

A GUIDE TO THE NEW
**HONG KONG
FINANCIAL REPORTING
STANDARDS 2010**

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**HONG KONG FINANCIAL REPORTING
STANDARDS 2010**

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► OVERVIEW

CHANGES INTRODUCED BY THE NEW AND AMENDED HKFRSs AND INTERPRETATIONS

The HKICPA has issued a number of new and revised HKFRSs and Interpretations which are effective for December 2010 year-end and beyond. Those which are effective first time for December 2010 year-end are called "2010 HKFRSs" and those beyond "2011 HKFRSs" in this publication.

2010 is no doubt another year of changes and challenges for preparers and auditors of financial statements because of the changes introduced by the 2010 HKFRSs listed below. Although the 2011 HKFRSs are not effective for the December 2010 year-end, HKFRSs preparers are still required to consider their requirements because HKAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" paragraph 30 still requires disclosure of the fact that they have not been early adopted and of the possible effects that their future application might have on the financial statements.

It should also be noted that in response to calls for more simplified reporting standards for SMEs, the IASB has issued the IFRS for SMEs which was adopted by the HKICPA in April 2010 as the HKFRS for Private Entities. This is a standalone reporting framework for the qualified private entities.

These changes are briefly explained below with further details and explanations provided in the BDO HKFRSs/IFRSs Updates from page 13 to page 76.

2010 HKFRSs

1. First-time adoption – HKFRS 1 amendments

1.1 Restructure of the standard

Since HKFRS 1 was issued in 2006, it has been amended many times to accommodate first-time adoption requirements resulting from new or amended HKFRSs, and as a result the text has become increasingly complex. Therefore, HKFRS 1 is revised so as to make it easier for the reader to understand and to design it to better accommodate future changes. The restructured HKFRS 1 has an improved structure but does not contain any technical changes.

The original effective date for the restructured HKFRS 1 was 1 January 2009 but was subsequently changed to 1 July 2009 due to potential problems arising from the interaction with the revised HKFRS 3 and the amended HKAS 27.

1.2 Oil and gas assets and lease classification

The amendment addresses the retrospective application of HKFRSs to particular situations and are aimed at ensuring that entities applying HKFRSs will not face undue cost or effort in the transition process.

The amendment:

- exempts entities using the full cost method from retrospective application of HKFRSs for oil and gas assets.
- exempts entities with existing leasing contracts from reassessing the classification of those contracts in accordance with HK(IFRIC)-Int 4 "Determining Whether an Arrangement Contains a Lease" when the application of their other accounting requirements produced the same result.

The amendment is effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.

2. Share-based payment – HKFRS 2 amendment – group cash-settled share-based payment transactions

This amendment responds to requests to clarify how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

The amendment clarifies:

- the scope of HKFRS 2. An entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, and no matter whether the transaction is settled in shares or cash.
- the interaction of HKFRS 2 and other standards. The amendment clarifies that in HKFRS 2 a “group” has the same meaning as in HKAS 27, that is, it includes only a parent and its subsidiaries.

The amendment also incorporates guidance previously included in HK(IFRIC)-Int 8 “Scope of HKFRS 2” and HK(IFRIC)-Int 11 “HKFRS 2-Group and Treasury Share Transactions”, and as a result, they are withdrawn.

An entity shall apply the amendment retrospectively to annual periods beginning on or after 1 January 2010, subject to the transitional requirements in HKFRS 2. If the information necessary for retrospective application is not available an entity shall reflect in its separate or individual financial statements the amounts previously recognised in the group’s consolidated financial statements. Early application is permitted.



3. Consolidations – revised HKFRS 3, amended HKAS 27

The main changes the revised HKFRS 3 and amended HKAS 27 will make to existing requirements or practice are:

- Partial acquisitions:** Non-controlling interests are measured either at their proportionate interest in the net identifiable assets (which is the original HKFRS 3 requirement) or at fair value (which is the new requirement in US GAAP).
- Step acquisitions:** The requirement to measure at fair value every asset and liability at each step for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill is measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired.
- Acquisition-related costs:** Acquisition-related costs are generally recognised as expenses (rather than included in goodwill).
- Contingent consideration:** Contingent consideration must be recognised and measured at fair value at the acquisition date. Subsequent changes in fair value are recognised in accordance with other HKFRSs, usually in profit or loss (rather than by adjusting goodwill).
- Transactions with non-controlling interests:** Changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions.

The revised HKFRS 3 shall be applied prospectively and is effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted for annual periods beginning on or after 30 June 2007 and provided that the amended HKAS 27 is applied at the same time. The amended HKAS 27 shall be applied retrospectively with certain exceptions and is effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted provided that the revised HKFRS 3 is applied at the same time.

4. Hedging of portions of financial instruments – HKAS 39 amendment

The amendment clarifies how the existing principles underlying hedge accounting should be applied in two particular situations:

- a. a one-sided risk in a hedged item
- b. inflation in a financial hedged item

Qualifying hedged items – a one-sided risk in a hedged item

An entity can designate all changes in the cash flows or fair value of a hedged item in a hedging relationship. An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a one-sided risk).

The amendment clarifies that only the intrinsic value, not the time value, of an option reflects a one-sided risk and therefore an option designated in its entirety cannot be perfectly effective.

Designation of inflation as a hedged item

The amendment clarifies that inflation cannot be designated as a risk or a portion of a financial instrument unless inflation is a contractually specified portion of the cash flows of a recognised financial instrument, such as an inflation-linked bond.

The amendment has developed application guidance to illustrate how the principles underlying hedge accounting should be applied in those situations.

An entity shall apply the amendment retrospectively for accounting periods beginning on or after 1 July 2009, with earlier adoption permitted.

5. Annual improvements

5.1 2008 Annual Improvements

The amendment to HKFRS 5 will result in accounting changes for presentation, recognition or measurement purposes by:

- introducing a new requirement that when a subsidiary is held for sale, all of its assets and liabilities shall be classified as held for sale under HKFRS 5, not only the portion of the interest to be disposed of, regardless of whether the entity will retain a non-controlling interest in the (former) subsidiary after the sale.
- clarifying that if the subsidiary described above is a disposal group meeting the definition of a discontinued operation, the relevant disclosures are required.

The amendment is effective for annual periods beginning on or after 1 July 2009 with early application permitted.

5.2 2009 Annual Improvements

They represent necessary, but non-urgent, amendments to 12 HKFRSs and Interpretations that will not be included as part of another major project. The following table lists the HKFRSs and topics addressed by the amendments.

HKFRSs/Interpretations	Subject of amendment
HKFRS 2 "Share-based Payment"	Scope of HKFRS 2 and revised HKFRS 3
HKFRS 5 "Non-current Assets Held for Sale and Discontinued Operations"	Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations
HKFRS 8 "Operating Segments"	Disclosure of information about segment assets
HKAS 1 "Presentation of Financial Statements"	Current/non-current classification of convertible instruments
HKAS 7 "Statement of Cash Flows"	Classification of expenditures on unrecognised assets
HKAS 17 "Leases"	Classification of leases of land and buildings
HKAS 18 "Revenue"	Determining whether an entity is acting as a principal or as an agent
HKAS 36 "Impairment of Assets"	Unit of accounting for goodwill impairment test
HKAS 38 "Intangible Assets"	<ul style="list-style-type: none"> • Additional consequential amendments arising from revised HKFRS 3 • Measuring fair value of an intangible asset acquired in a business combination
HKAS 39 "Financial Instruments: Recognition and Measurement"	<ul style="list-style-type: none"> • Treating loan repayment penalties as closely related embedded derivatives • Scope exemption for business combination contracts • Cash flow hedge accounting
HK(IFRIC)-Int 9 "Reassessment of Embedded Derivatives"	Scope of HK(IFRIC)-Int 9 and revised HKFRS 3
HK(IFRIC)-Int 16 "Hedges of a Net Investment in a Foreign Operation"	Amendment to the restriction on the entity that can hold hedging instruments

The local Interpretation HK-Int 4 is also revised as a consequence of amendment to HKAS 17 "Leases" made by the above 2009 Annual Improvements.

The amendment to HKAS 17 removes the specific guidance which stated that land held under a lease should be classified as an operating lease unless title to the land is expected to pass at the end of the lease term.

The new guidance, paragraph 15A, indicates that entities should use judgment to decide whether the lease transfers the significant risks and rewards of ownership of the land in accordance with the criteria set out in HKAS 17. A lease of land is therefore classified as a finance lease if the lease transfers substantially all the risks and rewards incidental to ownership to the lessee.

Following this amendment, the scope of the Interpretation has been expanded to cover all land leases, including those classified as finance leases. As a result, the Interpretation is applicable to all leases of property accounted for in accordance with HKAS 16 "Property, Plant and Equipment", HKAS 17 and HKAS 40 "Investment Property".

6. Distributions of non-cash assets to owners – HK(IFRIC)-Int 17

The Interpretation will standardise practice in the accounting treatment of distribution of non-cash assets to owners.

Existing HKFRSs do not address how an entity should measure distributions of assets other than cash when it pays dividends to its owners. At present the dividend payable is sometimes recognised at the carrying amount of the assets to be distributed and sometimes at their fair value. As a result significant diversity in practice has developed and HK(IFRIC)-Int 17 is issued to provide guidance.

The Interpretation clarifies that:

- a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity.
- an entity should measure the dividend payable at the fair value of the net assets to be distributed.
- an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss.

The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation.

The Interpretation applies to pro rata distributions of non-cash assets except for common control transactions.

The Interpretation is effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted. The Interpretation shall not be applied retrospectively (requires prospective application).

7. Withdrawal of HK-Int 1 "The Appropriate Accounting Policies for Infrastructure Facilities"

The local Interpretation HK-Int 1 was originally developed as guidance on the appropriate method of amortising infrastructure facilities. In particular, HK-Int 1 confirmed that the sinking fund method is not allowed. Moreover, as the phrase "consumption of economic benefits" used in HKAS 38 "Intangible Assets" was subject to debate at the time of issuing HK-Int 1, the HKICPA did not rule out either the straight-line depreciation method or the units-of-usage depreciation method prior to it obtaining clarification from the IFRIC.

With the issuance of HK(IFRIC)Int-12 "Service Concession Arrangements" in March 2007, an amendment to HKAS 38 "Intangible Assets" in October 2008 and the IFRIC's rejection notice in January 2010 – in response to the HKICPA's agenda request regarding the meaning of "consumption of economic benefits" in IAS 38 "Intangible Assets", various aspects of depreciation of property, plant and equipment and amortisation of intangible assets that are covered in HK-Int 1 have become outdated. The new pronouncements are summarised below:

- The sinking fund method is not allowed. Paragraphs BC 64 - 65 of HK(IFRIC)Int-12 explicitly state that interest methods of amortisation (which would include the sinking fund method) are not permitted under both HKAS 38 and HK(IFRIC)Int-12.
- HKAS 38 has been amended in October 2008 to delete the restriction in paragraph 98 relating to the use of a unit of production method in circumstances where it resulted in a lower amount of accumulated amortisation than under the straight line method.



- The IFRIC decided not to issue guidance on the meaning of “consumption of economic benefits” when determining the appropriate amortisation method for an intangible asset with a finite useful life. In its agenda decision issued in January 2010 the IFRIC noted that the determination of the amortisation method is a matter of judgment. Management should therefore use judgment in selecting the amortisation method that best reflects the pattern of consumption of the expected future economic benefits of the asset. In addition, in accordance with paragraph 122 of IAS 1 “Presentation of Financial Statements”, significant judgements made in determining the amortisation methods should be disclosed in the notes to the financial statements.

These pronouncements are consistent with the current application of HK-Int 1 but contain additional clarification and explanation. In order to eliminate textual differences from IFRSs, HK-Int 1 is withdrawn and is effective for financial periods beginning on or after 1 January 2010.



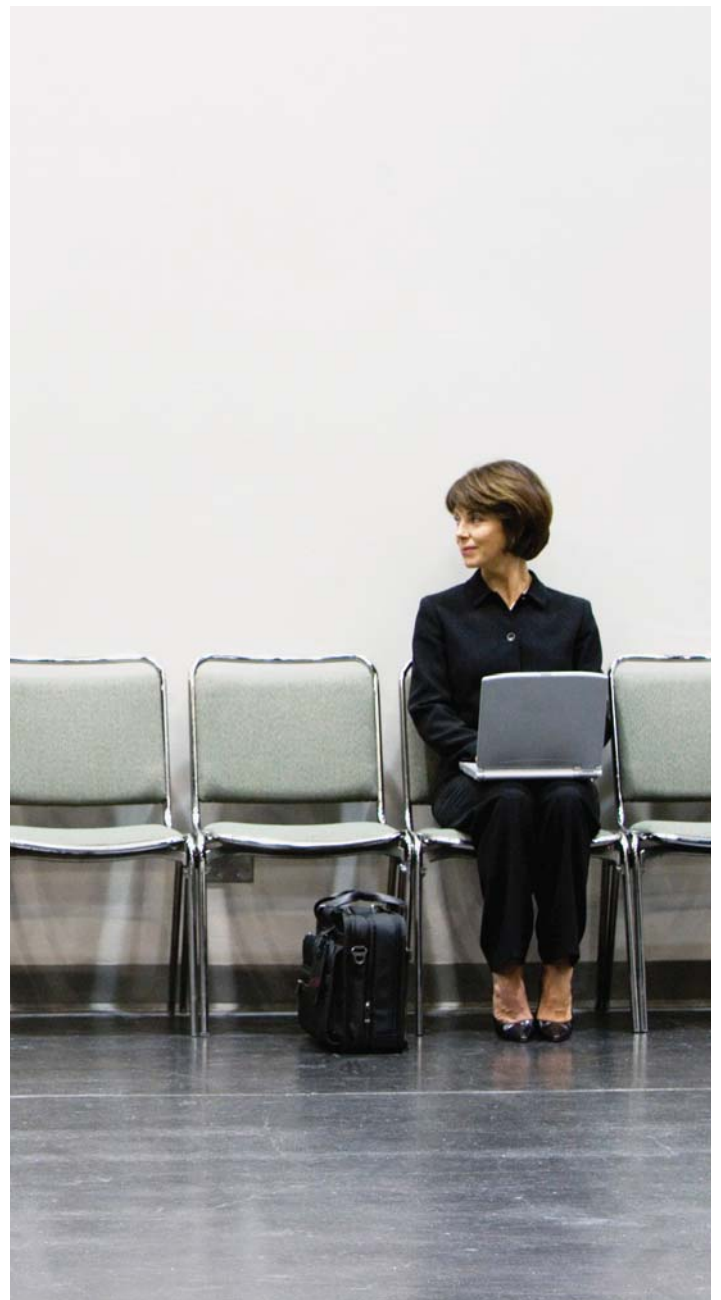
HKFRS FOR PRIVATE ENTITIES

This is a new standard for entities without public accountability. It is a self contained standard of about 230 pages tailored for the needs and capabilities of private businesses. Many of the principles in full HKFRSs have been simplified and disclosure requirements significantly reduced. Revisions to the HKFRS for PEs will be limited to once every three years.

ACCOUNTING GUIDANCE

Accounting Bulletin 4 "Guidance on the Determination of Realised Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance" provides guidance on the determination of distributable profits under the Hong Kong Companies Ordinance ("the Ordinance"). It is for general guidance only and does not introduce additional accounting, disclosure or legal requirements.

Its purpose is to identify, interpret and apply the principles relating to the determination of realised profits and losses for the purposes of making distributions under sections 79A to 79P of the Ordinance. The most common form of a distribution is a cash dividend paid pro rata to ordinary shareholders.



2011 HKFRSs

1. First-time adoption – HKFRS 1 amendment - financial instrument disclosures

The amendment relieves first-time adopters of HKFRSs from providing the additional disclosures introduced in the “Improving Disclosures about Financial Instruments (Amendments to HKFRS 7)”. It thereby ensures that first-time adopters benefit from the same transition provisions that amendment to HKFRS 7 provides to current HKFRSs preparers.

The amendment is effective for annual periods beginning on or after 1 July 2010.

2. Financial instruments

2.1 Classification and measurement of financial assets – HKFRS 9 “Financial Instruments” (new)

The issuance of HKFRS 9 represents the completion of the first part of a three-part project to replace HKAS 39. Proposals addressing the second part, the impairment methodology for financial assets were published for public comment at the beginning of November 2009, while proposals on the third part, on hedge accounting, continue to be developed.

HKFRS 9 uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in HKAS 39. The approach in HKFRS 9 is based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.

The new HKFRS is effective for annual periods beginning on or after 1 January 2013, with early adoption permitted.

2.2 Classification of rights issues – HKAS 32 amendment

The amendment addresses the accounting for rights issues (rights, options or warrants) that are denominated in a currency other than the functional currency of the issuer. Previously such rights issues were accounted for as derivative liabilities. However, the amendment requires that, provided certain conditions are met, such rights issues are classified as equity regardless of the currency in which the exercise price is denominated.

The amendment is effective for annual periods beginning on or after 1 February 2010.

2.3 Extinguishing financial liabilities with equity instruments – HK(IFRIC)Int-19

The Interpretation clarifies the requirements of HKFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially.

The Interpretation clarifies that:

- the entity's equity instruments issued to a creditor are part of the consideration paid to extinguish the financial liability.
- the equity instruments issued are measured at their fair value. If their fair value cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished.
- the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is included in the entity's profit or loss for the period.

The Interpretation is effective for annual periods beginning on or after 1 July 2010 with earlier application permitted.

3. Related-party disclosures – HKAS 24 amendment

HKAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

HKAS 24 has been revised in response to concerns that the previous disclosure requirements and the definition of a “related party” were too complex and difficult to apply in practice, especially in environments where government control is pervasive.

The amendment addresses these concerns by:

- providing a partial exemption for government-related entities. Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant.
- providing a revised definition of a related party. The definition has been simplified and inconsistencies been removed.

The amendment is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted.

4. 2010 Annual Improvements

They set out a collection of amendments to HKFRSs, considered necessary but non-urgent, to HKFRSs that will not be included as part of another major project.

In particular, the scope of paragraph D8 of HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards" has been extended for the use of the deemed cost exemption for an event-driven fair value. In some jurisdictions, local law requires an entity to revalue its assets and liabilities to fair value for a privatisation or initial public offering and to treat the revalued amounts as deemed cost for the entity's previous GAAP. Before the amendment, if that revaluation occurred after the entity's date of transition to HKFRSs, the entity could not have used that revaluation as deemed cost for HKFRSs. Therefore, the entity would have had to prepare two sets of measurements for its assets and liabilities – one to comply with HKFRSs, and one to comply with local law.



This is considered unduly onerous. Therefore, paragraph D8 has been amended to allow an entity to recognise an event-driven fair value measurement as deemed cost when the event occurs, provided that this is during the periods covered by its first HKFRSs financial statements. In addition, the same relief should apply to an entity that adopted HKFRSs in periods before the effective date of HKFRS 1 or applied HKFRS 1 in a previous period, provided the measurement date is within the period covered by its first HKFRSs financial statements.

The amendments are mostly effective for annual periods beginning on or after 1 January 2011, although entities are permitted to adopt them earlier.

The following table lists the HKFRSs and Interpretation, and topics addressed by the amendments.

HKFRSs/Interpretation	Subject of amendment
HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards"	<ul style="list-style-type: none"> Accounting policy changes in the year of adoption Revaluation basis as deemed cost Use of deemed cost for operations subject to rate regulation
HKFRS 3 "Business Combinations"	<ul style="list-style-type: none"> Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised HKFRS Measurement of non-controlling interests Un-replaced and voluntarily replaced share-based payment awards
HKFRS 7 "Financial Instruments: Disclosures"	Clarifications of disclosures
HKAS 1 "Presentation of Financial Statements"	Clarification of statement of changes in equity
HKAS 27 "Consolidated and Separate Financial Statements"	Transition requirements for amendments made as a result of HKAS 27 (as amended in 2008) to HKAS 21, HKAS 28 and HKAS 31
HKAS 34 "Interim Financial Reporting"	Significant events and transactions
HK(IFRIC)-Int 13 "Customer Loyalty Programmes"	Fair value of award credits

5. Amendment to HK(IFRIC)-Int 14 - Prepayments of a Minimum Funding Requirement

The amendment is itself an interpretation of HKAS 19 "Employee Benefits". The amendment applies in the limited circumstances when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendment permits such an entity to treat the benefit of such an early payment as an asset.

The amendment has an effective date for mandatory adoption of 1 January 2011, with early adoption permitted.

▶ BDO NEWSLETTERS

HKFRSs / IFRSs UPDATES

- 2008/01 IFRS 3 BUSINESS COMBINATIONS (REVISED) AND IAS 27 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS (AS AMENDED 2008)
- 2008/02 HKAS 39 AMENDMENT "FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT – ELIGIBLE HEDGED ITEMS"
- 2008/03 RESTRUCTURED HKFRS 1 "FIRST-TIME ADOPTION OF HONG KONG FINANCIAL REPORTING STANDARDS"
- 2009/01 IFRIC 17 DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS
- 2009/05 PART I : ADDITIONAL EXEMPTIONS FOR FIRST-TIME ADOPTERS (AMENDMENTS TO HKFRS 1)
PART II : GROUP CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS (AMENDMENTS TO HKFRS 2)
- 2009/08 IMPROVEMENTS TO HKFRSs 2009
- 2009/10 HKAS 24 RELATED PARTY DISCLOSURES
- 2009/11 AMENDMENT TO HKAS 32 FINANCIAL INSTRUMENTS : PRESENTATION - CLASSIFICATION OF RIGHTS ISSUES
- 2009/12 HKFRS 9 FINANCIAL INSTRUMENTS
- 2010/02 HK(IFRIC)-INT 19 'EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS'
- 2010/03 AMENDMENTS TO HK(IFRIC)-INT 14 PREPAYMENTS OF A MINIMUM FUNDING REQUIREMENT
- 2010/04 IMPROVEMENTS TO HKFRSs 2010
- 2010/05 AMENDMENT TO HKFRS 1 LIMITED EXEMPTION FROM COMPARATIVE HKFRS 7 DISCLOSURES FOR FIRST-TIME ADOPTERS
- 2010/06 HKFRS FOR PRIVATE ENTITIES (HKFRS FOR PEs) - A NEW FINANCIAL REPORTING OPTION

HKFRSs / IFRSs UPDATE

IFRS 3 BUSINESS COMBINATIONS (REVISED) AND IAS 27 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS (AS AMENDED 2008)

2008/01

31 January 2008

Background

The revised standards comprising amendments to IFRS 3 and IAS 27 are the second phase of the International Accounting Standards Board's (IASB's) business combinations project. This is a joint project with the US Financial Accounting Standards Board (FASB).

Requirements

The basic approach of the existing IFRS 3 to apply acquisition accounting in all cases and identify an acquirer is retained. This includes much of the current guidance for the identification and recognition of intangible assets separately from goodwill. However, in some respects the revised standard may result in very significant changes, such as an option to gross up the balance sheet for goodwill attributable to minority interests (which are renamed 'non-controlling interests'). Amendments to IAS 27 relate in particular to acquisitions of subsidiaries achieved in stages and disposals of interests, with significant differences in the accounting depending on whether control is gained or not, or a transaction simply results in a change in the percentage of the controlling interest.

Scope

The scope of IFRS 3R ("the standard") has been extended to cover business combinations involving only mutual entities and those achieved by contract alone. Transactions under common control continue to be outside the scope of the standard.

Definition of a business combination

The standard focuses on control, in determining whether a transaction gives rise to a business combination. This compares to the current approach under IFRS 3, where a business combination is defined as the bringing together of separate entities or businesses into one reporting entity.

STATUS

Revised and amended standards

EFFECTIVE DATE

Annual reporting periods
beginning on/after July 2009

ACCOUNTING IMPACT

Brings significant changes
to accounting for business
combinations and extends the
scope of IFRS 3

Definition of a business

The definition is extended to include integrated activities and assets that are capable of being conducted and managed as a business and that provide:

- dividends, lower costs, increased share prices, or
- other economic benefits to owners, members or participants.

This means that, to meet the definition of a business, assets and activities need not be conducted and managed as a business as at the acquisition date, so long as they can be in the future.

The acquisition method

The acquisition method of accounting remains mandatory for all business combinations within the scope of the standard, and involves four steps:

1. Identifying the acquirer;
2. Determining the acquisition date;
3. Recognising and measuring the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; and
4. Recognising and measuring goodwill or a gain from a bargain purchase.

Steps 1 and 2

The revised standard retains the approach set out in existing IFRS 3 for the first two of these steps. Changes are proposed for the others.

Step 3

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

All identifiable assets acquired and liabilities assumed as a result of the business combination will be measured at their **full** fair value (even if the business combination involves less than 100% of the acquiree or the business combination is achieved in stages), with fewer exceptions than under the current IFRS 3. The remaining exceptions are deferred tax assets and liabilities, indemnification assets, operating leases, employee benefit plans, reacquired rights, share-based payment awards and assets held for sale that are within the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Operating leases (IFRS 3R, Appendix B28 and B42)

When the acquiree is the lessee the approach for operating leases is that for each lease, as at the acquisition date, it is necessary to determine whether it is at a market rate. If an operating lease is not at a market rate, then the acquirer recognises an intangible asset if the terms of the operating lease are more favourable than market rates, and a liability if the terms are less favourable. In cases where the acquiree is the lessor, IFRS 3R Appendix B42 notes that the acquirer does not recognise a separate asset or liability. The terms of an operating lease are taken into account in measuring the acquisition-date fair value of an asset instead.

Intangible assets

The current IFRS 3 requires intangible assets to be recognised separately from goodwill if they meet the IAS 38 definition and are reliably measurable. The requirement in the existing standard that they be reliably measurable has been dropped, which may result in additional intangible assets being recognised separately. However, an assembled workforce will continue not to be recognised as a separate intangible.

Contingent assets and liabilities

Similar to the current IFRS 3, the revised standard requires contingent liabilities that are "present" obligations that arose from past events to be measured at fair value at the acquisition date. Contingent assets are still not to be recognised.

Non-controlling interest in the acquiree (IFRS 3R.19 and Appendix B44, Appendix A)

The non-controlling interest is the equity in a subsidiary that is not attributable, directly or indirectly, to a parent. The non-controlling interest in the acquiree can be measured either at its full fair value (including goodwill) or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets at the acquisition date. On a per-share basis the full fair value might be different to the fair value per share of the acquirer's controlling interest in the acquiree because of the inclusion of a discount for lack of control.

Step 4

Recognising and measuring goodwill or, less frequently, a gain from a bargain purchase. IFRS 3R.32 notes that:

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

- a. the aggregate of:
 - i. the consideration transferred measured in accordance with this IFRS, which generally requires acquisition-date fair value (see paragraph 37);
 - ii. the amount of any non-controlling interest in the acquiree measured in accordance with this IFRS; and
 - iii. in a business combination achieved in stages (see paragraphs 41 and 42), 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 this IFRS (see also above, Step 3 of acquisition accounting).

In a significant change from the current standard, IFRS 3R gives the acquirer the option to either account for the non-controlling interest at fair value or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets (IFRS 3R.19).

Measuring the non-controlling interest at fair value means that goodwill is recognised and measured at an amount equal to the total fair value exchanged in the purchase transaction less the full fair value of the identifiable assets, and liabilities assumed.

While this does not represent a change where 100% of a business is acquired, it is very significantly different where an acquirer owns less than 100%. This is because IFRS 3R permits goodwill attributable to the non-controlling interests to be recognised in the consolidated balance sheet, with the amount attributed to the non-controlling interest in equity being increased accordingly ("full goodwill method", see step 3 above).

Consideration transferred by the acquirer

IFRS 3R requires all items included in the consideration transferred by the acquirer to be measured at fair value at the acquisition date. In some cases, transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination (IFRS 3R.38).

The fair value of the consideration transferred is calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. The exception to this rule is that all or a portion of the acquirer's share-based payment awards exchanged as replacement for awards held by the acquiree's employees over equity instruments in the acquired entity may be part of the consideration transferred in the business combination. That portion of the consideration is measured in accordance with IFRS 2 *Share-based Payment* rather than at fair value (see IFRS 3R.37). However, it will be important to consider when determining the appropriate accounting treatment, the guidance in respect of whether the consideration is part of the cost of the acquired business, or remuneration for future employee services (see below).

The sum of fair values includes the *valuation of contingent consideration arrangements*. If contingent consideration is classified (applying IAS 32) as a liability (rather than equity), subsequent changes in fair value will be recognised in accordance with either IAS 39 *Financial Instruments: Recognition and Measurement*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, or other IFRSs. Contingent consideration classified as equity is not remeasured.

Goodwill is not affected by any subsequent adjustment to contingent consideration. This is a fundamental change from the current standard.

Previously held equity interest in the acquiree

The amount of any non-controlling interest in the acquired business that the acquirer owned immediately prior to the acquisition of the controlling interest is considered to be part of the consideration transferred. This could be an interest accounted for as an investment, or an interest in an associate or a joint venture. At the point of acquisition of the controlling interest, the existing interest is required to be remeasured at fair value, with any gain or loss being recorded in profit or loss.

Acquisition-related costs

In a further significant change from IFRS 3, the revised standard requires that all transaction costs, such as advisory, legal, accounting and valuation fees, together with all administrative costs, are to be excluded from the consideration transferred or the fair value attributed to the acquired business. Instead, they will be accounted for in accordance with other IFRSs, meaning that they will be charged to the income statement as incurred.

A bargain purchase

IFRS 3R notes that the price paid for an acquiree (consideration transferred plus amount of non-controlling interest in the acquiree plus fair value of the acquirer's previously held equity interest in the acquiree) might be less than the net of the acquisition-date fair values of the identifiable assets acquired and the liabilities assumed.

This might be the case in a forced sale of a business. In such circumstances, a review is first required of whether the acquiring entity has correctly identified and measured the fair value of:

- the identifiable assets acquired and liabilities assumed;
- the non-controlling interest in the acquiree;
- the acquirer's previously held non-controlling equity investment in the acquiree (if business combination achieved in stages); and
- consideration transferred.

If, after this review, the **full** fair value of the identifiable assets and liabilities assumed stills exceeds the total fair value exchanged in the purchase transaction, the excess will be recognised in profit or loss on the acquisition date.

Measurement period (IFRS 3R.45ff)

The measurement period is the period after the acquisition date during which the acquirer may adjust provisional accounting for a business combination. The revised standard carries forward the existing IFRS 3 requirement that if any of the fair value measurements can only be completed provisionally at the acquisition date, any adjustments to those measurements that are to be reflected in the business combination must be completed within 12 months of the acquisition date. If any fair values are provisional, a statement to the effect must be made in the entity's published financial statements. Like the current IFRS 3, after the end of the 12 month measurement period, the acquirer only revises the accounting for a business combination to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Determining what is part of the business combination transaction - assessing whether the exchange consideration is all in respect of the acquired business (IFRS 3R.51ff)

IFRS 3R clarifies that the consideration payable is not necessarily all exchanged for the business acquired. The new standard includes Application Guidance for a number of examples, including where the acquirer and the acquiree have a pre-existing relationship or payments are made to compensate employees or former owners of a business for service rendered after the acquisition. It should be noted that this guidance generally articulates more clearly the approach that should have been followed under the existing IFRS 3. However, it is possible that the additional clarification in IFRS 3R will result in a change in approach for some entities.

In assessing whether consideration represents payment for the business acquired or a different transaction or event (such as post acquisition services), the acquirer is required to consider:

- The reasons for the transaction or event;
- Who initiated the transaction or event; and
- The timing of the transaction or event.

Examples of transactions that will not be added to the cost of the acquisition, instead being charged to the income statement, include (but are not limited to):

- Transactions that effectively settle pre-existing relationships between the acquirer and the acquiree (such as supply agreements for goods and services);
- Transactions that remunerate employees or former owners of the acquiree for future services; and
- Transactions that reimburse the acquiree or its former owners for paying the acquirer's acquisition related costs.

Deferred tax arising from a business combination

Fair value adjustments to the carrying values in the acquiree of assets acquired, and liabilities assumed, may give rise to temporary differences which will result in the recognition of deferred tax on the acquisition of the business. Fair value adjustments may also change the amount of any deferred tax provision from the amount already recorded by the acquiree. This will affect the amount of goodwill recognised on the business combination.

Where a deferred tax asset arises, in a change from current IFRS 3, the revised standard prohibits any subsequent reduction in the carrying value of goodwill arising from changes in the deferred tax asset that are recognised after the date of acquisition. However, there is an exception to this general rule. Where the deferred tax benefits are recognised within the 12 month post acquisition measurement period, there is a rebuttable presumption that any adjustments to the deferred tax balance in that period relate to conditions that applied at the acquisition date. In these circumstances, the goodwill balance is adjusted unless the change to the deferred tax balance is clearly as a consequence of events after the acquisition date (IFRS 3R Appendix C4, IAS 12R.67).

The revised standard retains the existing IFRS 3 requirement that any adjustments to deferred tax assets of the acquirer that arise as a result of the business combination are excluded from the accounting for the business combination (IFRS 3R Appendix C4, IAS 12R.68).

Particular types of business combinations (IFRS 3R.41ff)

The revised standard also gives additional guidance for applying the acquisition method to particular types of business combinations including:

- Business combinations achieved in stages; and
- Business combinations achieved without the transfer of consideration.

For business combinations achieved in stages (ie a transaction where an acquirer gains control over another entity, and previously held an equity interest in that entity) the revised standard requires that the acquirer remeasures its previously held equity interest in the acquiree at its acquisition-date fair value and recognises the resulting gain or loss in profit or loss. This compares with the current IFRS 3 which notes that the date of each exchange transaction is relevant, and requires at each acquisition stage, a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets and liabilities at each step.

Further acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions (IAS 27.30 [2008]). This includes adjusting the amount of the remaining non-controlling interest to reflect the change in relative interests in the subsidiary. Any difference between the amount of the adjustment to non-controlling interest and the consideration paid or received by the parent on the change in holding is recognised directly in equity.

The same accounting treatment is required for disposals of equity interests while control is retained. In contrast, and consistent with transactions where control is gained, gains or losses from transactions resulting in a loss of control are recognised in profit or loss. The gain or loss includes remeasurement to fair value of any retained equity interest in the investee (IAS 27.30 and 34ff [2008]).

Pre-existing relationships

A business combination may involve the effective settlement of arrangements that existed prior to the date on which the business combination was contemplated (a "pre-existing relationship"). In such cases, a gain or loss is recognised and measured as follows:

- for a pre-existing non contractual relationship, such as a law suit: fair value.
- for a pre-existing contractual relationship: the lesser of two amounts, which are the amount by which the pre-existing contract is on favourable or unfavourable terms (from the perspective of the acquirer) in comparison with current market rates, and the amount of any settlement provision in the contract available to the counterparty to whom the contract is unfavourable.

Any gain or loss recognised will be adjusted for any related asset or liability previously recognised by the acquirer (such as a provision for the amount payable in respect of a law suit).

Effective settlement of a supply contract as a result of a business combination

An illustration of a business combination where there is effective settlement of a pre-existing supply contract between the acquirer and the new subsidiary is set out in paragraph IE54 to IE57. When allocating the cost of the business combination to the fair value of the assets and liabilities of the acquiree, the acquirer has to separate the fair value of the supply contract. The fair value has to be analysed as to whether it contains any favourable or unfavourable component from the acquirers point of view. "Favourable" or "unfavourable" is in the context of whether the contract pricing is below, or above, the price that applies in the marketplace at the acquisition date. Any favourable or unfavourable component has to be recognised in profit or loss immediately. The "at market"-component is part of the goodwill: it does not represent a reacquired right that the acquirer might subsequently reissue to a third party.

Disclosures

The revised standard requires certain new disclosures, and modifies existing disclosures, which are consistent with the changes in approach to permit recognition of the full fair value of the acquired business, whether or not a 100% interest is acquired. These additional disclosures include:

- The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- A qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition, or other factors.
- The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration such as:
 - Cash;
 - Other tangible or intangible assets, including a business or subsidiary of the acquirer;
 - Liabilities incurred, for example, a liability for contingent consideration;
 - Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of determining the fair value of those instruments or interests.
- For contingent consideration arrangements and indemnification assets:
 - The amount recognised at the acquisition date;
 - A description of the arrangement and the basis for determining the amount of the payment;
 - An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer is required to disclose that fact.
- For each contingent liability recognised in accordance with IFRS 3R.23, the information required in IAS 37.85, which includes:
 - a. a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
 - b. an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48 [of IAS 37].

If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

- The information required by IAS 37.86:

“Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

 - a. an estimate of its financial effect, measured under paragraphs 36-52 [of IAS 37];
 - b. an indication of the uncertainties relating to the amount or timing of any outflow; and
 - c. the possibility of any reimbursement.”; and
- The reasons the liability cannot be measured reliably.
- The total amount of goodwill that is expected to be deductible for tax purposes.
- For transactions that do not form part of the business combination and are therefore recognised separately from the acquisition of assets and assumptions of liabilities in the business combination in accordance with IFRS 3R.51 (eg where the acquirer and the acquiree have a pre-existing relationship):
 - A description of each transaction;
 - How the acquirer accounted for each transaction;
 - The amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised;
 - If the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.
- The disclosure of separately recognised transactions required by IFRS 3R. Appendix B64(l) and (m) includes the amount of acquisition-related costs, the amount recognised as an expense and the line item or items in the income statement in which those expenses are recognised. The amount of any issue costs (such as for example, costs in respect of the issue of new equity instruments) not recognised as an expense and how they were recognised also shall be disclosed.
- In a bargain purchase:
 - The amount of any gain recognised in accordance with IFRS 3R.34 and the line item in the income statement in which the gain is recognised;
 - A description of the reasons why the transaction resulted in a gain.

- For each business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date:
 - The amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount;
 - For each non-controlling interest in an acquiree measured at fair value, the valuation techniques and key model inputs used for determining that value.
- In a business combination achieved in stages:
 - The acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date;
 - The amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see IFRS 3R.42) and the line item in the income statement in which that gain or loss is recognised.
- For all business combinations:
 - The amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated income statement for the reporting period;
 - The revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

Profit and loss attributed to non-controlling interests

IAS 27.28 [2008] notes that 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. This could apply where a non wholly owned subsidiary was loss making.

Effective date and transition

The revised IFRS 3 and IAS 27 will apply to business combinations taking place during accounting periods commencing on or after 1 July 2009. Earlier application is permitted, although this is limited to accounting periods commencing on or after 30 June 2007. If the revised IFRS 3 were to be applied early, this would need to be disclosed and the revised version of IAS 27 would also need to be applied.

Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this IFRS are not adjusted on the adoption of IFRS 3R (ie the new standard is applied prospectively).

An entity, such as a mutual entity, that has not yet applied IFRS 3 and that had one or more business combinations that were accounted for using the purchase method is required to apply the transition provisions in Appendix B68 and B69. In summary these two paragraphs note the following:

IFRS 3R.64 provides that this IFRS applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after 1 July 2009. For business combinations involving only mutual entities or by contract alone and given the acquisition date for that business combination is before the application of this IFRS, IFRS 3R Appendix B69 notes that this prospective application implies that:

1. An entity shall continue to classify the prior business combination in accordance with the entity's previous accounting policies for such combinations.
2. The carrying amount of previously recognised goodwill in accordance with the entity's previous accounting policies is only amended by way of eliminating any amortisation previously recognised.
3. Goodwill previously recognised as a deduction from equity is neither recognised as an asset nor does the entity recognise in profit or loss any part of that goodwill when it disposes of all or part of the business to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired.

4. When accounting subsequently for goodwill, no amortisation is recognised. The goodwill is tested in accordance with IAS 36 for any impairment.
5. Previously recognised negative goodwill is eliminated at the beginning of the first annual period in which this IFRS is applied with a corresponding adjustment to the opening balance of retained earnings at that date.

Income taxes

For business combinations in which the acquisition date was before the effective date of this IFRS is applied, the acquirer applies the requirements of IAS 12.68, as amended by this IFRS prospectively. Therefore:

- a. The acquirer does not adjust the accounting for prior business combinations for previously recognised changes in recognised deferred tax assets.
- b. The acquirer recognises, as an adjustment to income tax expense (or a direct adjustment to equity in accordance with IAS 12.61), changes in recognised deferred tax assets.

Action required

The requirements of the revised standards are complex and, in certain respects, will bring accounting that is significantly different from that required by the current version of IFRS 3 and IAS 27. Entities which report in accordance with IFRS, or anticipate adopting IFRS in the future, should review the new requirements carefully. It may be appropriate to revisit planned transaction structures, and early communication of the effect of the new requirements to investors may be appropriate.

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HKFRSs / IFRSs UPDATE

HKAS 39 AMENDMENT

"FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT – ELIGIBLE HEDGED ITEMS"

2008/02

31 December 2008

Background - hedges and hedge accounting

Most business activity involves risk and uncertainty, and one of the roles of management is to manage that risk and uncertainty. One way in which that can be done is to enter into transactions that expose the entity to risk and/or uncertainty that fully or partially offsets one or more of the entity's other risks and uncertainties. Such transactions are known as 'hedges'; the instrument acquired or incurred to offset risk or uncertainty is known as 'the hedging instrument'; and the risk or uncertainty hedged is known as the 'hedged risk' or the 'hedged item'.

HKAS 39 permits entities to apply special, so-called hedge accounting to the hedged item and the hedging instrument when certain criteria are met. The result is that hedging instruments and hedged items are reported in ways that differ from the accounting that the normal accounting principles require. The aim of hedge accounting is to match the accounting effect of the hedged item and of the hedging instrument in profit or loss.

The criteria that HKAS 39 requires to be met for hedge accounting to be applied are:

- a. The hedge relationship must be designated and documented at inception;
- b. The hedge must be expected to be effective. In other words, the hedging instrument needs to be effective (within prescribed parameters) in offsetting the fair value changes or cash flow variability of the hedged item;
- c. Hedge effectiveness must be capable of being reliably measured on an ongoing basis. (Hedge ineffectiveness is required to be identified and reported in profit or loss; and, if ineffectiveness exceeds a certain limit, the use of hedge accounting is precluded); and
- d. When hedging future variability in cash flows, there must be a high probability of those cash flows occurring and affecting profit or loss.

STATUS

Final

EFFECTIVE DATE

Annual reporting periods beginning on or after 1 July 2009, with earlier application permitted. It should be applied retrospectively.

ACCOUNTING IMPACT

May be significant for entities applying hedge accounting

An entity may hedge risks and uncertainties that represent only some but not all of the risks or cash flows of a particular contract or forecast transaction. In order to enable entities to avoid reporting hedge ineffectiveness in such circumstances — relating to risks that are not being hedged — HKAS 39 allows entities to apply hedge accounting to something other than for example the entire contract. However, HKAS 39 imposes further restrictions in such cases to ensure that hedge accounting exceptions are applied appropriately and that any actual ineffectiveness that exists in the hedge relationship is reported in profit or loss.

Amendment

The IASB issued an amendment to IAS 39 “Financial Instruments: Recognition and Measurement – Eligible Hedged Items” in October 2008. The Amendment clarifies the following two aspects of the existing IAS 39:

- a. when inflation can be designated as a hedged item in a financial instrument under the hedge accounting provisions in IAS 39 (Clarification 1); and
- b. how hedge accounting can be applied to hedges where a hedging instrument is an option contract (Clarification 2).

The amendment was adopted by the HKICPA in November 2008 with the same effective date.

Clarification 1

Consider the following example. A fixed rate bond is issued by an entity which then enters into an inflation-adjusted payment versus fixed rate receipt swap. (In other words, in economic terms the fixed rate bond has been transformed into a liability with an inflation-linked interest rate.) The question that has arisen and is addressed in this part of the amendment is whether it is possible for accounting purposes to treat the fixed rate on the liability as being made up of an inflation-indexed component plus a real rate of interest and to apply hedge accounting in such a way that effectiveness is measured by comparing the offsetting effect of fair value changes of the swap against the fair value changes of the inflation-indexed component of the fixed rate liability.

Hedge accounting applied in this way would show no or little ineffectiveness. On the other hand, if hedge accounting is applied in such a way that the offsetting effect of fair value changes of the swap is measured against the fair value changes of the entire fixed rate liability, such a hedge would reveal ineffectiveness that would need to be reported in profit or loss and, depending on the extent of that ineffectiveness, might even preclude the application of hedge accounting.

In developing its guidance to this question, the IASB noted that it is possible to designate something other than the entire instrument as a hedged item as long as the item is a separately identifiable component of the financial instrument and the effects on fair value or cash flow changes of the entire instrument arising from the designated component are reliably measurable.

The IASB concluded that inflation is not a separately identifiable component of the fixed rate financial instrument and its effects on fair value or cash flow changes of the fixed rate financial instrument are not reliably measurable. Following from this conclusion, it is not possible to apply hedge accounting to the inflation portion in a hedge where a hedged item is a fixed rate financial instrument.

On the other hand, it is possible to apply hedge accounting to a hedge of an inflation portion if the inflation component is contractually specified and does not affect other cash flows of the financial instrument. An example where this would be the case is an inflation-indexed bond paying the interest at inflation plus 3 per cent.


Clarification 2

Entities might want to hedge the risk of the value of a future transaction falling below or rising above a specified price. To achieve this objective, some entities purchase option contracts. An option contract gives its holder the right, but not the obligation, to buy (for a call option) or sell (for a put option) a specific amount of a given stock, commodity, currency, index, or debt instrument, at a specified price (the strike price) during a specified period of time.

The value of an option contract is affected by its intrinsic value and its time value:

- a. The intrinsic value is the amount by which the current market price exceeds the strike price.
- b. The chance that the option contract will become profitable for its holder by the time the option contract expires is referred to as the time value of the option contract. The time value is positive at the time when the option contract is entered and will be zero when the option contract expires.

Consider the following example. An entity forecasts that in one year's time it will purchase 1,000 bushels of wheat at then current market price for use in its operations. The entity wishes to protect itself against an increase in the cost of wheat above the current



market price of US\$100 per bushel. It therefore purchases a 1-year option contract on 1,000 bushels of wheat, paying a total premium of US\$5,000 — which is the time value of the option contract at the date the contract is entered into. Under the terms of the option contract, if the price of wheat is above US\$100 per bushel at the maturity (settlement) date, the counterparty will pay the company 1,000 times the difference. If the price of wheat is US\$100 or below at the maturity date, the contract expires worthless. The company designates the purchased option contract as a hedge of the risk of the price increasing above US\$100 per bushel.

The issue that has arisen is whether the hedged item (the risk of the increase in the purchase price of wheat above US\$100 per bushel in the above example) includes a time value similar to the time value that is part of the value of the option contract.

This issue is important in deciding how effectiveness of the hedge should be measured. For example, if the fair value of the hedged item is considered not to contain a time value similar to that of the hedging option contract, the time value of the option contract

will be considered an ineffective part of the hedge and would need to be reported in profit or loss. If, however, the fair value of the hedged item is considered to contain a time value similar to that of the hedging option contract, the changes in the time value of the option contract will be deferred in equity as part of the effective value changes on the option contract.

In the amendment, the IASB reasoned that the hedged item has no cash flows that are equivalent to the time value premium in an option contract that would affect profit or loss. It follows that the time value in a hedging option contract should be reported as ineffectiveness of the hedge. The amendment also clarifies that entities have the possibility of excluding the time value of an option contract from hedge accounting entirely, in which case changes in the time value would be reported in the profit or loss in accordance with the normal accounting principles.

Effective date

Annual reporting periods beginning on or after 1 July 2009, with earlier application permitted. It should be applied retrospectively.

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HKFRSs / IFRSs UPDATE

RESTRUCTURED HKFRS 1 "FIRST-TIME ADOPTION OF HONG KONG FINANCIAL REPORTING STANDARDS"

2008/03

31 December 2008

Background

On 27 November 2008, the IASB issued a restructured IFRS 1 "First-time Adoption of International Financial Reporting Standards" ("Restructured IFRS 1").

IFRS 1 provides guidance on the initial adoption of IFRSs and provides a limited number of exemptions and exceptions as a practical solution for certain implementation issues. Since IFRS 1 was first issued in 2003 it has been amended several times to accommodate first-time adoption requirements of new or amended IFRSs, making IFRS 1 more complex than necessary and difficult to amend further.

The objective in issuing the Restructured IFRS 1 is to make IFRS 1 easier to use and amend in the future, and therefore no new or revised accounting or disclosure requirements have been introduced.

The Restructured IFRS 1 was adopted by the HKICPA in December 2008 by issuing a restructured HKFRS 1, with the same effective date.

Main difference

The main difference between the two versions of HKFRS 1 is that the existing version has been restructured by moving some paragraphs from the main body to appendices and grouping them as follows:

1. Appendix B includes exceptions to the retrospective application.
2. Appendix C includes exemptions for business combinations.
3. Appendix D includes exemptions from other HKFRSs.

A new appendix (Appendix E) has also been created which is intended to be used for future possible short-term exemptions from HKFRSs on first-time adoption.

In addition, outdated transitional provisions have been omitted. These provisions are those which made reference to long past effective dates.

STATUS


Final

EFFECTIVE DATE

Entities applying HKFRSs for the first time for annual reporting periods beginning on or after 1 July 2009

ACCOUNTING IMPACT

None



There have also been some minor wording changes. Some wording changes — such as changing paragraph references to appendices — were necessary consequential changes of the amendments already described. In addition, some references to GAAP or HKFRSs were changed from 'under' to 'in accordance with' but the intention is that those changes, and indeed all the changes being made, should have no impact on what HKFRS 1 requires.

Effective date

Effective for entities applying HKFRSs for the first time for annual reporting periods beginning on or after 1 July 2009, with earlier application permitted.

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HKFRSs / IFRSs UPDATE

IFRIC 17 DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS

2009/01

5 January 2009

Background and scope

The International Financial Reporting Interpretations Committee (IFRIC) has published IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners*, on the measurement of this type of distribution both when the obligation is incurred and when the distribution is made. This includes both distributions of specific assets and more complex transactions, such as demergers.

The interpretation was issued in response to the lack of guidance elsewhere in IFRSs and an apparent diversity in practice.

The guidance does not apply where the asset transferred is controlled by the same body both before and after the transaction, meaning that **it is not relevant to distributions from a subsidiary to a parent**, nor to transfers between subsidiaries accounted for as deemed distributions. It also does not apply if a parent distributes part of its investment in a subsidiary, creating a non-controlling interest but retaining control. In this case the distribution is accounted for under IAS 27 (as amended in 2008).

The Interpretation further clarifies that it only applies to distributions where all owners of the same class of equity instruments are treated equally.

If an entity distributes assets to its equity shareholders who constitute both a parent company and non-controlling shareholders, the whole distribution is scoped out of the Interpretation because a proportion of the assets transferred are controlled by the same entity before and after.

Requirements

When an entity declares a dividend to owners in the form of non-cash assets, the liability must be measured at the fair value of the assets at the date the dividend is appropriately authorised and no longer at the discretion of the entity. This date may vary depending on the requirements in different jurisdictions.

STATUS


Final

EFFECTIVE DATE

Periods beginning on or after 1 July 2009

ACCOUNTING IMPACT

New measurement requirements for certain distributions



If the recipient has a choice between cash and a non-cash asset, the entity must estimate the fair value of each alternative and recognise a liability based on the relative probability of the choices.

Any movements in the fair value of the dividend liability between declaration and settlement will be shown as movements in equity, as these are viewed as a change in the level of distribution to owners.

On settlement of the liability, when the asset is derecognised, any resulting credit (representing the excess of the value of the dividend liability over the carrying value of the asset on the entity's balance sheet) will be recorded in profit or loss.

It was not considered possible that the difference between the recorded liability and the derecognised asset value would give rise to a debit, because an asset with a fair value below its carrying value would normally already have been impaired, in accordance with the relevant standards.

Amendments to other standards

The Interpretation includes amendments to IFRS 5 to include in its scope assets held for distribution to owners. The IFRS 5 section on measurement clarifies that once an asset qualifies as held for distribution to owners, it is, like all other assets held for sale, measured at the lower of its carrying amount and fair value less costs to distribute. In order to trigger this remeasurement, though, the same principles are applied as in the rest of IFRS 5 – therefore even if management has declared a dividend, its approval by the shareholders must be highly probable before the asset can be classified as held for sale.

IAS 10 is also amended by the deletion of the definition of when dividends are declared. Instead IFRIC 17 removes any perceived conflict by referring only to the point when dividends are appropriately authorised and no longer at the entity's discretion. IFRIC has confirmed that this change clarifies but does not change the principle on when to recognise a dividend payable.

Effect

The Interpretation applies to future distributions of non-cash assets within its scope and is likely to mean many such distributions are measured at a higher value than they previously would have been. Entities choosing to distribute assets which were being carried at cost may now be in a position where they will report gains simply by virtue of distributing the assets. There may be a mismatch if the distribution is recognised in one period and settled in another period with a potential impact on net assets and debt covenants.

The treatment brings the measurement of dividends payable and receivable into line: at present, dividends receivable are, in accordance with IAS 18, measured in income at fair value.

Although the effective date is for annual periods beginning on or after 1 July 2009, with prospective application only, entities may choose to adopt the Interpretation early. If they do early adopt, they must disclose this fact and must also early adopt the revisions to IFRS 3, IAS 27 and IFRS 5.

Action required

Entities with a practice of making, or future intention to make, non-cash distributions (including demerger transactions) should assess the potential measurement difference which will be associated with this change, if future projections are required. A review of tax consequences will also be appropriate in advance of finalising any arrangements.

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HKFRSs / IFRSs UPDATE

2009/05

4 September 2009

PART I : ADDITIONAL EXEMPTIONS FOR FIRST-TIME ADOPTERS (AMENDMENTS TO HKFRS 1)

PART II : GROUP CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS (AMENDMENTS TO HKFRS 2)

PART I: ADDITIONAL EXEMPTIONS FOR FIRST-TIME ADOPTERS (AMENDMENTS TO HKFRS 1)

Summary

These Amendments were issued in August 2009 by the Hong Kong Institute of CPAs and introduce two further transitional reliefs into HKFRS 1 which:

- exempt first-time adopters using the full cost method under previous GAAP from retrospective application of HKFRSs for the measurement of oil and gas assets in certain instances.
- exempt first-time adopters with existing leasing contracts from reassessing the classification of those contracts in accordance with HK(IFRIC)-INT 4 *Determining whether an arrangement contains a lease* when the application of their previous GAAP produced the same result.

Use of deemed cost for oil and gas assets

Some GAAPs allow exploration and development costs for oil and gas properties in the development or production phases to be accounted for in cost centres that include all properties in a large geographical area. This will almost always be at a larger unit of account than the unit of account that is acceptable under HKFRSs.

A first-time adopter that adopted such treatments under its previous GAAP may elect to measure oil and gas assets at the date of transition to HKFRSs on the following basis:

- a. exploration and evaluation assets at the amount determined under the entity's previous GAAP; and
- b. assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP. An entity taking this exemption should allocate this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

For the purposes of this exemption, 'oil and gas assets' are restricted only to those assets used in the exploration, evaluation, development or production of oil and gas.

Part I:

STATUS

Final

EFFECTIVE DATE

1 January 2010

ACCOUNTING IMPACT

First time adopters only

Part II :

STATUS

Final

EFFECTIVE DATE

1 January 2010, retrospectively

ACCOUNTING IMPACT

May be significant

Once the allocation has been completed, the entity should test the exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to HKFRSs in accordance with HKFRS 6 or HKAS 36 respectively.

If an entity uses the exemption in respect of assets in the development or production phases (ie bullet (b) above), it should disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated.

In addition, an entity that uses the exemption in respect of assets in the development or production phases (ie bullet (b) above) shall, instead of applying HKFRS 1 (Revised 2008), paragraph D21 'Decommissioning liabilities included in the cost of property, plant and equipment' or HK(IFRIC)-INT 1 *Changes in existing decommissioning, restoration and similar liabilities*:

- a. measure decommissioning, restoration and similar liabilities as at the date of transition to HKFRSs in accordance with HKAS 37; and
- b. recognise directly in retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to HKFRSs determined under the entity's previous GAAP.

Leases

Some GAAPs have similar requirements to those included in HK(IFRIC)-INT 4. If a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by HK(IFRIC)-INT 4 but at a date other than that required by HK(IFRIC)-INT 4, the first-time adopter does not need to reassess that determination when it adopts HKFRSs.

For an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, that determination would have to have given the same outcome as that resulting from applying HKAS 17 *Leases* and HK(IFRIC)-INT 4.

Effective date

Both amendments are applicable for annual periods beginning on or after 1 January 2010, although earlier application is permitted.

An entity applying these amendments for an earlier period should disclose that fact.

PART II: GROUP CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS (AMENDMENTS TO HKFRS 2)

Background

Group Cash-settled Share-based Payment Transactions (Amendments to HKFRS 2) issued by the Hong Kong Institute of CPAs in July 2009 contains a series of amendments to HKFRS 2 *Share-based Payment*.

As well as including clarification of the rules for group cash-settled share-based payment transactions, it also incorporates the guidance in HK(IFRIC)-INT 8 *Scope of HKFRS 2* and HK(IFRIC)-INT 11 *HKFRS 2 – Group and Treasury Share Transactions* into HKFRS 2 itself. (As a result, HK(IFRIC)-INT 8 and HK(IFRIC)-INT 11 themselves have been withdrawn.)

HK(IFRIC)-INTs 8 & 11 are now familiar to us, and so this Update focuses on the clarifications to group cash-settled arrangements.

Simplified scope for cash-settled transactions

The scope of HKFRS 2 for cash-settled transactions has been simplified. In the past the scope referred to cash-settled transactions as follows:

'cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity' (HKFRS 2.2(b) (pre-amendment))

It now refers to 'cash-settled share-based payment transactions' as including situations where a cash payment is linked to the equity of another group company.

Broader definition of equity-settled

The broader scope of HKFRS 2 has been reflected in a slightly broader definition of 'equity-settled share-based payment transaction'. Previously to be classified as equity-settled the consideration to be given had to be in shares or share options of the entity. Now, following an editorial correction, it is defined as follows:

'A share-based payment transaction in which the entity

- (a) receives goods or services as consideration for its own equity instruments (including shares or share options)
- or
- (b) receives goods or services but has no obligation to settle the obligation with the supplier.'

(HKFRS 2 (amended) Appendix A)

Classification among group entities

Paragraph 3A of the amended standard sets out that a share-based payment arrangement exists where one group entity (or a shareholder of any group entity) incurs an obligation to settle a transaction on behalf of another group entity receiving the related goods or services. The requirements of HKFRS 2 apply to both the entity receiving the goods or services and to the entity incurring the obligation.

If a parent agrees to settle a transaction on behalf of a subsidiary then this will be an equity-settled share-based payment transaction in the separate books of the subsidiary. This is because the subsidiary has no obligation to settle the transaction with the supplier as noted above.

If the transaction is to be settled by the parent in its equity instruments it will be equity-settled in both the parent's separate financial statements and in the consolidated financial statements. If it is to be settled by the parent in equity of the subsidiary receiving the services then it will be cash-settled in the parent's separate financial statements and equity-settled in the consolidated financial statements. (HKFRS 2 (amended) paragraph 43C and B50)

'The amount recognised by the entity receiving the goods or services may differ from the amount recognised by the consolidated group or by another group entity settling the share-based payment transaction.'

(HKFRS 2 (amended) paragraph 43A)

An arrangement classified as cash settled will be re-measured at each balance sheet date whereas an equity-settled transaction will not be.

Recharges

It is common for group entities to recharge each other for the provision of share-based payment arrangements. Such recharges are to be disregarded for the purpose of analysing the share-based payment as equity-settled or cash-settled. (HKFRS 2 (amended) paragraph 43D)

Effective date

The amendments relating to the incorporation of HK(IFRIC)-INT 8 and HK(IFRIC)-INT 11 into HKFRS 2 include the transitional provisions and effective dates in those Interpretations.

The other amendments are effective for accounting periods beginning on or after 1 January 2010. They are to be applied retrospectively, so they might result in the reclassification of some share-based payment arrangements. If sufficient information for retrospective application is not available, the entity will reflect in its separate or individual financial statements the amounts previously recognised in the group's consolidated financial statements. Earlier application is permitted.

Action required

Group share-based payment arrangements should be analysed to assess whether these new requirements require them to be accounted for as cash-settled or equity-settled in the separate financial statements of the individual entities and in the consolidated financial statements. This may result in existing arrangements being reclassified, with consequential revisions to the cumulative share-based payment charge and prior period adjustments.

Appendix: Classification of group share-based payment arrangements

The table below summarises the method of accounting required for group share-based payment arrangements in the financial statements of individual group companies and in the consolidated financial statements. For ease of understanding it assumes that the companies involved are a parent and its subsidiary, but the same principles will apply in respect of any companies in the same group.

Entity receiving goods or services	Entity obliged to settle the transaction	Method of settlement	Classification (equity-settled or cash-settled)		
			Subsidiary's separate financial statements	Parent's separate financial statements	Group consolidated financial statements
Subsidiary	Subsidiary	Equity of subsidiary	Equity	N/A	Equity
Subsidiary	Subsidiary	Cash	Cash	N/A	Cash
Subsidiary	Subsidiary	Equity of parent	Cash	N/A	Equity
Subsidiary	Parent	Equity of parent	Equity	Equity	Equity
Subsidiary	Parent	Cash	Equity	Cash	Cash
Subsidiary	Parent	Equity of subsidiary	Equity	Cash	Equity

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HKFRSs / IFRSs UPDATE

IMPROVEMENTS TO HKFRSs 2009

2009/08

12 October 2009

Background

The International Accounting Standards Board (IASB) issued a second set of amendments to International Financial Reporting Standards (IFRSs) in April 2009. The amendments result from proposals published in October 2007, August 2008 and January 2009 and take various forms, including the clarification of the requirements of IFRSs and the elimination of inconsistencies between Standards. The IASB has indicated that "the objective of the annual improvements project is to provide a streamlined process for dealing efficiently with a collection of miscellaneous, non-urgent but necessary minor amendments to IFRSs". These amendments were adopted in Hong Kong in May 2009 as "Improvements to HKFRSs 2009". The standards amended are HKFRS 2, HKFRS 5, HKFRS 8, HKAS 1, HKAS 7, HKAS 17, HKAS 18, HKAS 36, HKAS 38 and HKAS 39, together with HK(IFRIC)-INT 9 and HK(IFRIC)-INT 16.

Action required

While many of the amendments are minor, it is possible that some – especially those affecting the classification of leases - may have a substantial effect on the financial statements of some companies. Consequently the effect of the amendments, which are effective for accounting periods beginning on/after 1 January 2009, 1 July 2009 or 1 January 2010 (see Appendix for more details), should be analysed carefully by those entities adopting, or intending to adopt, HKFRSs. Where the transitional provisions require a different treatment to the usual retrospective application this has been stated in this newsletter.

STATUS

Final

EFFECTIVE DATE

Annual accounting periods beginning on/after:
1 January 2009, 1 July 2009 or
1 January 2010

ACCOUNTING IMPACT

May be significant

Amendments**HKFRS 2 Share-based Payment****Issue: Scope of HKFRS 2 and revised HKFRS 3****Current requirements / Amendments**

Following the revised definition of a business combination in HKFRS 3 it has been clarified that the contribution of a business in exchange for shares on the formation of a joint venture, and combinations under common control, are not within the scope of HKFRS 2.

By amending a paragraph, the existing requirements have been clarified.

Effective date: 1 July 2009

HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations**Issue: Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations****Current requirements / Amendments**

The scope of HKFRS 5 has been clarified to make it clear that only the disclosures specified in HKFRS 5 are applicable to non-current assets (or disposal groups) classified as held for sale, and to discontinued operations. The disclosures in other HKFRSs do not apply unless those other HKFRSs require:

- specific disclosures in respect of non-current assets (or disposal groups) classified as held for sale, or discontinued operations; or
- disclosures about the measurement of assets and liabilities that are included within a disposal group, where those assets and liabilities are not themselves within the scope of the measurement requirements of HKFRS 5 and the additional disclosures required by those other HKFRSs have not already been made elsewhere in the financial statements.

Furthermore, additional disclosures about non-current assets (or disposal groups) classified as held for sale may be necessary to comply with the general requirements of HKAS 1, in particular paragraphs 15 and 125 of that standard.

By adding an additional paragraph, it has been clarified that the disclosure requirements of standards other than HKFRS 5 which do not specifically include such assets and operations are not mandatory.

Effective date: 1 January 2010

HKFRS 8 Operating Segments**Issue: Disclosure of information about segment assets**

Current requirements	Amendments
A measure of total assets needs to be reported for each reportable segment.	A measure of total assets for a reportable segment only needs to be reported if such an amount is regularly provided to the chief operating decision maker.

This amendment was made to eliminate inconsistency between HKFRS 8 and long-standing interpretations published in the US for the application of SFAS 131.

Effective date: 1 January 2010

HKAS 1 Presentation of Financial Statements**Issue: Current/non-current classification of convertible instruments**

Current requirements	Amendments
The liability component of a convertible instrument that the entity could be required to settle in shares at any time should be classified as current since the conversion of a liability into equity is a form of settlement. This classification would be required even if the entity would not be required to settle unconverted instruments with cash or other assets for more than twelve months after the reporting period.	Terms of a liability that could at the option of the counterparty result in its settlement by the issue of equity instruments do not affect its classification into current or non-current.

The IASB concluded that classifying the liability on the basis of the requirements to transfer cash or other assets rather than on settlement better reflects the liquidity and solvency position of an entity.

Effective date: 1 January 2010

HKAS 7 Statement of Cash Flows**Issue: Classification of expenditures on unrecognised assets**

Current requirements	Amendments
HKAS 7 does not explicitly state how expenditures incurred with the objective of generating future cash flows should be presented when those expenditures are not recognised as assets in accordance with HKFRSs.	Only an expenditure that results in a recognised asset in the statement of financial position (balance sheet) can be classified as a cash flow from investing activity.

Since there was some diversity in practice in regard to the classification of expenditures which do not result in the recognition of an asset, the IASB added an explicit requirement.

Effective date: 1 January 2010

HKAS 17 Leases**Issue: Classification of leases of land and buildings**

Current requirements	Amendments
A lease of land with an indefinite useful life is normally classified as an operating lease, unless title is expected to pass at the end of the lease term, or the significant risks and rewards at the end of the lease term are attributable to the lessee.	The classification of the land and building elements as finance or operating lease should still be made separately for each element and should follow the general lease classification guidance. However in evaluating the land element whether or not it has an indefinite useful life remains an important consideration.

Current guidance could lead to inconsistencies with general lease classification. Where title of the land is not expected to pass by the end of the lease term but the lease transfers significant risks and rewards to the lessee, the amendment is likely to produce a different classification of the land element.

Transitional provisions: Unexpired leases that include a land element need to be reassessed on the basis of information available at the inception of those leases. Leases newly classified as finance lease are recognised retrospectively. If, however, the information necessary

to apply amendments retrospectively is not available, recognition and measurement (at fair value) of any assets and liabilities will be based on the facts and circumstances prevailing at the date the amendments are adopted. Any difference between those fair values (leased assets compared to lease liabilities) is recognised in retained earnings.

General guidance issued by the HKICPA: In connection with the question on the extent of these amendments to HKAS 17 change the classification of leasehold land situated in Hong Kong, the HKICPA has issued additional guidance on 16 November 2009 in the form of Q&A which is available at http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/ref-material/2009/hkas17-q-n-a.pdf

Effective date: 1 January 2010

HKAS 18 Revenue

Issue: *Determining whether an entity is acting as a principal or as an agent*

Current requirements	Amendments
Appendix to HKAS 18 does not contain any specific guidance in regard to whether an entity is acting as a principal or as an agent.	An example has been added to the non-mandatory guidance in the Appendix, which sets out features that indicate whether an entity is acting as a principal or an agent.

Effective date: None – amendment to non-mandatory guidance

HKAS 36 Impairment of Assets

Issue: *Unit of accounting for goodwill impairment test*

Current requirements	Amendments
In regard to the allocation of goodwill to cash-generating units, HKAS 36 does not specify whether the largest level of cash-generating unit to which goodwill may be allocated is before or after aggregation of operating segments.	Each cash-generating unit or group of units to which goodwill is allocated shall not be larger than an operating segment before aggregation (ie as defined in HKFRS 8 paragraph 5).

This amendment resolves divergent views regarding the largest unit permitted by HKAS 36 for impairment testing of goodwill.

Effective date: 1 January 2010

HKAS 38 Intangible Assets

Issue: *Additional consequential amendments arising from revised HKFRS 3/Measuring the fair value of an intangible asset acquired in a business combination*

Current requirements / Amendments
HKAS 38 contains additional guidance in regard to how the fair value of an intangible asset acquired in a business combination should be measured.

HKFRS 3 (as revised in 2008) incorporates the presumption that if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure the fair value of the asset reliably. The IASB

amended the wording of HKAS 38 to clarify this presumption and, in addition, clarified the description of valuation techniques commonly used to measure intangible assets at fair value when assets are not traded in an active market.

Transitional provisions: Like HKFRS 3 (as revised in 2008), this amendment should be applied prospectively.

Effective date: 1 July 2009

HKAS 39 Financial Instruments: Recognition and Measurement

Issue: Treating loan prepayment penalties as closely related embedded derivatives

Current requirements / Amendments

HKAS 39 AG30(g) contains guidance on whether call, put or prepayment options embedded in a host contract are closely related or not. An apparent inconsistency was noted in relation to prepayment options and so additional guidance has been added in regard to prepayment options noting that they are not closely related to the host contract unless the exercise price reimburses the lender for an amount up to the approximate present value of the lost interest for the remaining term of the host contract.

The amendment of paragraph AG30(g) removes an apparent inconsistency in the guidance in HKAS 39 with respect to embedded prepayment options.

Effective date: 1 January 2010

Issue: Scope exemption for business combination contracts

Current requirements	Amendments
Contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date are excluded from the scope of HKAS 39.	The exclusion is limited to forward contracts that will result in a business combination at a future acquisition date.

The objective of this amendment was to resolve diversity in practice regarding the application of the scope exemption in paragraph 2(g) of HKAS 39.

Effective date: 1 January 2010

Issue: Cash flow hedge accounting – timing of reclassification from equity to profit or loss

Current requirements	Amendments
Gains or losses on the hedging instrument should be reclassified from equity to profit or loss during the period that the financial asset acquired or financial liability assumed affects profit or loss.	Gains or losses on the hedging instrument should be reclassified from equity to profit or loss during the period that the hedged forecast cash flows affect profit or loss.

The amendment resolves diversity where the designated cash flow exposure being hedged differs from the financial instrument arising from the forecast cash flows.

Effective date: 1 January 2010

Issue: Cash flow hedge accounting – hedging using internal contracts

Current requirements	Amendments
Current requirements include references to the designation of hedging instruments at the segment level.	References to the designation of hedging instruments at the segment level have been removed.

Paragraph 80 of HKAS 39 refers to the need for hedging instruments to involve a party external to the reporting entity. In doing so, it uses a segment as an example of a reporting entity. HKFRS 8 *Operating Segments* requires disclosure of information that is reported to the chief operating decision maker even if this is on a non-HKFRS basis. Therefore, the two HKFRSs appear to conflict. The IASB removed the reference to segments from paragraph 80.

Effective date: 1 January 2009

HK(IFRIC)-INT 9 Reassessment of Embedded Derivatives**Issue: Scope of HK(IFRIC)-INT 9 and revised HKFRS 3**

Current requirements	Amendments
The revised definition of business combinations in HKFRS 3 (2008), causes the accounting for the formation of a joint venture by the venturer to be within the scope of HK(IFRIC)-INT 9. The same issue might arise with transactions under common control, depending on which level of the group reporting entity is assessing the combination.	The scope paragraph in HK(IFRIC)-INT 9 is amended to clarify that the INT does not apply to embedded derivatives in contracts acquired in a combination between entities or businesses under common control or the formation of a joint venture by the venturer.

The IASB did not intend to change existing practice in regard to the scope of HK(IFRIC)-INT 9 when revising HKFRS 3 and has therefore clarified requirements.

Transitional provisions: This amendment should be applied prospectively.

Effective date: 1 July 2009

HK(IFRIC)-INT 16 Hedges of a Net Investment in a Foreign Operation**Issue: Amendment to the restriction on the entity that can hold hedging instruments**

Current requirements	Amendments
Paragraph 14 of HK(IFRIC)-INT 16 excludes instruments held by the foreign operation, whose net investment is being hedged, from being designated as hedging instruments.	This restriction has been removed.

This restriction has been removed since without hedge accounting, part of the foreign exchange difference arising from the hedging instrument would be included in consolidated profit or loss.

Effective date: 1 July 2009

Appendix

Effective date

Standard	Subject of amendment	Effective for annual accounting periods beginning on or after
HKFRS 2 Share-based Payment	Scope of HKFRS 2 and revised HKFRS 3	1 July 2009
HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations	Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations	1 January 2010
HKFRS 8 Operating Segments	Disclosure of information about segment assets	1 January 2010
HKAS 1 Presentation of Financial Statements	Current/non-current classification of convertible instruments	1 January 2010
HKAS 7 Statement of Cash Flows	Classification of expenditures on unrecognised assets	1 January 2010
HKAS 17 Leases	Classification of leases of land and buildings	1 January 2010
HKAS 18 Revenue	Determining whether an entity is acting as a principal or as an agent	None – amendment to non-mandatory guidance
HKAS 36 Impairment of Assets	Unit of accounting for goodwill impairment test	1 January 2010
HKAS 38 Intangible Assets	Additional consequential amendments arising from revised HKFRS 3 Measuring the fair value of an intangible asset acquired in a business combination	1 July 2009
HKAS 39 Financial Instruments: Recognition and Measurement	Treating loan prepayment penalties as closely related embedded derivatives	1 January 2010
	Scope exemption for business combination contracts	1 January 2010
	Cash flow hedge accounting – timing of reclassification from equity to profit or loss	1 January 2010
	Cash flow hedge accounting – hedging using internal contracts	1 January 2009
HK(IFRIC)-INT 9 Reassessment of Embedded Derivatives	Scope of HK(IFRIC)-INT 9 and revised HKFRS 3	1 July 2009
HK(IFRIC)-INT 16 Hedges of a Net Investment in a Foreign Operation	Removal of the restriction on the entity that can hold hedging instruments	1 July 2009

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HKFRSs / IFRSs Update

HKAS 24 RELATED PARTY DISCLOSURES

2009/10

26 November 2009

Background

The International Accounting Standards Board has issued a revised version of IAS 24 *Related Party Disclosures*. This follows two exposure drafts, which were issued in February 2007 and December 2008. It has been adopted in Hong Kong as revised HKAS 24.

Requirements

In a significant change from the existing HKAS 24, the revised standard provides a partial exemption from related party disclosures by 'government-related' entities. In other respects, changes are limited to simplifying the definition of a related party in order to clarify the intended meaning and eliminate inconsistencies.

The main changes from the previous version of HKAS 24 are as follows:

Scope

The standard now requires disclosure of commitments and clarifies that it applies to consolidated financial statements of a parent, venturer or investor and to an entity's individual financial statements.

Partial exemption for government-related entities

The most significant change is in relation to government-related entities. A government-related entity is defined as:

'...an entity that is controlled, jointly controlled or significantly influenced by a government.'

The previous version of HKAS 24 did not contain any exemption for such entities. Some entities, in particular those in jurisdictions (like the Mainland China) where government control is pervasive, found it difficult to comply with the requirements of the standard, as it was not straightforward to identify all of the related party transactions and balances that were required to be disclosed. In addition, the volume of disclosures required could be very significant.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on or after 1 January 2011

ACCOUNTING IMPACT

Provides a partial exemption from the disclosure requirements of HKAS 24 for entities that are controlled, jointly controlled or significantly influenced by a state in relation to other state-controlled entities. Amends and clarifies the definition of a related party.

As a means of dealing with these practical difficulties, the revised standard provides a partial exemption for government-related entities. This exempts a reporting entity, that is a government-related entity, from the disclosure of related party transactions and outstanding balances, including commitments, with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

In this context, the definition of 'government' includes government, government agencies and similar bodies whether local, national or international.

Certain disclosures are still required, and are outlined below.

Revised definition of a related party

As well as the addition of definitions of 'government' and 'government-related entity' outlined above, the definition of related party has been amended in order to clarify the meaning of a related party and to eliminate previous inconsistencies. The changes include:

- It has been clarified that, where an investor has a subsidiary and an associate, for the purposes of the associate's separate or individual financial statements, the subsidiary is regarded as a related party of the associate as well as the investor;
- The definition of a related party has been amended such that in the circumstances in the bullet point above, for the purposes of the subsidiary's separate or individual financial statements, the associate is a related party;
- An inconsistency has been removed in order that, when considering investments held by individuals rather than entities, two associates are not regarded as being related parties simply because one person has significant influence over one entity, and a close family member of that person has significant influence over another entity;
- The criteria for investments held by key management personnel have been changed, so that where the key management personnel of a reporting entity have control or joint control over other entities, disclosures are required in both the financial statements of the reporting entity and the financial statements of the other entities; and
- In any circumstances where a person or entity has joint control over a second entity, and joint control or significant influence over a third entity, then the second and third entities are regarded as being related to each other.

Other amendments have been made to the definition of a related party which clarify that:

- References to an associate and a joint venture include their subsidiaries; and
- Two entities are not related parties by virtue of a member of key management personnel of one entity having significant influence over another entity.

The definition of a 'close member of the family' has also been amended to state that this includes a person's spouse or domestic partner and children, rather than 'may include'.

Disclosures

The revised standard divides the disclosures into disclosures for 'all entities' and for 'government-related entities'.

The disclosures required for 'all entities' are substantially the same as the disclosures in the previous standard with minor changes having been made to certain paragraphs to clarify their meaning and to carry-forward the wording changes in the revised definitions.



For government-related entities, if the partial exemption referred to above is applied, the following disclosures are required:

- The name of the government and the nature of its relationship with the reporting entity; and
- Information in sufficient detail to give an understanding of:
 - The nature and amount of each individually significant transaction; and
 - A qualitative or quantitative description of other transactions that are collectively, but not individually, significant.

Factors that an entity is required to consider in determining the level of detail to be provided under the second main bullet point above include the closeness of the related party relationship, and the significance of the transaction such as whether it is

- significant in terms of size;
- carried out on non-market terms;
- outside normal day-to-day operations;
- disclosed to regulatory or supervisory authorities;
- reported to senior management; and
- subject to shareholder approval.

Effective date and transition

The revised standard is effective for annual periods beginning on or after 1 January 2011, with retrospective application. Earlier application is permitted, either in full or only for the partial exemption in paragraphs 25-27 for government-related entities. If the whole standard, or the partial exemption, is applied for a period beginning before 1 January 2011, this early adoption is required to be disclosed.

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HKFRSs / IFRSs UPDATE

AMENDMENT TO HKAS 32 FINANCIAL INSTRUMENTS : PRESENTATION - CLASSIFICATION OF RIGHTS ISSUES

2009/11

3 December 2009

Background

The International Accounting Standards Board (IASB) has published an amendment to International Accounting Standard (IAS) 32 *Financial Instruments: Presentation*.

The amendments change the accounting treatment when a rights issue is denominated in a currency other than the functional currency of the issuer. They require that if such rights are exercisable for a fixed amount of currency and are issued pro rata to all of the existing owners of the same class of an entity's own non-derivative equity instruments, they should be classified as equity regardless of the currency in which the exercise price is denominated.

The IASB has noted in the basis of conclusions to the exposure draft of the amendment that IAS 32 currently requires such rights issues to be accounted for as derivative financial liabilities, and that this outcome is not consistent with the substance of the transaction.

The principles underlying the amendment are set out below.

Rights Issues

A rights issue is where shares are offered to existing shareholders in proportion to their current shareholding. The exercise price is often below the current market price of the shares, which gives investors an incentive to buy the new shares. If a shareholder does not exercise its rights and others do exercise them, that shareholder's proportionate interest in an entity is diluted.

As a result of the global financial crisis, an increased number of entities, including banks and financial institutions have either undertaken, or are considering undertaking a rights issue in order to raise capital. The amounts involved can be significant.

The exercise price of a rights issue may be in a currency which is different from the functional currency of the issuer. This may be because the issuer is listed in more than one jurisdiction, and may also be due to legal requirements.

Accounting for a rights issue under the existing HKAS 32 where the exercise price is denominated in a currency other than the issuer's functional currency

In accordance with HKAS 32.11, a financial liability includes a derivative financial liability that will or may be settled by delivering a fixed number of an entity's own equity instruments for a variable amount of cash.

STATUS


Final

EFFECTIVE DATE

Annual periods beginning on/ after 1 February 2010

ACCOUNTING IMPACT

Classification of rights issue at a fixed price per share when that price is stated in a currency other than an entity's functional currency



In a rights issue, where the exercise price is a fixed price in a currency other than the functional currency of the entity, such an issue would meet the definition of a derivative financial liability. This is because the amount of cash received in functional currency will vary due to exchange rate fluctuations, meaning that the 'fixed' for 'fixed' criterion in HKAS 32.11 would not be met. The rights issue would therefore give rise to a financial instrument which meets the definition of a derivative under paragraph 9 of HKAS 39 *Financial Instruments: Recognition and Measurement*.

A consequence of accounting for such a rights issue as a derivative financial liability is that changes in the fair value of that liability will be recorded in profit or loss from the date of grant of the rights to their exercise date. Changes in value will arise from variations in an entity's own share price, and fluctuations in foreign exchange rates.

Rationale for, and scope of, the amendments

In its basis for conclusions the IASB acknowledges that accounting for such rights issues as derivative financial liabilities is not consistent with the substance of a rights issue which is a transaction with the owners of an entity in their capacity as owners.

In particular, it was considered that such accounting would not be consistent with the following:

- the exclusion of rights issues from the scope of HKFRS 2 *Share-Based Payment*, where it is recognised that the holder of the right receives it as a holder of equity instruments (ie as an owner); and
- the requirement in HKAS 1 *Presentation of Financial Statements* to report transactions with owners in their capacity as owners outside of comprehensive income.

The IASB therefore considered it necessary to make narrow targeted amendments to IAS 32. Due to the nature of the amendments there are no consequential amendments to other standards.

The scope of the amendments is limited to rights issues and does not extend to cover other instruments that grant the holder the right to purchase the entity's own equity instruments, such as the conversion feature in convertible bonds. It is noted that the exercise of such a conversion feature does not primarily represent a transaction with owners in their capacity as such.

The amendments

Amendments have been made to paragraphs 11 and 16(b)(ii) of HKAS 32 (the paragraphs which define a financial liability and an equity instrument) to include the following for the purpose of determining equity/liability classification:

'For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.'

Effective date

The effective date of the amendments to HKAS 32 is annual accounting periods commencing on or after 1 February 2010. Earlier application is permitted.

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HKFRSs / IFRSs UPDATE

HKFRS 9 FINANCIAL INSTRUMENTS

2009/12

7 December 2009

Background

In July 2009, the International Accounting Standards Board (IASB) issued for comment an Exposure Draft (ED) of proposed changes to the accounting for financial instruments. The exposure draft set out proposals to simplify the approach for classification and measurement of financial instruments in comparison to the current requirements set out in IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB's project to replace the existing financial instruments standards was accelerated in response to calls from the G-20, the Financial Stability Board and other constituents.

The ED was the first of three exposure drafts that the IASB will issue as proposals to replace IAS 39. The second exposure draft, *Financial Instruments: Amortised Cost and Impairment* was issued by the IASB on 5 November 2009 and is open for comment until 30 June 2010. The final ED will deal with hedge accounting and is expected to be published in the first quarter of 2010.

On 12 November 2009, the IASB issued IFRS 9 *Financial Instruments* (IFRS 9) as the first part of Phase I to replace IAS 39. The scope of IFRS 9 is currently limited to the classification and measurement of financial assets. The IASB will continue its work on financial liabilities, in particular measurement issues related to the effects of changes in an entity's own credit risk on fair value measurement, and will include the requirements for those instruments in IFRS 9 in due course.

Scope

HKFRS 9 applies to all assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*.

Classification and measurement

HKFRS 9 requires that on initial recognition, all financial assets are classified into one of two measurement categories:

- Amortised cost; or
- Fair value.

STATUS

Final

EFFECTIVE DATE

For annual periods beginning on or after 1 January 2013. Earlier application permitted. Extensive transition provisions exist

ACCOUNTING IMPACT

Significant changes to recognition, classification and measurement of financial assets

HKFRS 9 eliminates the Held to Maturity (HTM), Available for Sale (AFS) and Loans and Receivables categories. In addition, the exception that requires equity instruments and related derivatives to be measured at cost rather than fair value, where the fair value cannot be reliably determined, has been eliminated with fair value measurement being required for all of these instruments.

A financial asset is measured at amortised cost only if it meets the following two conditions:

- The objective of an entity's business model is to hold the financial asset in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other instruments are required to be measured at fair value. HKFRS 9 retains the current requirement for financial instruments that are held for trading to be recognised and measured at fair value through profit or loss, including all derivatives that are not designated in a hedging relationship.

The entity's business model for managing financial assets

The first test is whether the financial assets are being held in order to collect contractual cash flows. Financial assets are considered to be held in order to collect contractual cash flows on the basis of the objectives of the entity's business model as determined by key management personnel (as defined in HKAS 24 *Related Party Disclosures*).

Financial assets are not assessed on an individual instrument basis; instead classification is assessed at a higher level of aggregation on the basis of the entity's overall business model. HKFRS 9 acknowledges that an entity may have separate business models for portfolios of investments that are managed in different ways (for example, an entity may hold one portfolio of investments which are managed in order to collect cash flows and hold another portfolio of investments which are managed in order to trade to realise fair value changes).

An entity's business model could be to hold financial assets to collect contractual cash flows even when sales of those assets occur (ie an entity need not hold all instruments in a portfolio to maturity). For example, an entity may sell an investment which no longer meets its investment policy or when the entity needs to fund some capital expenditure. Judgement is needed in these situations as, if more than infrequent sales are made, an entity will need to assess whether such sales are consistent with an objective of collecting the contractual cash flows.

Financial assets that meet the definition in HKAS 39 of held for trading or whose performance is managed on a fair value basis, are not held to collect contractual cash flows and are required to be measured at fair value through profit or loss.

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

Having established which financial assets are held for the collection of contractual cash flows, an entity is then required to assess whether the contractual cash flows of each of those financial assets are solely payments of principal and interest on the principal amount outstanding. In contrast to the initial business model test, this second test is applied on an individual asset basis, and not on a portfolio basis.

Contractual terms that include leverage (such as a stand-alone option, or a forward or swap contract) result in economic characteristics that are not interest. Leverage is a feature that amplifies the variability of contractual cash flows (for example, one which changes an interest rate by a multiple of a benchmark rate). As such, contracts which include leverage do not meet the condition of being solely payments of principal and interest on the principal amount outstanding and are required to be measured at fair value through profit or loss.

The terms of a debt instrument may include terms which permit repayment before maturity, or the extension of the contractual term. These terms do not preclude the financial asset from being regarded as having contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. However, restrictions are included to limit the circumstances in which this would be the case.

The first restriction is that the prepayment or extension provision must not be contingent on future events, other than to protect:

- the holder of the debt instrument against credit deterioration of the issuer (this includes defaults, credit downgrades or loan covenant violations); or
- the holder or the issuer against changes in relevant tax legislation or in the law.

Where the terms permit early repayment, the amount payable must substantially represent unpaid principal and interest, and may also include compensation for the early repayment (this might apply in the event of the early repayment of a fixed rate loan, where the lender might incur swap breakage costs). Where the terms contain an extension option, the contractual cash flows during the extension period must represent only payments of principal and interest on the principal amount outstanding.

Contractual terms that change the timing of payments of principal and interest are not solely payments of principal and interest on the principal amount outstanding unless:

- the variable interest rate is for the time value of money and the credit risk (the guidance notes that for some instruments this may be determined at initial recognition only, and so may be fixed) associated with the principal amount outstanding; and
- if the contractual term is a prepayment option, it meets the conditions for a prepayment option (see above); or
- if the contractual term is an extension option, it meets the conditions for an extension option (see above).

Financial assets could have contractual cash flows that are described as principal and interest but do not actually represent the payment of principal and interest on the principal amount outstanding as set out in HKFRS 9, because other factors are included. This could be the case when a creditor's claim is limited to specific assets or to the cash flow from specified assets of the debtor. In such situations, the creditor is required to 'look through' to the particular underlying assets (which can be financial assets or non-financial assets) or cash flows, to assess whether the contractual cash flows on the financial asset being classified are payments of principal and interest on the principal amount outstanding. If a financial asset contains terms which give rise to other cash flows or limit the cash flows in a manner which is inconsistent with the payment of principal and interest, the financial asset fails to meet the conditions for measurement at amortised cost and must instead be measured at fair value.

However, the classification of a financial asset is not affected by what HKFRS 9 refers to as non-genuine cash flow characteristics. It is clarified that a cash flow is not genuine if it will affect contractual cash flows only on the occurrence of an event which is extremely rare, highly abnormal and very unlikely to occur. It is recognised that in many lending arrangements, financial liabilities are ranked relative to the debtor's other creditors. From the lender's perspective, financial assets that are subordinated relative to other financial assets may still have contractual cash flows that are payments of principal and interest on the principal amount outstanding as long as the subordination does not affect the contractual rights to the holders of the subordinated assets to unpaid principal and other amounts due. For this to be the case, the debtor's non payment would have to be breach of contract, and the lender (or holder of the financial asset) would need to retain the contractual rights to cash flows even in the event of the debtor's bankruptcy.

Certain financial assets include arrangements where payments to holders of financial assets are prioritised through multiple subordinated interests (ie tranches) in a 'waterfall' structure where payments to senior debt holders are prioritised over those to other tranches. As an example of this type of arrangement, an SPE might be set up to purchase a portfolio of mortgage receivables. In order to generate the required funding, the SPE issues bonds of various credit grades (from AAA to B) to external investors. When cash is received from the mortgage portfolio, these are used first to pay amounts due to the AAA bond holders. When the cash received exceeds the amount due to these bond holders, it 'overflows' down to the next level (the AA bond holders) – hence the term 'waterfall' structure. This means that the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy the higher-ranking tranches.

A tranche has cash flow characteristics that are payments of principal and interest only if:

- the contractual terms of the tranche being assessed (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding;
- the underlying pool of financial instruments has certain cash flow characteristics (described below); and
- the credit risk exposure of the underlying pool of financial instruments inherent in the tranche (and therefore the tranche itself) is equal to or lower than the credit risk exposure of the underlying pool of financial instruments.

The 'underlying pool' of financial instruments is the pool of instruments that are ultimately creating the cash flows. A holder of a tranche is required to 'look through' a structure until the 'underlying pool' has been identified. This might require the tracing of transactions through a number of linked entities.

If the holder cannot meet all of the conditions set out above at initial recognition, the tranche must be measured at fair value.

The cash flow characteristics on the underlying pool of financial instruments include the requirement for the pool to contain at least one or more instruments which have contractual cash flows that are solely payments of principal and interest. The underlying pool may also include instruments that reduce the cash flow variability of other instruments (such as an interest rate cap or floor) as long as, when combined with the other instruments, the resulting cash flows are solely for payments of principal and interest on the principal amount outstanding. Similarly, instruments may be included that align the cash flows of tranches with the cash flows of the pool of underlying instruments to address differences in (and only in) fixed or floating interest rates, the currency in which the cash flows are denominated or the timing of the cash flows.

If any instrument in the pool fails to meet either of the conditions set out in the paragraph above, or if the underlying pool of instruments can change after initial recognition in such a way that either of these conditions may not be met, the tranche must be measured at fair value.

Contracts which contain embedded features

The terms of a financial asset may include cash flow characteristic which contain certain embedded features, such as interest rate floors and caps, early repayment features and extension provision. Provided the host contract is within the scope of HKFRS 9 and all of the conditions in HKFRS 9 are met, these financial assets are measured at amortised cost and the embedded features are not bifurcated and accounted for separately.

Other financial assets contain more complex embedded features which cause some or all of the cash flows that would otherwise be required by the contract to be modified in such a way that they are not solely the payments of principal and interest on the principal amount outstanding. HKAS 39 would typically require these embedded features to be accounted for separately at fair value through profit or loss, with the host contract remaining either at amortised cost or at fair value with changes in value, other than impairment and certain foreign currency movements, being recorded in equity. For those contracts where the host contract is a financial instrument within the scope of HKFRS 9, the embedded derivatives are not accounted for separately and the entire contract is recorded at fair value.

Where the host contract is not within the scope of HKFRS 9, either not being a financial instrument, a financial liability, or a financial asset which is scoped out of the standard, the current guidance in HKAS 39 continues to apply to the analysis and accounting treatment of embedded derivatives.

Fair value option

HKFRS 9 includes an election, similar to that of HKAS 39, which permits an entity, on an optional basis, to classify a financial instrument at fair value through profit or loss where that financial instrument would otherwise be measured at amortised cost. This election, which can be applied on an individual financial instrument basis or to a group of financial instruments, is made at initial recognition and is irrevocable.

In a change from HKAS 39, this option is only available if the designation results in the elimination of, or significant reduction in, a measurement or recognition inconsistency. HKAS 39 also permits the fair value option to be applied to financial instruments that are managed on a fair value basis, and to those instruments that contain an embedded derivative that would be required to be accounted for separately but the entity elects to measure the entire contract at fair value. Both of these latter criteria are eliminated in HKFRS 9, because financial instruments managed on a fair value basis are required to be measured on that basis and the separation of embedded derivatives is eliminated, with contracts containing such embedded features being required to be measured at fair value in their entirety unless the instrument as a whole qualifies to be measured at amortised cost.

Reclassification

The classification of financial assets is made on initial recognition. Reclassification after initial recognition is prohibited, unless an entity fundamentally changes its business model for managing its financial assets in which case reclassification is required. The circumstances

in which reclassification is required are extremely restrictive, with fundamental changes in the business model being expected to be very infrequent. The following examples are given of circumstances which are not changes in business model:

- a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions);
- a temporary disappearance of a particular market for financial assets; and
- a transfer of financial assets between parts of an entity with different business models.

Investments in equity instruments

Investments in equity instruments do not meet the conditions to be measured at amortised cost because they do not contain contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on the principal amount outstanding. Consequently investments in equity instruments are measured at fair value.

For investments in equity instruments which are not held for trading (for example, those held for strategic purposes), HKFRS 9 allows an entity, on initial recognition, to make an irrevocable election to recognise all changes in fair value in Other Comprehensive Income (OCI). There are no transfers from OCI to profit or loss (that is, no recycling) and hence no impairment requirements. Dividends from such designated equity instruments are recognised in profit or loss when the right to receive payment of the dividend has been established, in accordance with HKAS 18 *Revenue*.

In a change from HKAS 39, HKFRS 9 has no exemption from fair value measurement for those instruments for which fair value cannot be reliably measured. The IASB notes in its Basis for Conclusions that the Standard requires investments measured at cost to be monitored for impairment, and that this approach effectively requires fair value measurement to be adopted for the purposes of impairment.

However, it is also noted that in certain extremely limited circumstances, cost might be representative of fair value and additional guidance has been included in HKFRS 9 in comparison with the exposure draft. However, it is also noted that those circumstances will never apply to equity investments held by entities such as financial institutions and investment funds.

Disclosure and consequential amendments to other accounting standards

HKFRS 9 is accompanied by consequential amendments to a wide range of other accounting standards and interpretations. These include significant changes to HKFRS 7 *Financial Instruments: Disclosures*, including substantial new disclosures for any equity instruments where changes in their value are recorded in OCI, and to HKAS 1 *Presentation of Financial Statements* which would require separate disclosure on the face of the income statement of gains or losses arising on the sale of financial assets measured at amortised cost.

Effective date and transition

HKFRS 9 applies to annual accounting periods commencing on or after 1 January 2013, with earlier application permitted. If it is applied for a period beginning before 1 January 2013, disclosure is required of that early adoption and the extensive consequential amendments to other HKFRSs also need to be applied.

The new standard is required to be applied on a fully retrospective basis in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to extensive transitional provisions. However HKFRS 9 is prohibited from being applied to financial assets in comparative periods where those financial assets have already been derecognised at the date of initial application.

A summary of the transitional provisions is as follows:

- For the purpose of the transitional provisions, the date of initial application is the date when an entity first applies the requirements of HKFRS 9. This date can be any date between the issue of HKFRS 9 (IFRS 9 was issued on 12 November 2009 and HKFRS 9 was issued on 19 November 2009) and 31 December 2010 if an entity adopts the new standard before 1 January 2011. If HKFRS 9 is adopted on or after 1 January 2011, the date of initial application is the beginning of the first reporting period in which the standard is adopted.
- If an entity adopts HKFRS 9 during a reporting period, additional disclosures are required, including the reasons why the particular date of adoption has been used.

- Assessing whether a financial asset is managed on a contractual yield basis is made as at the date of initial application of HKFRS 9. That measurement basis is then applied on a fully retrospective basis.
- If a hybrid contract (ie one containing an embedded derivative as defined in HKAS 39) is required by HKFRS 9 to be measured at fair value, but that fair value has not been determined in previous accounting periods, the hybrid contract is measured in comparative periods using the sum of the fair value of the components (ie the host contract and embedded derivative(s)). At the date of initial application of HKFRS 9, the entire (combined) contract is measured at fair value, with any difference between that fair value and the combined fair value of the component parts being recognised either in opening retained earnings of the reporting period of initial application (if the date of initial application of HKFRS 9 is the beginning of a reporting period) or in profit or loss (if the date of initial application of HKFRS 9 is during a reporting period).
- At the date of initial application an entity may designate a financial asset as measured at fair value through profit or loss in order to eliminate or significantly reduce an accounting mismatch or an investment in an equity instrument as at fair value through other comprehensive income based on the facts and circumstances that exist at that date. These classifications are then applied on a fully retrospective basis.
- The previous optional designation of a financial asset as at fair value through profit or loss in accordance with HKAS 39 may be revoked on the basis of facts and circumstances as at the date of initial application and is required to be revoked if the eligibility criterion for such designation is not met. The applicable measurement basis is then applied on a fully retrospective basis.
- Although the scope of HKFRS 9 covers only financial assets, as part of the transitional guidance, financial liabilities that were designated as at fair value through profit or loss on the basis that this designation eliminated or significantly reduced a measurement mismatch are also revisited. Financial liabilities may be so designated as at the date of initial application of HKFRS 9, and the designation may (or may be required) to be revoked, based on the facts and circumstances at the date of initial application of the standard.
- If an instrument previously measured at fair value is reclassified to be measured at amortised cost and it is impracticable (as defined in HKAS 8) for the effective interest rate and impairment requirements of HKAS 39 to be applied on a retrospective basis, then the amortised cost of the financial instrument, or any impairment of the financial asset, is determined on the basis of the fair value of the financial instrument at the end of each comparative period. The fair value of the instrument as at the date of initial application then becomes its new deemed amortised cost.
- Investments in unquoted equity investments (or derivatives linked to, and required to be settled by delivery of, such instruments) that were measured at cost under HKAS 39, are remeasured to fair value as at the date of initial application. Any difference between that fair value and the previous carrying amount is recognised in opening retained earnings of the reporting period of initial application.
- Notwithstanding the requirement to apply HKFRS 9 retrospectively in accordance with HKAS 8, entities that adopt HKFRS 9 for reporting periods beginning before 1 January 2012 need not restate prior periods. If prior periods are not restated, any difference between previous carrying amounts and the carrying amount at the start of the reporting period that includes the date of initial application of HKFRS 9 is recognised in opening retained earnings of the reporting period that includes the date of initial application.
- Entities which prepare interim financial reports in accordance with HKAS 34 *Interim Financial Reporting* are not required to restate comparative information if such restatement is impracticable (as defined in HKAS 8).

On initial application of HKFRS 9, the disclosures required by HKAS 8 will be required. These include, to the extent practicable (as set out in HKAS 8) the effect on each financial statement line item and on basic and diluted earnings per share for the current and prior period(s) presented.



In addition, when HKFRS 9 is applied for the first time, the following disclosures are required for each class of financial assets at the date of initial application:

- The original measurement category and carrying amount, determined in accordance with HKAS 39;
- The new measurement category and carrying amount, determined in accordance with HKFRS 9; and
- The amount of any financial assets that were previously designated as at fair value through profit or loss that are no longer so designated, with separate disclosures being required for those that HKFRS 9 requires to be redesignated and those which have been redesignated on an optional basis.

This information is required to be presented in tabular format, together with a narrative explanation of how the classification requirements in HKFRS 9 have been applied, and the reasons for any designation or revocation of the designation of financial assets at fair value through profit or loss.

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HKFRSs / IFRSs UPDATE

2010/02

14 January 2010

HK(IFRIC)-INT 19 'EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS'

Background

The International Financial Reporting Interpretations Committee (IFRIC) has published IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (IFRIC 19), which has been adopted in Hong Kong as HK(IFRIC)-INT 19.

HK(IFRIC)-INT 19 applies where an entity renegotiates the terms of a financial liability and as a result, issues its own equity instruments to the creditor to settle all or a part of the financial liability. Such situations are commonly referred to as debt for equity swaps.

HK(IFRIC)-INT 19 clarifies how such transactions are accounted for under HKFRSs, and is aimed at eliminating diversity in practice. Some entities have recognised equity instruments issued at the carrying amount of the debt extinguished, with no gain or loss recognised in profit or loss. Others did recognise a gain or loss but some recognised the equity instruments issued at the fair value of the debt extinguished and others at the fair value of the equity instruments issued.

HK(IFRIC)-INT 19 does not apply to transactions in situations where:

- i. the creditor is also a direct or indirect shareholder and is acting in this capacity;
- ii. the entity and creditor are controlled by the same party or parties before and after the transaction and the substance of the transaction includes equity distributions by, or contributions to the entity; and
- iii. extinguishing the financial liability by issuing equity is in accordance with the original terms of the financial liability.

Situations (i) and (ii) have been excluded from the scope of HK(IFRIC)-INT 19 as judgement will be required in determining whether the transaction constitutes a transaction with shareholders in their capacity as such.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on or after 1 July 2010. Earlier application permitted

ACCOUNTING IMPACT

Clarifies accounting for the renegotiation of the terms of a financial liability that results in the debtor extinguishing all or part of the liability by issuing its own equity instruments to the creditor

Requirements

When an entity issues its own equity instruments to a creditor to settle a financial liability (in whole or in part), as a result of renegotiating the terms of that financial liability, the equity instruments issued are the 'consideration paid'. The equity instruments are recognised initially and measured at their fair value on the date the financial liability (or part thereof) is extinguished. The difference between the carrying amount of the financial liability (or part thereof) extinguished and the consideration paid is recognised in profit or loss. The amount recognised in profit or loss is disclosed either as a separate line item, or in the notes.

If the fair value of the equity instruments issued cannot be reliably measured, then the equity instruments are measured to reflect the fair value of the liability extinguished. If the financial liability includes a demand feature, paragraph 49 of HKAS 39 *Financial Instruments: Recognition and Measurement* (HKAS 39) which states that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand, is not applied when measuring the fair value of the financial liability. It was noted that debt for equity swaps often take place when the terms of a financial liability have been breached, often meaning it is payable on demand. However, it was considered that in the circumstances of a debt for equity swap, the demand feature is no longer substantive.

When only part of a financial liability is extinguished, an entity is required to assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If this is determined to be the case, an entity allocates the consideration paid between the part of the liability that was extinguished and the part that remains outstanding. All relevant facts and circumstances relating to the transaction are required to be considered when making this allocation.

In addition, the consideration allocated to the remaining liability forms part of an assessment that then needs to be carried out to determine whether the terms of the remaining liability have been 'substantially modified' (see HKAS 39.40 and HKAS 39.AG62). If it is determined that the remaining liability has been substantially modified then the modification is accounted for as an extinguishment of the original liability and the recognition of a new liability.

Effective date

The effective date of HK(IFRIC)-INT 19 is annual periods beginning on or after 1 July 2010. Earlier application is permitted. If HK(IFRIC)-INT 19 is applied for a period beginning before 1 July 2010 that fact is required to be disclosed. In addition, a change in accounting policy is applied in accordance with HKAS 8 (ie full retrospective application) from the beginning of the earliest comparative period presented.

Amendments to other standards

The interpretation also includes an amendment to HKFRS 1 to allow first time adopters to apply the transitional provisions in HK(IFRIC)-INT 19.

Action required

Entities that have recently renegotiated, are currently renegotiating or are expecting to renegotiate any of their financial liabilities and have issued or expect to issue equity instruments to extinguish all or part of the liability should assess the effect of HK(IFRIC)-INT 19. A review of tax consequences may also be appropriate in advance of finalising any arrangements.

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HKFRSs / IFRSs UPDATE

AMENDMENTS TO HK(IFRIC)-INT 14 PREPAYMENTS OF A MINIMUM FUNDING REQUIREMENT

2010/03

14 January 2010

Background

IFRIC 14, *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* was published by the International Financial Reporting Interpretations Committee (IFRIC) in July 2007, which has been adopted in Hong Kong.

Paragraph 20 of IFRIC 14 limited the extent to which reductions in future contributions could be recognised as an asset. This limit was the present value of the estimated service cost each year, less the minimum estimated funding contributions required in respect of the future accrual of benefits each year.

The IFRIC amended IFRIC 14 in November 2009 because in some cases the requirements of the original Interpretation had the unintended consequence of preventing a prepayment of future minimum funding requirements from being recognised as an asset. The amendments have been adopted in Hong Kong.

Requirements

HK(IFRIC)-INT 14.20 has been revised to expand the circumstances in which an asset can be recognised. It now requires that, if there is a minimum funding requirement for contributions relating to future service and an entity makes a prepayment of those contributions, the amount that is recognised as an asset is the sum of:

- a. any amount that reduces the future minimum funding requirement contribution for future service because the entity made a prepayment; and
- b. the estimated future service costs in each period less the estimated minimum funding requirement contributions that would be required for future service in that period if there were no prepayment of those contributions as described in (a), subject to a minimum of zero.

The limit on the amount that can be calculated under (b) has been included in order that the economic benefit available as a reduction in future contributions (and hence the amount of the asset recognised) will, at a minimum, correspond to the amount of any prepayment.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on or after 1 January 2011.
Earlier application permitted

ACCOUNTING IMPACT

Prepayments of contributions to cover minimum funding requirements are recorded as an asset



Effective date

The effective date of HK(IFRIC)-INT 14 (as originally issued) is annual periods beginning 1 January 2008.

The effective date of the amendments is annual periods beginning on or after 1 January 2011, with earlier application being permitted. If the amendments are applied for an earlier period, an entity is required to disclose that fact.

If HK(IFRIC)-INT 14 (as originally issued) and the amendments are applied initially in the same accounting period, the amendments to HK(IFRIC)-INT 14 are applied from the beginning of the earliest comparative period presented in the first financial statements in which an entity applies HK(IFRIC)-INT 14.

HK(IFRIC)-INT 14 (as originally issued) may have been adopted before applying the subsequent amendments. If this is the case, the adjustment resulting from the application of the amendments is recognised in retained earnings at the beginning of the earliest comparative period presented.

Action required

Entities subject to minimum funding requirements under their post-employment and other long-term employee benefit plans that have made, or are considering making, prepayments of contributions to cover those requirements should assess the consequences of adopting the amendments to HK(IFRIC)-INT 14.

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HKFRSs / IFRSs UPDATE

IMPROVEMENTS TO HKFRSs 2010

2010/04

24 May 2010

Background

Improvements to HKFRSs 2010 sets out a collection of amendments to HKFRSs which is issued in response to the International Accounting Standards Board's (IASB) annual improvements project to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of another major project. By presenting the amendments in a single document rather than as a series of piecemeal changes, the IASB aims to ease the burden of change for all concerned.

In particular, the IASB extended the scope of paragraph D8 to IFRS 1 *First-time Adoption of International Financial Reporting Standards* for the use of the deemed cost exemption for an event-driven fair value. In some jurisdictions, local law requires an entity to revalue its assets and liabilities to fair value for a privatisation or initial public offering (IPO) and to treat the revalued amounts as deemed cost for the entity's previous GAAP. Before the amendment made in May 2010, if that revaluation occurred after the entity's date of transition to IFRSs, the entity could not have used that revaluation as deemed cost for IFRSs. Therefore, the entity would have had to prepare two sets of measurements for its assets and liabilities – one to comply with IFRSs, and one to comply with local law. The IASB considered this unduly onerous. Therefore, the IASB amended paragraph D8 to allow an entity to recognise an event-driven fair value measurement as deemed cost when the event occurs, provided that this is during the periods covered by its first IFRS financial statements. In addition, the IASB concluded that the same relief should apply to an entity that adopted IFRSs in periods before the effective date of IFRS 1 or applied IFRS 1 in a previous period, provided the measurement date is within the period covered by its first IFRS financial statements.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on/after 1 July 2010 or 1 January 2011

ACCOUNTING IMPACT

May be significant

The following table lists the HKFRSs and topics addressed by the amendments.

HKFRS	Subject of amendment
HKFRS 1 <i>First-time Adoption of Hong Kong Financial Reporting Standards</i>	Accounting policy changes in the year of adoption
	Revaluation basis as deemed cost
	Use of deemed cost for operations subject to rate regulation
HKFRS 3 <i>Business Combinations</i>	Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised HKFRS
	Measurement of non-controlling interests
	Un-replaced and voluntarily replaced share-based payment awards
HKFRS 7 <i>Financial Instruments: Disclosures</i>	Clarifications of disclosures
HKAS 1 <i>Presentation of Financial Statements</i>	Clarification of statement of changes in equity
HKAS 27 <i>Consolidated and Separate Financial Statements</i>	Transition requirements for amendments made as a result of HKAS 27 (as amended in 2008) to HKAS 21, HKAS 28 and HKAS 31
HKAS 34 <i>Interim Financial Reporting</i>	Significant events and transactions
HK (IFRIC)-Int 13 <i>Customer Loyalty Programmes</i>	Fair value of award credits

While some of the amendments are minor, it is possible that some, particularly those relating to the measurement of non-controlling interest and the use of deemed cost for operations subject to rate regulated activities, will have a significant effect on financial statements. Consequently the effect of the amendments should be analysed carefully by those entities that have adopted, or plan to adopt, HKFRSs.

The effective date of each of the amendments, and their transitional arrangements, are included below.

Amendments

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

Issue: Changes in accounting policies during an entity's year of adoption of HKFRSs

If a first-time adopter changes its accounting policies or its use of exemptions in HKFRS 1 after the date of its first interim financial report prepared in accordance with HKAS 34, but before the issue of its first annual HKFRS financial statements, the reconciliations between previous GAAP and HKFRSs are required to be updated. The requirements of HKAS 8 do not apply.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

Issue: Use of revalued amount as deemed cost

Some GAAPs permit an event driven fair value (being a remeasurement to fair value of some or all assets and liabilities on an event such as a privatisation or public offering) to be established as a deemed cost. The amendment extends the relief available under HKFRS 1, to permit a first-time adopter to use that event driven fair value as deemed cost under HKFRSs, from measurements which are carried out at or before transition date to measurements that are carried out between the date of transition and the end of the entity's first annual HKFRS reporting period.

As an example, if an entity chooses to use an event driven fair value as deemed cost under HKFRS for an asset where the measurement date is after its date of transition to HKFRS but before the end of the entity's first annual HKFRS reporting period, an adjustment will be made to equity as at the measurement date. During the period from transition date to the measurement date, historical cost or other amounts permitted by HKFRS are presented. The HKICPA agrees with the IASB's decision to reject an approach of 'working back' from the measurement date to a deemed cost at the date of transition, on the basis that this would require the use of hindsight and would result in a carrying amount at transition date that was neither historical cost nor fair value.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

Issue: Deemed cost for assets used in operations subject to rate regulation

The amendment permits a first-time adopter to use its previous GAAP carrying amount of property, plant and equipment and intangible assets that are, or were previously, used in operations subject to rate regulation as deemed cost at the date of transition to HKFRS. This election is available on an individual asset basis.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

HKFRS 3 Business Combinations**Issue: Transition – contingent consideration balances arising from business combinations that took place prior to the adoption of HKFRS 3 (2008)**

HKFRS 3 (2008) included a consequential amendment to HKAS 39 that brought contingent consideration balances within the scope of that standard. This means that instead of changes in the amount of contingent consideration being accounted for as an adjustment to the cost of the original business combination, they are now accounted for in accordance with HKAS 39 and recognised in profit or loss. The amendment clarifies that the change in scope of HKAS 39 is applied to business combinations on a prospective basis, meaning that where a business combination took place before the date of adoption of HKFRS 3 (2008), changes in contingent consideration are accounted for as an adjustment to the cost of the original business combination.

Effective date and transition: Annual periods beginning on/after 1 July 2010, with earlier application permitted.

Issue: Measurement of Non-controlling Interest (NCI)

The amendment clarifies that the option to measure NCI at either fair value, or the proportionate share of the acquisition date fair value of the acquiree's identifiable net assets that are recognised by the acquirer, applies only to instruments that give the NCI a present ownership interest and entitle the holder to a proportionate share of net assets in the event of liquidation. All other components of NCI are measured at their acquisition date fair value, unless another measurement is required by HKFRS.

This amendment has been made to ensure that certain components of NCI are not measured at zero. For example, if a share-based payment transaction is classified as equity, it is measured in accordance with HKFRS 2 *Share-based Payment*. Another example is a preference share that represents NCI, being an equity instrument, with its holder being entitled to a return of the initial amount subscribed on liquidation. The NCI that relates to the preference shares is measured at fair value.

Effective date and transition: Annual periods commencing on/after 1 July 2010, with earlier application permitted. On adoption, to be applied prospectively from the date on which HKFRS 3 (2008) was first applied.

Issue: Share-based payment transactions of an acquiree that are either not replaced on a business combination, or are voluntarily replaced

The current requirement for an acquirer to measure share-based payment awards that it issues to replace existing awards of an acquiree at the acquisition date, in accordance with HKFRS 2 is extended. This means that existing share-based payment awards of an acquiree that are not replaced in a business combination are also measured by the acquirer in accordance with HKFRS 2 at the acquisition date. If the awards have vested at the acquisition date, they are accounted for as part of NCI in the acquiree. If the awards have not vested at the acquisition date, they are accounted for as if the acquisition date was the grant date.

An acquirer may exchange its own share-based payment awards for awards held by employees of the acquiree. The current requirement to account for that exchange as a modification of the existing arrangement, where the acquirer is obliged to replace the existing awards, is retained with the amount calculated in accordance with HKFRS 2 being allocated between the cost of the business combination and post acquisition services. The amendment extends this to cover replacement awards where the acquirer is not obliged to replace the existing awards, but chooses to voluntarily.

In some cases, existing share-based payment awards in an acquiree expire as a result of a business combination. In those circumstances, if the acquirer replaces those awards voluntarily, the entire fair value of those replacement awards calculated in accordance with HKFRS 2 is accounted for as a post acquisition remuneration expense.

Effective date and transition: Annual periods commencing on/after 1 July 2010, with earlier application permitted. On adoption, to be applied prospectively from the date on which HKFRS 3 (2008) was first applied.

HKFRS 7 Financial Instruments: Disclosures**Issue: Clarification of disclosure requirements**

The amendment clarifies quantitative disclosure requirements for risks arising from financial instruments, and encourages accompanying narrative disclosures if the concentration of risk is not apparent from the quantitative disclosures.

The requirements for disclosures of credit risk, including collateral held, are clarified and reduced, with the carrying amount of assets that would have been past due or impaired unless they had been renegotiated no longer needing to be disclosed.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

HKAS 1 Presentation of Financial Statements**Issue: Presentation of changes in equity**

The amendment clarifies that the analysis of items of Other Comprehensive Income may be shown in either the (primary) statement of changes in equity, or in the notes to the financial statements.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

HKAS 27 Consolidated and Separate Financial Statements – consequential amendments to HKAS 21 The Effects of Changes in Foreign Exchange Rates, HKAS 28 Investments in Associates and HKAS 31 Interests in Joint Ventures**Issue: Transitional requirements for consequential amendments**

The amendments to HKAS 21, HKAS 28 and HKAS 31 clarify that the amendments made to these standards as a consequence of HKAS 27 (revised 2008) are to be applied prospectively from the date of adoption of that standard (annual periods beginning on/after 1 July 2009 with earlier application permitted). As exceptions, paragraph 35 of HKAS 28 and paragraph 46 of HKAS 31, which relate to accounting in the separate financial statements of the investor, are applied retrospectively.

Effective date and transition: Annual periods beginning on/after 1 July 2010, with earlier application permitted.



HKAS 34 *Interim Financial Reporting*

Issue: Content of an interim financial report – significant events and transactions

The amendments emphasise that disclosure about significant transactions and events is required to update relevant information presented in the most recent annual financial report.

HKAS 34 is made more specific about events and transactions for which disclosure is required, and guidance has been added covering the application of the requirements for financial instruments.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

HK(IFRIC)-Int 13 *Customer Loyalty Programmes*

Issue: Fair value of award credits

The amendment clarifies that the fair value of award credits includes consideration of the amount of discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale.

Effective date and transition: Annual periods beginning on/after 1 January 2011, with earlier application permitted.

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HKFRSs / IFRSs UPDATE

2010/05

24 May 2010

AMENDMENT TO HKFRS 1 LIMITED EXEMPTION FROM COMPARATIVE HKFRS 7 DISCLOSURES FOR FIRST-TIME ADOPTERS

Background

In March 2009 the Hong Kong Institute of Certified Public Accountants (HKICPA) issued *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7). These amendments introduced a three tier hierarchy for certain fair value disclosures, with financial instruments being analysed among level 1 (quoted prices in active markets), level 2 (where inputs to valuations are directly or indirectly linked to quoted prices in active markets) and level 3 (where inputs to valuations are not based on observable market data).

Entities that already report in accordance with HKFRSs are required to apply these amendments for annual periods beginning on or after 1 January 2009 with earlier application permitted. However, in its first year of application of the amendments to HKFRS 7, an entity that already reports in accordance with HKFRSs is not required to provide comparative information.

To avoid the potential use of hindsight and to ensure a first-time adopter is treated no differently from current HKFRSs preparers, the HKICPA decided that first-time adopters should be permitted to use the same transitional provisions permitted for existing HKFRSs preparers that are included in related amendments to HKFRS 7. As a result, the *Limited Exemption from Comparative HKFRS 7 Disclosures for First-Time Adopters* (Amendment to HKFRS 1) adds a paragraph to Appendix E of HKFRS 1, which covers short-term exemptions from HKFRSs, to give that relief.

Amendment

The amendment to HKFRS 1 permits a first-time adopter to apply the transitional provisions in paragraph 44G of HKFRS 7. The effect is that an entity does not need to provide comparative information for the disclosures required by the amendments to HKFRS 7 where the comparative period end is before 31 December 2009.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on or after 1 July 2010

ACCOUNTING IMPACT

Relief from the provision of certain comparative HKFRS 7 disclosures



Effective date

The amendment to HKFRS 1 is effective for annual periods beginning on or after 1 July 2010, with earlier application being permitted. If the amendment is applied for an earlier period, an entity is required to disclose that fact.

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HKFRSs / IFRSs UPDATE

HKFRS FOR PRIVATE ENTITIES (HKFRS FOR PEs) - A NEW FINANCIAL REPORTING OPTION

2010/06

11 June 2010

Introduction

IFRS for SMEs

On 9 July 2009 the International Accounting Standards Board (IASB) issued an International Financial Reporting Standard (IFRS) designed for use by small and medium-sized entities (SMEs). The IFRS for SMEs is the result of a five-year development process involving extensive consultation with SMEs worldwide.

The IFRS for SMEs responds to strong international demand from both developed and emerging economies for a rigorous and common set of accounting standards for SMEs that is much simpler than the full IFRSs. In particular, the IFRS for SMEs will:

- provide improved comparability for users of accounts;
- enhance the overall confidence in the accounts of SMEs; and
- reduce the significant costs involved of maintaining standards on a national basis.

The IASB's stated objective in creating the IFRS for SMEs is to create information from the "specific perspective of an SME" that would assist a broad range of users in making economic decisions. The financial statements should also reflect the stewardship function of management.

In order to achieve this goal, the IASB designed the IFRS for SMEs that is based on, but stands alone and is distinct from, the full IFRSs.

The IFRS for SMEs will be updated by an omnibus of changes, which the IASB will prepare on a three year cycle. However, prior to the first omnibus, the IASB have indicated that they will review the first two years of reporting under the IFRS for SMEs. Hence, the first omnibus may take longer than three years to issue in order to incorporate this review of financial statements.

STATUS

Final

EFFECTIVE DATE

Upon issue on 30 April 2010

ACCOUNTING IMPACT

A new financial reporting option for private companies

HKFRS for PEs and its effective date

On 30 April 2010 the HKFRS for PEs was issued as a new financial reporting option in Hong Kong with immediate effect, which is based on the IFRS for SMEs. PEs have the option of choosing the HKFRS for PEs in preparing their annual financial statements, and they are even permitted to use this new financial reporting framework to prepare their financial statements for prior period(s) where the relevant financial statements have not been finalised and approved.

As a result, Hong Kong now has three financial reporting frameworks:

- a. HKFRS for PEs which may be applied by PEs;
- b. Full HKFRSs which apply to the majority of companies before the issuance of the HKFRS for PEs; and
- c. SME-FRF&FRS which may be applied by Hong Kong incorporated companies eligible for claiming relief under s141D of the Companies Ordinance and by other companies that meet the eligibility requirements contained in SME-FRF&FRS (Small GAAP).

Differences between the HKFRS for PEs and the IFRS for SMEs

- i. The term "SME" is widely used in Hong Kong and associated with the Small GAAP. For clarity and differentiation the new Standard is called "HKFRS for Private Entities". The term "SMEs" used throughout the IFRS for SMEs is therefore replaced by "Private Entities" in the HKFRS for PEs.
- ii. The accounting for income taxes contained in the IFRS for SMEs closely follows proposals contained in the IASB Exposure Draft which was intended to replace IAS 12 "Income Taxes". Many respondents expressed their views that the proposed changes in the IASB Exposure Draft are not improvements but rather the introduction of complex new rules. Accordingly, IASB has expressed that it is unlikely that the project will proceed in its current form. As the commenting period of the IASB Exposure Draft ended on 31 July 2009, which is after the issue of the IFRS for SMEs by the IASB on 9 July 2009, the accounting for income taxes section of the IFRS for SMEs retained the proposals contained in the IASB Exposure Draft.

Given the effective rejection of the IASB Exposure Draft on accounting for taxes, in order to ensure ease of application by Hong Kong users, the HKFRS for PEs has replaced the recognition and measurement principles contained in Section 29 of the IFRS for SMEs with those contained in the extant version of HKAS 12, while retaining the relevant disclosure requirements contained in the IFRS for SMEs.

- iii. The section on accounting for income tax contained in the HKFRS for PEs has been written to ensure no provision is required in relation to revaluation gains on investment properties to reflect the Hong Kong situation. This provision is incorporated in order to exempt recognition of deferred taxation in relation to revaluation gains of investment properties where such tax is never paid in Hong Kong to remove an anomaly currently in HKAS 12.

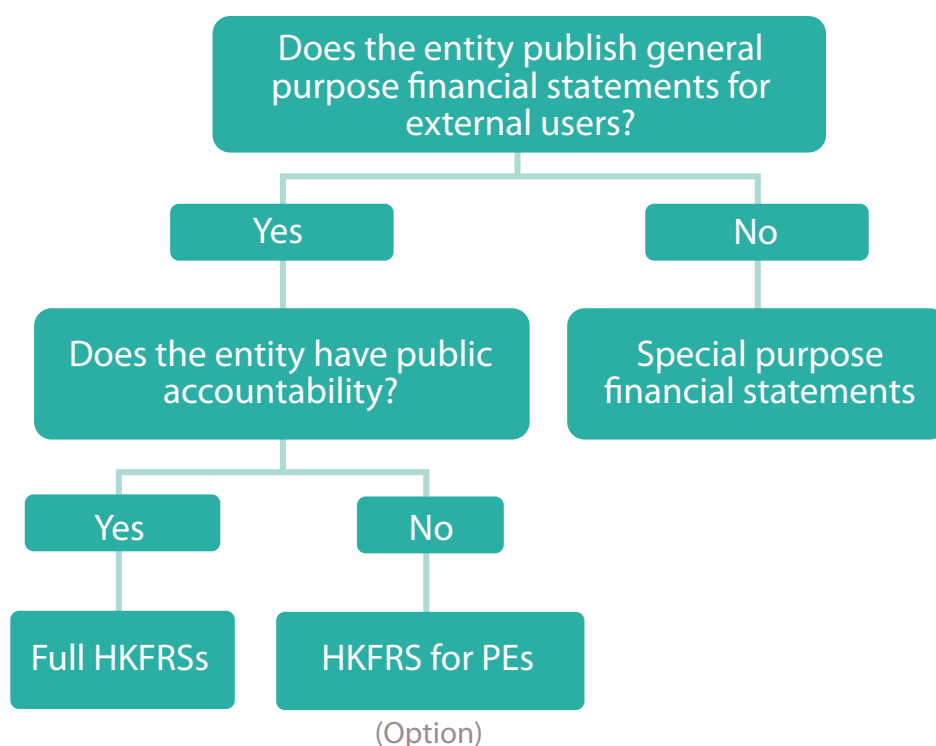
Definition of PEs and scope of the HKFRS for PEs

A PE is an entity that:

- Does not have public accountability.
- Publishes general-purpose financial statements for external users.

An entity has public accountability if:

- It files, or it is 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.
- It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.



The definition of a PE is therefore based on the nature of an entity rather than on its size.

Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit, and sellers that receive payment in advance of delivery of the goods or services such as utility companies), that does **not** make them publicly accountable.

The HKICPA has issued a Q&A on the applicability of the HKFRS for PEs which suggests a thought process that entities should go through in determining whether or not they are eligible to use the HKFRS for PEs and contains eleven commonly asked questions together with answers.

Checkpoint

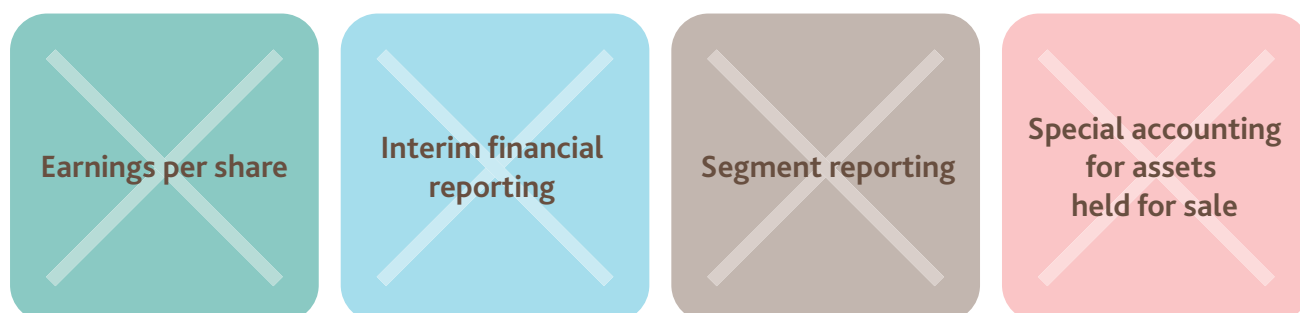
A subsidiary whose parent uses the full HKFRSs, or that is part of a consolidated group that uses the full HKFRSs, is not prohibited from using the HKFRS for PEs in its own financial statements if that subsidiary by itself does not have public accountability.

The subsidiary would, however, have to keep two sets of records because the parent entity would require the application of the full HKFRSs for consolidation purposes.

Comparison with the full HKFRSs

The omitted topics

The following topics have been completely omitted from the HKFRS for PEs, because they are not expected to be relevant for the majority of PEs:



Checkpoint

The HKFRS for PEs states that a PE should select an accounting policy that results in relevant and reliable information, but what if the HKFRS for PEs does not address a transaction or other event or condition or provide a cross-reference back to another HKFRS?

Firstly, the PE should consider the requirements and guidance in the HKFRS for PEs dealing with similar and related issues. Secondly, the PE should consider the pervasive principles in the HKFRS for PEs. Lastly, consider the full HKFRSs (including Interpretations).

Not an option

The HKFRS for PEs does not include the following options, because it is considered that PEs will choose to follow the simpler options as they will generally be less costly, require less expertise and achieve greater comparability with their peers.

If a PE feels strongly about using one or more of the complex options, it could elect to follow the full HKFRSs rather than the HKFRS for PEs.

Property, plant and equipment

- The revaluation model is not an option.
- Property, plant and equipment carried at cost less accumulated depreciation and impairment.

Intangible assets

- The revaluation model is not an option.
- Intangible assets carried at cost less accumulated amortisation and impairment.

Borrowing costs

- The capitalisation model is not allowed.
- All borrowing costs should be expensed.

Jointly controlled entities

- No proportionate consolidation.

Government grants

- Various options excluded.
- Only single simplified method retained, that is, recognition in income (at fair value) when the performance conditions are met.

Investment property

- Measurement is driven by circumstances rather than allowing an accounting policy choice between the cost and fair value models.

Financial instruments

- Available-for-sale and held-to-maturity categories are not available.

Recognition and measurement simplified

Financial instruments	<ul style="list-style-type: none"> • Measured at: <ul style="list-style-type: none"> – cost or amortised cost; or – fair value through profit or loss (FVTPL). • Simple principle for derecognition, because the 'pass-through' and 'continuing involvement' tests have been deleted. • Hedge accounting requirements, including detailed calculations, are simplified and tailored.
Goodwill and other indefinite-life intangible assets	<ul style="list-style-type: none"> • Can the useful lives be estimated reliably? <ul style="list-style-type: none"> – Yes – Amortise over their estimated useful lives. – No – Amortise over 10 years.
Investments in joint ventures and associates	<ul style="list-style-type: none"> • Is there a published price quotation? <ul style="list-style-type: none"> – Yes – Fair value. – No – Cost.
R&D costs	<ul style="list-style-type: none"> • Must be recognised as expenses.
Borrowing costs	<ul style="list-style-type: none"> • Must be recognised as expenses.
Property, plant and equipment	<ul style="list-style-type: none"> • No annual review of residual values, useful lives and depreciation method, except presence of "indicator" requiring such a review.
Intangible assets	<ul style="list-style-type: none"> • No annual review of amortisation period and amortisation method, except presence of "indicator" requiring such a review.
Defined benefit plans	<ul style="list-style-type: none"> • All past service cost must be recognised immediately in profit or loss. • All actuarial gains and losses must be recognised immediately, either in profit or loss or other comprehensive income. • Projected unit credit method – only if can be applied without undue cost or effort.
Income taxes	<ul style="list-style-type: none"> • Based on the existing requirements of HKAS 12 "Income Taxes" with simplification for deferred tax on investment property revaluation gains.
Assets held-for-sale	<ul style="list-style-type: none"> • No separate held-for-sale classification. Instead, holding an asset (or group of assets) for sale is an impairment indicator.
Biological assets	<ul style="list-style-type: none"> • Is fair value of biological assets readily determinable without undue cost or effort? <ul style="list-style-type: none"> – Yes – FVTPL model. – No – Cost-depreciation-impairment model.
Equity-settled share-based payments	<ul style="list-style-type: none"> • Are observable market prices available for equity-settled share-based payments? <ul style="list-style-type: none"> – Yes – Fair value. – No – Directors' best estimate of the fair value.

Checkpoint

Consolidated financial statements

The HKFRS for PEs requires preparation of consolidated financial statements in relation to all subsidiaries of the parent. A parent need not present consolidated financial statements if:

- the parent itself is a subsidiary and its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with the full HKFRSs, the full IFRSs, the HKFRS for PEs or the IFRS for SMEs; or
- it has no subsidiaries other than one that was acquired with the intention of selling or disposing of it within one year.

Disclosure simplifications

The disclosure requirements in the HKFRS for PEs are substantially reduced when compared with the disclosure requirements in the full HKFRSs. The reasons for the reductions are of four principal types:

- they relate to topics covered in the full HKFRSs that are omitted from the HKFRS for PEs;
- they relate to recognition and measurement principles in the full HKFRSs that have been replaced by simplifications in the HKFRS for PEs;
- they relate to options in the full HKFRSs that are not included in the HKFRS for PEs; or
- on the basis of users' needs or cost-benefit considerations.

"To adopt or not to adopt" - considerations prior to adopting the HKFRS for PEs

The HKFRS for PEs aims to simplify and reduce the potentially ever-increasing reporting requirements of the full HKFRSs. However, in determining whether to adopt the HKFRS for PEs, management is advised to consider the facts and circumstances of the PE, including but not limited to the following matters:

Must all PEs apply the HKFRS for PEs?

No. The adoption of the HKFRS for PEs is an option for PEs. If compliance with the full HKFRSs is required, desired or preferred by a PE, the PE may continue using or adopt the full HKFRSs and need not adopt the HKFRS for PEs.

Will the financial statements of a PE meet the needs of users?

PEs will have to consider whether financial statements prepared under the HKFRS for PEs meet the needs of their own specific users. The financial statements of PEs generally are not widely circulated, and the needs of individual users of those financial statements tend to be specific, but not necessarily the same.

The HKFRS for PEs is based on the same framework as the full HKFRSs. In developing the IFRS for SMEs, the IASB attempted to consider the needs of users of the financial statements of an SME. However, due to the specific needs of individual users, careful assessment will be needed by each SME to determine whether the IFRS for SMEs will meet their needs. The IFRS for SMEs concentrates on items such as short-term cash flows, liquidity, and balance sheet strength. The IASB concluded that the full IFRSs at times provided too much information for the needs of an SME user, while in other situations other needs were not being met by the full IFRSs.

The HKICPA has held meetings with the Inland Revenue Department of the HKSAR Government and representatives of Hong Kong Association of Banks since the issuance of the IFRS for SMEs. Both parties acknowledged the standard setting role of the HKICPA and have no objection in principle to relieving PEs from complying with the full HKFRSs in the preparation of financial statements.

Are there any long-term considerations that should be taken into account?

The PE's long-term plans need to be considered; where such plans include becoming publicly accountable or a possible listing of debt or equity instruments, this could affect the choices made by the PE. A PE with such plans would be precluded from using the HKFRS for PEs in the future, as it would fail to meet the definition of a PE. This would then force the PE into a second conversion to the full HKFRSs.

Another consideration is whether a PE's holding company reports (or will report) under the full HKFRSs. In such cases, it may be easier for that PE to also report under the full HKFRSs in order to facilitate the consolidation process in its parent company – thereby avoiding the need for dual reporting.

Are there any cost impacts on adoption?

Yes. Adopting the HKFRS for PEs may have various cost implications to consider, including:

- a. **Upfront investment costs** may have to be incurred, such as those resulting from system changes, reformatting of the financial statements and additional staff training. These may be one-off costs which may be offset in future years by reduced training costs as the HKFRS for PEs is not updated every year.
- b. **Preparation costs** for the financial statements may be reduced but the extent of reduction depends on the facts and circumstances of the PE.
- c. **Consultation costs and costs of engaging experts** may be reduced because many complex areas in the full HKFRSs are simplified in the HKFRS for PEs. On the other hand, the absence of detailed guidance in the HKFRS for PEs may sometimes require additional consultations with experts.

Is the first time adoption of the HKFRS for PEs complicated?

The process by which a PE adopts the HKFRS for PEs is dealt with in Section 35, and is based on HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards".

To summarise, the PE determines the date of transition. This is the date at the beginning of the earliest period for which the PE presents full comparative information. Generally, as most PEs provide one year of comparatives, a PE with a year ended 31 December 2009 would have a date of transition of 1 January 2008.

As in HKFRS 1, certain exceptions and exemptions are provided in order to facilitate a smoother transition into the HKFRS for PEs. However, there are additional disclosures specific to the year of adoption, including certain reconciliations from the previous GAAP reports to the financial statements prepared under the HKFRS for PEs.

Are there any implementation guidance and support to smoothen the transition?

Both the websites of IASB and HKICPA contain useful resources and implementation guidance. In particular, the HKICPA has issued an illustrative set of financial statements which have incorporated the disclosure requirements of the Companies Ordinance. There is also a disclosure checklist based on the requirements of the IFRS for SMEs.

Conclusion

The HKFRS for PEs offers an opportunity for PEs to adopt a reporting framework that may reduce their reporting burden.

Apart from the accounting differences between the HKFRS for PEs and the full HKFRSs (and also Small GAAP), there are many other issues that PEs must take into account before adopting the HKFRS for PEs. The considerations often relate to qualitative factors, and require management's judgment to be exercised before the conclusion can be reached that the HKFRS for PEs is the preferred route for the PEs.

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▶ LESSONS LEARNT FROM REGULATORY REVIEWS OF FINANCIAL STATEMENTS

THE STOCK EXCHANGE OF HONG KONG LIMITED FINANCIAL STATEMENTS REVIEW PROGRAMME REPORT 2010 AUGUST 2010

www.hkex.com.hk/eng/rulesreg/listrules/listguid/documents/frm-10.pdf

The Listing Division of the Stock Exchange of Hong Kong Limited completed its 2008/09 annual review of listed issuers' published financial reports for compliance with the disclosure requirements of the Listing Rules and accounting standards, and published a report in August 2010. This is the second published report which summarises the Listing Division's observations and findings.

During the review process, the Listing Division selected and reviewed 100 published periodic financial reports of issuers covering annual, interim and quarterly reports released between October 2008 and September 2009.

The Listing Division issued 98 letters to issuers that contained more than 400 enquiries and observations. Its enquiries requested explanations and information about the accounting treatment adopted or clarifications on possible non-compliance or omitted disclosures.

Based on the responses to its enquiries made during the 2008/2009 review, except for four cases which have been referred to the Financial Reporting Council to consider further enquiry and investigation of possible accounting and auditing irregularities and one caution letter to an issuer, there were no significant breaches of the Listing Rules or accounting standards that would render the financial statements false or misleading or would require a restatement or reissue of financial statements or warrant disciplinary action by the Listing Committee. Where the omitted disclosures were regarded as less significant or material, issuers were requested to confirm in writing that the required information will be provided in their future financial reports.

The major findings and recommendations arising from the review are set out below:

- Disclosure of significant "other" account balances were simply described as "other gains/expenses" or "other receivables/payables" without further details;
- Performance indicators (eg "EBITDA" or "adjusted EBITDA") were used without adequate explanation of their meaning, how they are computed and what they were supposed to indicate;
- Where going concern is an issue, adequate information on going concern assessment should be included in the corporate governance report and other relevant sections of the annual report;
- Clearer explanations of the assessment of the effectiveness of internal controls should be made in corporate governance reports where there is a matter which indicates a weakness in internal controls;
- Robust asset impairment review processes should be in place so that shareholders and investors have confidence on the reported asset values;

- Disclosures of the amortisation/depreciation method adopted for mining assets, in particular, the measurement basis and key assumptions used in the estimation of proven and probable reserves, should be improved; and
- Disclosure of assumptions and methods to arrive at fair values of financial instruments, including the assumptions and valuation techniques used, should be more detailed.

The Listing Division encourages directors and other persons responsible for the financial reporting function to review and continuously improve their existing financial reporting systems and take note of the matters discussed in its report to ensure that useful information is presented to readers of financial statements.



HONG KONG INSTITUTE OF CPAs QUALITY ASSURANCE ANNUAL REPORT MARCH 2010

www.hkicpa.org.hk/file/media/section6_standards/quality_assurance/2009/qa-report.pdf

The section "findings and educational points from professional standards monitoring programme" of the Report sets out an overview of the more significant or topical issues noted from reviews of published financial statements. The issues are presented by topic with references being made to applicable financial reporting standards.

During the course of reviews, the HKICPA noted that there were common accounting issues that seemed to be related to or exacerbated by the global financial crisis which include:

- Impairment of assets including goodwill.
- Investments in available-for-sale financial assets.
- Going concern considerations.
- Financial risk management disclosures.

Other specific topics include application issues in accounting for business combinations, revenue recognition on multiple deliverables and agriculture accounting and disclosures.

▶ FUTURE HKFRSs/IFRSs LANDSCAPE IASB PROJECT PLAN

Public capital markets are predicated on trust and transparency. The quality of information that companies provide is essential to the confidence of investors and other capital providers in making investment decisions, and the quality of accounting standards directly affects the quality of company-reported financial information.

The global nature of financial markets gives rise to a need for high-quality, globally comparable financial information. Thus, it is critically important to achieve high-quality, globally converged financial reporting standards that provide relevant, transparent, neutral, and comparable financial information, regardless of the geographical location of the entity.

Recognising those realities, the FASB and the IASB (Boards) have committed to increase their efforts to complete the major projects described in their Memorandum of Understanding (MoU) by end of June 2011. As a result, the exposure drafts already published and scheduled for publication in the rest of 2010 and the first half of 2011 are expected to be significant both in nature and number.

In response to concerns voiced by stakeholders about their ability to provide high quality input on the large number of major exposure drafts planned for publication, the Boards published in June 2010 a modified strategy which retains the target completion date of June 2011 or earlier for the MoU projects for which the need for improvements is considered the most urgent. Projects the Boards believe are a relatively lower priority or for which further research and analysis is necessary are now targeted for completion after the original June 2011 target date.

Further information is available at the IASB website
www.ifrs.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm



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*this list is current as of 1 January 2010

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