

Charitable Conference for Sichuan

(Technical Update on Financial Reporting Standards)

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Nelson Lam 林智遠

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

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A Simple Test to You



- Statement of financial position (財務狀況表)
- Statement of comprehensive income (全面收益表)
- Other comprehensive income (其他全面收益)
- Total comprehensive income (全面收益總額)
- Reclassification adjustment (重新分類調整)
- Non-controlling interest
- Gain on bargain purchase
- Full goodwill method

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Amendment Effective After 1.1.2008

Selected new interpretations and amendments to HKFRSs issued in 2007 to 2008

Effective for periods beginning on/after

- HK(IFRIC) 12 *Service Concession Arrangements* (2007) ➤ 1 Jan. 2008
- HK(IFRIC) 13 *Customer Loyalty Programmes* (2007) ➤ 1 Jul. 2008
- HK(IFRIC) 14 *HKAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (2007) ➤ 1 Jan. 2008
- HKFRS 8 *Operating Segments* (2007) ➤ 1 Jan. 2009
- HKFRS 23 *Borrowing Costs* (2007) ➤ 1 Jan. 2009
- HKAS 1 *Presentation of Financial Statements* (2007) ➤ 1 Jan. 2009
- HKAS 27 *Consolidated and Separate Financial Statements* (2008) ➤ 1 Jul. 2009
- HKFRS 3 *Business Combination* (2008) ➤ 1 Jul. 2009

Today's Agenda



HKAS 1 (Revised in 2007)

HKAS 27 (Revised in 2008)

HKFRS 3 (Revised in 2008)

Other Issues

Today's Agenda

HKAS 1 (Revised in 2007)

Presentation of Financial Statements



Summary of Changes

- A complete set of financial statements comprises:
 - a statement of financial position as at the end of the period;
 - a statement of comprehensive income for the period;
 - a statement of changes in equity for the period;
 - a statement of cash flows for the period;
 - notes, comprising a summary of significant accounting policies and other explanatory information; and
 - a statement of financial position as at the beginning of the earliest comparative period
 - when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or
 - when it reclassifies items in its financial statements.
- An entity may use titles for the statements other than those used in HKAS 1. (HKAS 1.10)

Previously, we call it "Balance Sheet"

Previously, we call it "Income Statement"

3 years' "balance sheets"

Summary of Changes

- A complete set of financial statements comprises:
 - a) a statement of financial position as at the end of the period;
 - b) a statement of comprehensive income for the period;
 - c) a statement of changes in equity for the period;
 - d) a statement of cash flows for the period;
 - e) notes, comprising a summary of significant accounting policies and other explanatory information; and
 - f) a statement of financial position as at the beginning of the earliest comparative period
 - when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or
 - when it reclassifies items in its financial statements.
- An entity may use titles for the statements other than those used in HKAS 1. (HKAS 1.10)

財務狀況表

全面收益表

Summary of Changes

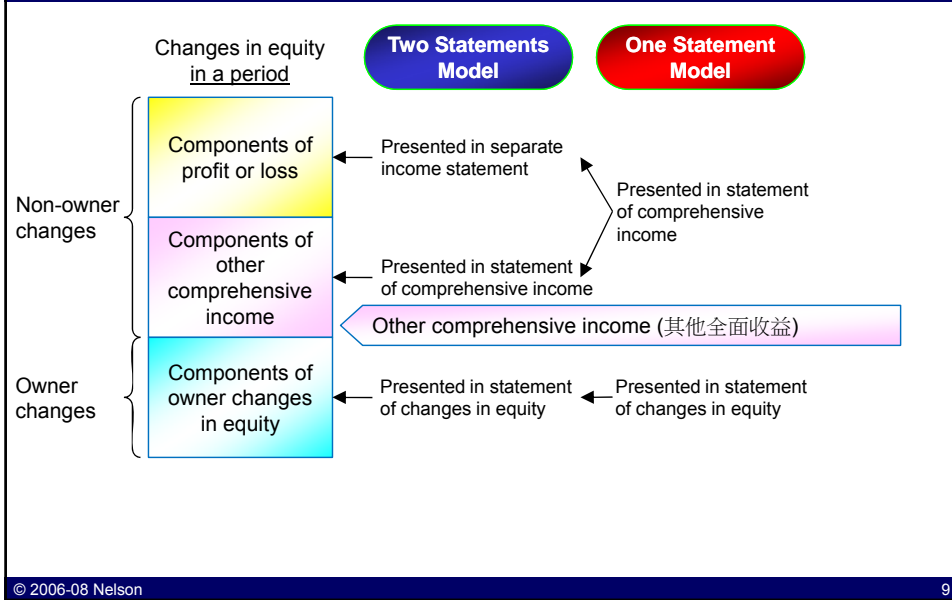
- Statement of comprehensive income can be further divided into 2 statements
- An entity shall present all items of income and expense recognised in a period:
 - a) in a single statement of comprehensive income, or
 - b) in two statements:
 - i. a statement displaying components of profit or loss (*separate income statement*) and
 - ii. a second statement beginning with profit or loss and displaying components of other comprehensive income (*statement of comprehensive income*). (HKAS 1.81)

One Statement Model

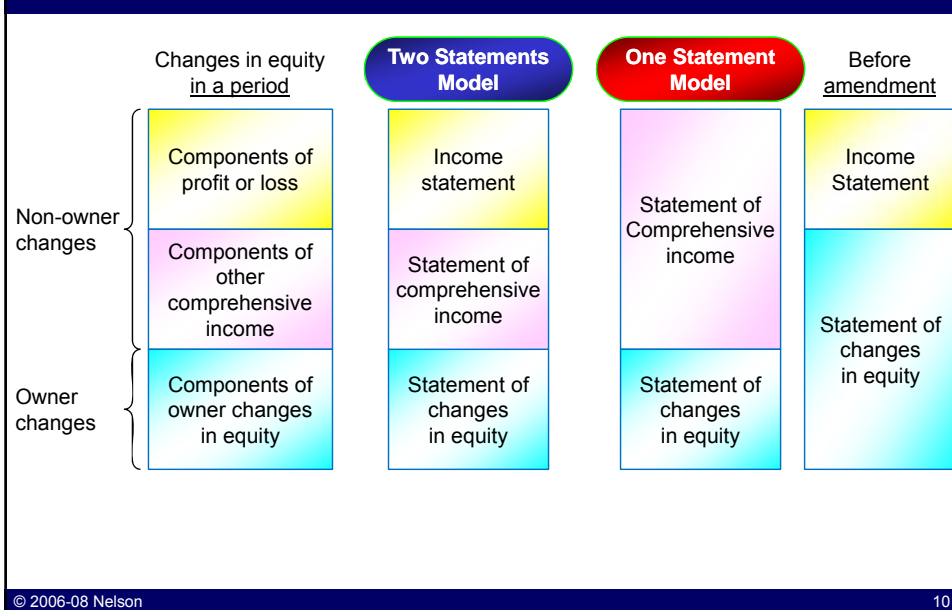
Two Statements Model

Comprehensive income concept used in US since 1997

Summary of Changes



Summary of Changes



Summary of Changes

- Other comprehensive income (其他全面收益) comprises
 - items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other HKFRSs.
- Other comprehensive income may include:
 - a) changes in revaluation surplus (see HKAS 16);
 - b) actuarial gains and losses on defined benefit plans recognised in accordance with HKAS 19.93A;
 - c) gains and losses arising from translating the financial statements of a foreign operation (see HKAS 21);
 - d) gains and losses on remeasuring available-for-sale financial assets (see HKAS 39);
 - e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see HKAS 39).

Components of
other
comprehensive
income

Summary of Changes

- HKAS 1 requires an entity to disclose in the statement of comprehensive income:
 - each component of other comprehensive income classified by nature
 - share of the other comprehensive income of associates and joint ventures accounted for using the equity method
 - total comprehensive income (全面收益總額).

Statement of
Comprehensive
income



Summary of Changes

- Either in the statement of comprehensive income or in the notes,
 - To disclose income tax relating to each component of other comprehensive income.
 - The previous version of HKAS 1 did not include such a requirement.
 - The purpose is to provide users with tax information relating to these components because the components often have tax rates different from those applied to profit or loss
 - To disclose reclassification adjustments relating to components of other comprehensive income.

Reclassification adjustments (重新分類調整) are defined as:

- amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

Today's Agenda



HKAS 27 (Revised in 2008)

Consolidated Financial Statements

HKAS 27 (Revised in 2008)

- Scope and definitions
- Presentation of consolidated financial statements
- Scope of consolidated financial statements
- Consolidation procedures
- Loss of control
- Accounting in separate financial statements

Significant changes

New section



Presentation of Consol. Fin. State.

- A parent, other than a parent described below, shall present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with this Standard.
- A parent need not present consolidated financial statements if and only if:
 - a) the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
 - b) the parent's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
 - c) the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of 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 Hong Kong Financial Reporting Standards or International Financial Reporting Standards.

Scope of Consol. Fin. State.

- Consolidated financial statements shall include all subsidiaries of the parent.
- Potential voting rights are also counted in assessing whether there is any control on an entity.



Consolidation Procedures

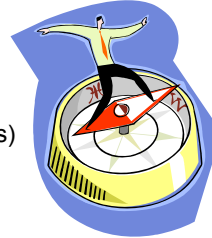
- Consolidation procedures are similar to previous standard, but
- Minority interests renamed as “non-controlling interests”, which
 - shall be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.
- Profit or loss and each component of other comprehensive income are attributed
 - to the owners of the parent and
 - to the non-controlling interests.
- Total comprehensive income is attributed
 - to the owners of the parent and
 - to the non-controlling interests

even if this results in the non-controlling interests having a deficit balance.



Consolidation Procedures

- Most critical
 - Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control
 - are accounted for **as equity transactions** (i.e. transactions with owners in their capacity as owners)
 - i.e. no gain or loss on disposal of interests in subsidiary can be recognised in profit or loss if the subsidiary is still a subsidiary.



- In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary.
- Any difference between
 - the amount by which the non-controlling interests are adjusted and
 - the fair value of the consideration paid or receivedshall be recognised directly in equity and attributed to the owners of the parent.

Loss of Control

- Specific requirements introduced when a parent loses control of a subsidiary:
 - If a parent loses control of a subsidiary, it:
 - a) derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost;
 - b) derecognises the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them);
 - c) recognises:
 - i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and
 - ii) if the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution;

Loss of Control

- Specific requirements introduced when a parent loses control of a subsidiary:
 - If a parent loses control of a subsidiary, it:
 - d) recognises any investment retained in the former subsidiary at its fair value at the date when control is lost;
 - e) reclassifies to profit or loss, or transfers directly to retained earnings if required in accordance with other HKFRSs, the amounts identified in HKAS 27.35 (discussed in next slide); and
 - f) recognises any resulting difference as a gain or loss in profit or loss attributable to the parent.



Loss of Control

- If a parent loses control of a subsidiary,
 - the parent shall account for all amounts recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.
- Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities,
 - the parent reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary.



Loss of Control

Example

A parent loses control of a subsidiary and the subsidiary has the following assets:

- The subsidiary has available-for-sale financial assets
- The subsidiary has property, plant and equipment with revaluation surplus previously recognised in other comprehensive income

The parent shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to those assets.

The parent transfers the revaluation surplus directly to retained earnings when it loses control of the subsidiary

- since the revaluation surplus would be transferred directly to retained earnings on the disposal of the asset

Loss of Control

- On the loss of control of a subsidiary, any investment retained in the former subsidiary and any amounts owed by or to the former subsidiary shall be accounted for in accordance with other HKFRSs from the date when control is lost.
- The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with
 - HKAS 39 *Financial Instruments: Recognition and Measurement* or,
 - when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity.

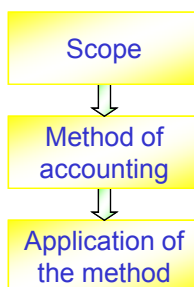
Today's Agenda



HKFRS 3 (Revised in 2008)

Business Combinations

Introduction



- The objective of HKFRS 3 (revised 2008) is
 - to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects.
- To accomplish that, HKFRS 3 establishes principles and requirements for how the acquirer:
 - a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
 - b) recognises and measures
 - the goodwill acquired in the business combination or
 - a gain from a bargain purchase; and What is it?
 - c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.



Scope

Scope

- HKFRS 3 applies to a transaction or other event that meets the definition of a business combination.
- HKFRS 3 does not apply to:
 - a) the formation of a joint venture.
 - b) the acquisition of an asset or a group of assets that does not constitute a business.
 - Brief requirements set out for such acquisition and it does not give rise to goodwill
 - c) a combination of entities or businesses under common control.

AG 5 is still applicable

Scope

Scope

- An entity shall determine whether a transaction or other event is a business combination by applying the definition in HKFRS 3,
 - which requires that the assets acquired and liabilities assumed constitute a business.
- If the assets acquired are not a business,
 - the reporting entity shall account for the transaction or other event as an asset acquisition. (HKFRS 3.3)
- HKFRS 3.B5–B12 provide guidance on identifying a business combination and the definition of a business.

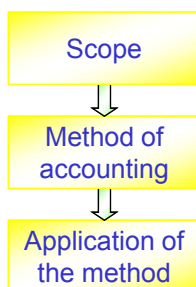
Scope

Scope

- An entity shall determine whether a transaction or other event is a business combination by applying the definition in HKFRS 3,
 - which requires that the assets acquired and liabilities assumed constitute a business. (HKFRS 3.3)

- Business is defined as:
 - an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.
- Business combination is defined as
 - a transaction or other event in which an acquirer obtains control of one or more businesses.
 - Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in HKFRS 3.

The Acquisition Method



- An entity shall account for each business combination by applying the acquisition method. (HKFRS 3.4)
- Applying the acquisition method requires:
 - a) identifying the acquirer; Guidance in HKAS 27
 - b) determining the acquisition date; Date of control obtained
 - c) recognising and measuring
 - the identifiable assets acquired,
 - the liabilities assumed and
 - any non-controlling interest in the acquiree; and
 - d) recognising and measuring
 - goodwill or
 - a gain from a bargain purchase. (HKFRS 3.5)

The Acquisition Method

- Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Application of the method

- As of the acquisition date, the acquirer shall **recognise**, separately from goodwill,
 - the identifiable assets acquired,
 - the liabilities assumed and
 - any non-controlling interest in the acquiree.
- Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in HKFRS 3.11 and 3.12. (HKFRS 3.10)

The Acquisition Method

- Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

- The acquirer shall **measure** the identifiable assets acquired and the liabilities assumed

- at their **acquisition-date fair values**. (HKFRS 3.18)

Affect acquisition in stages

- For each business combination, the acquirer shall **measure** any non-controlling interest in the acquiree either

- at **fair value** or

New alternative (“full goodwill method”)

- at the non-controlling interest’s proportionate share of the acquiree’s identifiable net assets. (HKFRS 3.19)

Existing practice

The Acquisition Method

Critical Amendment

- Recognising and measuring goodwill or a gain from a bargain purchase

- The acquirer shall **recognise goodwill** as of the acquisition date measured as the excess of (a) over (b) below:

Application of the method

If fair value is adopted, it will affect the amount of goodwill

Practices changed

- a) the aggregate of:
 - i) the consideration transferred measured in accordance with HKFRS 3, which generally requires acquisition-date fair value;
 - ii) the amount of any non-controlling interest in the acquiree measured in accordance with HKFRS 3; and
 - iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.
- b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with HKFRS 3. (HKFRS 3. 32)

The Acquisition Method

- Additional guidance
 - Amended practices on business combination achieved in stages

- In a business combination achieved in stages, the acquirer shall
 - remeasure its previously held equity interest in the acquiree **at its acquisition-date fair value** and
 - recognise the resulting gain or loss, if any, in profit or loss. (HKFRS 3.42)



The Acquisition Method

- Additional guidance
 - Amended practices on business combination achieved in stages
- In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income (for example, because the investment was classified as available for sale).
 - If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest. (HKFRS 3.42)
 - In other words, “the amount recognised directly in other comprehensive income is reclassified and included in the calculation of the gain or loss recognised in profit or loss”. (KPMG-UK, 2008.01)

The Acquisition Method

Example

<u>On 1.1.2010</u>	<u>Parent P</u>	<u>Sub S</u>
Property	\$ 0	\$ 6,000
Investment	0	0
Cash at bank	<u>30,000</u>	<u>2,000</u>
	<u>30,000</u>	<u>8,000</u>
Issued equity	\$ (30,000)	\$ (5,000)
Retained earnings	<u>0</u>	<u>(3,000)</u>
	<u>(30,000)</u>	<u>(8,000)</u>

On 1.1.2010

- Parent P acquired 20% interest in Subsidiary S at \$3,500 by cash.
- Fair value of the property of S was \$8,000.

During 2010

- Parent P reported nil profit and profit of S was HK\$6,000 (became cash).
- Fair value of S is HK\$30,000 at year-end.
- P accounted for S as held for trading.

On 1.1.2011

- P acquired additional 60% interest in S at \$22,000 by cash.
- Fair value of the property of S was \$11,000.

The Acquisition Method

Example

- Firstly, the acquirer (i.e. P) shall
 - remeasure its previously held equity interest in the acquiree (i.e. S) at its acquisition-date fair value and
 - recognise the resulting gain or loss, if any, in profit or loss.
- On 1.1.2011, P acquired additional 60% interest in S at \$22,000 by cash
 - It implies that previously held equity interest of 20% (acquired on 1.1.2010) should have a fair value of \$7,333 ($\$22,000 \div 60\% \times 20\%$)
 - The resulting gain should be recognised in profit or loss as follows:

	Dr(\$)	Cr(\$)
Dr Investment (\$7,333 – \$6,000)	1,333	
Cr Profit or loss		1,333
To remeasure the previously held 20% in S at acquisition-date fair value		

The Acquisition Method

You would miss this

Example

	1 st Transaction	2 nd Transaction	
	<u>1.1.2010</u>	<u>1.1.2011</u>	<u>Total</u>
Cost of combinations (or investments)	<u>3,500</u>	<u>22,000</u>	25,500
Fair value information			
Property, at fair value	8,000	11,000	
Cash	2,000	2,000	
Cash (profit for the year)	<u>0</u>	<u>6,000</u>	
	10,000	19,000	
Ownership interest	<u>20%</u>	<u>60%</u>	80%
Share of fair value	<u>2,000</u>	<u>11,400</u>	
Goodwill	<u>1,500</u>	<u>10,600</u>	12,100

The Acquisition Method

Example

The calculation approach would be revised as

	NCI at old approach	NCI at fair value
	<u>New 1</u>	<u>New 2</u>
1. Consideration transferred	22,000	22,000
2. Non-controlling interest (NCI)	(\$19K x 20%) 3,800	(\$22K + 60% x 20%) 7,333
3. Acquisition-date fair value of the acquirer's previously held equity interest in the acquiree	<u>7,333</u>	<u>7,333</u>
	<u>33,133</u>	<u>36,666</u>
Less: Acquisition-date amount of net identifiable assets		
Property, at fair value	11,000	11,000
Cash	2,000	2,000
Cash (profit for the year)	<u>6,000</u>	<u>6,000</u>
	<u>19,000</u>	<u>19,000</u>
Goodwill	<u>14,133</u>	<u>17,666</u>

The Acquisition Method

Example

Consolidation journals (for NCI at old approach):

	Dr(\$)	Cr(\$)
Dr Property – fair value adjustment (\$11,000 - \$6,000)	5,000	
Issued equity – subsidiary (given)	5,000	
Retained earnings – subsidiary (given)	9,000	
Goodwill (as calculated in last slide)	14,133	
Cr Investment (\$7,333 + \$22,000)		29,333
Non-controlling interest (\$19,000 x 20%)		3,800
To recognise the goodwill and eliminate the investments with the equity shares		

The Acquisition Method

Example

Consolidation journals (for NCI at fair value):

	Dr(\$)	Cr(\$)
Dr Property – fair value adjustment (\$11,000 - \$6,000)	5,000	
Issued equity – subsidiary (given)	5,000	
Retained earnings – subsidiary (given)	9,000	
Goodwill (as calculated in last slide)	17,666	
Cr Investment (\$7,333 + \$22,000)		29,333
Non-controlling interest (\$22,000 ÷ 60% x 20%)		7,333

To recognise the goodwill and eliminate the investments with the equity shares

The Acquisition Method

Example

<u>On 1.1.2011</u>	<u>Parent P</u>	<u>Sub S</u>	<u>Old</u>	<u>New 1</u>	<u>New 2</u>
Property	\$ 0	\$ 6,000	\$ 11,000	\$ 11,000	\$ 11,000
Goodwill	0	0	12,100	14,133	17,666
Investment	28,000	0	0	0	0
Cash at bank	<u>4,500</u>	<u>8,000</u>	<u>12,500</u>	<u>12,500</u>	<u>12,500</u>
	<u>32,500</u>	<u>14,000</u>	<u>35,600</u>	<u>37,633</u>	<u>41,166</u>
Issued equity	\$ (30,000)	\$ (5,000)	\$(30,000)	\$(30,000)	\$(30,000)
Retained earnings	(2,500)	(9,000)	(1,200)	(3,833)	(3,833)
Revaluation reserves	0	0	(600)	0	0
Minority interest	<u>0</u>	<u>0</u>	<u>(3,800)</u>	<u>(3,800)</u>	<u>(7,333)</u>
Non-controlling interests	<u>(32,500)</u>	<u>(14,000)</u>	<u>(35,600)</u>	<u>(37,633)</u>	<u>(41,166)</u>

The Acquisition Method

- Acquisition-related costs

- Acquisition-related costs are costs the acquirer incurs to effect a business combination.
 - Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities.
- The acquirer shall account for acquisition-related costs **as expenses in the periods** in which the costs are incurred and the services are received, with one exception.
 - The costs to issue debt or equity securities shall be recognised in accordance with HKAS 32 and HKAS 39.

Effective Date

- HKFRS 3 (revised 2008) shall be applied prospectively to
 - business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.
- Earlier application is permitted.
 - However, HKFRS 3 shall be applied only at the beginning of an annual reporting period that begins on or after 30 June 2007.
 - If an entity applies HKFRS 3 before 1 July 2009, it shall
 - disclose that fact and
 - apply HKAS 27 (as amended in 2008) at the same time.



Today's Agenda



Other Issues

Forthcoming Change in 2008 – 2009

- **Exposure Drafts finalised by IASB in 2008**
 - Financial Instruments: Puttable Instruments (IAS 32)
 - Amendments to IFRS 1 First-time Adoption of IFRSs
 - Annual Improvement
- **Exposure Drafts to be finalised in 2008**
(per IASB Work Plan – Project Timetable)
 - Related Party Disclosures (IAS 24)
 - Joint Ventures (IAS 31)
 - IFRS for SMEs
 - Earnings per Share: Treasury Stock Method (IAS 33)



Charitable Conference for Sichuan

(Technical Update on Financial Reporting Standards)

June 2008



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Nelson Lam 林智遠
nelson@nelsoncpa.com.hk
www.nelsoncpa.com.hk