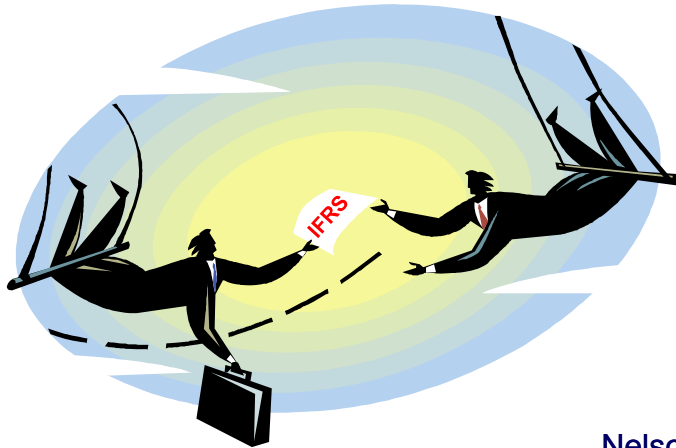


IFRS Implementation in Hong Kong

4 April 2008



Nelson Lam

MBA MSc BBA ACA ACS CFA CPA(Aust.)
CPA(US) CPA(HK) FCCA MSCA MHKSI

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Today's Agenda

Simple but
Comprehensive

Sharing and
Experience

Real Life Cases



A. Introduction

B. Impact of IFRS

C. Time and Effort for IFRS

D. Importance and Benefits of IFRS

E. IFRS Compliance Agenda

F. Challenges Ahead

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Today's Agenda

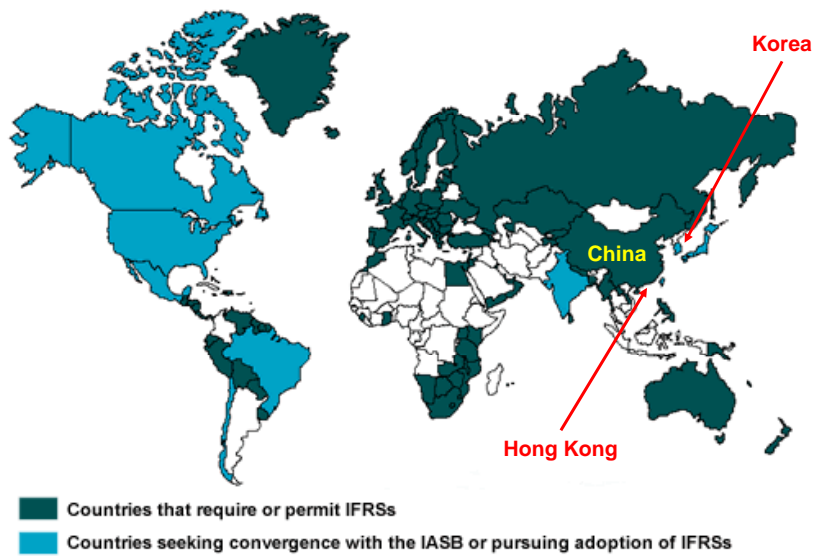
A. Introduction



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Introduction: Global Harmonisation



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Introduction: Hong Kong Position

- Nearly 100 countries or places currently require or permit the use of, or have a policy of convergence with, IFRSs
- Hong Kong is one of the places fully converged to IFRS (since 2005)
 - Full set of IFRS and IAS converged as HKFRS and HKAS
 - Applies to all entities, including listed and unlisted
 - Unlisted entities can choose a new set of Small GAAP (with only 73 pages in total)



Introduction: Hong Kong Position

International Financial Reporting Standards are:

- Standards and Interpretations issued by the International Accounting Standards Board (IASB) and comprise:

– International Financial Reporting Standards (IFRSs);

Hong Kong Financial Reporting Standards (HKFRS 1 to 8)

– International Accounting Standards (IASs); and

Hong Kong Accounting Standards (HKAS 1 to 41 with 11 sets withdrawn)

– Interpretations (SIC and IFRIC).
(as at 20.3.2008)

HK(SIC) Interpretations and
HK(IFRIC) Interpretations

or choose

SME Framework and Standard

Today's Agenda

B. Impact of IFRS

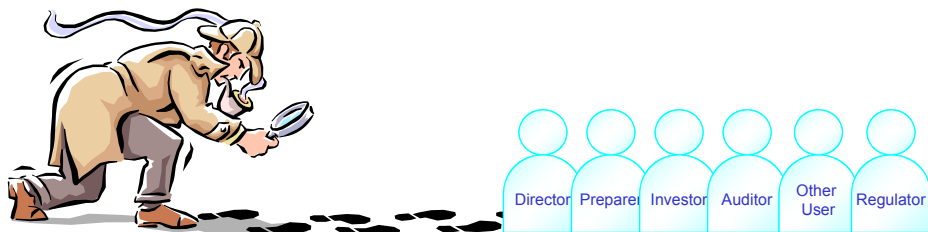


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B. Impact of IFRS: Summary

1. Financial position and performance
2. Human resources
3. Market expectation
4. Judgement and Estimates
5. Tax implication
6. Legal implication



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1. Financial Position & Performance

- Balance sheet approach
- Re-measure assets to fair value in the balance sheet
- Income statement and profit or loss become a residue
 - Volatile or unstable?
- New assets, new liabilities, new gains, new expenses
 - Certain off-balance sheet items are no longer “off” and should be recognised “on” balance sheet
- New practices, new disclosure



1. Financial Position & Performance

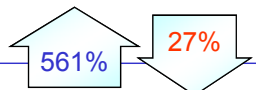
Case



<u>For year ended 31 Dec.</u>	<u>2004</u> \$'M	<u>2005</u> \$'M	<u>2006</u> \$'M
Turnover	1,154	1,250	1,268
Profit before tax	783	5,176	3,798

After crediting:

• Fair value changes on investment properties (HKAS 40)	-	4,226	2,576
---	---	-------	-------



Hysan is a property holding company.
Its profit is constantly higher than the revenue!

1. Financial Position & Performance

Case



For year ended 30 Dec.	2004 \$'M	2005 \$'M	2006 \$'M
Turnover	5,257	2,275	4,764
Gross profit	959	785	924
Profit before tax	1,705	7,384	9,063
<i>After crediting:</i>			
• Fair value changes on investment properties (HKAS 40)	-	4,977	6,921

Profit is also constantly higher than the revenue!

1. Financial Position & Performance

Case



- Not only IAS 40, but also IFRS 3
- HSBC Holdings plc changed from UK GAAP to IFRS in 2005
- It assessed that the impact of those changes from IFRS 3 would be *high*
- Its US SEC filing (Dec. 2004) further stated that:
 - Goodwill recorded at 31 Dec. 2003 will be the subject of impairment testing thereafter In the event of impairment, the absence of previous amortisation is likely to lead to *larger impairment charges* than would have been required under UK GAAP
 - The cessation of goodwill amortisation will impact the income statement

Comments argued that IFRS 3 introduced “*more volatility*” but also agreed that it can lead to

- Greater international applicability
- Comparability and reliability
- Transparency

CFA Institute Conference Proceedings (2005)

1. Financial Position & Performance

Case



- Not only IAS 40 and IFRS 3, but also IAS 39 (the most difficult and complicated one)
- In 2005, Li & Fung adopted full set of HKFRS and its interim report set out that:
 - the Group's discounted bills with recourse, which were previously treated as contingent liabilities, have been accounted for as collateralized bank advances prospectively on or after 1 January 2005, as the financial asset derecognition conditions as stipulated in HKAS 39 have not been fulfilled

Total advances recognised:	\$ 822M
Current liabilities of that date:	\$ 7,578M
Net current assets of that date:	\$ 1,229M

2. Human Resources

- New standards and new interpretations
 - Training: sufficient and appropriate
 - Resistance to change
 - Additional workload: new adoption and restating
- Shortage of competent and experienced personnel



3. Market Expectation

- Expectation gap
 - Top management
 - Auditors
 - Shareholders
 - Analysts
 - Other users
- Comparability (time series and cross sectional)
- Balance sheet focus vs. Income statement focus



4. Judgement and Estimates

- Principle base (instead of rule base)
 - Judgement involved
 - No clear or objective yardsticks
- Fair value basis
 - Judgement and estimates involved
 - Who is responsible for that? Competence?
- Accounting choices
 - Cost Model vs. Revaluation Model
 - Proportionate consolidation vs. equity method
 - Categorisation of financial assets



4. Judgement: Fair Value



- Fair value is used or mentioned in most IFRSs
- **Fair value** is defined as:
 - the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction
- The same definition is used in different IFRSs,
 - The application to different assets and liabilities may not be the same, for example:
 - IAS 16 *Property, plant and equipment*
 - IAS 18 *Revenue*
 - IAS 39 *Financial instruments: recognition & measurement*
 - IAS 40 *Investment property*
 - IFRS 2 *Share-based payment*



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4. Judgement: Fair Value

Example

- Fair value can be applied to
 - initial measurement,
 - subsequent measurement, or
 - both

Applied to both initial and subsequent measurement:

- Inventories (IAS 2)
- Financial assets and liabilities at fair value through P/L (IAS 39)
- Available for sale financial assets (IAS 39)
- Agriculture (IAS 41)

Applied to initial measurement but not subsequent measurement:

- Held-to-maturity (IAS 39)
- Loans and receivables (IAS 39)
- Business combination (IFRS 3)

Not applied to initial measurement but applied to subsequent measurement (incl. selective):

- Property, plant and equipment (IAS 16)
- Intangible assets (IAS 38)
- Investment property (IAS 40)

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4. Judgement: Fair Value

Example

Fair value model (e.g. IAS 40)

- Refers to fair value
- Changes in fair value recognised in profit or loss
- No depreciation or amortisation is required
- Revalued at each reporting date
- N/A

Revaluation model (e.g. IAS 16)

- Refers to fair value
- Changes in fair value recognised in equity (or other comprehensive income)
- Depreciation or amortisation is required
- Not clearly defined, only require sufficient regular that no material different from fair value
- Deficit about fair value below depreciated cost is recognised in profit or loss

4. Judgement: Fair Value

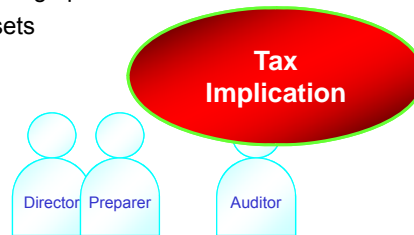
How is fair value determined?



1. The best evidence for fair value is the current bid price in an active market
2. If no such price in an active market, the information from a variety of sources can be considered, e.g.:
 - a) Recent transaction price
 - b) Current prices in a less active market
 - c) Value derived from valuation techniques, including
 - using recent arm's length market transactions between knowledgeable, willing parties
 - discounted cash flow analysis
 - option pricing models
 - other valuation techniques commonly used in the market
3. If some conditions are met and there is no other reliable measure, the item is stated at cost

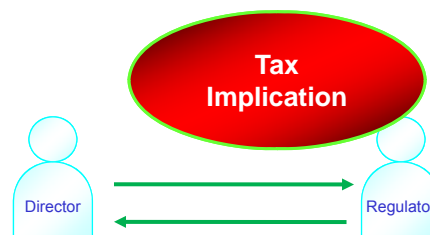
4. Judgement and Estimates

- All these are accounting choices; in addition to these
 - Cost Model vs. Revaluation Model
 - IAS 16 Property, plant and equipment
 - IAS 38 Intangible assets
 - Proportionate consolidation vs. equity method
 - IAS 31 Joint venture
 - Categorisation of financial assets (IAS 39)
 - Financial asset at fair value through profit or loss
 - Available for sale financial assets
 - Loans and receivables
 - Held-to-maturity investments



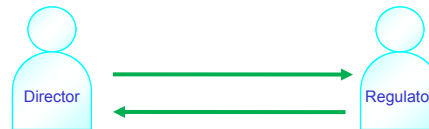
5. Tax Implication

1. Conflict with certain tax laws and rules
2. Fair value changes as income in profit or loss – Taxable?
3. Fair value changes as expense in profit or loss – Non-deductible?
4. Tax follows accounting?
5. Uncertainty and additional cost incurred



5. Tax Implication: Taxable?

- Fair value changes recognised as income in profit or loss
 - Effective interest income and amortisation of premium/discount (IAS 39)
 - Financial asset at fair value through profit or loss (IAS 39)
 - Investment property (IAS 40)
 - Agriculture (IAS 41)



5. Tax Implication: Non-Deductible?

- Fair value changes recognised as expense in profit or loss
 - Effective interest expenses (IAS 32)
 - Impairment loss (or bad debt) on financial assets (IAS 39)
 - Expenses recognised on financial guarantee contract (IAS 39)
 - Investment property (IAS 40)
 - Share-based payment or employee share option (IFRS 2)



6. Legal Implication

1. Any conflict with the law and/or regulation?
 - Definition of subsidiary
 - Fair value recognised in profit or loss
 - Recognised vs. realised gains
2. Full compliance can be achieved?
 - Law revised in Hong Kong



Today's Agenda



C. Time and Effort for IFRS

D. Importance and Benefits of IFRS

C. Time and Effort

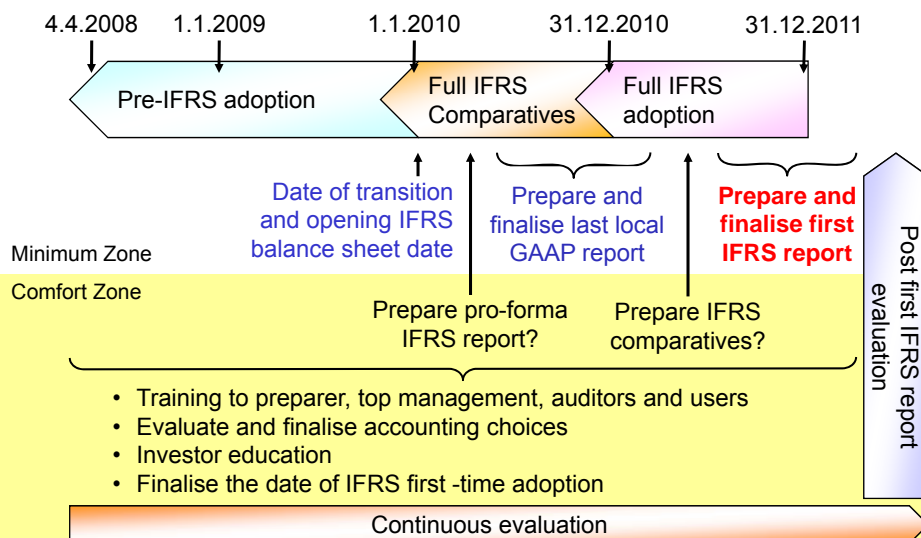


To continue further study or evaluate
or
To decide the first adoption date first



C. Time and Effort: Timeline

Sample



C. Time and Effort: Comfort Zone

1. Lead time – 1 to 2 years before date of transition (i.e. 2008 to 2009)
2. Training to preparer, top management, auditors and users
3. Evaluate and finalise accounting choices
4. Investor education
5. Finalise the date of IFRS first-time adoption
6. Ready for comparative adjustments and convergence adjustments

Errors or mistakes seems inevitable



C. Time and Effort: Comfort Zone

Case



CLP Holdings

- Adopted IFRS-equivalent HKFRS since 2005
- Its accounting policy for fixed assets in 2005:
 - Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Major renewals and improvements which will result in future economic benefits, in excess of the originally assessed standard of performance of the existing assets, are capitalised, while maintenance and repair costs are charged to the profit and loss account in the year in which they are incurred.
- Its accounting policy for fixed assets in 2006:
 - Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Old IAS 16 wordings before 2005

New IAS 16 wordings since 2005

C. Time and Effort: Comfort Zone

Case

- Its 7-page announcement of 24 Jan. 2006 explained that:
 - “The adoption of, transition to and application of the requirements of HKAS 39 were new to the Group’s accounting staff
 - “This inadvertent error resulted **in material misstatements** of the Group’s unaudited net profit
- 9-month net profit should be \$7 million, not previously reported \$104 million, **overstated over 1,300%**
- Observations were:
 - 60-page Interim Report with material misstatements has not been amended and reissued
 - Only explained the error by 7-page announcement
 - Accounting professors from universities and experienced accountants were still unable to understand what and why the errors were occurred



Pacific Century
Insurance
Holdings Ltd.

D. Importance and Benefits

1. International recognition
 - Enhance transparency and comparability
 - Enhance reliability and relevance
2. International experience and sharing
3. Common language and password to the globe
 - Cross border listing
 - Cross border investing
4. Reduction on cost and risk premium

In 2006, Mr. Mike Bloomberg, New York City Mayor, claimed that one of the key success factors of Hong Kong in being one of the leading financial centres is because of

- **Implementation of IFRSs in 2005**

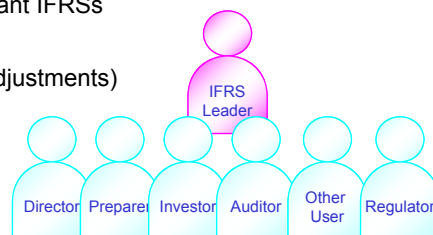
Today's Agenda



E. IFRS Compliance Agenda

E. IFRS Compliance Agenda

1. Appoint IFRS compliance coordinator or leader
2. Set up the time line and expected due date
3. Staffing and training plan
4. Evaluate and ascertain accounting choices
5. Evaluate the impact of IFRS
6. Revisit the agenda continuous
7. Meet minimum IFRS compliance
 - a) Compliance with IFRS 1 and relevant IFRSs
 - b) Convergence adjustments
 - c) Comparatives (and comparative adjustments)
 - d) Transition explanation



E. IFRS Compliance Agenda

Example

a. Opening IFRS Balance Sheet

- The reporting date of Company A's first IFRS financial statements is 31 Dec. 2011
- It prepares to present comparative information in the statements for 1 year only
- It also discloses its five year's financial summary.

Not full comparative

• Opening IFRS balance sheet	–	1 Jan. 2010
• Date of transition to IFRSs	–	1 Jan. 2010
• First reporting date	–	31 Dec. 2011

E. IFRS Compliance Agenda

b. Convergence Adjustments

An entity shall in its opening IFRS balance sheet:

Recognise

- a. recognise all assets and liabilities whose recognition is required by IFRSs

Not Recognise

- b. not recognise items as assets or liabilities if IFRSs do not permit such recognition

Reclassify

- c. reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and

Measure

- d. apply IFRSs in measuring all recognised assets and liabilities

Can you give some examples?

E. IFRS Compliance Agenda

Example

b. Convergence Adjustments

Selected examples:

Recognise

➤ Derivatives, deferred tax, actuarial gain or loss under defined benefit plan, environmental or decommissioning costs

Not Recognise

➤ Research, start-up and pre-operating costs, staff training, deferred advertising cost, relocation costs

Reclassify

➤ Some intangible assets from goodwill, some preference shares reclassified to debts, compound financial instruments, some investments that meet the definitions of a subsidiary

Measure

➤ Deferred tax can't be discounted, derivatives at fair value

Can you give some examples?

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E. IFRS Compliance Agenda

c. Comparatives

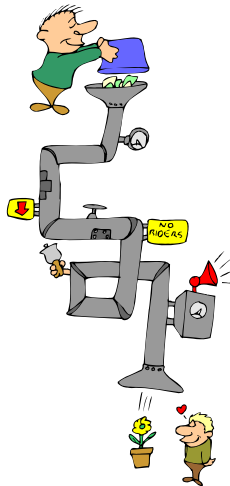
- To comply with IAS 1, an entity's first IFRS financial statements shall include at least one year of comparative information under IFRSs
- Restatement or re-presentation



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E. IFRS Compliance Agenda

d. Explanation of transition to IFRSs



- An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows
- At least to remember two issues now:
 1. Reconciliations
 2. Interim financial reports

E. IFRS Compliance Agenda

d. Explanation of transition to IFRSs

1. Reconciliations

- The first IFRS financial statements shall include:
 - a. Reconciliations of:
 - its equity reported under previous GAAP to
 - its equity under IFRSs, for both:
 - the date of transition to IFRSs and
 - the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP
 - b. Reconciliation of
 - the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial statements to
 - its profit or loss under IFRSs for the same period.

Reconciliation of
Equity

Reconciliation of
Profit or Loss

E. IFRS Compliance Agenda

Example

d. Explanation of transition to IFRSs

1. Reconciliations

- If Entity NAA adopts IFRSs in full for the year ending 31 December 2011 and provide one year comparative.
- Please suggest the date or period of reconciliation required under IFRS 1.

1 Jan. 2010 and 31 Dec. 2010

Reconciliation of
Equity

The year ended 31 Dec. 2010

Reconciliation of
Profit or Loss

E. IFRS Compliance Agenda

Case

2005 Annual Report

HSBC 

Reconciliation of previously reported shareholders' funds under UK GAAP to total shareholders' equity under IFRSs at 31 December 2004 and 1 January 2004

	At 31 December 2004 US\$m	At 1 January 2004 US\$m
Shareholders' funds as previously reported under UK GAAP	86,623	74,473
Goodwill	1,869	(22)
	88,492	74,451
Retirement benefits	(4,470)	(3,529)
Dividends	2,996	2,627
Leases	(503)	(402)
Share-based payments	198	211
Software capitalisation	551	518
Property	(1,607)	-
Land held under operating leases	(495)	(755)
Other	42	245
Tax	318	382
Total shareholders' equity under IFRSs	<u>85,522</u>	<u>73,748</u>

E. IFRS Compliance Agenda

Case

2005 Annual Report



Reconciliation of previously reported profit attributable to shareholders under UK GAAP to profit attributable to shareholders under IFRSs for the year ended 31 December 2004

	Year ended 31 December 2004 US\$m
Profit before tax under UK GAAP	17,608
Goodwill amortisation	<u>1,818</u>
	19,426
Other goodwill adjustments	(102)
Retirement benefits	(170)
Lenses	(90)
Share-based payments	(152)
Software capitalisation	25
Property	106
Tax on associates	(48)
Other	<u>(52)</u>
Profit before tax under IFRSs	18,943
Tax – UK GAAP	(4,507)
Tax – IFRSs adjustments	(178)
Minority interests – UK GAAP	(1,261)
Minority interests – IFRSs adjustments	<u>(79)</u>
Profit attributable to shareholders under IFRSs	<u>12,918</u>

E. IFRS Compliance Agenda

Case

Extract of Reconciliations (2004 Annual Report)

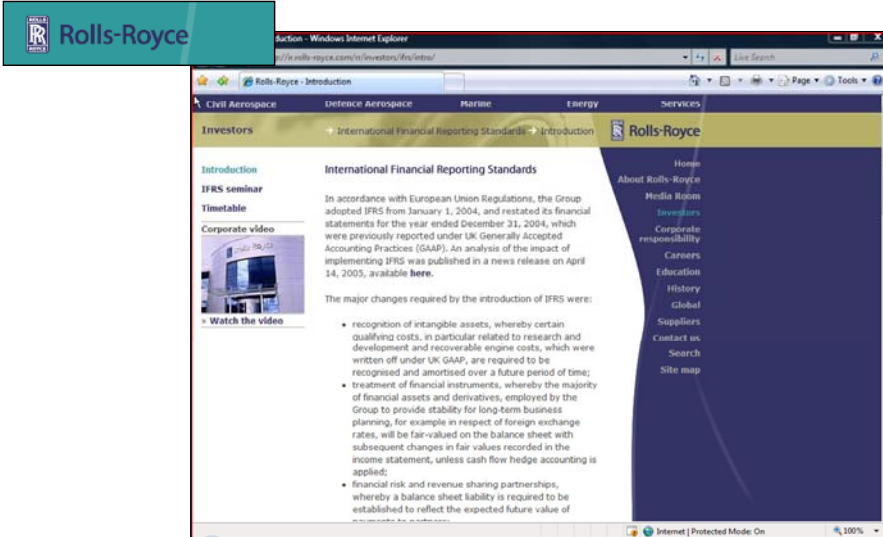
35 RECONCILIATION OF EQUITY AND PROFIT FROM HKGAAP TO IFRS *continued*
(c) Reconciliation of profit for the year ended June 30, 2003

	NOTES	HKGAAP HK\$'000	Effect of conversions to IFRS HK\$'000	IFRS HK\$'000
Turnover		12,381,458	–	12,381,458
Cost of goods sold		(6,198,869)	–	(6,198,869)
Gross profit		6,182,589	–	6,182,589
Staff costs		(1,603,630)	–	(1,603,630)
Depreciation and amortization	(i), (ii), (iii)	(378,884)	106,314	(272,570)
Other operating costs	(i), (v)	(2,479,118)	(2,900)	(2,482,018)
Operating profit		1,720,957	103,414	1,824,371
Interest income		41,584	–	41,584
Finance costs		(32,463)	–	(32,463)
Share of results of associates	(iv)	61,024	(15,561)	45,463
Profit before taxation		1,791,102	87,853	1,878,955
Taxation				
– Company and subsidiaries	(vi)	(592,208)	2,082	(590,126)
– Associates	(iv)	(13,324)	13,324	–
		(605,532)	15,406	(590,126)
Profit attributable to shareholders		1,185,570	103,259	1,288,829

ESPRIT

E. IFRS Compliance Agenda

Case



The screenshot shows the Rolls-Royce website's 'International Financial Reporting Standards' page. The page is titled 'International Financial Reporting Standards' and contains the following text:

In accordance with European Union Regulations, the Group adopted IFRS from January 1, 2004, and restated its financial statements for the year ended December 31, 2004, which were previously reported under UK Generally Accepted Accounting Practices (GAAP). An analysis of the impact of implementing IFRS was published in a news release on April 14, 2005, available [here](#).

The major changes required by the introduction of IFRS were:

- recognition of intangible assets, whereby certain qualifying costs, in particular related to research and development and recoverable engine costs, which were written off under UK GAAP, are required to be recognised and amortised over a future period of time;
- treatment of financial instruments, whereby the majority of financial assets and derivatives, employed by the Group to provide stability for long-term business planning, for example in respect of foreign exchange rates, will be fair-valued on the balance sheet with subsequent changes in fair values recorded in the income statement, unless cash flow hedge accounting is applied;
- financial risk and revenue sharing partnerships, whereby a balance sheet liability is required to be established to reflect the expected future value of payments to partners.

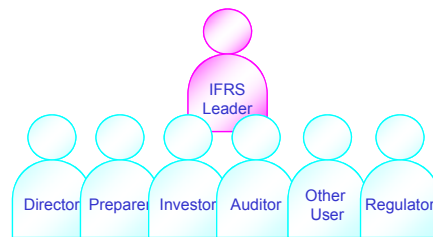
Today's Agenda



F. Challenges Ahead

F. Challenges Ahead

1. National differences not easily reconciled and/or removed
2. Inevitable and continuous changes
3. Lack of or limited experience in IFRS application
 - Any proactive (or reactive) mechanism to resolve dispute
 - Sufficient and appropriate advisors and consultants
4. Reliance on external experts
 - Surveyors and business valuation
5. Complicated IFRSs



F. Challenges Ahead



- Fitch Ratings made the following two comments
 - IFRS: The devil is in the detail
 - Companies face the risk that investors will misinterpret information



International
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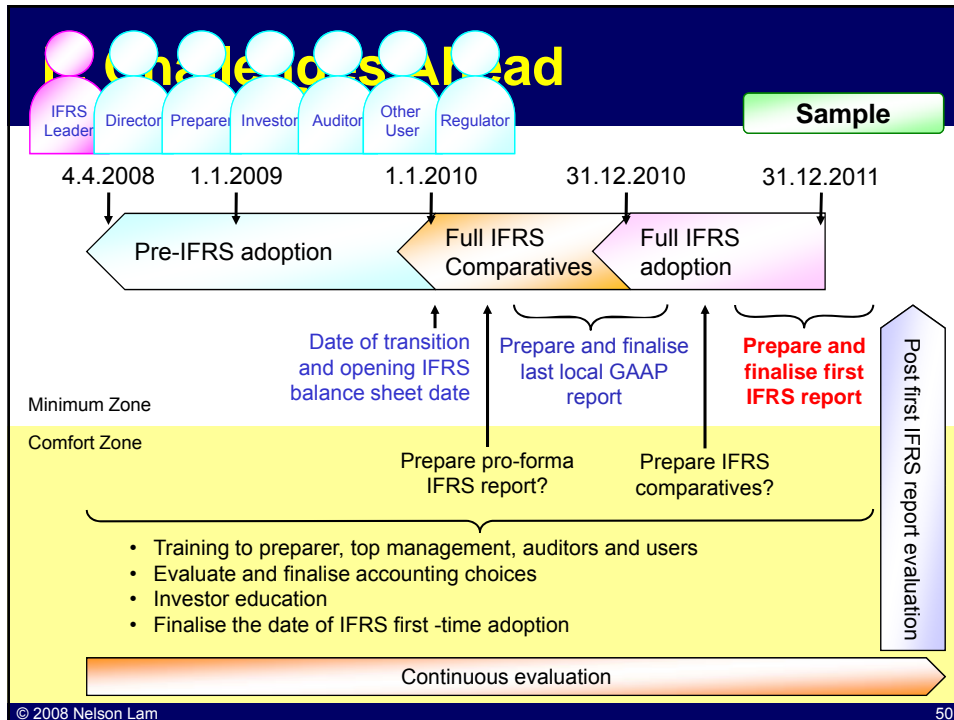
- Professor Sir David Tweedie, IASB Chairman, also said
 - Anyone who says they understand IAS 39 has not read it

F. Challenges Ahead: IFRS Itself

- IAS 12 *Income taxes*
- IAS 19 *Employee benefits*
- IAS 36 *Impairment of assets*
- IAS 40 *Investment properties*
- IFRS 2 *Share-based payments*
- IFRS 3 *Business combinations*
- IFRS 7 *Financial instruments: Disclosures*

Are errors or mistakes really inevitable?

- ↓
- IAS 32 *Financial instruments: Disclosures*
 - IAS 39 *Financial instruments: Recognition and measurement*



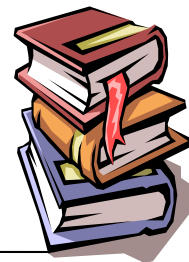
Closing Remarks

路漫漫其修遠兮
吾將上下而求索

屈原《離騷》
(340–278 B.C.)



“There is a long road,
we keep on search here and there.”
Li Sao of Qu Yuan (340-278 B.C.)



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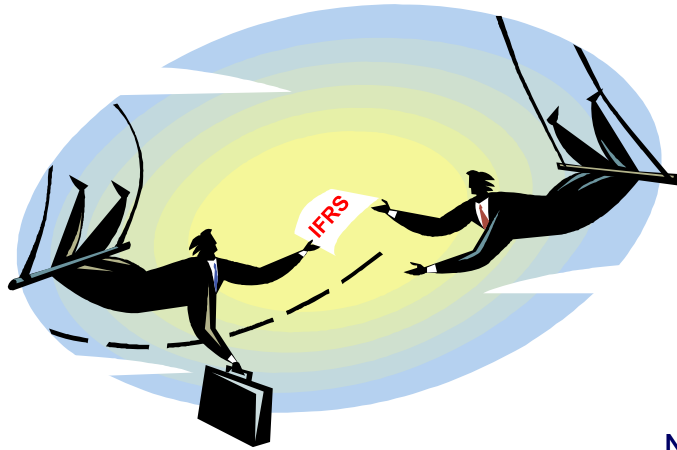
Mr. Nelson Lam

MBA MSc BBA ACA ACS ACIS CFA CPA(Aust) CPA(US) FCCA FCPA(Practising) MHKSI MSCA

- CFA Charter holder, Chartered Accountant and CPA in Australia, HK, US & UK
- One of regular and popular consultants and speakers in International and Hong Kong Financial Reporting Standards in Hong Kong, Macau and China
- Completed over 300 IFRS or HKFRS related consultancy and advisory projects, seminars, conferences and workshops since 2005
- His clients included listed or private companies from Africa, HK, China, Netherlands, Russia, Singapore and UK and US Fortune 500 companies
- His firm's website, www.NelsonCPA.com.hk, contains his presentation materials (over 200 sets of PDF file) for free public download
- Being a member of the Financial Reporting Review Panel in Hong Kong
- Being the Chairman of the Accounting and Auditing Standards Committee of the Society of Chinese Accountants and Auditors

IFRS Implementation in Hong Kong

4 April 2008



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