IFRS for Hospitality and Gaming Industry

(**Part 2**)

26 May 2010

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Workshop Agenda

- Property, Plant and Equipment (IAS 16)
- Leases (IAS 17)
- Revenue (IAS 18)
- Intangible Assets (IAS 38)
- Investment Property (IAS 40)

Part 1 This Evening

Part 2 Tomorrow

Updated Practices

Cases & Examples from Hospitality & Gaming Industry

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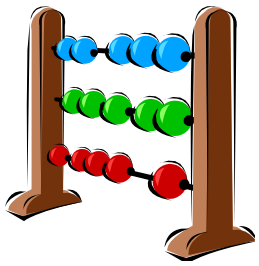
Scope of IAS 18

Sale of goods

Rendering of services

Interest, royalties and dividend

- IAS 18 shall be applied in accounting for revenue arising from the following transactions and events:
  a) the sale of goods;
  b) the rendering of services; and
  c) the use by others of entity assets yielding interest, royalties and dividends.



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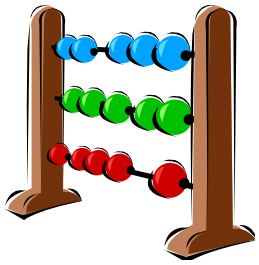
1. Sale of Goods

Sale of goods

Rendering of services

Interest, royalties and dividend



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1. Sale of Goods

Main Principle

- Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:
  a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
  b) the entity retains
     – neither continuing managerial involvement to the degree usually associated with ownership
     – nor effective control over the goods sold;
  c) the amount of revenue can be measured reliably;
  d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
  e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

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1. Sale of Goods

Main Principle

- The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer
  – requires an examination of the circumstances of the transaction.
- In most cases, the transfer of risks and rewards of ownership
  – coincides with the transfer of the legal title or the passing of possession to the buyer.
  – This is the case for most retail sales.
- In other cases, the transfer of the risks and rewards of ownership
  – occurs at a different time from the transfer of legal title or the passing of possession.

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1. Sale of Goods

Revenue not recognised if inflow is not probable

- Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.
- In some cases, this may not be probable
  - until the consideration is received or
  - until an uncertainty is removed.

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1. Sale of Goods

Case

Sands China Limited
(Prospectus – Accountants' Report 2009)

- Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities.
- The Group recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below.
  - The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved.
  - The Group bases its estimates on historical results, taking into consideration
    - the type of customer,
    - the type of transaction and
    - the specifics of each arrangement.

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1. Sale of Goods

Case

Sands China Limited
(Prospectus – Accountants' Report 2009)

i. Casino revenue
   - Casino revenue is the aggregate of gaming wins and losses.
   - Commissions rebated directly or indirectly through gaming promoters to customers, cash discounts and other cash incentives to customers related to gaming play are recorded as a reduction of gross casino revenue.
   - Gaming promoters (博彩中介人) are entities that bring in high rollers to casinos and loan them rolling chips.

ii. Hotel revenue
   - Hotel revenue is recognized at the time of occupancy.

iii. Food and beverage revenue
   - Food and beverage revenue is recognized at the time of service.

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1. Sale of Goods

Case

Sands China Limited
(Prospectus – Accountants' Report 2009)

iv. Lease/right of use income
   - Lease/right of use income from the grant of right of use (net of any incentives given to tenants/retailers) is recognized on a straight-line basis over the terms of the lease/right of use.

v. Convention revenue
   - Convention revenue is recognized when the event is held or the related services are rendered.

vi. Retail sales ……

vii. Mall management fees ……

viii. Entertainment revenue ……

ix. Ferry ticket sales ……

x. Commission revenue ……

xi. Interest income ……

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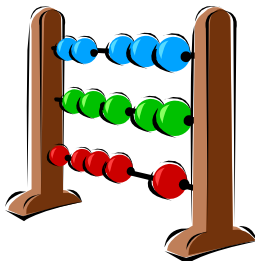
2. Rendering of Services

Sale of goods

Rendering of services

Interest, royalties and dividend



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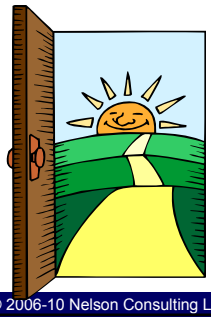
2. Rendering of Services

Main Principle

- When the outcome of a transaction involving the rendering of services can be estimated reliably
  - revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of reporting period.

Often referred to as the *percentage of completion method*



- The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:
  a) the amount of revenue can be measured reliably;
  b) it is probable that the economic benefits associated with the transaction will flow to the entity;
  c) the stage of completion of the transaction at the end of reporting period can be measured reliably; and
  d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

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2. Rendering of Services

- Under the percentage of completion method
  - revenue is recognised in the accounting periods in which the services are rendered.
- The recognition of revenue on this basis provides
  - useful information on the extent of service activity and performance during a period.
- IAS 11 *Construction Contracts* also requires the recognition of revenue on this basis.
  - The requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.

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2. Rendering of Services

Stage of Completion of a Transaction

- The stage of completion of a transaction may be determined by a variety of methods.
  - An entity uses the method that measures reliably the services performed.
- Depending on the nature of the transaction, the methods may include:
  a) surveys of work performed;
  b) services performed to date as a percentage of total services to be performed; or
  c) the proportion that costs incurred to date bear to the estimated total costs of the transaction.
    - Only costs that reflect services performed to date are included in costs incurred to date.
    - Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.
- Progress payments and advances received from customers often do not reflect the services performed.

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2. Rendering of Services

Case

Wynn Macau, Limited
(Prospectus – Accountants' Report 2009)

- Rooms, food and beverage, retail and other operating revenues
  - are recognized when services are performed or the retail goods are sold.
- Deposits received from customers in advance on rooms or other services
  - are recorded as liabilities until services are provided to the customers.

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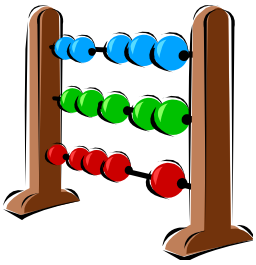
3. Interest, Royalties and Dividends

Sale of goods

Rendering of services

Interest, royalties and dividend



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3. Interest, Royalties and Dividends

Main Principle

- Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases set out in the following paragraph when:
  a) it is probable that the economic benefits associated with the transaction will flow to the entity; and
  b) the amount of the revenue can be measured reliably.

- Revenue shall be recognised on the following bases:
  a) interest shall be recognised using the effective interest method as set out in IAS 39.9 and AG5-AG8;
  b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and
  c) dividends shall be recognised when the shareholder's right to receive payment is established.

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3. Interest, Royalties and Dividends

Example

Licence fees and royalties

- Fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films)
  - are normally recognised in accordance with the substance of the agreement.
  - As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

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3. Interest, Royalties and Dividends

Example

Licence fees and royalties

- An assignment of rights for a fixed fee or non refundable guarantee under a non-cancellable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform
  - is, in substance, a sale.
- An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery.
- Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts.
- In such cases, revenue is recognised at the time of sale.

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3. Interest, Royalties and Dividends

•Example

Licence fees and royalties

- In some cases, whether or not a licence fee or royalty will be received
  - is contingent on the occurrence of a future event.
- In such cases, revenue is recognised only when
  - it is probable that the fee or royalty will be received, which is normally when the event has occurred.

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3. Interest, Royalties and Dividends

Case

The Hong Kong Jockey Club
(Annual Report 2009)

- Revenue comprises the fair value of the consideration for the sale of goods and services provided in the ordinary course of the activities of the Group. Revenue is shown net of returns, rebates and discounts.
- Revenue from horse race betting ……
- Interest income
  - is recognised on a time-proportion basis using the effective interest method.
- Dividend income
  - is recognised when the right to receive payment is established.
- Royalty income
  - is shown net of overseas withholding taxes and recognised on the accruals basis in accordance with the substance of the relevant agreements.

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Intangible Assets (IAS 38)

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1. Objective and Scope

- IAS 38 *Intangible Assets*
  - is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard
  - requires an entity to recognise an intangible asset if, and only if, specified criteria are met
  - specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.
- Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting
  - any accumulated amortisation and
  - accumulated impairment losses thereon

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2. Definition of Intangible Assets

An intangible asset is
- an identifiable non-monetary asset without physical substance.

An asset is a resource:
a) controlled by an entity as a result of past events; and
b) from which future economic benefits are expected to flow to the entity.

Monetary assets are
- money held and assets to be received in fixed or determined amounts of money

Identifiability

Control

Future economic benefit

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2. Definition of Intangible Assets

Case

Galaxy Entertainment Group Limited

- Galaxy accounts for its gaming licence as intangible assets with a carrying amount of HK$16.87 Billion at 31 Dec. 2009.
- Its annual report of 2009 set out the accounting policy as follows:
  - Gaming licence is carried at
    - cost
    - less accumulated amortisation and impairment losses.
  - It has a finite useful life and is amortised over its estimated useful life of 17 years on a straight-line basis.

Further discussed later

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3. Recognition and Initial Measurement

General principle

- The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
  a) the definition of an intangible asset (as discussed); and
  b) the recognition criteria
- This requirement applies to
  - costs incurred initially to acquire or internally generate an intangible asset (i.e. initial cost) and
  - those incurred subsequently to add to, replace part of, or service it (i.e. subsequent expenditure).

Implies both initial and subsequent costs with same recognition criteria

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3. Recognition and Initial Measurement

Recognition criteria

- An intangible asset shall be recognised if, and only if:
  a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
  b) the cost of the asset can be measured reliably.

- An entity shall assess the probability
  – using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset

Initial measurement

- An intangible asset shall be measured initially at cost.

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3. Recognition and Initial Measurement

Intangible assets may arise from

1. Separate acquisition
2. Acquisition as part of a business combination
3. Acquisition by way of a government grant
4. Exchange of assets
5. Internally generated goodwill
6. Internally generated intangible assets

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3. Recognition and Initial Measurement

1. Separate acquisition

- The price an entity pays to acquire separately an intangible asset
  - will normally reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity.
    - In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion is always considered to be satisfied for separately acquired intangible assets.
- The cost of a separately acquired intangible asset can usually be measured reliably
  - in particular when the purchase consideration is in the form of cash or other monetary assets.

Cost comprises?

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3. Recognition and Initial Measurement

1. Separate acquisition

More guidance is given in IAS 38

- The cost of a separately acquired intangible asset comprises:
  a) its purchase price,
     including - import duties and non-refundable purchase taxes,
     after deducting - trade discounts and rebates; and
  b) any directly attributable cost of preparing the asset for its intended use.

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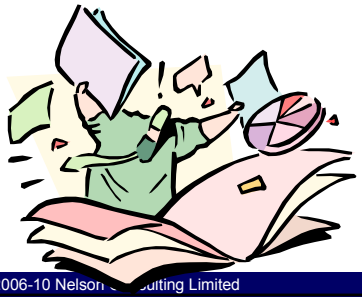
3. Recognition and Initial Measurement

6. Internally generated intangible assets

Research and Development

- **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.



- **Development** is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

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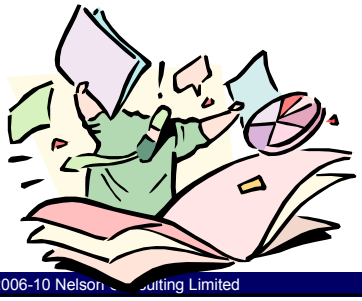
3. Recognition and Initial Measurement

6. Internally generated intangible assets

Research and Development

- **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.



- **No** intangible asset arising from research (or from the research phase of an internal project) **shall be recognised**.
- Expenditure on research (or on the research phase of an internal project) shall be recognised **as an expense** when it is incurred.

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3. Recognition and Initial Measurement

6. Internally generated intangible assets

Research and Development

- An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:
  a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
  b) its intention to complete the intangible asset and use or sell it.
  c) its ability to use or sell the intangible asset.
  d) how the intangible asset will generate probable future economic benefits. (Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
  e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
  f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

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4. Recognition of Expense

- Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:
  a) it forms part of the cost of an intangible asset that meets the recognition criteria; or
  b) the item is acquired in a business combination and cannot be recognised as an intangible asset.

  If this is the case, it forms part of the amount recognised as goodwill at the acquisition date.

Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

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5. Measurement after Recognition

- An entity shall choose either:

  Cost Model

  Revaluation Model

  as its accounting policy
- If an intangible asset is accounted for using the revaluation model,
  - all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

An active market is a market in which all the following conditions exist:

a) the items traded in the market are homogeneous;
b) willing buyers and sellers can normally be found at any time; and
c) prices are available to the public.

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5. Measurement after Recognition

Cost Model

- After initial recognition, an intangible asset shall be carried at *its cost less any accumulated depreciation and any accumulated impairment losses*

Revaluation Model

- After initial recognition, an intangible asset shall be carried at *a revalued amount*, being its fair value at the date of the revaluation, *less any subsequent accumulated amortisation and any subsequent accumulated impairment losses*.
- For the purpose of revaluations under IAS 38, fair value shall be determined by reference to an active market.
- Revaluations shall be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

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5. Measurement after Recognition

Revaluation Model

Application of revaluation model

- The revaluation model does not allow:
  a) the revaluation of intangible assets that have not previously been recognised as assets; or
  b) the initial recognition of intangible assets at amounts other than cost.

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5. Measurement after Recognition

Revaluation Model

Frequency of revaluations

- The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued.
- If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary.
  - Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation.
  - Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

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6. Useful Life

- No matter, which of the following model is used by an entity:

Cost Model or **Revaluation Model**

- IAS 38 sets out that an entity shall assess whether the useful life of an intangible asset is

Finite or **Indefinite**

If finite
- the length of, or number of production or similar units constituting, that useful life.

An intangible asset has an indefinite useful life when
- based on an analysis of all of the relevant factors
- there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

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6. Useful Life

- The accounting for an intangible asset is based on its useful life.
  - Many factors are considered in determining the useful life of an intangible asset.

Finite or **Indefinite**

Amortisation required

Amortisation not required

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6. Useful Life

- The term ‘indefinite’ does not mean ‘infinite’.
- The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset’s useful life, and the entity’s ability and intention to reach such a level.

Finite **Indefinite**

- A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

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6. Useful Life

Intangible asset arising from contractual or other legal rights

- The useful life of such intangible asset
  - shall not exceed the period of the contractual or other legal rights,
  - but may be shorter depending on the period over which the entity expects to use the asset.

Finite **Indefinite**

- If the contractual or other legal rights can be renewed, the useful life of the intangible asset shall include the renewal period only if
  - there is evidence to support renewal by the entity without significant cost.

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7. Finite Useful Life

Amortisation

- The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.
  - Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
- Amortisation
  - shall begin when the asset is available for use,
    - i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
  - shall cease at the earlier of
    - the date that the asset is classified as held for sale (or included in a disposal group held for sale) in accordance with IFRS 5 and
    - the date that the asset is derecognised.

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7. Finite Useful Life

Amortisation

Amortisation Method

- The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
  - If that pattern cannot be determined reliably, the straight-line method shall be used.
- The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.

Say PPE or Inventories

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7. Finite Useful Life

Amortisation

Amortisation Method

Residual Value

- The residual value of an intangible asset is the estimated amount that
  - an entity would currently obtain from disposal of the asset,
  - after deducting the estimated costs of disposal, if the asset were
    - already of the age and
    - in the condition expected at the end of its useful life.
- The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:
  a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
  b) there is an active market for the asset and:
     i) residual value can be determined by reference to that market; and
     ii) it is probable that such a market will exist at the end of the asset's useful life

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7. Finite Useful Life

Amortisation

Amortisation Method

Residual Value

- The residual value is reviewed at least at each financial year-end.
  - A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with IAS 8.
- In addition, the amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end.
  - If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly.
  - If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortization method shall be changed to reflect the changed pattern.
  - Such changes shall be accounted for as changes in accounting estimates in accordance with IAS 8.

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7. Finite Useful Life

Case

Galaxy Entertainment Group Limited

– Galaxy's annual report of 2008 set out the impairment of gaming licence as follows:

- When there is indication for impairment, the Group tests whether the assets within a cash generating unit has suffered any impairment.
- The recoverable amount has been determined based on the higher of fair value less cost to sell and value-in-use.
- The methodologies are based upon estimates of future results, assumptions as to income and expenses of the business, future economic conditions on growth rates and estimation of the future returns.
- An impairment charge of HK$12.3 billion arose in the gaming and entertainment division cash generating unit during 2008, resulting in the carrying amount of the gaming licence being written down to its recoverable amount ……

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8. Indefinite Useful Life

- An intangible asset with an indefinite useful life shall not be amortised.
- In accordance with IAS 36 *Impairment of Assets*
  - an entity is required to test an intangible asset with an indefinite life for impairment by comparing its recoverable amount with its carrying amount
    a) annually, and
    b) whenever there is an indication that the intangible asset may be impaired.

Indefinite

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8. Indefinite Useful Life

- The useful life of such intangible asset shall be reviewed each period
  - to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset.
  - If they do not (support an indefinite useful life assessment for that asset)
    - such change in the useful life assessment shall be accounted for as a change in an accounting estimate in accordance with IAS 8

Indefinite

Be careful ……

- In accordance with IAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired.
  - As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount, and recognising any impairment loss.

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8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- The route authority may be renewed every 5 years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal.
- Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations.
- The acquiring entity
  - expects to provide service indefinitely between the 2 cities from its hub airports and
  - expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority.
- An analysis of demand and cash flows supports those assumptions.

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8. Indefinite Useful Life

Example

Assessing the useful lives of intangible assets

- Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life.
- Therefore, the route authority would not be amortised until its useful life is determined to be finite.
- It would be tested for impairment in accordance with IAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

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9. Impairment Losses

- To determine whether an intangible asset is impaired, an entity applies IAS 36 *Impairment of Assets*, that explains
  - when and how an entity reviews the carrying amount of its assets,
  - how it determines the recoverable amount of an asset and
  - when it recognises or reverses an impairment loss.
- In IAS 36, under normal situation

Triggering events

- An entity shall assess at each reporting date whether there is any indication that an asset may be impaired.
- If any such indication exists, the entity shall estimate the recoverable amount of the asset.

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9. Impairment Losses

Triggering events

- However, irrespective of whether there is any indication of impairment, an entity shall also:
  a) test
     - an intangible asset with an indefinite useful life, or
     - an intangible asset not yet available for use

     for impairment annually by comparing its carrying amount with its recoverable amount.

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9. Impairment Losses

Case

Galaxy Entertainment Group Limited

– Galaxy's annual report of 2008 set out the impairment of gaming licence as follows:
  - In the face of a weakening global economy and the tightening of Mainland China's policy on visa issuance to the PRC nationals to visit Macau, visitor growth in Macau has slowed down which also adversely affected the Macau gaming market.
  - Keen competition from the other five concession/sub-concession holders together with the rising labour and operating costs in Macau has exerted pressure on the Group's gaming operation net margin.
  - Taking into account the presently available indicators, the Group performed an impairment assessment on the net assets of the gaming business which is regarded as a cash-generating unit. This assessment indicated an impairment on the gaming licence as at 31 December 2008.

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9. Impairment Losses

Case

Galaxy Entertainment Group Limited

– Galaxy's annual report of 2008 set out the impairment of gaming licence as follows:

- With reference to a valuation carried out by an independent professional valuer, American Appraisal China Limited, the carrying value of the gaming licence is written down by approximately HK$12.3 billion to the recoverable amount of HK$1.4 billion at 31 December 2008.
- The recoverable amount of the gaming licence has been determined based on its fair value less cost to sell which the Group considers to be higher than the value-in-use.
- It is calculated using the cash flow projections derived from the financial forecasts for the remaining concession tenure in respect of a normal market participant.

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9. Impairment Losses

Timing of impairment test on intangible assets

- This impairment test may be performed at any time during an annual period
  - provided it is performed at the same time every year.
- Different intangible assets may be tested for impairment at different times.
- However, if such an intangible asset was initially recognised during the current annual period
  - that intangible asset shall be tested for impairment before the end of the current annual period.

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Improvement to IFRSs

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Amendments to IAS 38

IAS 38 *Intangible Assets*

- IAS 38.69 is amended as:
  - In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised.
    - In the cases of the supply of goods, the entity recognises such expenditure as an expense <u>when it has a right to access those goods</u>.
    - In the case of the supply of services, the entity recognises the expenditure as an expense <u>when it receives the services</u>.

Previously, an entity recognises expense when it is incurred

New requirements

<u>Implication:</u>

- An entity might have got the right, for example television advertisement, but not yet broadcasted it.

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Amendments to IAS 38

IAS 38 *Intangible Assets*

- Specific example is given in IAS 38.69(c)
  - Other examples of expenditure that is recognised as an expense when it is incurred include:

    (c) expenditure on advertising and promotional activities (including mail order catalogues).

Implication:

- An entity might have to recognise the expense when the catalogues are printed and received (but not yet delivered or mailed to the customers).

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Amendments to IAS 38

IAS 38 *Intangible Assets*

- IAS 38.69A is also added to further explain:
  - An entity has a right to access goods
    - When it owns them
    - When the goods have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment.
  - Services are received
    - when they are performed by a supplier in accordance with a contract to deliver them to the entity and
    - Not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers.

Implication:

- An entity might have to recognise the expense when the catalogues are printed and received (but not yet delivered or mailed to the customers).

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Amendments to IAS 38

Example

- If an entity employs an advertising agency to create a television advertisement,
  - the production costs should be expensed by the entity at the latest when the advertising agency completes its assigned task of creating the advertisement.
  - However, the entity would expense the costs of the television air time later, as and when the television advertisement is aired.
- If the advertising and promotional materials are being produced internally,
  - then such production costs should be expensed immediately as incurred, i.e. as production progresses.

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Investment Property (IAS 40)

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Cases First ……

Case

Hysan 希慎

For year ended 31 Dec.	2004 $'M	2005 $'M	2006 $'M	2007 $'M	2008 $'M
Turnover	1,154	1,250	1,268	1,368	1,638
Profit before tax	783	5,176	3,798	4,862	1,719
		561%	27%	28%	65%
After crediting:					
• Fair value changes on investment properties	-	4,226	2,576	3,131	(212)

- Profit is often higher than the revenue!

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Cases First ……

Case

華人置業集團
CHINESE ESTATES GROUP

For year ended 30 Dec.	2004 $'M	2005 $'M	2006 $'M	2007 $'M	2008 $'M
Turnover	5,257	2,275	4,764	4,478	1,265
Gross profit	959	785	924	1,937	985
Profit before tax	1,705	7,384	9,063	9,510	(2,961)
After crediting:					
• Fair value changes on investment properties	-	4,977	6,921	6,422	(7,468)

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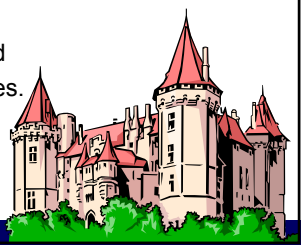
1. Scope

- IAS 40 shall be applied in the recognition, measurement and disclosure of investment property.
- However, IAS 40 does not deal with matters covered in IAS 17 *Leases*, including:
  a) classification of leases as finance leases or operating leases;
  b) recognition of lease income from investment property (see also IAS 18 Revenue);
  c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
  d) measurement in a lessor's financial statements of its net investment in a finance lease;
  e) accounting for sale and leaseback transactions; and
  f) disclosure about finance leases and operating leases.



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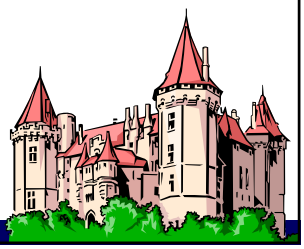
2. Definitions

- Investment property is property (land or a building – or part of a building – or both)
  - held (by the owner or by the lessee under a finance lease)
  - to earn rentals or for capital appreciation or both, rather than for:
    a) use in the production or supply of goods or services or for administrative purposes; or
    b) sale in the ordinary course of business



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2. Definitions

Examples of investment property under IAS 40 include:

- Property leased out under operating leases
- Property held for long-term capital appreciation
- Property held for a currently undetermined future use
- Vacant property to be leased out under operating leases

How's about property held by the lessee under an operating lease?

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2. Definitions – Extend to Operating Leases

- A property interest
  - that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if
    - the property would otherwise meet the definition of an investment property and
    - the lessee uses the Fair Value Model
- This classification alternative is available on a property-by-property basis
- However, once this classification alternative is selected for one such property interest held under an operating lease, all properties classified as investment property shall be accounted for using the Fair Value Model

An entity has a choice

•Let's term this classification as
"Operating Lease IP Alternative"

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2. Definitions – Extend to Operating Leases

Case

Melco Development Limited (新濠國際發展有限公司)

Annual report 2009

- The Group's investment properties comprise leasehold land in Hong Kong and Macau held under long term lease and short term leases respectively ……
- All of the Group's property interests held under operating leases to earn rentals and/or for capital appreciation purposes
  - are measured using the fair value model and
  - are classified and accounted for as investment properties.

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2. Definitions – Owner-Occupied Property

- Introduce a new term, **owner-occupied property**
  - Defined as a property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes
  - In substance, a property under IAS 16
  - Being one of the examples that is NOT an investment property

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2. Definitions – Owner-Occupied Property

Example

Examples that are NOT investment property include: **Which IAS?**

- Owner-occupied property ➢ IAS 16 & 17
- Property (completed or under development) intended for sale in the ordinary course of business ➢ IAS 2
- Property being constructed or developed for third parties ➢ IAS 11
- Property leased out under finance lease ➢ IAS 17
- Property that is being constructed or developed for future use as investment property — **Still Investment Property**
- How's the classification for existing investment property being redeveloped for continued future use as investment property? — **Still Investment Property**

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2. Definitions – Owner-Occupied Property

Refer back to IAS 16 for definition of property, plant and equipment

- Property, plant and equipment are tangible items that:
  a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  b) are expected to be used during more than one period.

Both for rental, how to distinguish?

For example, how to distinguish:

- A flat leased out for rental
- A hotel

Investment Property

Owner-occupied Property

Cash Flow → Extent of Ancillary Services

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2. Definitions – Owner-Occupied Property

Cash Flow

- One of the key indicators in determining the classification between investment property and owner-occupied property

Investment Property

- held to earn rentals or for capital appreciation or both
- therefore, generates cash flows largely independently of the other assets held by an entity.

Owner-occupied property

- the production or supply of goods or services (or the use of property for administrative purposes)
- generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process

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2. Definitions – Owner-Occupied Property

Cash Flow → Extent of Ancillary Services

- provided by an entity to the occupants of a property it holds is also considered

Ancillary services not significant → investment property

owner-occupied property ← **Significant ancillary services provided**

e.g. a owner-managed hotel is not an investment property

In consequence, owner-managed hotel shall be reclassified as

- *property, plant and equipment* (IAS 16) or
- *lease* (IAS 17)

- **Significant impact on hotel group**

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2. Definitions – Owner-Occupied Property

- It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property
- for example, there may be a spectrum from one end to another:

Ancillary services not significant ⇔ How to determine those in between these 2 ends? ⇔ **Significant ancillary services provided**

Passive investor
⇒ Investment property
⇒ Use IAS 40

Significant exposure to variation in the cash flows
⇒ Owner-occupied
⇒ Use IAS 16

- Then, judgement is required to determine
- Entities should develop consistent criteria for use in exercising the judgement

- **Significant impact on hotel group**

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2. Definitions - Partially Used Only

- Some properties comprise a portion held as investment property and another portion NOT held as investment property.
- If these portions:

Could be sold separately — or leased out separately under a finance lease
⇒ an entity accounts for the portions separately

Could not be sold separately — ⇒ the property is investment property only if an insignificant portion is NOT held as investment property

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2. Definitions - Partially Used Only

An entity owns property that is leased to, and occupied by, its parent or another subsidiary

⇒ The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group

⇒ But, from the perspective of the entity that owns it, the property is investment property if it meets the definition of investment property

- The lessor treats the property as investment property in its individual financial statements.

Consolidated

Individual

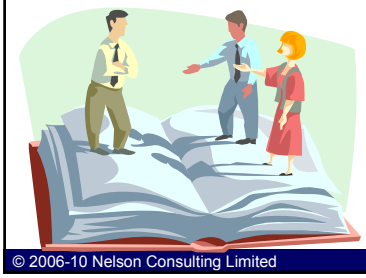
3. Recognition and Measurement

Recognition criteria

Initial Cost

Subsequent Expenditure

- Same as IAS 16 *Property, Plant and Equipment*
- Investment property shall be recognised as an asset when, and only when:
  a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
  b) the cost of the investment property can be measured reliably.



3. Recognition and Measurement

Measurement at Recognition

- An investment property shall be measured initially at its cost.
- Transaction costs shall be included in the initial measurement.
- The initial cost of a property interest held under a lease and classified as an investment property
  - shall be as prescribed for a finance lease in IAS 17
  - i.e. the asset shall be recognised at the lower of
    - the fair value of the property and
    - the present value of the minimum lease payments.
  - an equivalent amount shall be recognised as a liability.
- Introduce the measurement base for investment property acquired from exchange
  - Same as IAS 16 Property, Plant and Equipment

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4. Measurement after Recognition

Introduce Cost Model and choose either **Fair Value Model**

and **Cost Model**

- IAS 40 implicitly implies that the choice can only be elected on the first-time adoption of IAS 40
- The model chosen should be applied to all investment properties, except for
  1. Property held under operating lease classified as investment properties → No choice, only fair value model
  2. Investment property backing liabilities that pay a return linked directly to the fair value of, or returns from specific assets including that investment property → Choose a model for all such properties
  3. Investment property with a fair value that cannot be reliably determinable on a continuing basis *(i.e. inability to determine fair value reliably)* → No choice, only cost model

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4. Measurement after Recognition

Introduce Cost Model and choose either **Fair Value Model**

and **Cost Model**

- However, even Cost Model is adopted, IAS 40 still requires all entities to determine the fair value of investment property ……
  - For disclosure purpose, the fair value of the investment property has to be disclosed in notes to the financial statement!
  - In determining the fair value of investment property for both cost model and fair value model
    - ⇒ an entity is only encouraged, but not required, to rely on a professional valuer's valuation

More Flexible?

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4. Measurement after Recognition

After initial recognition, an entity that chooses → **Fair Value Model**

- shall measure all of its investment property at fair value, except in the cases that

1. the fair value cannot be determined reliably, or
2. the cost model is chosen for the investment property backing liabilities that pay a return linked directly to the fair value of, or returns from specific assets including that investment property

- When a property interest held by a lessee under an operating lease is classified as an investment property
  - ⇒ the fair value model must be applied for all investment properties
- A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises

Depreciation?

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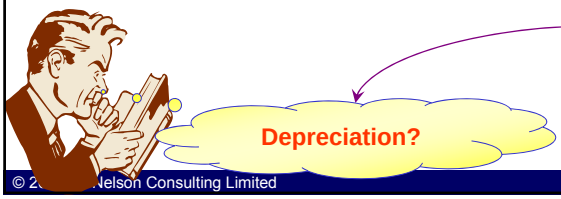
4. Measurement after Recognition

Fair Value Model

- Fair value is defined as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction
  - Same definition used in other IFRSs and IASs
  - But IAS 40 provides more explanations unique for a fair value of a property

- The fair value of investment property shall reflect market conditions at the balance sheet date

No depreciation required in IAS 40



4. Measurement after Recognition

Fair Value Model

- There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis.
- In exceptional cases, there is clear evidence when an entity first acquires an investment property (or first becomes it after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when,
  - comparable market transactions are infrequent and
  - alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available.
- In such cases, an entity shall measure that investment property (alone) using the cost model in IAS 16
  - residual value shall be assumed to be zero
  - apply IAS 16 until disposal of the investment property
  - shall continue to account for other investment properties using the fair value model.

4. Measurement after Recognition

Fair Value Model

- If an entity has previously measured an investment property at fair value
  - it shall continue to measure the property at fair value until disposal or cessation to be investment property, even if
    - comparable market transactions become less frequent or
    - market prices become less readily available.

Once you chose Fair Value Model, you cannot fall back to Cost Model

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4. Measurement after Recognition

Fair Value Model

After initial recognition, an entity that chooses → **Cost Model**

- shall measure all of its investment properties in accordance with the requirements of IAS 16 for that cost model other than
  - those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
  - then, those investment properties shall be measured in accordance with IFRS 5

Once you chose Fair Value Model, you cannot fall back to Cost Model

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4. Measurement after Recognition

Case

Casino, Guichard-Perrachon

- A retailing and real estate group stated in its annual report 2009:
  - Investment property is property held to earn rentals or for capital appreciation or both.
  - It is recognised and measured in accordance with IAS 40.
  - The shopping centres owned by the Group are classified as investment property.
  - Subsequent to initial recognition, they are measured at historical cost less accumulated depreciation and any accumulated impairment losses.
  - Their fair value is disclosed in the notes to the consolidated financial statements.
  - Investment property is depreciated over the same useful life and according to the same rules as owner-occupied property.

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5. Transfer

- Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

Change in use	Transfer from investment property
a) Commencement of owner-occupation	Owner-Occupied Property → Investment Property
b) Commencement of development with a view to sale	Inventories → Investment Property
Change in use	**Transfer to investment property**
a) End of owner-occupation	Owner-Occupied Property → Investment Property
b) Commencement of an operating lease to another party	Inventories → Investment Property

Measurement at transfer? **Depend on the model the entity is using ……**

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5. Transfer

- When an entity uses → **Cost Model**
  - transfers DO NOT change the carrying amount of the property transferred and
  - they DO NOT change the cost of that property for measurement or disclosure purposes.

Measurement at transfer?

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5. Transfer

- For a transfer from investment property (i.e. the following cases) carried at fair value

Fair Value Model

Change in use

a) Commencement of owner-occupation

b) Commencement of development with a view to sale

Transfer from investment property

Owner-Occupied Property

Inventories

Investment Property

➢ the property's deemed cost for subsequent accounting in accordance with IAS 16 or IAS 2 shall be its fair value at the date of change in use.

Measurement at transfer?

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5. Transfer

- For a transfer to investment property (i.e. the following cases) and that investment property will be carried at fair value

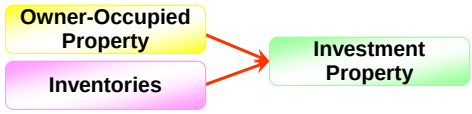
Fair Value Model

Change in use

a) End of owner-occupation

b) Commencement of an operating lease to another party

Transfer to investment property



Measurement at transfer?

5. Transfer

- For a transfer to investment property (i.e. the following cases) and that investment property will be carried at fair value

Fair Value Model

Owner-Occupied Property → **Investment Property**

- ➢ apply IAS 16 up to the date of change in use.
- ➢ treat any difference at that date between its
  - carrying amount under IAS 16, and
  - its fair value

  in the same way as a revaluation under IAS 16

⇒ Revaluation reserve is
- frozen and
- accounted for in accordance with IAS 16 subsequently

Inventories → **Investment Property**

- ➢ any difference between
  - the fair value of the property at that date and
  - its previous carrying amount

  shall be recognised in profit/loss

Measurement at transfer?

5. Transfer

Example

- GV has adopted IAS 40 and stated its investment properties at fair value even the properties are held under operating leases.
- On 1 Mar. 2010, freehold property B stated at revalued amount of $1,000 (originally used as its own office) has been leased out to derive rental income. Revaluation surplus recognised for B was $300 while B's fair value at that date should be $1,200.
- What is the accounting implication on the decision?

- Property B would be reclassified as investment property.
- In accordance with IAS 40, GV should apply IAS 16 on B up to the date of change in use and treat any difference at that date between its carrying amount under IAS 16, and its fair value in the same way as a revaluation under IAS 16.
  - Thus, a revaluation surplus of $200 would be further recognised.
  - Total revaluation reserves would become $500 ($200 + $300)
- The revaluation reserves of $500 would be frozen and accounted for in accordance with IAS 16 subsequently.

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5. Transfer

Case

Galaxy Entertainment Group Limited

- Galaxy's annual report of 2009:
  - If an investment property becomes owner-occupied,
    - it is reclassified as property, plant and equipment, and its fair value at the date of reclassification becomes its cost for accounting purposes.
  - If a property becomes an investment property because its use has changed, any difference resulting between
    - the carrying amount and
    - the fair value of this property at the date of transfer

    is recognised in equity as revaluation of property, plant and equipment.
  - However, if the fair value gives rise to a reversal of the previous impairment loss, this write-back is recognised in the income statement.

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6. Derecognition (or Disposals)

- An investment property shall be derecognised (eliminated from the balance sheet):
  1. on disposal or
  2. when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal
- Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between
  1. the net disposal proceeds and
  2. the carrying amount of the asset,

     and shall be recognised in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal

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Improvement to IFRSs

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Amendments to IAS 40

IAS 40 *Investment Property*

- The following property is added as an example of investment property:
  - Property that is being constructed or developed for future use as investment property (IAS 40.8)
- Previously, such property is accounted for in accordance with IAS 16.
- To align with this scope amendment, IAS 40.48 and 53 are amended to extend the fair value model to such property.

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Amendments to IAS 40

IAS 40 *Investment Property*

- IAS 40.53 is added with:
  - If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete,
    - it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier).
  - If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in IAS 16.

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Amendments to IAS 40

IAS 40 *Investment Property*

- IAS 40.53A and 53B are also added:
  - Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value.
  - Once construction of that property is complete, it is presumed that fair value can be measured reliably ……
  - The presumption that the fair value of investment property under construction can be measured reliably can be rebutted only on initial recognition.
  - An entity that has measured an item of investment property under construction at fair value may not conclude that the fair value of the completed investment property cannot be determined reliably.

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Amendments to IAS 40

Case

Sands China Limited
(Annual Report 2009)

- Investment properties, principally comprising buildings and building improvements, are held for long-term rental yields or capital appreciation or both and are not occupied by the Group.
- Prior to January 1, 2009,
  - investment properties under construction or development were classified as construction-in-progress and included in property and equipment.
  - Completed properties were transferred to investment properties at their carrying costs and subsequently carried at cost less accumulated depreciation and accumulated impairment losses ……
- Upon the adoption of IAS 40 (Amendment) on January 1, 2009,
  - investment properties that are currently being constructed or developed are
    - classified as investment properties and
    - stated at cost less accumulated impairment losses.

Why is there no accumulated depreciation?

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Workshop Agenda

Property, Plant and Equipment (IAS 16)

Leases (IAS 17)

Revenue (IAS 18)

Intangibl (IAS

Investment Prope (IAS 40)

Part 1 This Evening

Updated Practices

Cases & Examples from Hospitality & Gaming Industry

Bonus

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Financial Instruments (IFRS 9)

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Next Step .....

- IFRS 9 is the first part of Phase 1 of the project to replace IAS 39. The main phases are:
  - ***Phase 1: Classification and measurement***. (Requirements for financial liabilities will be included in IFRS 9 in due course.
  - ***Phase 2: Impairment methodology***. The request for Information on the feasibility of an expected loss model for the impairment of financial assets was published on 25 Jun. 2009. This formed the basis of an exposure draft, Financial Instruments: Amortised Cost and Impairment, published in Nov. 2009 with a comment deadline of 30 Jun. 2010.
  - ***Phase 3: Hedge accounting***. The project for considering how to improve and simplify the hedge accounting requirements of IAS 39 has started and the proposals are expected to be published shortly.

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Structure of IFRS 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)*
8 Effective Date and Transition

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Chapter 4 Classification

- Unless para. 4.5 of IFRS 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)

Amortised cost

Fair value

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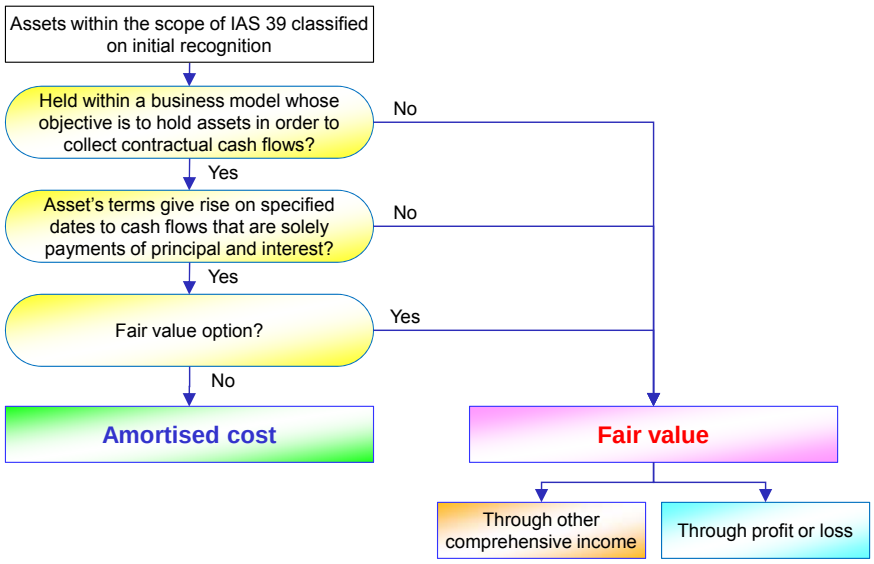
Chapter 4 Classification



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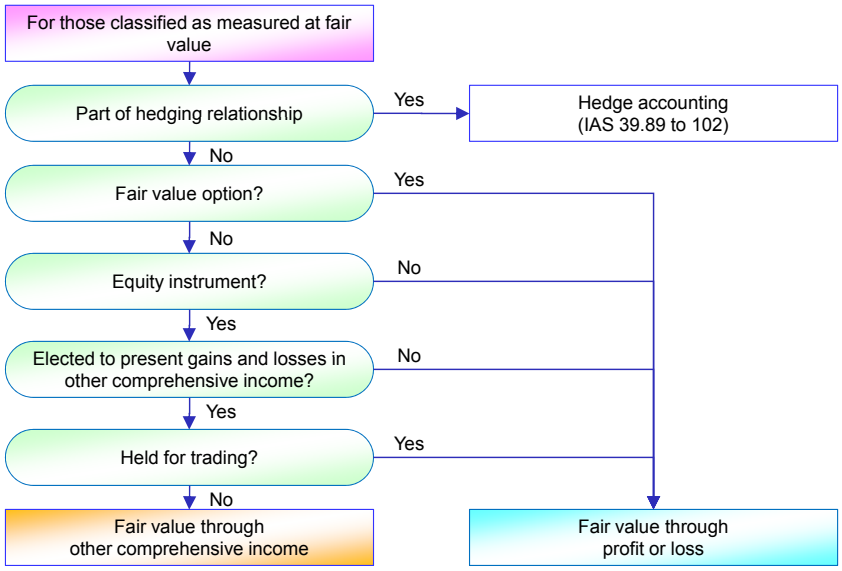
Chapter 5 Measurement



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