

HKFRS 5 and HKAS 27, 28 and 31

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Topics to be discussed

HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations

HKAS 27 Consolidated and Separate Financial Statements

HKAS 28 Investment in Associates

HKAS 31 Interests in Joint Ventures

More emphasis

Update on major changes

Simple but Comprehensive

Issues and Implementation

Cases and Examples

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Question First?

HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Why do we change

- from discontinued (SSAP 2) to discontinuing (SSAP 33)
- and then from discontinuing (SSAP 33) to discontinued (HKFRS 5)
once again and in such short period of time?

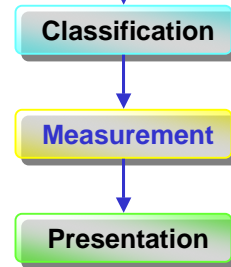
IASB and US

Non-current Assets Held for Sale and Discontinued Operations (HKFRS 5)



Objective of HKFRS 5

- To specify
 - The **accounting** for **assets held for sale**
 - The **presentation** and **disclosure** of **discontinued operations**
- In particular, to require
 - asset** that **meet the criteria** to be **classified** as **held for sale** to be:
 - measured** at
 - the lower of carrying amount and fair value less costs to sell, and
 - depreciation on such assets to cease; and
 - presented** separately on the face of the balance sheet, and
 - the results of **discontinued operations** to be **presented** separately in the income statement

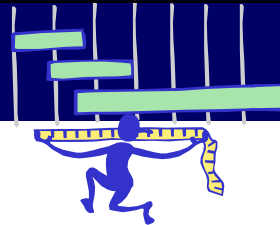


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Scope of HKFRS 5

- Classification** and **presentation** requirements of HKFRS 5 apply
 - to all recognised **non-current asset** and
 - to all **disposal groups** of an entity



Not necessary an operation

- Assets **classified as non-current** in accordance with HKAS 1 shall not be reclassified as current assets
 - until** they meet the criteria to be classified as held for sale in accordance with HKFRS 5
- Assets of a class that an entity would normally regard as non-current that are **acquired exclusively with a view to resale** shall not be classified as current
 - unless** they meet the criteria to be classified as held for sale in accordance with HKFRS 5

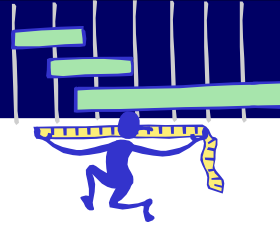
Classification

Presentation

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Scope of HKFRS 5



Disposal group

- A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction

Not necessary an operation

- The group includes **goodwill** acquired in a business combination
 - if the group is a cash-generating unit (CGU) to which goodwill has been allocated in accordance with the requirements of HKAS 36, or
 - if it is an operation within such a CGU
- It may be a group of CGU, a single CGU or part of a CGU
- If a non-current asset within the scope of the **measurement** requirements of HKFRS 5 is part of a disposal group, the measurement requirements of HKFRS 5 **apply to the group as a whole**

Classification

Presentation

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Scope of HKFRS 5

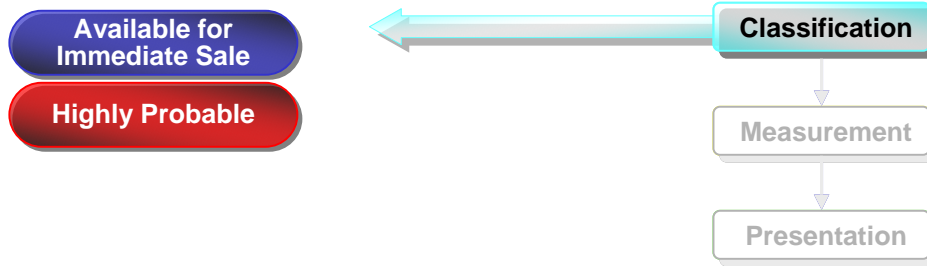
- **Measurement** requirements of HKFRS 5 also apply to all recognised non-current asset and to all disposal groups, **except for** (either as individual assets or as part of a disposal group)
 - deferred tax assets (HKAS 12 *Income Taxes*)
 - assets arising from employee benefits (HKAS 19 *Employee Benefits*)
 - financial assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*
 - non-current assets that are accounted for in accordance with the fair value model in HKAS 40 *Investment Property*
 - non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with HKAS 41 *Agriculture*
 - contractual rights under insurance contracts as defined in HKFRS 4 *Insurance Contracts*

Measurement

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Classification as Held For Sale



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Classification as Held For Sale

- An entity shall classify a non-current asset (or disposal group) as held for sale if
 - its carrying amount will be recovered principally
 - through a sale transaction
 - rather than through continuing use
- For this to be the case
 - the asset (or disposal group) must be available for immediate sale
 - its sale must be highly probable

Available for Immediate Sale
Highly Probable



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Classification as Held For Sale

Available for Immediate Sale

To be classified as held for sale

- the asset (or disposal group) must be available for immediate sale
 - in its present condition
 - subject only to terms that are usual and customary for sales of such assets (or disposal groups)



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Classification as Held For Sale

Example

An entity is committed to a plan to sell its headquarters building and has initiated actions to locate a buyer.

However, the entity has 2 plans and intends to:

1. transfer the building to the buyer after it vacates the building; or ✓
2. continue to use the building until construction of a new headquarters building is completed ✗

← The time necessary to vacate is usual and customary for sale of such asset

← The delay in time implies not available for immediate sale

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Classification as Held For Sale

Example

An entity is committed to a plan to sell a manufacturing facility and has initiated actions to locate a buyer.

At the plan commitment date, there is a backlog of uncompleted customer orders.

The entity has 2 plans and intends to:

1. ✓ sell the facility with its operations. Any uncompleted customer orders at the sale date will be transferred to the buyer.
2. ✗ sell the facility, but without its operations. The entity does not intend to transfer the facility to a buyer until after it ceases all operations of the facility and eliminates the backlog of uncompleted customer orders.

It will not affect the timing of the transfer.

The delay in the timing of the transfer of the facility imposed by the entity (seller) demonstrates that the facility is not available for immediate sale.

Classification as Held For Sale

- **Highly probable**

- Significantly more likely than probable
- Probable ⇒ more likely than not

- **For the sale to be highly probable**

- Appropriate level of management must be committed to a plan to sell the asset (or disposal group)
- Active programme to locate a buyer and complete the plan must have been initiated
- Asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value
- The sale expected to qualify for recognition as a completed sale within 1 year from the date of classification, except as permitted under HKFRS 5; and
- Unlikely that significant changes to the plan will be made or that the plan will be withdrawn

Highly Probable

Extension to Complete
Beyond 1 year

Classification as Held For Sale



Highly Probable

Extension to Complete
Beyond 1 year

Extension to complete sale beyond one year

- Events or circumstances may extend the period to complete the sale beyond one year
- Not preclude an asset from being classified as held for sale if
 1. the delay is caused by events or circumstances beyond the entity's control and
 2. there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group)

Beyond Control

Remain Committed

3 situations listed
in HKFRS 5

Classification as Held For Sale

Situation 1

At the date an entity commits itself to a plan to sell a non-current asset, it reasonably expects that

- others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:
 - (i) actions necessary to respond to those conditions cannot be initiated until after a firm purchase commitment is obtained, and
 - (ii) a firm purchase commitment is highly probable within one year.

Classification as Held For Sale

Example

Situation 1

- Entity A in the power generating industry is committed to a plan to sell a disposal group that represents a significant portion of its regulated operations.
- The sale requires regulatory approval, which could extend the period required to complete the sale beyond one year.
- Actions necessary to obtain that approval cannot be initiated until after a buyer is known and a firm purchase commitment is obtained.
- However, a firm purchase commitment is highly probable within one year.

- In that situation, the conditions for an exception to the one-year requirement would be met.

Classification as Held For Sale

Situation 2

An entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:

- (i) timely actions necessary to respond to the conditions have been taken, and
- (ii) a favourable resolution of the delaying factors is expected.

Classification as Held For Sale

Example

Situation 2

- Entity A is committed to a plan to sell a manufacturing facility in its present condition and classifies the facility as held for sale at that date.
 - After a firm purchase commitment is obtained, the buyer's inspection of the property identifies environmental damage not previously known to exist.
 - Entity A is required by the buyer to make good the damage, which will extend the period required to complete the sale beyond one year.
 - However, the entity has initiated actions to make good the damage, and satisfactory rectification of the damage is highly probable.
- In that situation, the conditions for an exception to the one-year requirement would be met.

Classification as Held For Sale

Situation 3

During the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:

- i) during the initial one-year period the entity took action necessary to respond to the change in circumstances,
- ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and
- iii) the criteria of available for immediate sale and highly probable are met.

Classification as Held For Sale

Example

Situation 3

- **HC Bank** is committed to a plan to sell its old head office building and classifies it as held for sale.
 - During the initial one-year period, the original market conditions deteriorate and, as a result, the asset is not sold by the end of that period.
 - During that period, the bank actively solicited but did not receive any reasonable offers to purchase the asset and then, reduced the price.
 - The building continues to be actively marketed at a price that is reasonable given the change in market conditions.
- The criteria to be classified as held for sale are still met, in that situation, the conditions for an exception to the one-year requirement would be met.
- At the end of the initial one-year period, the building would continue to be classified as held for sale.

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Classification as Held For Sale

Example

Situation 3



- If, during the following one-year period, market conditions deteriorate further, and the old head office building is not sold by the end of that period.
- **HC Bank** believes that the market conditions will improve and has not further reduced the price of the asset.
- The building continues to be held for sale, but at a price in excess of its current fair value.

- In that situation, the absence of a price reduction demonstrates that the asset is not available for immediate sale.
- In addition, HKFRS 5 also requires an asset to be marketed at a price that is reasonable in relation to its current fair value.
- Therefore, the conditions for an exception to the one-year requirement would not be met.
- The asset would be reclassified as held and used in accordance with HKFRS 5 (to be discussed).

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Classification as Held For Sale

Implication to subsidiary acquired for disposal?

Available for Immediate Sale

Highly Probable

Sale transactions include

- exchanges of non-current assets for other non-current assets when the exchange has **commercial substance**

Non-current asset (or disposal group) acquired exclusively with a view to its subsequent disposal shall be classified as held for sale at the acquisition date only if

- the one-year requirement is met and
- it is highly probable that any other criteria that are not met at that date will be met within a short period following the acquisition (usually within 3 months)

If the criteria to be classified as asset held for sale are met after the balance sheet date

- an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued

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Classification as Held For Sale

Available for Immediate Sale

Highly Probable

Non-current assets (or disposal group) that are to be abandoned

- Shall not classify them as held for sale
- Because its carrying amount will be
 - recovered principally through continuing use,
 - not recovered principally through a sale transaction
- If such disposal group meets the criteria as an operation (discussed later)
 - the entity shall still present the results and cash flows of the disposal group as discontinued operations at the date on which it ceases to be used
- They include non-current assets (disposal group)
 - used to the end of their economic life
 - closed rather than sold
 - but excluded those temporarily taken out of use

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Classification as Held For Sale

Example

- In Oct 2005 an entity decides to abandon all of its cotton mills, which constitute a major line of business.
- All work stops at the cotton mills during the year ended 31 Dec. 2006.
- In the financial statements for the year ended 31 Dec. 2005, results and cash flows of the cotton mills are treated as continuing operations.

← In the financial statements for the year ended 31 Dec. 2006, the results and cash flows of the cotton mills are treated as discontinued operations. The entity makes the disclosures required as set out in HKFRS 5 (to be discussed).

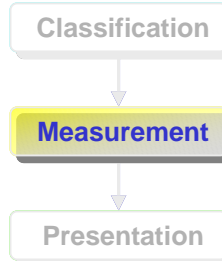
- An entity ceases to use a production plant because demand for its product has declined.
- However, the plant is maintained in workable condition and it is expected that it will be brought back into use if demand picks up.

← The plant is not regarded as abandoned.

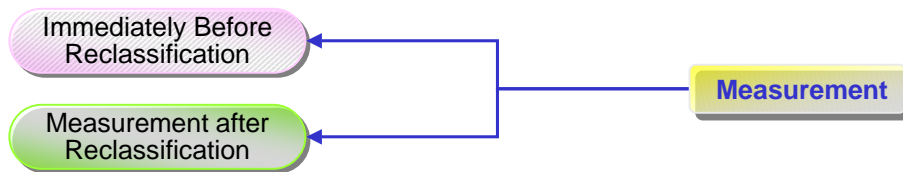
Measurement

- Measure non-current asset (or disposal group) classified as held for sale at the **lower** of its
 - **Carrying amount** and
 - **Fair value less costs to sell**
- Same for those newly acquired asset (or disposal group) meets the criteria to be classified as held for sale
- When the sale is expected to occur beyond one year,
 - the entity shall measure the costs to sell at their present value
 - examples: those situations with exception to one-year requirement

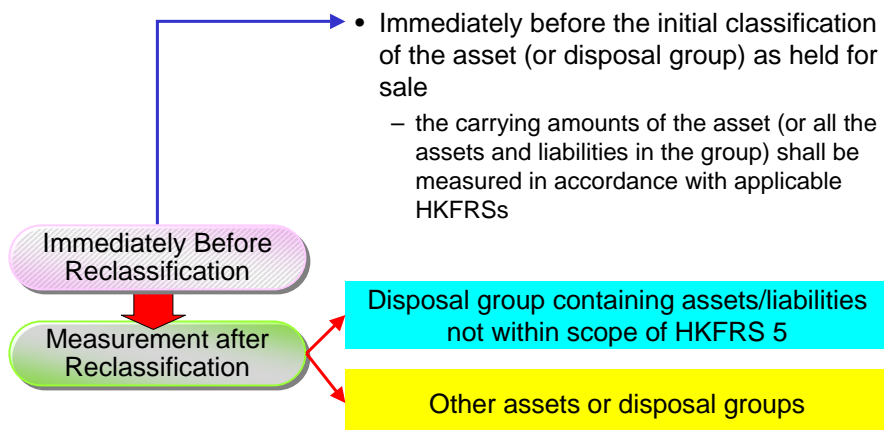
Fair Value less Cost to Sell:
a new name of **Net Selling Price**



Measurement



Measurement



Measurement

Disposal group containing assets/liabilities not within scope of HKFRS 5

- some assets and liabilities included in disposal group may not be measured in accordance with HKFRS 5
- because they are not within the measurement requirements of HKFRS 5
 - say deferred tax assets and investment properties
- **Firstly**, the carrying amounts of such assets and liabilities
 - shall be re-measured in accordance with applicable HKFRSs before the fair value less costs to sell of the disposal group is remeasured
- **Then**, the whole disposal group
 - shall be remeasured at lower of the whole disposal group's carrying amount or fair value less costs to sell
 - i.e. then follows



Measurement

Other assets or disposal groups

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Measurement

Other assets or disposal groups

Recognition of impairment losses and reversals

- HKAS 36 becomes ineffective on those assets or disposal groups when they are classified as held for sale under HKFRS 5
- In recognition of impairment loss under HKFRS 5
 - **Fair value less costs to sell** is used,
 - instead of **recoverable amount**
- an entity shall
 - recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell
 - also recognise a gain for any subsequent increase in fair value less costs to sell of an asset,
 - but not in excess of the cumulative impairment loss that has been recognised either under HKFRS 5 or HKAS 36

Measurement

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Measurement

Other assets or disposal groups

Recognition of impairment losses and reversals

- The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group
 - that are within the scope of the measurement requirements of HKFRS 5, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of HKAS 36 *Impairment of Assets*, that is
 - **Recognition of impairment loss**
 - a) first, to reduce the carrying amount of any goodwill allocated to the disposal group; and
 - b) then, to the other assets of the disposal group pro rata on the basis of the carrying amount of each asset in the group.
 - **Reversal of impairment loss**
 - allocated to the assets of the group, except for goodwill, pro rata with the carrying amounts of those assets.

Measurement

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Measurement

Example

	Carrying amount at the reporting date before classification as <u>held for sale</u>	Carrying amount as remeasured immediately before classification as <u>held for sale</u>
Goodwill	\$ 1,500	\$ 1,500
Property, plant and equipment (carried at revalued amounts)	4,600	4,000
Property, plant and equipment (carried at cost)	5,700	5,700
Inventory	2,400	2,200
AFS financial assets	<u>1,800</u>	<u>1,500</u>
Total	16,000	14,900

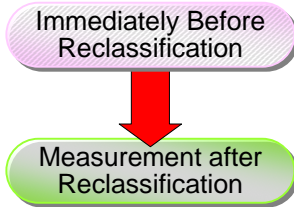
- Pursuant to the classification of the group of assets as disposal group, the entity estimates that fair value less costs to sell of the disposal group amounts to \$13,000.
- Calculate the impairment loss and allocate to the individual asset.

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Measurement

Example



- The entity recognises the loss of **\$1,100** (\$16,000 - \$14,900) immediately before classifying the disposal group as held for sale.

- Since an entity measures a disposal group classified as held for sale at the lower of its carrying amount and fair value less costs to sell
 - the entity recognises an impairment loss of **\$1,900** (\$14,900 - \$13,000) when the group is initially classified as held for sale.

Then, allocate \$1,900

Measurement

Example

	Carrying amount as remeasured immediately before classification as held for sale	Allocated impairment loss	Carrying amount after allocation of impairment loss
Goodwill	\$ 1,500	\$ (1,500)	\$ 0
Property, plant and equipment (carried at revalued amounts)	4,000	(165)	3,835
Property, plant and equipment (carried at cost)	5,700	(235)	5,465
Inventory	2,200	-	2,200
AFS financial assets	<u>1,500</u>	-	<u>1,500</u>
Total	14,900	(1,900)	13,000

- Firstly, the impairment loss reduces any amount of goodwill
- Then, the residual loss is allocated to other non-current assets pro rata based on the carrying amounts of those non-current asset.

Measurement

- No depreciation (or amortisation) made on non-current asset while
 - it is classified as held for sale, or
 - while it is part of a disposal group classified as held for sale
- Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.



Measurement

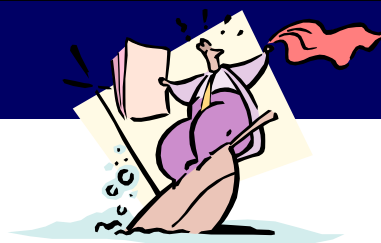
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Measurement

Changes to a plan of sale

- If the criteria to be classified as held for sale are no longer met
 - the entity shall cease to classify the asset as held for sale
- Then, an entity shall measure such non-current asset that ceases to be classified as held for sale at the lower of:
 - its carrying amount before the asset was classified as held for sale
 - adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset not been classified as held for sale, and
 - its recoverable amount at the date of the subsequent decision not to sell
- Any consequential adjustment shall be included
 - in income from continuing operations in the period in which the criteria on asset to be classified as held for sale are no longer met
 - unless revaluation under HKAS 16 or 38 is adopted before classification as held for sale



Measurement

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Measurement



Changes to a plan of sale

- Removal from disposal group
 - If an entity removes an individual asset or liability from a disposal group classified as held for sale
 - the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group only if
 - the group (as a whole) meets the criteria on asset to be classified as held for sale.
 - Otherwise, the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale
 - shall be measured individually at the lower of their carrying amounts and fair values less costs to sell at that date.
 - Any non-current assets that do not meet the criteria shall cease to be classified as held for sale.

Measurement

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Measurement – Case



Stated in its 2005 Interim Financial Statements (issued on 1 Aug. 2005)

- Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in 'Other assets'.
- The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange.
- No depreciation is provided in respect of assets held for sale.
- Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement.
- Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the income statement.

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Presentation

1. Presenting non-current asset (or disposal group) held for sale

2. Presenting discontinued operations

3. Additional disclosures



Classification

Measurement

Presentation

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Presentation

1. Presenting non-current asset (or disposal group) held for sale

- Such non-current asset or disposal group
 - shall be presented separately from other assets in the balance sheet.
- The liabilities of a disposal group classified as held for sale shall be
 - shall be presented separately from other liabilities in the balance sheet.
- Such assets and liabilities shall not be offset and presented as a single amount.
- The major classes of assets and liabilities classified as held for sale shall be separately disclosed either
 - on the face of the balance sheet or
 - in the notes,except for newly acquired subsidiary classified as held for sale
- An entity shall present separately any cumulative income or expense recognised directly in equity relating to a non-current asset (or disposal group) classified as held for sale.

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Presentation

1. Presenting non-current asset (or disposal group) held for sale

	<u>2005</u>	<u>2004</u>
Assets		
Non current assets		
Item 1	\$ x	\$ x
Item 2	<u>x</u>	<u>x</u>
	<u>x</u>	<u>x</u>
Current assets		
Item 3	x	x
Item 4	<u>x</u>	<u>x</u>
	x	x
<i>Non-current assets classified as held for sale</i>	8,000	-
	<u>x</u>	<u>x</u>
Total assets	<u>x</u>	<u>x</u>

Presentation

1. Presenting non-current asset (or disposal group) held for sale

	<u>2005</u>	<u>2004</u>
Liabilities		
Non-current liabilities		
Item 8	x	x
Item 9	<u>x</u>	<u>x</u>
	<u>x</u>	<u>x</u>
Current liabilities		
Item 10	x	x
Item 11	<u>x</u>	<u>x</u>
	x	x
<i>Liabilities directly associated with non-current assets classified as held for sale</i>	3,300	-
	<u>x</u>	<u>x</u>
Total liabilities	<u>x</u>	<u>x</u>

Presentation

1. Presenting non-current asset (or disposal group) held for sale

	<u>2005</u>	<u>2004</u>
Equity		
Equity attributable to equity holders of the parent		
Item 6	\$ x	\$ x
Item 7	x	x
<i>Amounts recognised directly in equity relating to non-current assets held for sale</i>		
	<u>400</u>	<u>-</u>
e.g. revaluation reserves	x	x
Minority interest	<u>x</u>	<u>x</u>
Total equity	<u>x</u>	<u>x</u>

Presentation

1. Presenting non-current asset (or disposal group) held for sale

- If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition
 - disclosure of the major classes of assets and liabilities is not required.
- Prior period's presentation shall not be revised
 - An entity shall not reclassify or re-present amounts presented for non-current assets (or for the assets and liabilities of disposal groups) classified as held for sale in the balance sheets for prior periods to reflect the classification in the balance sheet for the latest period presented.

(except for associate and jointly controlled entities accounted for under equity method or proportionate consolidation, to be discussed later)

Presentation

2. Presenting discontinued operations

- Discontinued operation replaced discontinuing operation
- A discontinued operation is defined as
 - a **component of an entity** that either **has been disposed of** or **is classified as held for sale** and:
 - represents a separate major line of business or geographical area of operations,
 - is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or
 - is a subsidiary acquired exclusively with a view to resale
- A **component of an entity** is defined as
 - operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity
 - In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use

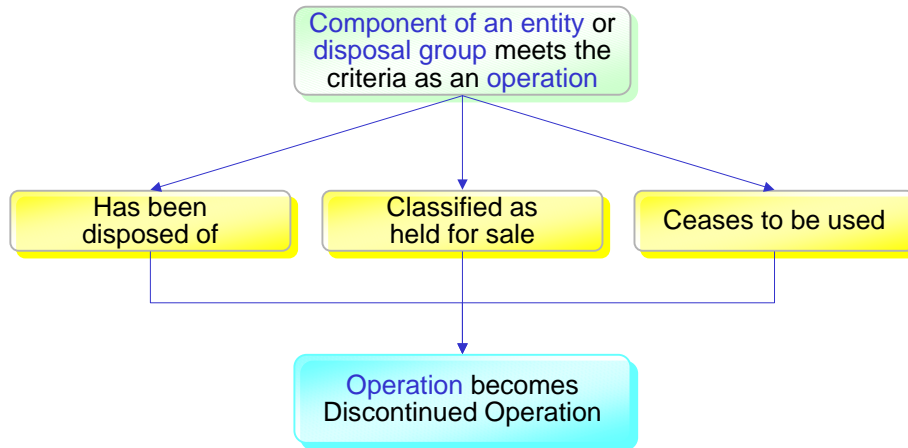
Presentation

2. Presenting discontinued operations

- As discussed before, a discontinued operation also includes a disposal group to be abandoned
 - at the date on which it ceases to be used (i.e. to be abandoned),
 - so long as it also meets the following criteria:
 - represents a separate major line of business or geographical area of operations,
 - is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or
 - is a subsidiary acquired exclusively with a view to resale

Presentation

2. Presenting discontinued operations



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Presentation – Cases

Tian Teck Land Limited (266)

- Land owner of the Hyatt Regency Hotel in TST, has early adopted only one new HKFRS, states in its 2004/05 Annual Report:
 - The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 March 2005, except for HKFRS 5 “Non-current assets held for sale and discontinued operations”.
 - The HKFRS 5 has defined the timing of the classification of an operation as “discontinued” to be the date
 - when the operation
 - meets the criteria as “held for sale” or
 - has already been disposed of, or
 - the assets have ceased to be used.
 - Following the adoption of this HKFRS, the hotel operation (see note 3) will not be disclosed as discontinuing operation until the operation has ceased.
 - The early adoption of HKFRS 5 has no significant impact on the Group’s results of operations and financial position.



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Presentation

2. Presenting discontinued operations

- An entity shall disclose:
 - a single amount on the face of the income statement comprising the total of:
 - the post-tax profit or loss of discontinued operations and
 - the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation
- A further analysis of the above single amount is required and may be presented in the notes or on the face of the income statement, e.g.
 - i) the revenue, expenses and pre-tax profit or loss of discontinued operations;
 - ii) the gain or loss recognised on the measurement to fair value less costs to sell; and
 - iii) the related income tax expense as required by HKAS 12

Presentation

2. Presenting discontinued operations

- An entity shall disclose:
 - the net cash flows attributable to the operating, investing and financing activities of discontinued operations (but it is not required for newly acquired subsidiaries classified as held for sale on acquisition). These disclosures may be presented either in the notes or on the face of the financial statements.
- An entity shall re-present the above disclosures for prior periods presented in the financial statements
 - so that the disclosures relate to all operations that have been discontinued by the balance sheet date for the latest period presented.

Presentation

Example

	<u>2002</u>	<u>2001</u>
Continuing operations		
Revenue	\$1,200	\$1,000

	<u>.....</u>	<u>.....</u>
Profit before tax	700	500
Income tax expense	<u>(80)</u>	<u>(75)</u>
Profit for the period from continuing operations	620	425
Discontinued operations		
Profit for the period from discontinued operations*	<u>120</u>	<u>105</u>
Profit for the period	<u>740</u>	<u>530</u>
Attributable to:		
Equity holders of the parent	600	400
Minority interest	<u>140</u>	<u>130</u>
	<u>740</u>	<u>530</u>

* As permitted by HKFRS 5, the required analysis would be given in the notes to the financial statements

Presentation

2. Presenting discontinued operations

- Prohibit retroactive classification of an operation as discontinued
 - when the criteria for that classification are not met until after the balance sheet date.



Presentation

2. Presenting discontinued operations

Adjustments in current period relating to amounts previously presented in discontinued operations

- Such adjustments (if directly related to the disposal of a discontinued operation in a prior period) shall be classified separately in discontinued operations.
- The nature and amount of such adjustments shall be disclosed.
 - Examples of circumstances in which these adjustments may arise include the resolution of uncertainties:
 - that arise from the terms of the disposal transaction (say resolution of purchase price adjustments)
 - arise from and are directly related to the operations of the component before its disposal (say environmental and product warranty obligations)

Presentation

2. Presenting discontinued operations

Cease to be Held for Sale

- If an entity ceases to classify a component of an entity as held for sale
 - the results of operations of the component previously presented in discontinued operations in accordance with above requirements
 - shall be reclassified and included in income from continuing operations for all periods presented.
 - the amounts for prior periods shall be described as having been re-presented.

Why is there only cease to be held for sale?

Presentation

2. Presenting discontinued operations

Gains or Losses Relating to Continuing Operations

- Any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale that does not meet the definition of a discontinued operation
 - shall be included in profit or loss from continuing operations.



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Presentation

3. Additional disclosures

- An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:
 - a) a description of the non-current asset (or disposal group);
 - b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
 - c) the gain or loss recognised in respect of the impairment loss (or reversal) and, if not separately presented on the face of the income statement, the caption in the income statement that includes that gain or loss;
 - d) if applicable, the segment in which the non-current asset (or disposal group) is presented in accordance with HKAS 14 *Segment Reporting*.

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Transitional Provisions

- The HKFRS shall be applied prospectively to
 - non-current assets (or disposal groups) that meet the criteria to be classified as held for sale, and
 - operations that meet the criteria to be classified as discontinued after the effective date of the HKFRS.
- An entity may apply the requirements of the HKFRS to
 - all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and
 - operations that meet the criteria to be classified as discontinued after any date before the effective date of the HKFRS, provided the valuations and other information needed to apply the HKFRS were obtained at the time those criteria were originally met.

Implication – Cases

Beijing Enterprises Holdings Ltd.



- Has early adopted all new HKFRS in 2004 and stated that:
 - The adoption of HKFRS 5, which has resulted in a change in accounting policy on the recognition of a discontinued operation.
 - Prior to the adoption of HKFRS 5, the Group would have previously recognised a discontinued operation at the earlier of when:
 - The group enters into a binding agreement, and
 - The board of directors have approved and announced a formal disposal plan
 - HKFRS 5 now requires an operation to be classified as discontinued when the criteria to be classified as held for sale have been met or the Group has disposed of the operation.
 - Held for sale is when the carrying amount of an operation will be recovered principally through a sale transaction and not through continuing use.
 - The result of this change in accounting policy is that a discontinued operation is recognised by the Group at a later point than (always?) the accounting policy previously adopted due to the recognition criteria being stricter under HKFRS 5.

Implication – Newly Acquired Subsidiary

- A subsidiary acquired with a view to sale is not exempt from consolidation in accordance with HKAS 27 *Consolidated and Separate Financial Statements*.
 - However, if it meets the criteria (as discussed before):
 - the one-year requirement is met, and
 - it is highly probable that any other criteria that are not met at the acquisition date will be met within a short period following the acquisition (usually within 3 months)
- then, it is presented as a disposal group classified as held for sale.

Implication – Newly Acquired Subsidiary

Example

- Entity A acquires an entity H, which is a holding company with 2 subsidiaries, S and SS.
- SS is acquired exclusively with a view to sale and meets the criteria to be classified as held for sale.
- In accordance with the definition of discontinued operation in HKFRS 5, SS is also a discontinued operation.
- Given that
 - initially, the estimated fair value less costs to sell of S2 is \$135.
 - Identifiable liabilities of SS at fair value is \$40
 - at the balance sheet date, the disposal group at the lower of its cost and fair value less costs to sell is at \$130
 - Liabilities are stated in accordance with applicable HKFRSs, say at \$35

Implication – Newly Acquired Subsidiary

Example

- Initially, Entity A measures
 - the identifiable liabilities of SS at fair value at \$ 40
 - the acquired total assets at (\$135 + \$40) 175
- At the balance sheet date, Entity A
 - remeasures the disposal group at 130
 - remeasured the liabilities in accordance with applicable HKFRSs at 35
 - the total assets are measured at \$130 + \$35, i.e. at 165
 - in its consolidated financial statements, presents
 - the assets and liabilities separately from other assets and liabilities
 - in the income statement, presents
 - the total of the post-tax profit or loss of SS and
 - the post-tax loss (or gain in other cases) recognised on the subsequent remeasurement of SS, which equals the remeasurement of the disposal group from \$135 to \$130
- Further analysis of the assets and liabilities or of the change in value of the disposal group is not required.

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Consolidated and Separate Financial Statements (HKAS 27)



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Consolidated and Separate Financial Statements

Main Issues

1. Scope
2. Presentation of Consolidated Financial Statements
3. Scope of Consolidated Financial Statements
4. Consolidation Procedures
5. Separate Financial Statements
6. Disclosure
7. HK Incorporated Companies

Consolidated
Financial Statements

Separate
Financial Statements

1. Scope

- HKAS 27 *Consolidated and Separate Financial Statements*
 - shall be applied in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent.
- Consolidated financial statements are the financial statements of a group presented as those of a single economic entity.
- HKAS 27 shall also be applied in accounting for
 - investments in subsidiaries,
 - jointly controlled entities
 - and associateswhen an entity elects, or is required by local regulations, to present separate financial statements

Consolidated
Financial Statements

Separate
Financial Statements

2. Presentation of Consolidated Financial Statements

- A parent, other than a parent described below, shall present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with HKAS 27.
 - A parent is an entity that has one or more subsidiaries.
 - A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).
- A parent need not present consolidated financial statements if and only if:
 - a) the parent is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners do not object such non-presenting
 - b) the parent's debt or equity instruments are not traded in a public market;
 - c) the parent did not file, nor is it in the process of filing, its financial statements with a regulatory organization for issuing instruments in a public market; and
 - d) the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with HKFRSs or IFRSs.

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2. Presentation of Consolidated Financial Statements

- Section 124(2) of the HK Companies Ordinance permits a holding company not to prepare group accounts
 - if the company is a wholly-owned subsidiary of another company at the end of its financial year.
- Accordingly, a HK incorporated parent company can only take advantage of the exemption of HKAS 27
 - if it also satisfies the exemption allowed under the above section.



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3. Scope of Consolidated Financial Statements

- Consolidated financial statements shall include all subsidiaries of the parent.
 - As defined, a subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (i.e. the parent).
 - Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with HKFRS 5, it shall be accounted for in accordance with HKFRS 5 (not HKAS 27).
 - It implies that previous exclusions in SSAP 32 are eliminated and
 - Control intended to be temporary should still meet HKFRS 5
 - Control of an entity, which is operating under severe long-term restrictions that significantly impair its ability to transfer funds to the parent, is no longer a reason to exclude a subsidiary

What is Control?

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3. Scope of Consolidated Financial Statements – Control

- **Control** is presumed to exist when the parent owns, directly or indirectly, more than half of the voting power of an entity
 - unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.
- **Control** also exists when the parent owns half or less of the voting power of an entity when there is:
 - a) power over more than half of the voting rights by virtue of an agreement with other investors;
 - b) power to govern the financial and operating policies of the entity under a statute or an agreement;
 - c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
 - d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

Similar to HKFRS 3

What is Control?

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3. Scope of Consolidated Financial Statements – Control

- Potential voting rights refer to the situation that an entity may own
 - share warrants, share call options and other instruments that are convertible into ordinary shares, or
 - other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power of another entity.
- Potential voting rights that are currently exercisable or convertible are considered when assessing control.
 - Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
- In assessing whether potential voting rights contribute to control, the entity examines all facts and circumstances that affect potential voting rights, except the intention of management and the financial ability to exercise or convert.

What is Control?

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Implication - Cases

But, those statements are prepared under IFRS



Jilin Chemical Industrial Co. Ltd.
(2004 Annual Report)

- The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.



Datang International Power Generation Co. Ltd.
(2004 Annual Report)

- The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Company and its subsidiaries control another entity.

What is Control?

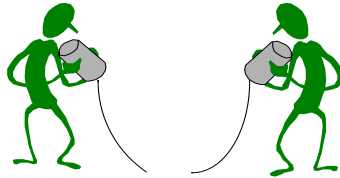
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3. Scope of Consolidated Financial Statements – Control

Loss of Control

- It occurs when a parent loses the power to govern the financial and operating policies of an investee so as to obtain benefits from its activities
- It can occur with or without a change in absolute or relative ownership levels, for example:
 - when a subsidiary becomes subject to the control of a government, court, administrator or regulator, or
 - as a result of a contractual agreement



What is **Control**?

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3. Scope of Consolidated Financial Statements – Control

Special Purpose Entities

- An entity may be created to accomplish a narrow and well-defined objective. Such a special purpose entity (SPE) may take the form of a corporation, trust, partnership or unincorporated entity.
- The sponsor or creator frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE. An entity that engages in transactions with an SPE may in substance control the SPE.
- A beneficial interest in an SPE may, for example, take the form of a debt or equity instrument, a participation right, a residual interest or a lease.
- Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits of the SPE's activities

What is **Control**?

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3. Scope of Consolidated Financial Statements – Control

Special Purpose Entities

- HKAS 27 requires the consolidation of entities that are controlled by the reporting entity.
- Thus, an special purpose entity (SPE) should be consolidated
 - when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.
- Reference is made to HKAS Interpretation 12 *Consolidation – Special Purpose Entities*.

What is **Control**?

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3. Scope of Consolidated Financial Statements – Control

Special Purpose Entities

- The followings, for example, may indicate a relationship in which an entity controls an SPE and consequently should consolidate the SPE:
 - a) in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation;
 - b) in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an "autopilot" mechanism, the entity has delegated these decision making powers;
 - c) in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
 - d) in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

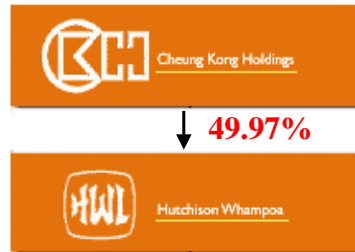
What is **Control**?

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3. Scope of Consolidated Financial Statements – Control

Example



- Is it Control or Significant Influence?
- Why not over 50%?

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3. Scope of Consolidated Financial Statements – Control

Subsidiary excluded from consolidation

- HKAS 27 specifically states that a subsidiary is NOT excluded from consolidation because
 - the investor is a venture capital organisation, mutual fund, unit trust or similar entity.
 - its business activities are dissimilar from those of the other entities within the group.
 - Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.
 - For example, the disclosures required by HKAS 14 *Segment Reporting* help to explain the significance of different business activities within the group.

What is Control?

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4. Consolidation Procedures

General procedures

- In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses.
- In consolidation, the following steps are taken:
 - a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see HKFRS 3, which describes the treatment of any resultant goodwill);
 - b) minority interests in the profit or loss of consolidated subsidiaries for the reporting period are identified; and
 - c) minority interests in the net assets of consolidated subsidiaries are identified separately from the parent shareholders' equity in them. Minority interests in the net assets consist of:
 - i) the amount of those minority interests at the date of the original combination calculated in accordance with HKFRS 3; and
 - ii) the minority's share of changes in equity since the date of the combination.

4. Consolidation Procedures

General procedures

- When potential voting rights exist
 - the proportions of profit or loss and changes in equity allocated to the parent and minority interests
 - are determined on the basis of present ownership interests and
 - do not reflect the possible exercise or conversion of potential voting rights.

4. Consolidation Procedures

Intragroup balances, transactions, income and expenses

- Intragroup balances, transactions, income and expenses shall be eliminated in full.
- Examples include:
 - Income, expenses and dividends
 - Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets
 - Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.
- HKAS 12 Income Taxes applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions

4. Consolidation Procedures

Same reporting date of parent and subsidiaries

- The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements
 - Shall be prepared as of the same reporting date.
 - When the reporting dates are different, the subsidiary prepares additional financial statements as of the same date as the financial statements of the parent unless it is impracticable to do so.
- When the financial statements of a subsidiary used in the preparation of consolidated financial statements are prepared as of a reporting date different from that of the parent
 - adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the parent's financial statements.
 - In any case, the difference between the reporting date of the subsidiary and that of the parent shall be no more than 3 months.
- The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.

4. Consolidation Procedures

Uniform accounting policies

- Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.
- If different accounting policies are adopted for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements

4. Consolidation Procedures

Income and expenses of a subsidiary

- Included in the consolidated financial statements
 - from the acquisition date, as defined in HKFRS 3.
 - until the date on which the parent ceases to control the subsidiary.
- The difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity (per HKAS 21)
 - is recognised in the consolidated income statement as the gain or loss on the disposal of the subsidiary.

4. Consolidation Procedures

Minority Interests

- Minority interest is that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent
- Minority interest shall be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity
- Minority interest in the profit or loss of the group shall also be separately disclosed

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4. Consolidation Procedures

Example

Entity A acquired 80% of Entity X at year end by issuing 1,600 shares of HK\$1 each and their financial statements are set out below:

	<u>A</u>	<u>X</u>	<u>Line by Line Consol</u>
Non-current assets			
Property, plant & equipment	<u>1,500</u>	<u>2,000</u>	<u>3,500</u>
Current assets			
Inventories	100	500	600
Cash at bank	<u>100</u>	<u>100</u>	<u>200</u>
	<u>200</u>	<u>600</u>	<u>800</u>
Current liabilities			
Account payables	<u>(100)</u>	<u>(600)</u>	<u>(700)</u>
Net current assets	<u>100</u>	<u>0</u>	<u>100</u>
Net assets	<u>1,600</u>	<u>2,000</u>	<u>3,600</u>
Equity			
Share capital	100	200	1,700
Reserves	<u>1,500</u>	<u>1,800</u>	1,500
	<u>1,600</u>	<u>2,000</u>	3,200
Minority interest			<u>400</u>
			3,600

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4. Consolidation Procedures

Minority Interests

- Losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the subsidiary's equity.
 - The excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority
 - has a binding obligation and
 - is able to make an additional investment to cover the losses.
 - If the subsidiary subsequently reports profits, such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered
- If a subsidiary has outstanding cumulative preference shares that are held by minority interests and classified as equity
 - the parent computes its share of profits or losses after adjusting for the dividends on such shares, whether or not dividends have been declared

4. Consolidation Procedures

Cease to be a Subsidiary

- An investment in an entity shall be accounted for in accordance with HKAS 39 from the date that it ceases to be a subsidiary
 - provided that it does not become
 - an associate as defined in HKAS 28 or
 - a jointly controlled entity as described in HKAS 31.
- The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as
 - the cost on initial measurement of a financial asset in accordance with HKAS 39

5. Separate Financial Statements

Separate Financial Statements

are defined as those presented by

- a parent, an investor in an associate, or a venturer in a jointly controlled entity,
- in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.
- They are those prepared and presented in addition to consolidated financial statements
- But they are not the financial statements of an entity that does not have a subsidiary, associate or venturer's interest in a jointly controlled entity

Same requirements apply to entities having associates or jointly controlled entities elect to present separate financial statements



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5. Separate Financial Statements

- When separate financial statements are prepared
 - investments in subsidiaries, jointly controlled entities and associates (that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5) shall be accounted for either:

At cost

or

In accordance with HKAS 39

- The same accounting shall be applied for each category of investments.
- Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5
 - shall be accounted for in accordance with HKFRS 5

Same requirements apply to entities having associates or jointly controlled entities elect to present separate financial statements



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5. Separate Financial Statements

- When separate financial statements are prepared
 - investments in subsidiaries, jointly controlled entities and associates (that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5) shall be accounted for either:

At cost

or

In accordance with HKAS 39

- Investment is recognised at cost
 - Recognise income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition
 - Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment
- Investments in jointly controlled entities and associates that are accounted for in accordance with HKAS 39 in the consolidated financial statements
 - shall be accounted for in the same way in the investor's separate financial statements

5. Separate Financial Statements

FA at FV through P/L

at **Fair Value** through profit or loss

AFS financial assets

at **Fair Value** through equity
at **Cost**

In accordance with HKAS 39

HTM investments

at **Amortised Cost**

Loans and receivables

at **Amortised Cost**

6. Disclosure

In Consolidated Financial Statements

- The following disclosures shall be made:
 - a) the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
 - b) the reasons why the ownership, directly or indirectly through subsidiaries, of more than half of the voting or potential voting power of an investee does not constitute control;
 - c) the reporting date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the parent, and the reason for using a different reporting date or period; and
 - d) the nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans or advances.

6. Disclosure

In Separate Financial Statements

- When separate financial statements are prepared for a parent that elects not to prepare consolidated financial statements, those separate financial statements shall disclose:
 - a) the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name and country of incorporation or residence of the entity whose consolidated financial statements that comply with HKFRSs or IFRSs have been produced for public use; and the address where those consolidated financial statements are obtainable;
 - b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including
 - i) the name,
 - ii) country of incorporation or residence,
 - iii) proportion of ownership interest and,
 - iv) if different, proportion of voting power held; and
 - c) a description of the method used to account for the investments listed under (b).

6. Disclosure

In Separate Financial Statements

- When a parent (other than a parent discussed before), venturer with an interest in a jointly controlled entity, or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:
 - a) the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;
 - b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including
 - i) the name,
 - ii) country of incorporation or residence,
 - iii) proportion of ownership interest and,
 - iv) if different, proportion of voting power held; and
 - c) a description of the method used to account for the investments listed under (b); and shall identify the financial statements prepared in accordance with paragraph 9 of HKAS 27, HKAS 28 and HKAS 31 to which they relate.

7. HK Incorporated Companies

- Section 2(4) of the HK Companies Ordinance has a different definition on subsidiary
- HK incorporated company may not consolidate a company that does not meet the definition of a subsidiary in the HK Companies Ordinance
- In preparing consolidated financial statements of a HK incorporated company, only companies that fall within the definition of a subsidiary as set out in section 2(4) of the HK Companies Ordinance may be consolidated.
- When a HK incorporated company holds an entity which would be a subsidiary as defined in HKAS 27 but is not accounted for as a subsidiary as a result of the HK Companies Ordinance, it should disclose in the notes details of the effect on the consolidated financial statements had the requirements of HK Companies Ordinance not applied.

Interests in Associates (HKAS 28)



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Summary of Changes

1. Scope amended – similar amendment in HKAS 31
2. Application of equity method to an Associate
3. Share of associate's losses
4. Investment in associate acquired with a view to resale now under HKFRS 5
5. Requirements on separate financial statements amended – same as HKAS 27 and HKAS 28
6. Amendments in disclosure requirements

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1. Scope Amended

- HKAS 28 *Investments in Associates* shall be applied in accounting for investments in associates.
- However, it does not apply to investments in associates held by:
 - a) venture capital organisations, or
 - b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that upon initial recognition

- are designated as at fair value through profit or loss or
- are classified as held for trading and

accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.

Such investments shall be measured at fair value in accordance with HKAS 39, with changes in fair value recognised in profit or loss in the period of the change.

2. Apply Equity Method to an Associate

- An investment in an associate shall be accounted for using the Equity Method
 - whether or not the investor also has investments in subsidiaries and/or prepares consolidated financial statements
- Except when:

Implication

 - a) the investment is classified as held for sale in accordance with HKFRS 5;
 - b) the exception in HKAS 27, allowing a parent that also has an investment in an associate not to present consolidated financial statements, applies; or
 - c) all of the following apply:
 - i) the investor is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners do not object to such non-application;
 - ii) the investor's debt or equity instruments are not traded in a public market;
 - iii) the investor did not file, nor is it in the process of filing, its financial statements for issuing any class of securities in a public market; and
 - iv) the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with HKFRSs/IFRSs.

2. Apply Equity Method to an Associate



Implication

New rules as resulted

- Unless the above exemption rule can be relied upon
- Otherwise, an entity
 - which does not prepare consolidated financial statements and does not have subsidiaries
 - is still required to use Equity Method to account for associate in its financial statements
 - such financial statements are not separate financial statements as discussed in HKAS 27 and HKAS 28

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3. Share of Associate's Losses

In **HKAS 28**, if an investor's share of losses of an associate equals or exceeds its interest in the associate (so-called the base against losses)

- the investor discontinues recognising its share of further losses.

In **SSAP 10**

- the carrying amount of an investment is used as the base
- It includes only
 - the carrying amount of instruments that provide unlimited rights of participation in earnings or losses and a residual equity interest in the investee.



In **HKAS 28**

- A broader base, the interest in an associate, is used
- It includes
 - the carrying amount of the investment in the associate under the equity method together with
 - any long-term interests that, in substance, form part of the investor's net investment in the associate.

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3. Share of Associate's Losses

HKAS 28 further clarifies that:

- Losses recognised under the equity method in excess of the investor's investment in ordinary shares
 - are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (i.e. priority in liquidation).
- After the investor's interest is reduced to zero
 - additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate.
- If the associate subsequently reports profits
 - the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

3. Share of Associate's Losses – Case

ESPRIT

Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003 and begin to adopt all the new/revised IFRS in 2004 Annual Report, which stated
 - The Group's share of its associates' post-acquisition profits or losses is recognized in the income statement, and its share of post-acquisition movements in reserves is recognized in reserves.
 - The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.
 - When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any long-term interests that form part of the investor's net investment in the associates, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

4. Associate Held for Sale

- As discussed, an investment in an associate shall not be accounted for using the equity method when
 - the investment is classified as held for sale in accordance with HKFRS 5
- Such investments described above shall be accounted for in accordance with HKFRS 5.
- When an investment in an associate previously classified as held for sale no longer meets the criteria to be so classified
 - it shall be accounted for using the equity method as from the date of its classification as held for sale.
 - Financial statements for the periods since classification as held for sale shall be amended accordingly (i.e. all financial statements for the prior periods shall be amended)

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5. Separate Financial Statements

Same contents as in HKAS 27

- An investment in an associate shall be accounted for in the investor's separate financial statements in accordance with the requirements on separate financial statements of HKAS 27



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6. Disclosure

- The following disclosures shall be made:

- a) fair value of investments in associates for which there are published price quotations;
- b) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss;
- c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20% of the voting or potential voting power of the investee but concludes that it has significant influence;
- d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20% or more of the voting or potential voting power of the investee but concludes that it does not have significant influence;
- e) the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;

6. Disclosure

- The following disclosures shall be made:

- f) the nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;
- g) the unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;
- (h) the fact that an associate is not accounted for using the equity method in accordance with HKAS 28; and
- (i) summarised financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and profit or loss.

6. Disclosure

- Investments in associates accounted for using the equity method shall be **classified as non-current assets**.
- The investor's share of the profit or loss of such associates, and the carrying amount of those investments, shall be **separately disclosed**.
- The investor's share of any discontinued operations of such associates shall also be **separately disclosed**.
- The investor's share of changes recognised directly in the associate's equity shall be **recognised directly in equity** by the investor and **shall be disclosed** in the statement of changes in equity required by HKAS 1 *Presentation of Financial Statements*.
- In accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the investor shall disclose:
 - a) its share of the contingent liabilities of an associate incurred jointly with other investors; and
 - b) those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.

Interests in Joint Ventures (HKAS 31)



Summary of Changes

1. Scope amended – similar to HKAS 28
2. Definition expanded
3. New choice in recognition of jointly controlled entity
4. Investment in jointly controlled entities acquired with a view to resale now under HKFRS 5
5. Requirements on separate financial statements amended – same as HKAS 27 and HKAS 28
6. Amendments in disclosure requirements

1. Scope Amended

- HKAS 31 does not apply to venturers' interests in jointly controlled entities held by:
 - a) venture capital organisations, or
 - b) mutual funds, unit trusts and similar entities including investment-linked insurance funds
- that upon initial recognition
- are designated as at fair value through profit or loss or
 - are classified as held for trading and
- accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.
- Such investments shall be measured at fair value in accordance with HKAS 39, with changes in fair value being recognised in profit or loss in the period of the change.

Similar to
HKAS 28

1. Scope Amended

- A venturer with an interest in a jointly controlled entity is exempted from complying HKAS 31 when it meets the following conditions:

Similar to
HKAS 28

- a) the investment is classified as held for sale in accordance with HKFRS 5;
- b) the exception in HKAS 27, allowing a parent that has an interest in a jointly controlled entity not to present consolidated financial statements, applies; or
- c) all of the following apply:
 - i) the investor is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners do not object to such non-application;
 - ii) the investor's debt or equity instruments are not traded in a public market;
 - iii) the investor did not file, nor is it in the process of filing, its financial statements for issuing any class of securities in a public market; and
 - iv) the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with HKFRSs/IFRSs.

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1. Scope Amended



Implication

Same as HKAS 28

- Unless the above exemption rule can be relied upon
- Otherwise, an entity
 - which does not prepare consolidated financial statements and does not have subsidiaries
 - is still required to use Proportionate Consolidation (to be discussed) or Equity Method in its financial statements to account for jointly controlled entities
 - such financial statements are not separate financial statements as discussed in HKAS 27 and HKAS 28

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2. Definition Expanded

- A joint venture is a contractual arrangement whereby 2 or more parties undertake an economic activity that is subject to joint control.

In **SSAP 21**

- Joint control is the contractually agreed sharing of control over an economic activity



In **HKAS 31**

- Joint control is the contractually agreed sharing of control over an economic activity
and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

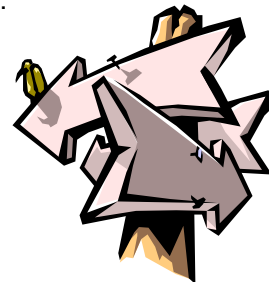
3. Jointly Controlled Entities

- HKAS 31 identifies 3 broad types of joint ventures :

Jointly controlled operations

Jointly controlled assets

Jointly controlled entities



3. Jointly Controlled Entities

Recognition of jointly controlled entities:

- A venturer shall recognise its interest in jointly controlled entity using either

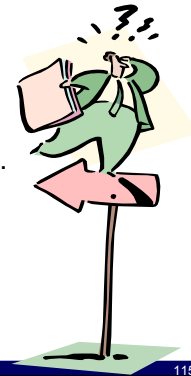
Proportionate Consolidation

or

Equity Method

An entity has a choice

- When proportionate consolidation is used, one of the two reporting formats identified in HKAS 31 shall be used.



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3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

- a method of accounting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity
 - is combined line by line with similar items in the venturer's financial statements, or
 - reported as separate line items in the venturer's financial statements
- A venturer recognises its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation irrespective of whether it also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.

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3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

Not really new in HK!

- It has already used by a number of HK listed companies, which have prepared their financial statements in accordance with IFRS



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3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

- When recognising an interest in a jointly controlled entity, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form.
- In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture.
- The application of proportionate consolidation means that the balance sheet of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible.
- The income statement of the venturer includes its share of the income and expenses of the jointly controlled entity.

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3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

- When **Proportionate Consolidation** is used, One of the Two Reporting Formats shall be used, the venturer may:

- 1. Combine** its share of each of the assets, liabilities, income and expenses of the jointly controlled entity **with the similar items, line by line**, in its financial statements, or alternatively
- 2. Include separate line items** for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its financial statements

Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in HKAS 27.

3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

Two Reporting Formats

Proportionate Consolidation
Reporting Format 1
(PCRF 1)

- 1. Combine with the similar items line by line**

- 2. Include separate line items**

Proportionate Consolidation
Reporting Format 2
(PCRF 2)

3. Jointly Controlled Entities

Example

The financial statements of A and its 50% jointly controlled entity, X, are set out below:

	A	X	Equity Method	PCRF 1	PCRF 2	
Non-current assets						
Property, plant & equipment	1,000	2,000	1,000	2,000	1,000	PPE-A
Interest in JCE	<u>500</u>	<u>0</u>	<u>1,000</u>	<u>0</u>	<u>1,000</u>	PPE-X
	<u>1,500</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>		
Current assets						
Inventories	100	500	100	350	100	Inv.-A
Cash at bank	<u>100</u>	<u>100</u>	<u>100</u>	<u>150</u>	<u>250</u>	Inv.-X
	<u>200</u>	<u>600</u>	<u>200</u>	<u>500</u>		
Current liabilities						
Account payables	<u>(100)</u>	<u>(600)</u>	<u>(100)</u>	<u>(400)</u>	<u>(100)</u>	A/P-A
					<u>(300)</u>	A/P-X
Net current assets	<u>100</u>	<u>0</u>	<u>100</u>	<u>100</u>		
Net assets	<u>1,600</u>	<u>2,000</u>	<u>2,100</u>	<u>2,100</u>	<u>2,100</u>	

3. Jointly Controlled Entities

Example

The financial statements of A and its 50% jointly controlled entity, X, are set out below:

	A	X	Equity Method	PCRF 1	PCRF 2
Non-current assets					
PPE	1,000	2,000	1,000	2,000	1,000
PPE - JCE					1,000
Interest in JCE	<u>500</u>	<u>0</u>	<u>1,000</u>	<u>0</u>	<u>0</u>
	<u>1,500</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>
Current assets					
Inventories	100	500	100	350	100
Inventories - JCE					250
Cash at bank	100	100	100	150	100
Cash at bank - JCE	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>50</u>
	<u>200</u>	<u>600</u>	<u>200</u>	<u>500</u>	<u>500</u>

3. Jointly Controlled Entities

Example

	Equity Method	PCRF
Non-current assets		1
Property, plant & equipment	1,000	2,000
Interest in JCE	<u>1,000</u>	<u>0</u>
	<u>2,000</u>	<u>2,000</u>
Current assets		
Inventories	100	350
Cash at bank	<u>100</u>	<u>150</u>
	<u>200</u>	<u>500</u>
Total assets	<u>2,200</u>	<u>2,500</u>
Current liabilities		
Account payables	<u>(100)</u>	<u>(400)</u>
Net assets	<u>2,100</u>	<u>2,100</u>



PCRF

- Has a higher total assets
⇒ Return on total assets ↓
- Has a higher debt level
⇒ Gearing ↑
- Offsetting effect eliminated
- What's the difference between 49%, 50% and 51%?

3. Jointly Controlled Entities – Case



Hopewell Highway Infrastructure Limited
合和公路基建有限公司

2004 Annual Report states:

- The Group reports its interests in jointly controlled entities using proportionate consolidation based on the profit-sharing ratios specified in the relevant joint venture agreements.
- The Group's share of the income, expenses, assets and liabilities, of jointly controlled entities, other than the transactions and balances between the Group and jointly controlled entities, are consolidated with the equivalent items in the consolidated financial statements on a line-by-line basis.

3. Jointly Controlled Entities – Case



2004 Annual Report states:

- The Group's interests in jointly controlled entities are accounted for by proportionate consolidation.
- Under this method the Group includes
 - its share of the jointly controlled entities' individual income and expenses, assets and liabilities and cash flows
 - in the relevant components of the financial statements.

3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

Two Reporting Formats

Proportionate Consolidation
Reporting Format 1
(PCRF 1)

1. Combine with the similar items line by line

3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

- A venturer shall discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.

3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Equity Method

- As an alternative to proportionate consolidation described above
 - a venturer shall recognise its interest in a jointly controlled entity using the [equity method](#)
- HKAS 31 “[does not recommend the use of the equity method](#) because proportionate consolidation better reflects the substance and economic reality of a venturer’s interest in a jointly controlled entity, that is to say, control over the venturer’s share of the future economic benefits.”
- Nevertheless, HKAS 31 permits the use of the equity method, as an alternative treatment, when recognising interests in jointly controlled entities.

But

3. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation



Equity Method

HKAS 8 states that a voluntary change in accounting policy shall be made only if the change will result in a more appropriate presentation

Such recommendation in HKAS 31 implies that

- a change from Equity Method to Proportionate Consolidation is supported (by such recommendation)
- but a change from Proportionate Consolidation to Equity Method may not be supported

4. JCE Classified as Held for Sale

Recognition of jointly controlled entities:

Proportionate Consolidation

Equity Method

Exceptions to Proportionate Consolidation and Equity Method

- Interests in jointly controlled entities that are classified as held for sale in accordance with HKFRS 5 shall be accounted for in accordance with that HKFRS.
- When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale.
- Financial statements for the periods since classification as held for sale shall be amended accordingly.

5. Separate Financial Statements

Same contents as in HKAS 27

- An interest in a jointly controlled entity shall be accounted for in a venturer's separate financial statements in accordance with the requirements on separate financial statements of HKAS 27



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6. Disclosure

Contingent liabilities

- A venturer shall disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:
 - a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other venturers;
 - b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
 - d) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

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6. Disclosure

Commitments

- A venturer shall disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:
 - a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
 - b) its share of the capital commitments of the joint ventures themselves.

6. Disclosure

Other disclosure

- A venturer shall disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities.
- A venturer that recognises its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method shall disclose the aggregate amounts of each of current assets, long-term assets, current liabilities, long-term liabilities, income and expenses related to its interests in joint ventures.
- A venturer shall disclose the method it uses to recognise its interests in jointly controlled entities.

Further Developments

- Companies (Amendment) Bill
- Proposed amendments to IFRS/IAS



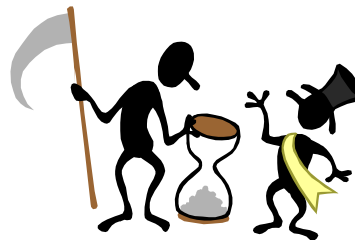
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Companies (Amendment) Bill

Companies (Amendment) Bill 2004

- Gazette Date: 8 October 2004
- 2nd reading debate / 3rd reading: 29 June 2005
- The principal purpose of this Bill is to modify the meaning of the term “subsidiary” in the Companies Ordinance (“the principal Ordinance”) in order to make the meaning of the term more closely in alignment with the meaning attached to the term in the IAS.
- However, the new meaning will only apply for the purposes of the group accounts of a company.
- For other purposes, the present meaning of the term “subsidiary” in the principal Ordinance will apply.

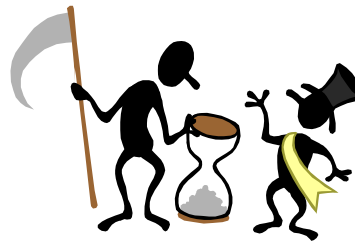


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Companies (Amendment) Bill

- Such amendments are mainly set out in the new 23rd Schedule to the Ordinance
- In particular:
 - An undertaking is a parent undertaking (“parent undertaking”) in relation to another undertaking (“subsidiary undertaking”) if the parent undertaking has [the right to exercise a dominant influence](#) over the subsidiary undertaking by virtue of —
 - (i) the provisions contained in [the subsidiary undertaking’s memorandum or articles](#) or [equivalent constitutional documents](#);
or
 - (ii) [a control contract](#).



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Proposed amendments to

- On 30 June 2005 (1 month before), IASB and FASB published their first joint proposal to improve the accounting and reporting of business combinations.

Changes once again!

- Proposed amendments include:
 - HKFRS 3 Business Combinations
 - HKAS 27 Consolidated and separate financial statements
 - HKAS 37 Provision, contingent liabilities and contingent assets



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Proposed amendments to IFRS/IAS

Selected main changes proposal to IAS 27:

- a) Minority interest is termed as non-controlling interest
- b) to require changes in the parent's ownership interest that do not result in the loss of control of a subsidiary to be accounted for as transactions with equity holders in their capacity as equity holders.
 - Therefore, such changes would not result in a gain or loss being recognised in profit or loss.
- c) to specify how an entity measures a gain or loss arising on loss of control of a subsidiary, and to require any such gain or loss to be recognised in profit or loss.
 - The gain or loss arising on loss of control includes the parent's share of gains or losses related to the former subsidiary that were previously recognised in equity.
- d) to require any remaining non-controlling equity investment in a former subsidiary to be re-measured to its fair value in the consolidated financial statements on the date control of it is lost.

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HKFRS 5 and HKAS 27, 28 and 31

9 August 2005



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HKFRS 5 and HKAS 27, 28 and 31

9 August 2005



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