For each component of equity an entity shall present, either
      - in the statement of changes in equity or
      - in the notes,

      an analysis of other comprehensive income by item (see HKAS 1.106(d)(ii)). (HKAS 1.106A)

Amendments to HKAS 1

Clarification of Statement of Changes in Equity

- HKAS 1.106(d) states that:
  - for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:
    i. profit or loss;
    ii. other comprehensive income; and
    iii. transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control. (HKAS 1.106(d))

Amendments to HKAS 1

Effective date

- An entity shall apply those amendments for annual periods beginning on or after 1 January 2011.
- Earlier application is permitted. (HKAS 1.139F)

No specific transition stated

↓

Imply Retrospectively

Comparatives should be re-presented

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Recovery of Underlying Asset

(Amendments to HKAS 12 Income Tax)

Introduction

- HKAS 12 *Income Taxes* requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through
  - use or sale.
- It can be difficult and subjective to assess whether recovery will be through use or through sale
  - when the asset is measured using the fair value model in HKAS 40 Investment Property.
- The amendment provides a practical solution to the problem
  - by introducing a presumption that recovery of the carrying amount will, normally be, be through sale.

No such exemption for PPE using revaluation model under HKAS 16

Recovery of Underlying Asset

- If a deferred tax liability or asset arises from investment property that is measured using the **fair value model** in HKAS 40,
  - there is a **rebuttable presumption** that the carrying amount of the investment property will be recovered through sale.
- Accordingly, unless the presumption is rebutted,
  - the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property **entirely through sale**. (HKAS 12.51C)

i.e. no deferred tax is required when tax on sale is zero!

- This presumption is rebutted if the investment property
  - is depreciable and
  - is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.
- If the presumption is rebutted, the requirements of HKAS 12. 51 and 51A shall be followed.

Effective Date and Transition

- An entity shall apply the amendments for annual periods beginning on or after 1 January 2012.
- Earlier application is permitted.
- If an entity applies the amendments for an earlier period, it shall disclose that fact.

Amendments to HKAS 12

Case

Hysan 希慎

Financial Statements 2010

- Note 2 states "Amendments to HKAS 12 *Income Taxes*" as follows:
  - Amendments to HKAS 12 titled "Deferred Tax: Recovery of Underlying Assets" <u>have been applied in advance of their effective date</u> (annual periods beginning on or after 1 January 2012).
    - Under the amendments, investment properties that are measured using the fair value model in accordance with HKAS 40 "Investment Property" <u>are presumed to be recovered through sale</u>, unless the presumption is rebutted in certain circumstances.

Amendments to HKAS 12

Case

Hysan 希慎 **Financial Statements 2010**

- Note 2 states "Amendments to HKAS 12 *Income Taxes*" as follows:
  - As a result, the Group's investment properties that are measured using the fair value model have been presumed to be recovered through sale for the purpose of measuring deferred tax liabilities and deferred tax assets in respect of such properties.
    - This resulted in deferred tax liabilities being decreased by HK$3,409 million and HK$3,616 million as at 1 January 2009 and 31 December 2009 respectively, with the corresponding adjustment being recognised in retained profits.
  - In the current year, no deferred tax has been provided for in respect of changes in fair value of such investment properties, whereas previously deferred tax liabilities were provided for in relation to the changes in fair value of such investment properties.
    - The application of the amendments has resulted in profit for the year being increased by HK$426 million.

Financial Instruments

(HKFRS 9)

Chapters

1 Objective

2 Scope

3 Recognition and Derecognition

4 Classification

5 Measurement

6 Hedge Accounting *(not used yet)*

~~7 Disclosures *(not used yet)*~~

7 ~~8~~ Effective Date and Transition

Background

- Because of financial tsunami, the three main phases of the project to replace IAS 39 are:
  a) Phase 1: Classification and measurement of financial assets and financial liabilities.
  b) Phase 2: Impairment methodology.
  c) Phase 3: Hedge accounting.
- IFRS/HKFRS 9 issued so far includes only the chapters relating to Phase 1 (classification and measurement of financial assets and financial liabilities).

Additions of Financial Liabilities issued on 25 Nov. 2010 in HK

Chapter 1 and 2

Objective

- The objective of HKFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows. (para. 1.1)

Scope

- An entity shall apply HKFRS 9 to all assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*. (para. 2.1)

Chapter 3 Recognition & Derecognition

- An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when,
  - the entity becomes party to the contractual provisions of the instrument.
- When an entity first recognises a financial asset, it shall
  - **classify** it in accordance with paragraphs 4.1.1-4.1.5 and
  - **measure** it in accordance with paragraph 5.1.1 and 5.1.2.
- When an entity first recognises a financial liability, it shall
  - **classify** it in accordance with paragraphs 4.2.1 and 4.2.2 and
  - **measure** it in accordance with paragraph 5.1.1.

  (para. 3.1.1)

Same as before

Amended (Ch. 4 of HKFRS 9)

Amended (Ch. 5 of HKFRS 9)

Similar to HKAS 39

Same para. as financial assets

Chapter 3 Recognition & Derecognition

- A regular way purchase or sale of a financial asset
  - shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (see para. B3.1.3–B3.1.6).

    (para. 3.1.2)

Same as before

- Derecogition
  - In addition to the three phases described, the IASB published in March 2009 an ED Derecognition (proposed amendments to IAS 39 and IFRS 7).
  - However, in June 2010 the IASB
    - revised its strategy and work plan and
    - decided to retain the existing requirements in IAS 39 for the derecognition of financial assets and financial liabilities
    - but to finalise improved disclosure requirements. (para. IN8)

Chapter 4.1 Classification of FA

- Unless para. 4.1.5 of HKFRS 9 (so-called "fair value option") applies, an entity shall classify financial assets as subsequently measured at either
  - **amortised cost** or
  - **fair value**

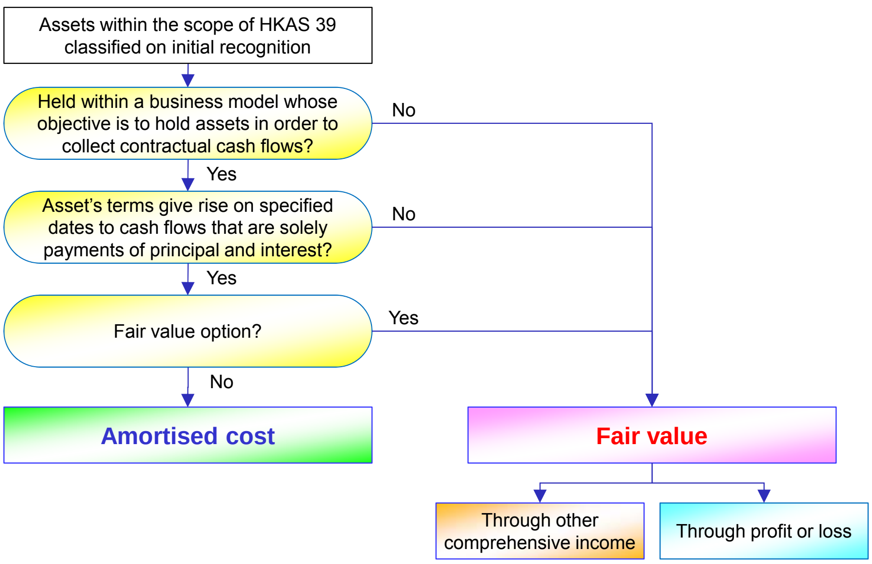
  on the basis of both:

  a) the entity's **business model** for managing the financial assets; and

  b) the **contractual cash flow characteristics** of the financial asset.
  (para. 4.1.1)

Amortised cost | **Fair value**

Chapter 4.1 Classification of FA



Chapter 4.1 Classification of FA

Assets within the scope of HKAS 39 classified on initial recognition

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

Yes

Amortised cost

- A financial asset shall be measured at **amortised cost** if both of the following conditions are met:
  a. the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.
  b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
  (para. 4.1.2)

Chapter 4.1 Classification of FA

Assets within the scope of HKAS 39 classified on initial recognition

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

No

Yes

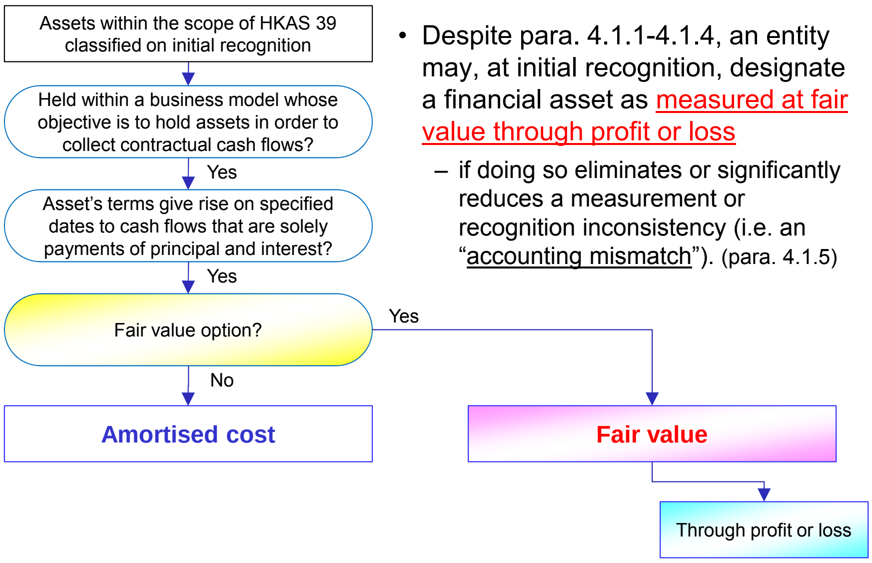
Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

No

- A financial asset shall be measured at **fair value**
  – unless it is measured at amortised cost in accordance with para. 4.1.2.
  (para. 4.1.4)

Fair value

Chapter 4.1 Classification of FA



- Despite para. 4.1.1-4.1.4, an entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss
  - if doing so eliminates or significantly reduces a measurement or recognition inconsistency (i.e. an "accounting mismatch"). (para. 4.1.5)

Chapter 4.1 Classification of FA

Case

香港交易所 HKEx

Financial statements 2009 states that:

- Following the adoption of HKFRS 9, investments and other financial assets of the Group extant at 31 December 2009 are classified under the following categories:

  Financial assets measured at amortised cost

  Investments are classified under this category if they satisfy both of the following conditions:

  - the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows for managing liquidity and generating income on its investment, but not for the purpose of realising fair value gains; and
  - the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, with interest being the consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and are unleveraged.

  Bank deposits, trade and accounts receivable and other deposits are also classified under this category.

Chapter 4.1 Classification of FA

Case

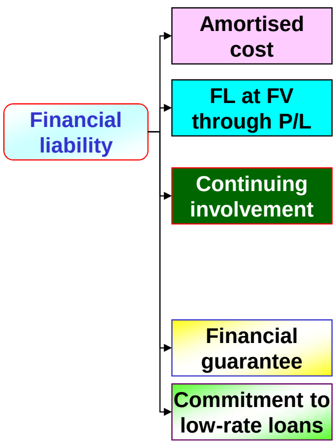
Financial statements 2009 states that:

Financial assets measured at fair value through profit or loss

Investments and other financial assets are classified under this category if they do not meet the conditions to be measured at amortised cost.

Securities or bank deposits with embedded derivatives are classified in their entirety as measured at fair value through profit or loss, where the economic characteristics and risks of the embedded derivatives are dissimilar to those of the host contracts and modify the contractual cash flows, such that they are not solely payments of principal and interest on the principal amount outstanding or the interest rate does not reflect only consideration for the time value of money and credit risk.

Chapter 4.2 Classification of FL



- An entity shall classify all financial liabilities as subsequently measured at amortised cost using the effective interest method, except for:
  a. financial liabilities at fair value through profit or loss.
  b. financial liabilities that arise
     - when a transfer of a financial asset does not qualify for derecognition or
     - when the continuing involvement approach applies.
  c. financial guarantee contracts.
  d. commitments to provide a loan at a below-market interest rate.
  (para. 4.2.1)

Chapter 4.3 Embeded Derivatives

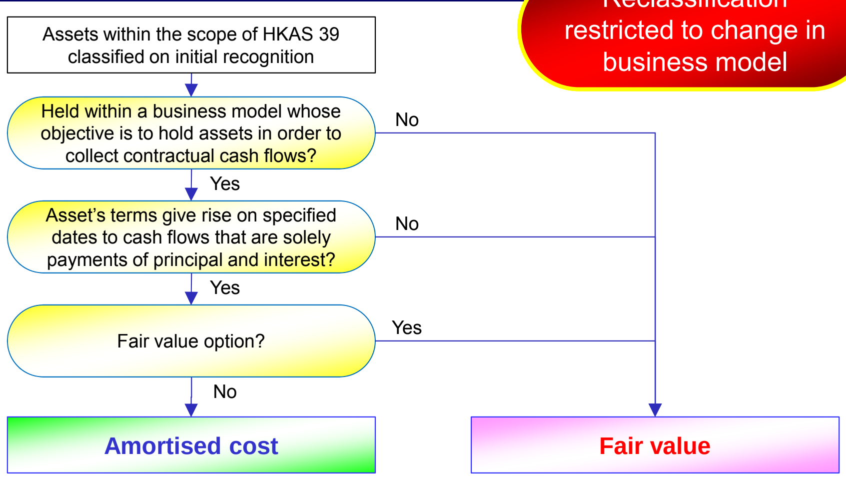
- If a hybrid contract contains a host that is an asset within the scope of HKFRS 9,
  - an entity shall apply the requirements in para. 4.1.1-4.1.5 (as discussed above) to the entire hybrid contract. (para. 4.3.2)
- If a hybrid contract contains a host that is not an asset within the scope of HKFRS 9,
  - an embedded derivative shall be separated from the host and accounted for as a derivative under HKFRS 9 if, and only if:
    - All 3 conditions are met (same as those set out in HKAS 39), including:
      a. Economic characteristics & risks not closely related
      b. Embedded derivative meets the definition of derivative
      c. Hybrid contract is not measured at FV through P/L. (para. 4.3.3)

Host is an assets within HKFRS 9

Other Contracts

Chapter 4.4 Reclassification

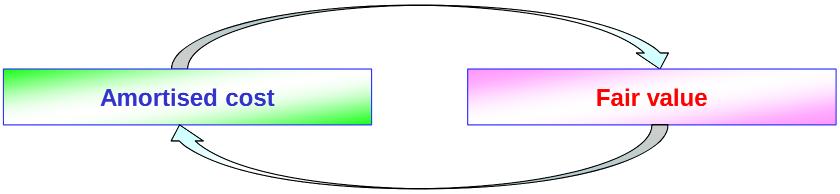
Reclassification restricted to change in business model



- When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with para. 4.1.1–4.1.4. (para. 4.4.1)

Chapter 4.4 Reclassification

- HKFRS 9 requires an entity to reclassify financial assets if the objective of the entity's business model for managing those financial assets changes.
  - Such changes are expected to be very infrequent.
  - Such changes
    - must be determined by the entity's senior management as a result of external or internal changes and
    - must be significant to the entity's operations and demonstrable to external parties. (para. B4.4.1)



Chapter 5 Measurement

Initial measurement (same as HKAS 39)

- At initial recognition, an entity shall measure a financial asset or financial liabilities at
  - its fair value plus or minus,
  - in the case of a financial asset or financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. (para. 5.1.1)

Initial Measurement
Fair Value
+
Transaction Cost

- When an entity uses settlement date accounting for an asset that is subsequently measured at amortised cost,
  - the asset is recognised initially at its fair value on the trade date (see para. B3.1.3–B3.1.6). (para. 5.1.2)

Chapter 5 Measurement

Subsequent Measurement of Financial Assets

- After initial recognition, an entity shall measure financial assets in accordance with para. 4.1.1 -4.1.5 (as discussed above) at
  - fair value or
  - amortised cost. (para. 5.2.1)
- An entity shall apply the impairment requirements of HKAS 39 to all financial assets measured at amortised cost. (para. 5.2.2)
  - ➢ No impairment requirements on financial assets measured at fair value
- An entity shall apply the hedge accounting requirements of HKAS 39 to a financial asset that is designated as a hedged item. (para. 5.2.3)

Amortised cost | **Fair value**

Chapter 5.7 Gains and Losses

Assets within the scope of HKAS 39 classified on initial recognition

↓

Held within a business model whose objective is to hold assets in order to collect contractual cash flows?

↓ Yes

Asset's terms give rise on specified dates to cash flows that are solely payments of principal and interest?

↓ Yes

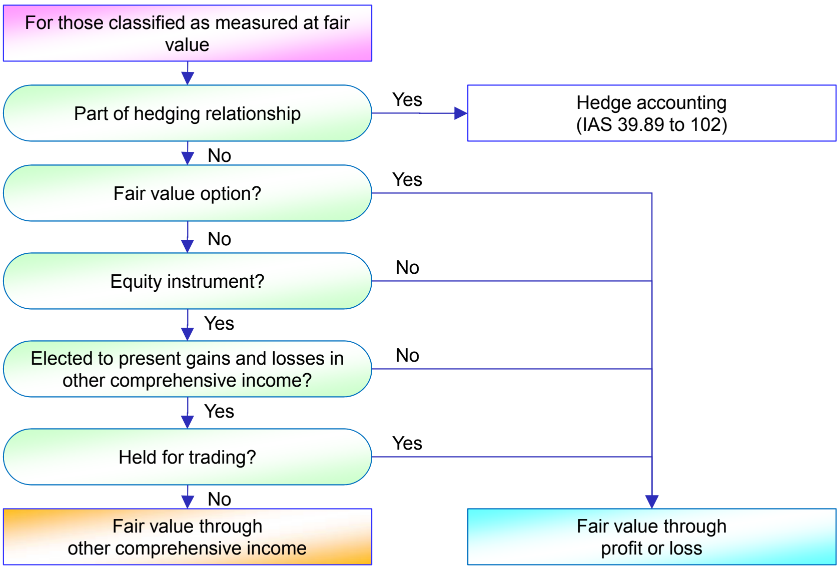
Fair value option?

↓ No

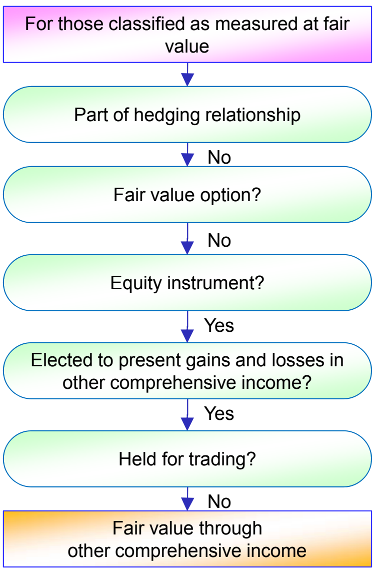
Amortised cost

- A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship
  - shall be recognised in profit or loss
    - when the financial asset is derecognised, impaired or reclassified, and through the amortisation process. (para. 5.7.2)

Chapter 5.7 Gains and Losses



Chapter 5.7 Gains and Losses

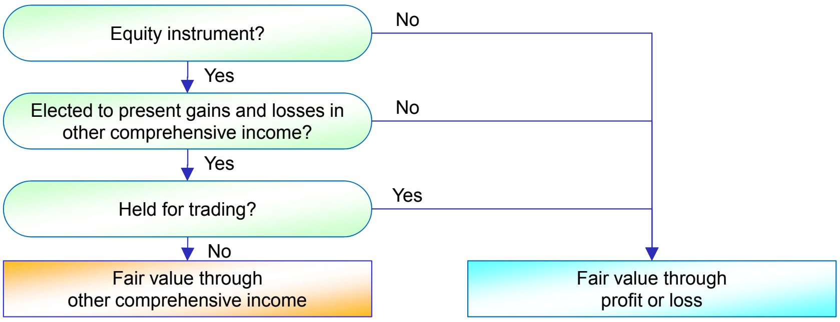


- A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in **profit or loss** unless
  a. It is part of a hedging relationship
  b. the financial asset is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income ……
  (para. 5.7.1)

Fair value through profit or loss

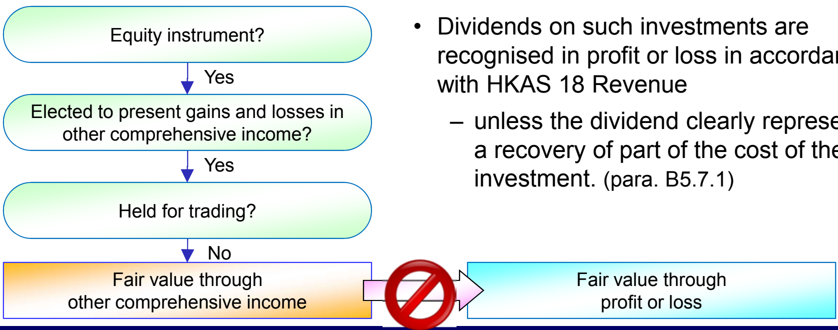
Chapter 5.7 Gains and Losses

- At initial recognition, an entity may make an irrevocable election to
  - present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of HKFRS 9 that are not held for trading. (para. 5.7.5)
- If an entity makes such election, it shall recognise in profit or loss dividends from that investment when the entity's right to receive payment of the dividend is established in accordance with HKAS 18 *Revenue*. (para. 5.7.6)



Chapter 5.7 Gains and Losses

- Such irrevocable election (presenting fair value changes in OCI)
  - is made on an instrument-by-instrument (ie share-by-share) basis.
- Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss.
  - However, the entity may transfer the cumulative gain or loss within equity (e.g.. transfer between reserves).

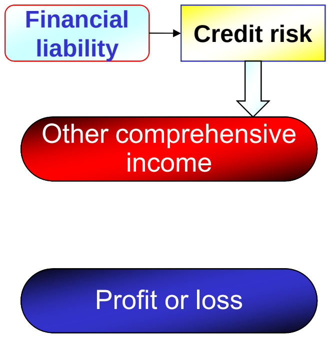


- Dividends on such investments are recognised in profit or loss in accordance with HKAS 18 Revenue
  - unless the dividend clearly represents a recovery of part of the cost of the investment. (para. B5.7.1)

Chapter 5.7 Gains and Losses

- An entity shall present a gain or loss on a financial liability designated as at fair value through profit or loss as follows:
  a. The amount of change in the fair value of the financial liability that is attributable to <u>changes in the credit risk of that liability shall be presented in other comprehensive income</u> (see para. B5.7.13–B5.7.20), and
  b. the <u>remaining amount of change in the fair value</u> of the liability shall be <u>presented in profit or loss</u>

  unless
  – the treatment of the effects of changes in the liability's credit risk described in (a) would <u>create or enlarge an accounting mismatch in profit or loss</u> (in which case paragraph 5.7.8 applies). (para. 5.7.7)



In that case, an entity shall present all gains or losses on that liability in profit or loss (para. 5.7.8)

Chapter 7 Effective Date & Transition

<u>Effective date</u>

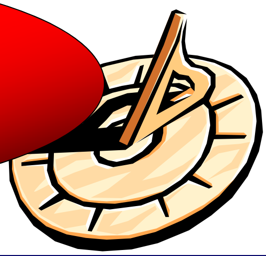
- An entity shall apply HKFRS 9 for annual periods beginning <u>on or after 1 January 2013</u>.
- Earlier application is permitted.
- However, if an entity elects to apply HKFRS 9 early and has not already applied HKFRS 9 issued in 2009, it must apply all of the requirements in HKFRS 9 at the same time (but see also para. 7.3.2).
- If an entity applies HKFRS 9 in its financial statements for a period beginning before 1 January 2013,
  – it shall disclose that fact and at the same time apply the amendments in Appendix C (i.e. Amendments to other HKFRSs). (para. 7.1.1)

Chapter 7 Effective Date & Transition

Transition

- An entity shall apply HKFRS 9 retrospectively, in accordance with HKAS 8, except as specified in paragraphs 7.2.4–7.2.15.
- HKFRS 9 shall not be applied to items that have already been derecognised at the date of initial application. (para. 7.2.1)

The IASB published on 4 Aug. 2011 for public comment an exposure draft of proposals to adjust the mandatory effective date of IFRS 9 to 1 January 2015



IASB Activities in 2011 ......

IASB Activities in 2011 ......

On 12 May 2011

- The IASB issued 4 new IFRS ……
  - IFRS 10 *Consolidated Financial Statements*
  - IFRS 11 *Joint Arrangements*
  - IFRS 12 *Disclosure of Interests in Other Entities*
  - IFRS 13 *Fair Value Measurement*

On 16 June 2011

- The IASB amended 2 other IFRS
  - IAS 1 Presentation of Financial Statements
  - IAS 19 Employee Benefits

On 24 June and 14 July 2011

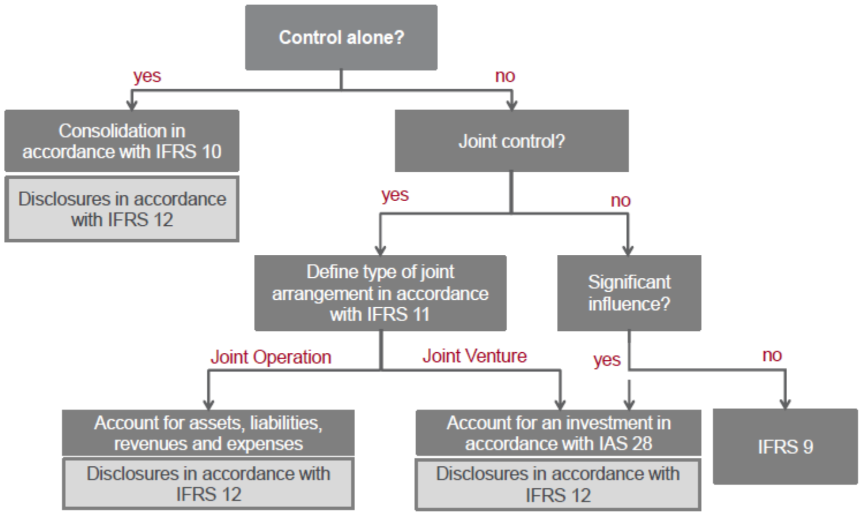
- The HKICPA issued the same in HKFRS and HKAS

Consolidated Financial Statements

(HKFRS 10)

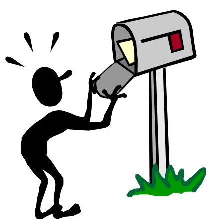
Briefing on HKFRS 10, 11 and 12

Interaction between IFRS/HKFRS 10, 11 and 12 and IAS/HKAS 28



HKFRS 10 Consol. Financial Statements

- The contents of HKFRS 10:
  - a. requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;
  - b. defines the principle of control, and establishes control as the basis for consolidation;
  - c. sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; and
  - d. sets out the accounting requirements for the preparation of consolidated financial statements (HKFRS 10.2).



HKFRS 10 Consol. Financial Statements

- The IASB explains that
  - The application of IAS 27 and SIC-12 revealed inconsistent application in a number of areas:
    - Applying the definition of control: the perceived conflict of emphasis between
      - IAS 27 (power to govern financial and operating policies) and
      - SIC-12 (risks and rewards)

      led to inconsistent application of the definition of control for different types of entities.
    - Control without a majority of voting rights: because IAS 27 does not provide explicit guidance in this area, similar relationships between entities were being accounted for differently.
    - Agency relationships: the lack of guidance for these relationships meant that similar transactions (e.g. those involving funds or investment conduits) were being accounted for differently.
  - Instead, IFRS 10 contains a single consolidation model that identifies control as the basis for consolidation for all types of entities
    - Also providing additional application guidance, will increase consistent application in these areas.

HKFRS 10 Consol. Financial Statements

- While HKFRS 10 become effective,
  - HKAS 27 becomes "separate financial statements"
- Indicator still refers to "**control**" but ……
- An investor, regardless of the nature of its involvement with an entity (the investee),
  - shall determine whether it is a parent by assessing whether it controls the investee. (HKFRS 10.5)
- An investor controls an investee when
  - it is exposed, or has rights, to variable returns from its involvement with the investee and
  - has the ability to affect those returns through its power over the investee. (HKFRS 10.6)

HKFRS 10 Consol. Financial Statements

- Thus, an investor controls an investee if and only if the investor has all the following:
  - a. **power** over the investee;
  - b. **exposure**, or **rights**, to **variable returns** from its involvement with the investee; and
  - c. the **ability to use its power** over the investee to **affect** the amount of the investor's **returns** (HKFRS 10.7)

Power is defined as "existing rights that give the current ability to direct the *relevant activities*"

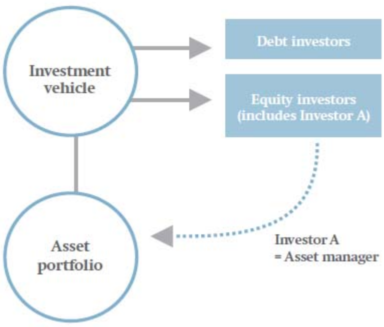
relevant activities are "activities of the investee that significantly affect the investee's returns"

Rights include
- voting rights, potential voting rights, proportionate voting rights, substantive rights, removal rights, decision-making rights, protective rights, contractual rights ……

HKFRS 10 Consol. Financial Statements

Example

- An investment vehicle
  - It is created to purchase a portfolio of financial assets, funded by debt and equity instruments issued to a number of investors.
  - The equity tranche is designed to absorb the first losses and to receive residual returns of the investee.
- Investor A holds 30% of the equity
  - is also the asset manager who manages the vehicle's asset portfolio within portfolio guidelines.
  - The management includes decisions about
    - the selection, acquisition and disposal of the assets within those portfolio guidelines and
    - the management upon default of any asset in the portfolio.



 The graph is adapted from the IASB

HKFRS 10 Consol. Financial Statements

Example

- In applying HK(SIC)-Int 12, some would conclude that Investor A does not consolidate the investment vehicle.
  - Investor A holds 30% of the equity and therefore does not bear the majority of the risks and rewards.
  - The investment vehicle was arguably created for the benefit of all investors, and not only for the benefit of Investor A.
- According to IFRS 10, Investor A controls the investment vehicle.
  - Investor A
    - has the ability to direct the relevant activities,
    - has rights to variable returns from the performance of the vehicle and
    - has the ability to use its power to affect its own returns.

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HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Control as the basis for consolidation • HKAS 27 identifies control as the basis for consolidation and focuses on the power to govern the financial and operating policies for assessing control of typical operating entities. • In contrast, HK(SIC)-Int 12 focuses on risks and rewards for assessing control of special purpose entities.	**HKFRS 10 identifies control as the single basis for consolidation for all types of entities.** • There is no separate guidance with a different consolidation model for special purposes entities (as incorporated into the single consolidation model in IFRS 10) • The new control definition reflects that an investor <u>can achieve power over an investee in many ways</u>, <u>not just through governing financial and operating policies</u>. • The investor must assess whether it has <u>rights to direct the relevant activities</u>. • Although exposure to risks and rewards is an indicator of control, it is not the sole focus for consolidation for any type of entity.

 The table is adapted from the IASB 84

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Control without a majority of voting rights • Although the idea that an investor could control an investee while holding less than 50% of the voting rights was implicit in HKAS 27, it was not explicitly stated.	**HKFRS 10 states that an investor can control an investee with less than 50% of the voting rights of the investee.** • HKFRS 10 provides specific application guidance for assessing control in such cases.

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Potential voting rights • Only *currently exercisable* potential voting rights are considered when assessing control.	**Potential voting rights need to be considered in assessing control, but only if they are *substantive*.** • Potential voting rights are substantive – when the holder has the practical ability to exercise its rights and – when those rights are exercisable when decisions about the direction of the relevant activities need to be made. – Deciding whether potential voting rights are substantive requires judgement. • Potential voting rights may need to be considered even if they are not currently exercisable.

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Agency relationships • HKAS 27 has no specific guidance regarding situations when power is delegated by a principal to an agent.	**HKFRS 10 contains specific application guidance for agency relationships.** • When decision-making authority has been delegated by a principal to an agent, an agent in such a relationship does not control the entity. • The principal that has delegated the decision-making authority would consolidate the entity. • The application guidance offers a range of factors to consider and contains examples.

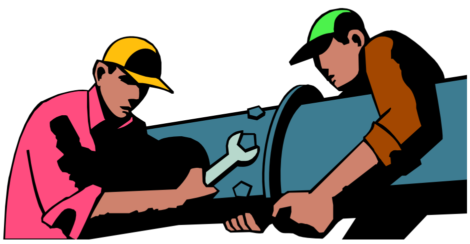
HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Disclosures • HKAS 27 and HK(SIC)-Int 12 contain limited disclosure requirements for consolidated entities and no disclosure requirements for unconsolidated structured entities.	**HKFRS 12 expands the disclosure requirements for both consolidated entities and unconsolidated structured entities.** • The disclosure objectives in HKFRS 12 will give preparers flexibility to tailor their individual disclosures to meet these objectives. • HKFRS 12 presents a single disclosure standard for reporting entities with special relationships with other entities, including subsidiaries, joint ventures, associates and unconsolidated structured entities.

HKFRS 10: Effective Date

- An entity shall apply HKFRS 11 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- If an entity applies HKFRS 11 earlier, it shall disclose that fact and apply HKFRS 11, HKFRS 12 , HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) at the same time. (HKFRS 10.C1)

Joint Arrangement
(HKFRS 11)



HKFRS 11 Joint Arrangements

- **Joint Arrangement**,
  - a new name to subrogate joint venture, simultaneously, joint venture has another meaning now
  - is defined to be an arrangement of which two or more parties have **joint control**.
  - has the following characteristics:
    a. The parties are bound by a contractual arrangement .
    b. The contractual arrangement gives two or more of those parties joint control of the arrangement.
    (HKFRS 11.4-5)

Joint control is defined as
- the contractually agreed sharing of control of an arrangement,
- which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

HKFRS 11 Joint Arrangements

Assessing Joint Control

Does the contractual arrangement give all the parties, or a group of the parties, control of the arrangement collectively?

No → Outside the scope of HKFRS 11

Yes ↓

Do decisions about the relevant activities require the unanimous consent of all the parties, or of a group of the parties, that collectively control the arrangement?

No → Outside the scope of HKFRS 11

Yes ↓

The arrangement is jointly controlled: the arrangement is a joint arrangement

The graph is adapted from HKFRS 11.B10

HKFRS 11 Joint Arrangements

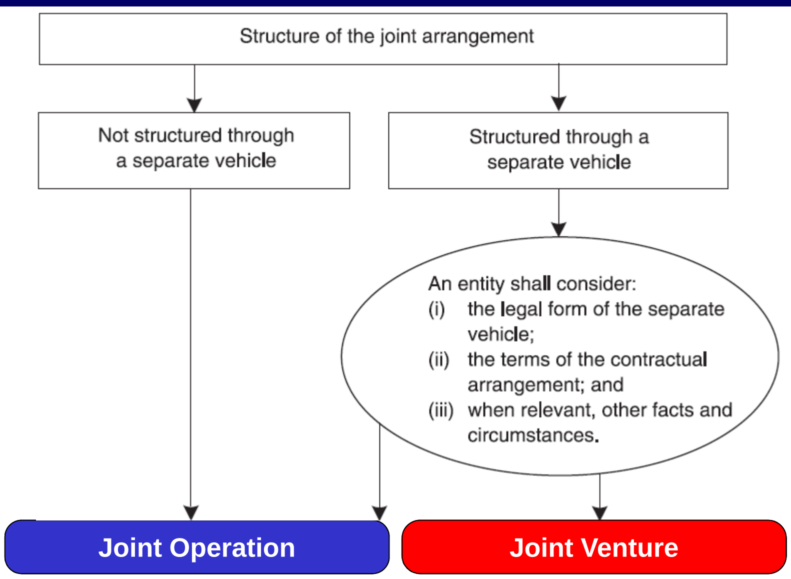
- In consequence, joint arrangement is a new name to subrogate joint venture,
  - simultaneously, joint venture has another meaning now
- A new structure in classification, a joint arrangement is either (HKFRS 11.6)

Joint Operation

Joint Venture

- An entity shall determine the type of joint arrangement in which it is involved.
- The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement. (HKFRS 11.14)

HKFRS 11 Joint Arrangements



The graph is adapted from HKFRS 11.B21

HKFRS 11 Joint Arrangements

Does the **legal form** of the separate vehicle give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement?

Yes → Joint Operation

No ↓

Do the **terms of the contractual arrangement** specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement?

Yes → Joint Operation

No ↓

Other facts and circumstances: Have the parties designed the arrangement so that:

a. its activities primarily aim to provide the parties with an output (i.e. the parties have rights to substantially all the economic benefits of the assets held in the separate vehicle) and

b. it depends on the parties on a continuous basis for setting the liabilities relating to the activity conducted through the arrangement

Yes → Joint Operation

No → Joint Venture

Joint Operation | **Joint Venture**

The graph is adapted from HKFRS 11.B33

HKFRS 11 Joint Arrangements

Joint Operation

A joint operation is

- a joint arrangement whereby the parties that have joint control of the arrangement have rights to ***the assets, and obligations for the liabilities***, relating to the arrangement.

Those parties are called joint operators (HKFRS 11.15).

Joint Venture

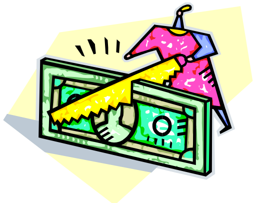
A joint venture is

- a joint arrangement whereby the parties that have joint control of the arrangement have rights to the ***net assets*** of the arrangement.

Those parties are called joint venturers (HKFRS 11.16).

HKFRS 11 Joint Arrangements

Joint Operation



- A joint operator shall recognise <u>in relation to its interest</u> in a joint operation:
  a. its assets, including its share of any assets held jointly;
  b. its liabilities, including its share of any liabilities incurred jointly;
  c. its revenue from the sale of its share of the output arising from the joint operation;
  d. its share of the revenue from the sale of the output by the joint operation; and
  e. its expenses, including its share of any expenses incurred jointly. (HKFRS 11.20)

HKFRS 11 Joint Arrangements

Joint Venture

- A joint venturer
  - shall recognise its interest in a joint venture <u>***as an investment***</u> and
  - shall account for that investment using <u>***the equity method***</u> in accordance with HKAS 28 *Investments in Associates and Joint Ventures*
    - unless the entity is exempted from applying the equity method as specified in HKAS 28 (HKFRS 11.24).
- HKAS 28 is renamed as "<u>*Investments in Associates and Joint Ventures*</u>"

HKFRS 11 Joint Arrangements

Joint Venture

- A party that participates in, but does not have joint control of, a joint venture
  - shall account for its interest in the arrangement in accordance with HKFRS 9 *Financial Instruments*,
    - unless it has significant influence over the joint venture, in which case it shall account for it in accordance with HKAS 28 (as amended in 2011). (HKFRS 11.25)

HKFRS 11: Effective Date

- An entity shall apply HKFRS 11 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- If an entity applies HKFRS 11 earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 12, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) at the same time. (HKFRS 11.C1)

Discl. Interests in Other Entities
(HKFRS 12)

HKFRS 12 Discl. of Interest in Other Entities

- The objective of HKFRS 12 is to require an entity to disclose information that enables users of its financial statements to evaluate:
  a. the nature of, and risks associated with, its interests in other entities; and
  b. the effects of those interests on its financial position, financial performance and cash flows (HKFRS 12.1).

HKFRS 12 Discl. of Interest in Other Entities

- To meet the objective of HKFRS 12, an entity shall disclose:
  - a. the significant judgements and assumptions it has made
    - in determining the nature of its interest in another entity or arrangement, and
    - in determining the type of joint arrangement in which it has an interest; and
  - b. information about its interests in:
    - i. subsidiaries;
    - ii. joint arrangements and associates; and
    - ***iii. structured entities*** that are not controlled by the entity (unconsolidated structured entities) (HKFRS 12.2).

What is Structured Entity?

HKFRS 12 Discl. of Interest in Other Entities

- Structured entity is defined as:
  - An entity that has been designed so that
    - voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and
    - the *relevant activities* are directed by means of contractual arrangements.
- HKFRS 12.B22–B24 provide further information about structured entities.

What is Structured Entity?

HKFRS 12 Discl. of Interest in Other Entities

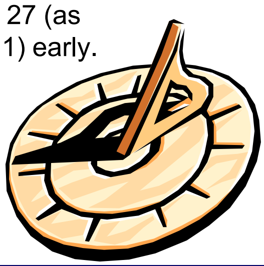
- Structured entity often has some or all of the following features or attributes:
  a. restricted activities.
  b. a narrow and well-defined objective, such as
     - to effect a tax-efficient lease,
     - to carry out research and development activities,
     - to provide a source of capital or funding to an entity or
     - to provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.
  c. insufficient equity to permit the structured entity to finance its activities without subordinated financial support.
  d. financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches). (HKFRS 12.B22).

Examples include:
a. securitisation vehicles,
b. asset-backed financings.
c. some investment funds.

What is Structured Entity?

HKFRS 12: Effective Date

- An entity shall apply HKFRS 12 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- An entity is encouraged to provide information required by HKFRS 12 earlier than annual periods beginning on or after 1 January 2013.
- Providing some of the disclosures required by HKFRS 12 does not compel the entity to comply with all the requirements of HKFRS 12 or to apply HKFRS 10, HKFRS 11, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) early. (HKFRS 12.C1)



Fair Value Measurement
(HKFRS 13)

Introduction – Fair Value Debate

- In the global financial crisis, accountants and their accounting standards had been pleaded as guilty to create the financial tsunami
- To be accountable for the global financial stability, the IASB and FASB were forced to tak measures to address the issues and to amend their respective accounting standards
- IFRS 13 *Fair Value Measurement* is one of the consequences to provide converged guidance on fair value measurement.

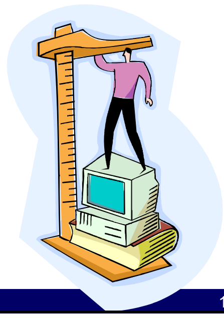
Introduction

- HKFRS 13 is a single standard to address the measurement fair value used in many other HKFRSs:
  a. defines fair value;
  b. sets out in a single HKFRS a framework for measuring fair value; and
  c. requires disclosures about fair value measurements. (HKFRS 13.1)

Definition of Fair Value

Single Framework for FV Measurement

Disclosure



Agenda for HKFRS 13

1. Applicable Standard and Scope
2. Definition of Fair Value
3. Fair Value Measurement
4. Application to Specific Situations
5. Fair Value at Initial Recognition
6. Valuation Techniques
7. Fair Value Hierarchy
8. Disclosure

Definition of Fair Value

Single Framework for FV Measurement

Disclosure

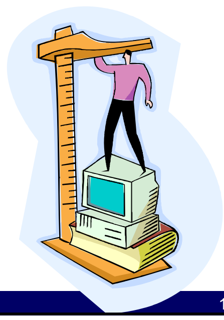
1. Applicable Standard and Scope

- HKFRS 13:
  a. defines fair value;
  b. sets out in a single IFRS a framework for measuring fair value; and
  c. requires disclosures about fair value measurements (HKFRS 13.1).
- HKFRS 13 applies when another IFRS requires or permits FV measurements or disclosures about FV measurements (and measurements, such as FV less costs to sell, based on FV or disclosures about those measurements), except:
  – Measurement of HKFRS 2, HKAS 17, NRV in HKAS 2, VIU in HKAS 36, and
  – Disclosure of plan assets in HKAS 19, plan investments in HKAS 26, FY less costs to disposal HKAS 36

Definition of Fair Value

Single Framework for FV Measurement

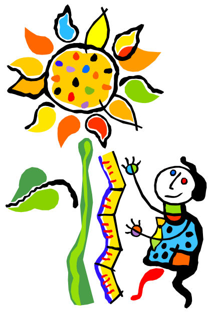
Disclosure



2. Definition of Fair Value

Definition of Fair Value

- Fair value is defined as
  - the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (HKFRS 13.9)
  - i.e. an exit price
    - It is a market-based measurement, not an entity-specific measurement
- Historically, fair value is normally defined as:
  - The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.



2. Definition of Fair Value

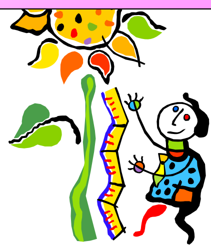
The IASB considered the previous definition of fair value:

a. did not specify whether an entity is buying or selling the asset;

b. was unclear about what is meant by settling a liability because it did not refer to the creditor, but to knowledgeable, willing parties; and

c. did not state explicitly whether the exchange or settlement takes place at the measurement date or at some other date (HKFRS 13.BC30)

- Historically, fair value is normally defined as:
  - The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.



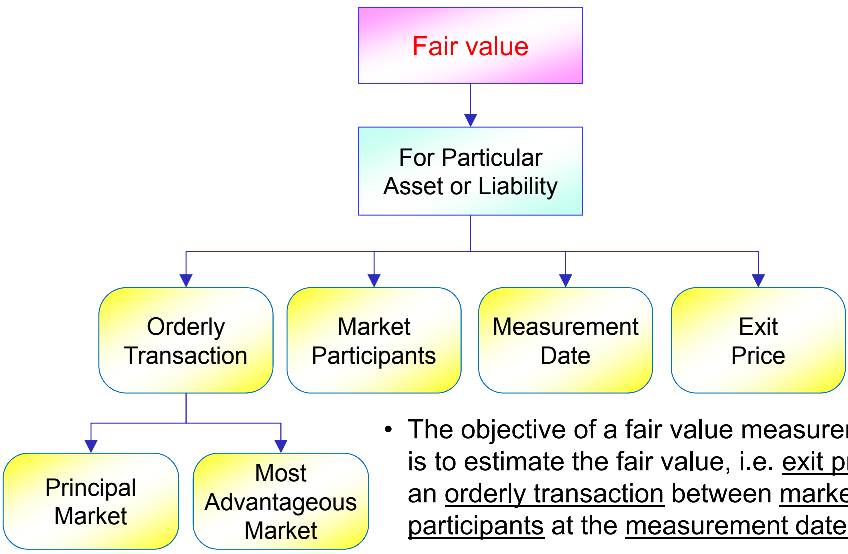
3. Fair Value Measurement

- HKFRS 13 explains that a fair value measurement requires an entity to determine the following:
  a. the particular asset or liability being measured;
  b. for a non-financial asset, the highest and best use of the asset and whether the asset is used
     - in combination with other assets or
     - on a stand-alone basis;
  c. the market in which an orderly transaction would take place for the asset or liability; and
  d. the appropriate valuation technique(s) to use when measuring fair value.
     - The valuation technique(s) used should maximise the use of relevant observable inputs and minimise unobservable inputs.
     - Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability. (HKFRS 13.IN10)

Single Framework for FV Measurement

Fair Value Hierarchy (3 levels)

3. Fair Value Measurement



- The objective of a fair value measurement is to estimate the fair value, i.e. exit price in an orderly transaction between market participants at the measurement date.

4. Application to Specific Situations

- In applying the fair value measurement, HKFRS 3 introduces the concepts of highest and best use and valuation premise for non-financial assets, but it also explains that they would not apply to financial assets or to liabilities.
- Together with the application to non-financial assets, IFRS 3 addresses application to at least three groups of items:
  1. Application to non-financial assets;
  2. Application to liabilities and an entity's own equity instruments; and
  3. Application to financial instruments within a portfolio, i.e. the financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk.

5. Fair Value at Initial Recognition

- HKFRS 13 specifies the consideration when fair value is required or permitted to use in initial recognition of an asset or a liability.
  - HKFRS 13 has not specified whether fair value should be used for initial recognition of an asset or a liability
  - An asset or a liability is initially recognised at a basis in accordance with the corresponding HKFRS and.
- Historically, HKFRS commonly addresses that the **fair value** on initial recognition is normally the **transaction price**.
- However, HKFRS 13 uses the phrase "in many cases" to substitute the word "normally" in describing the relationship between the fair value and transaction price.
  - The change represents that a fair value is defined as a current exit price in HKFRS 13
  - but a transaction price is considered as an entry price.

6. Valuation Techniques

- HKFRS 13 sets out the following three valuation approaches to guide the selection and usage of valuation techniques and
  1. Market approach,
  2. Cost Approach, and
  3. Income Approach.
- An entity is required to use valuation techniques consistent with one or more of the valuation approaches to measure fair value.

6. Valuation Techniques

- In fair value measurement,
  – an entity is not only required to use the valuation techniques consistent with one or more of the three valuation approaches, but also required to use the techniques,
    1. Maximising the use of relevant observable inputs and
    2. Minimising the use of unobservable inputs (HKFRS 13.67)

6. Valuation Techniques

- Present value techniques are the valuation techniques consistent with income approach to measure fair value and are specified in the application guidance of HKFRS 13.
- The application guidance of HKFRS 13 sets out
  - the general principles in using present value techniques and
  - the consideration of risk and uncertainty.
- HKFRS 13 also specifies the following two present value techniques:
  1. Discount rate adjustment technique; and
  2. Expected present value technique.

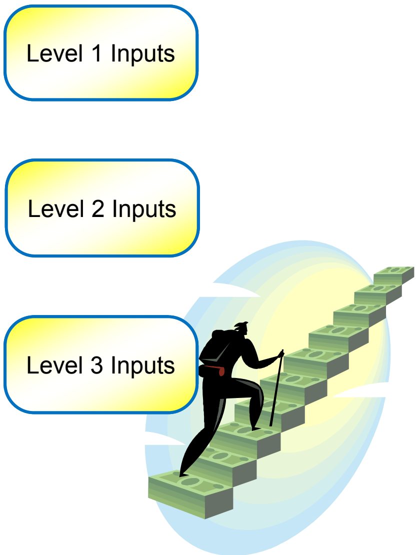
In order to understand them, HKFRS 13 also explains the portfolio theory, unsystematic (diversifiable) risk, systematic (non-diversifiable) risk ……

7. Fair Value Hierarchy

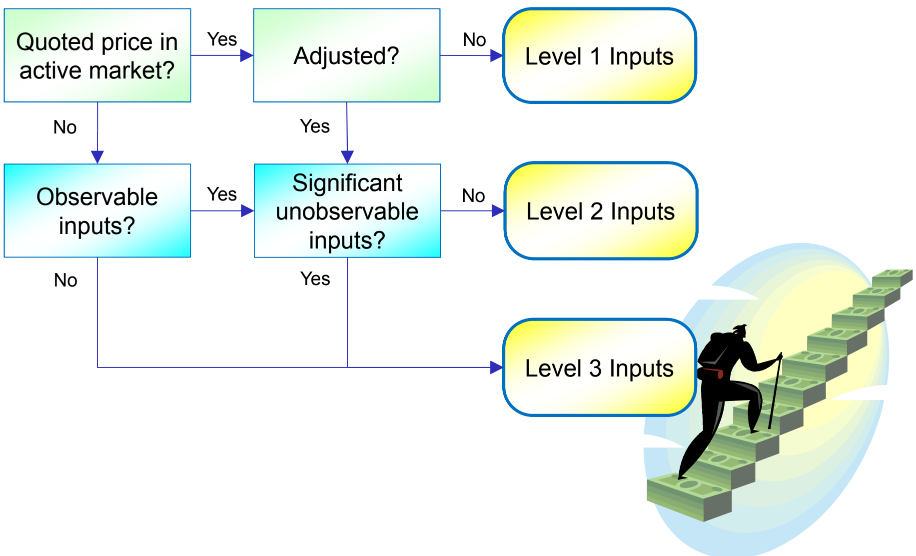
- To increase consistency and comparability in fair value measurements and related disclosures, IFRS 13 establishes a fair value hierarchy that categorises the inputs to valuation techniques used to measure fair value into the following three levels:
  - Level 1 inputs
  - Level 2 inputs
  - Level 3 inputs

7. Fair Value Hierarchy

- Level 1 inputs
  - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2 inputs
  - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs
  - Unobservable inputs for the asset or liability.



7. Fair Value Hierarchy

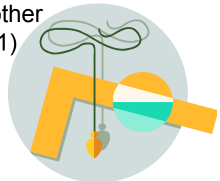


8. Disclosure

Objectives and General Principles for Disclosure

- An entity is required to disclose information that helps users of its financial statements assess both of the following:
  1. For assets and liabilities that are measured at fair value <u>on a recurring or non-recurring basis</u> in the statement of financial position after initial recognition,
     a. The valuation techniques, and
     b. Inputs used to develop those measurements.
  2. <u>For recurring fair value measurements using significant unobservable inputs (Level 3)</u>,
     - the effect of the measurements on profit or loss or other comprehensive income for the period (HKFRS 13.91)

Disclosure



8. Disclosure

Objectives and General Principles for Disclosure

- To meet the above objectives, an entity is required to consider all the following:
  1. The level of detail necessary to satisfy the disclosure requirements;
  2. How much emphasis to place on each of the various requirements;
  3. How much aggregation or disaggregation to undertake; and
  4. Whether users of financial statements need additional information to evaluate the quantitative information disclosed.

Disclosure

8. Disclosure

- Disclosure requirements are set out in 4 pages (lengthy?)
- In addition,
  - If the disclosures provided in accordance with HKFRS 13 and other HKFRSs are insufficient to meet the objectives in HKFRS 13.91, an entity shall <u>disclose additional information necessary to meet those objectives</u> (HKFRS 13.92).

Disclosure

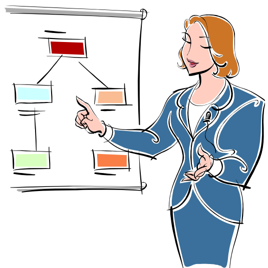
HKFRS 13: Effective Date

- An entity shall apply HKFRS 13 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- HKFRS 13 shall be applied prospectively as of the beginning of the annual period in which it is initially applied.
- The disclosure requirements of HKFRS 13 need not be applied in comparative information provided for periods before initial application of HKFRS 13. (HKFRS 13.C1)

Presentation of Financial Statements
(HKAS 1 Revised)

Presentation of Financial Statements

- In June 2011, the IASB further amended IAS 1 for annual periods beginning on or after 1 July 2012 in order to
  - Distinguish different items of other comprehensive income, and
  - Align with the accounting practices in US.
- The presentation of other comprehensive income in IFRS and accounting practices in US will be aligned.
- HKICPA issued the same amendment in July 2011.



Presentation of Financial Statements

- The main amendment of HKAS 1 requires an entity to
  - Classify line items for amounts of other comprehensive income (OCI) in a period by nature,
  - Group and present them in accordance with other HKFRSs into:
    1. Those items of OCI that <u>will not be reclassified subsequently to P/L</u>; and
    2. Those items of OCI that <u>will be reclassified subsequently to P/L when specific conditions are met</u> (HKAS 1.82A).

OCI not reclassified

OCI may be reclassified

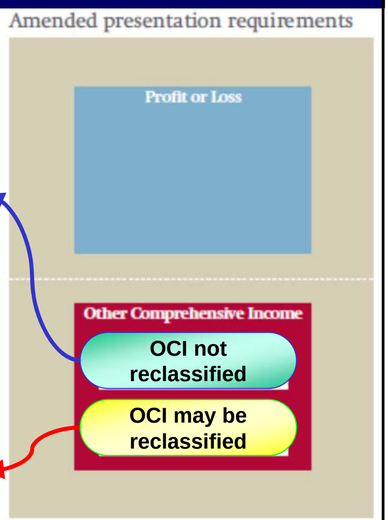
Presentation of Financial Statements

Those items of OCI that will not be reclassified subsequently to P/L include:

- Changes in revaluation surplus of PPE recognised under HKAS 16;
- Changes in revaluation surplus of intangible assets under HKAS 38;
- Actuarial gains and losses on defined benefit plans under HKAS 19; and
- FV changes of investment in equity instrument recognised in OCI under HKFRS 9.

Those items of OCI that may be reclassified subsequently to P/L include:

- Translation reserves under HKAS 21;
- FV changes on available-for-sale financial assets under HKAS 39; and
- Cash flow hedge reserves under HKAS 39.



The graph is sourced from the IASB

Presentation of Financial Statements

- In addition to the main amendment, HKAS 1 is also amended and updated with the following points:
  1. A new statement title, **statement of profit or loss and other comprehensive income**, is introduced and it can be used to distinguish from statement of comprehensive income which may be used to present comprehensive income only (HKAS 1.10 revised in 2011);
  2. Similar to the above title, another new statement title, **statement of profit or loss**, is also introduced to formally replace income statement, or separate income statement, to present items of profit or loss only (HKAS 1.10A);
  3. Components of other comprehensive income is formally described as items of other comprehensive income; and
  4. A term, i.e. comprehensive income, is formally introduced and represents the total of profit or loss and other comprehensive income (HKAS 1.81A).

HKAS 1: Effective Date

- *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraphs 7, 10, 82, 85–87, 90, 91, 94, 100 and 115, added paragraphs 10A, 81A, 81B and 82A, and deleted paragraphs 12, 81, 83 and 84.
- An entity shall apply those amendments for annual periods beginning on or after 1 July 2012.
- Earlier application is permitted.
- If an entity applies the amendments for an earlier period it shall disclose that fact.(HKAS 1.139J)

Employee Benefits (HKAS 19 Revised)

Employee Benefits

- The IASB issued amendments to IAS 19 *Employee Benefits* in June 2011.
- The amendments to the recognition, presentation and disclosure requirements will ensure that the financial statements provide investors and other users with a clear picture of an entity's commitments resulting from defined benefit plans.
- HKICPA issued the same in July 2011.

Employee Benefits

- The amendments focus on three key areas in most need of improvement **for defined benefit plans**:
  - **Recognition**: the elimination of the option to defer the recognition of gains and losses resulting from defined benefit plans (the corridor approach)
  - **Presentation**: the elimination of options for the presentation of gains and losses relating to those plans; and
  - **Disclosures**: the improvement of disclosure requirements that will better show the characteristics of defined benefit plans and the risks arising from those plans.
- The amendments also incorporate amendments to
  - The definition of short-term and long-term benefits
  - The accounting for termination benefits

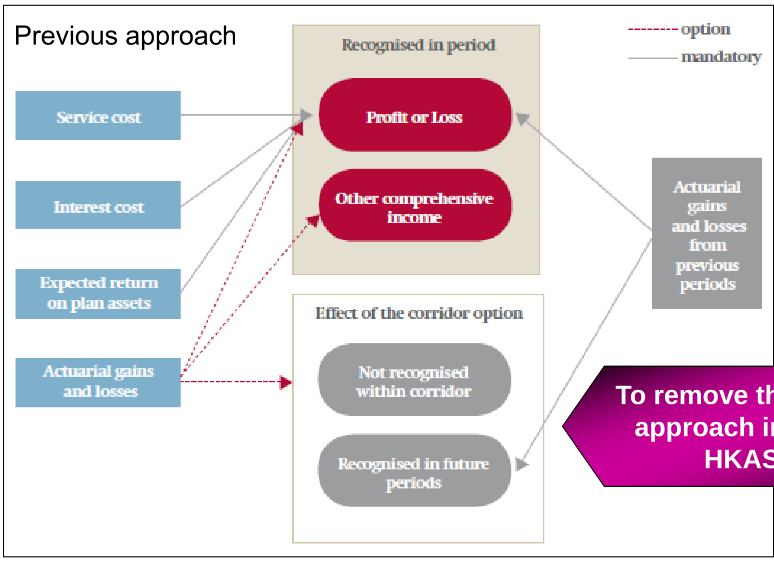
Recognition

Presentation

Disclosures

Other Issues

Defined Benefit Plans (revised in 2011)



Recognition

Benefit Cost

To remove the corridor approach in revised HKAS 19

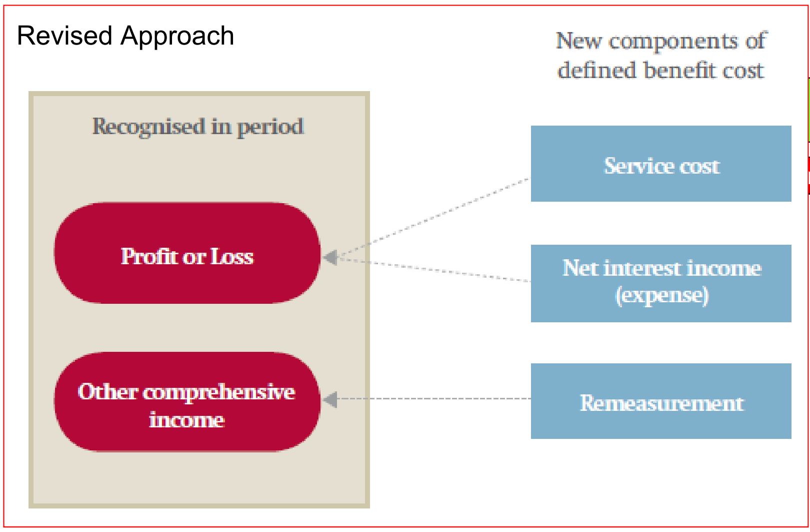
Defined Benefit Plans (revised in 2011)

Recognition

Defined Benefit Cost

- An entity shall recognise the components of defined benefit cost, except to the extent that another HKFRS requires or permits their inclusion in the cost of an asset, as follows:
  a. Service cost in profit or loss;
  b. Net interest on the net defined benefit liability (asset) in profit or loss; and
  c. Remeasurements of the net defined benefit liability (asset) in other comprehensive income. (HKAS 19.120)

Defined Benefit Plans (revised in 2011)



Defined Benefit Plans (revised in 2011)

- Remeasurements of the net defined benefit liability (asset) now comprise:
  a. actuarial gains and losses;
  b. the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
  c. any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset). (HKAS 19.8)
- Remeasurements of the net defined benefit liability (asset) recognised in other comprehensive income
  - shall not be reclassified to profit or loss in a subsequent period
  - may be transferred within equity. (HKAS 19.122)

Recognition

Remeasurement

Asset ceiling is PV of any refund or reduction in contributions

Other Issues in HKAS 19 (revised in 2011)

- In HKAS 19 (revised in 2011)
  - Short-term employee benefits are defined as
    - employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service. (HKAS 19.8)
  - Other long-term employee benefits are defined as:
    - all employee benefits other than
      - short-term employee benefits,
      - post-employment benefits and
      - termination benefits. (HKAS 19.8)

Previously,
“due to be settled”
vs
new definition
“expected to be settled”

Other Issues

Other Issues in HKAS 19 (revised in 2011)

- In HKAS 19 (revised in 2011), for **termination benefits**
  - An entity shall recognise a liability and expense for termination benefits at the earlier of the following dates:
    a. when the entity can no longer withdraw the offer of those benefits; and
    b. when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves the payment of termination benefits. (HKAS 19.165)

Remove the concept of "*demonstrably committed*" (as the same removal for curtailment)

Other Issues

HKAS 19: Transition and Effective Date

- An entity shall apply HKAS 19 for annual periods beginning on or after 1 January 2013.
  - Earlier application is permitted.
  - If an entity applies HKAS 19 for an earlier period, it shall disclose that fact.
- An entity shall apply HKAS 19 retrospectively, in accordance with HKAS 8, except that the conditions set out in HKAS 19.173 are met. (HKAS 19.172-173)

Plan of IASB ......

Target New and Amended IFRS in 2011

- 2011 Third and Fourth Quarter
  - New parts for IFRS 9
    - General hedge accounting
    - Asset and liability offsetting
- 2012 First Half
  - New IFRS on Leases
  - New IFRS on Revenue Recognition
  - New IFRS on Insurance Contract

蘋果日

「瑞銀的分析員可能沒有看過筆者的分析，同時亦可能忽略了，過去放在財務滙報準則第3條的商譽減值測試，現在只放在會計準則第36條，故此在其報告中弄錯了新會計準則的要求，利豐澄清其報告的錯誤是合理的。」

「大型證券行也弄錯不斷改變的會計準則，一般投資者可能更無法理解，故此更要小心。」

《香港經濟日報》楊青峰 (2011.6.2)

「上周利豐（494）突然上演利豐大戰瑞銀 ...... 嘩，一牽涉會計制度，當然觸動投資者的神經，因投資者除了可以風聲鶴唳，根本沒有空間加入討論 ......

「老實說，上述艱澀的會計用詞對於公眾來說實在不易理解 ...... 」

《信報》陳焱 (2011.5.30)

Financial Reporting Update 2011

27 August 2011

Full set of slides in PDF can be found in
www.NelsonCPA.com.hk

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Financial Reporting Update 2011

27 August 2011

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