HKFRS/IFRS UPDATE 2024/06

October 2024

HKFRS/IFRS 19 – Subsidiaries without Public Accountability: Disclosures

Background

On 9 May 2024, the International Accounting Standards Board (IASB) issued IFRS 19 *Subsidiaries without Public Accountability: Disclosures* (the Standard). The HKICPA published the equivalent standard, HKFRS 19, on 29 July 2024. When a parent company prepares consolidated financial statements that comply with HKFRS/IFRS® Accounting Standards, its subsidiaries are required to report to the parent using HKFRS/IFRS Accounting Standards. For their own financial statements, subsidiaries are permitted to use other financial reporting frameworks including national financial reporting standards subject to local legal requirements (if any) and the eligibility criteria of the frameworks. For example, such subsidiaries may use *IFRS for SMEs*® Accounting Standard if they meet the eligibility criteria. For subsidiaries preparing their financial statements using accounting standards published by the HKICPA, there are two financial reporting frameworks other than HKFRS Accounting Standards that are available for adoption, also subject to meeting the criteria (the other Financial Reporting Options in Hong Kong). These frameworks are *HKFRS for Private Entities* and the *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* (SME-FRF & FRS). However, the subsidiaries may not opt to apply the *IFRS for SMEs* Accounting Standard or the other Financial Reporting Options in Hong Kong, as they are already required to report to their parent entities using HKFRS/IFRS Accounting Standards, and the *IFRS for SMEs* Accounting Standard and the other Financial Reporting Options in Hong Kong differ significantly from HKFRS/IFRS Accounting Standards, which may result in the subsidiary being required to maintain two sets of financial records. When subsidiaries apply HKFRS/IFRS Accounting Standards for their own financial statements, they are required to provide the disclosures required by HKFRS/IFRS Accounting Standards, which may be disproportionate to the information needs of their users.

This issue was highlighted by stakeholders in their response to the IASB's *Request for Views – 2015 Agenda Consultation*. The stakeholders asked the IASB to permit a subsidiary reporting to a parent applying IFRS Accounting Standards in its consolidated financial statements to apply IFRS Accounting Standards with reduced disclosure requirements in its own financial statements. Considering this feedback, the IASB added a project to its research pipeline to provide reduced disclosure requirements for subsidiaries without public accountability. The project has now culminated in the issuance of IFRS 19, which permits eligible subsidiaries to apply reduced disclosure requirements while applying the recognition, measurement and presentation requirements in IFRS Accounting Standards.

The IASB's project page contains all published documents related to IFRS 19.

Status

Final

Effective date

1 January 2027

Accounting impact

Subsidiaries meeting the specified eligibility criteria may elect to apply reduced disclosure requirements as compared to the disclosure requirements of HKFRS/IFRS Accounting Standards while complying with the recognition, measurement and presentation requirements in HKFRS/IFRS Accounting Standards.

Requirements of HKFRS/IFRS 19

Eligibility criteria

Application of HKFRS/IFRS 19 is voluntary.

An entity may elect to apply HKFRS/IFRS 19 in its consolidated, separate or individual financial statements if, and only if, it meets the eligibility criteria **at the end of the reporting period**.

The eligibility criteria are:

- The entity is a subsidiary (as defined in Appendix A of HKFRS/IFRS 10 *Consolidated Financial Statements*);
- The entity does not have public accountability; and
- The entity has an ultimate or intermediate parent that produces consolidated financial statements available for public use that comply with HKFRS/IFRS Accounting Standards.

An entity has public accountability if:

- Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market; or
- It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

An entity is permitted to elect to apply HKFRS/IFRS 19 more than once. An entity that applied HKFRS/IFRS 19 in a prior period but not in the immediately preceding period may elect to apply it in the current period.

For example, Entity X (an entity eligible to apply HKFRS/IFRS 19) elected to apply HKFRS/IFRS 19 in 20X1, but did not apply it in 20X2 because its parent, Entity Y, ceased to apply HKFRS/IFRS Accounting Standards. In 20X3, Entity X was acquired by Entity Z, which applies HKFRS/IFRS Accounting Standards. Entity X would be eligible to apply HKFRS/IFRS 19 again in 20X3, provided it meets all the eligibility criteria.

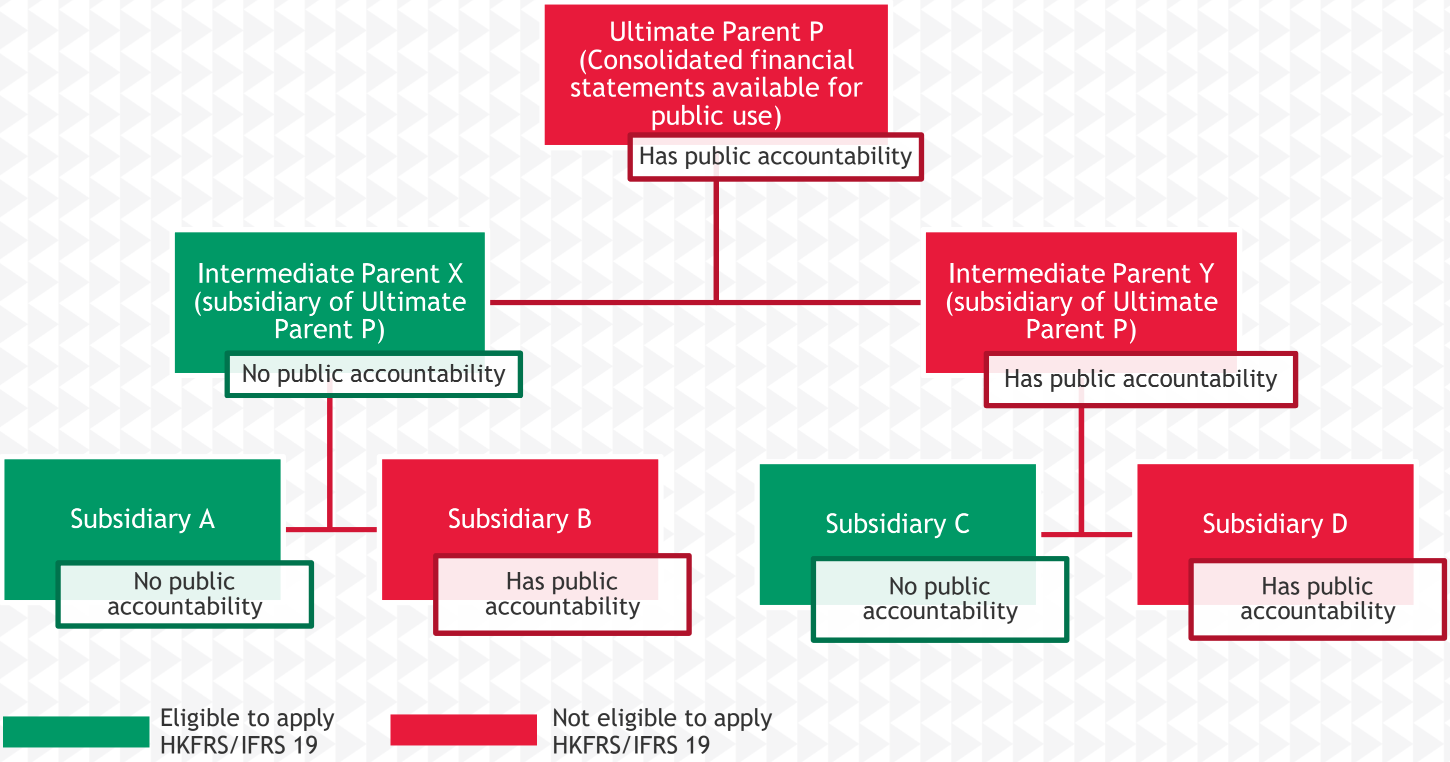
An entity that has elected to apply HKFRS/IFRS 19 may later revoke that election.

Can an intermediate parent apply HKFRS/IFRS 19?

An intermediate parent that meets the eligibility criteria specified above is permitted to apply HKFRS/IFRS 19.

An entity is permitted to make separate election to apply HKFRS/IFRS 19 to its separate, individual or consolidated financial statements. For example, an intermediate parent may elect to apply HKFRS/IFRS 19 in its separate financial statements (provided it meets the eligibility criteria), even if it does not apply the Standard in its consolidated financial statements.

The following diagram shows an example of a group of entities, some of which are eligible to apply HKFRS/IFRS 19. (*All entities in the group currently prepare individual/ separate/ consolidated financial statements that comply with HKFRS/IFRS Accounting Standards.*)



Out of all the entities in the group that are subsidiaries; Intermediate Parent Y, Subsidiary B and Subsidiary D have public accountability and therefore, are not eligible to apply HKFRS/IFRS 19. Intermediate Parent X, Subsidiary A and Subsidiary C do not have public accountability. These entities are subsidiaries and they have an ultimate or intermediate parent that produces consolidated financial statements available for public use that comply with HKFRS/IFRS Accounting Standards. Therefore, these entities are permitted to elect to apply HKFRS/IFRS 19. Intermediate Parent X is permitted to make separate election to apply HKFRS/IFRS 19 for its separate and consolidated financial statements.

It should be noted that, in the above example, Ultimate Parent P prepares its consolidated financial statements that comply with HKFRS/IFRS Accounting Standards and those financial statements are available for public use.

If Ultimate Parent P's financial statements are not available for public use, Intermediate Parent X would not be eligible to apply HKFRS/IFRS 19. Subsidiary A would also be ineligible to apply HKFRS/IFRS 19 unless Intermediate Parent X's financial statements are available for public use.

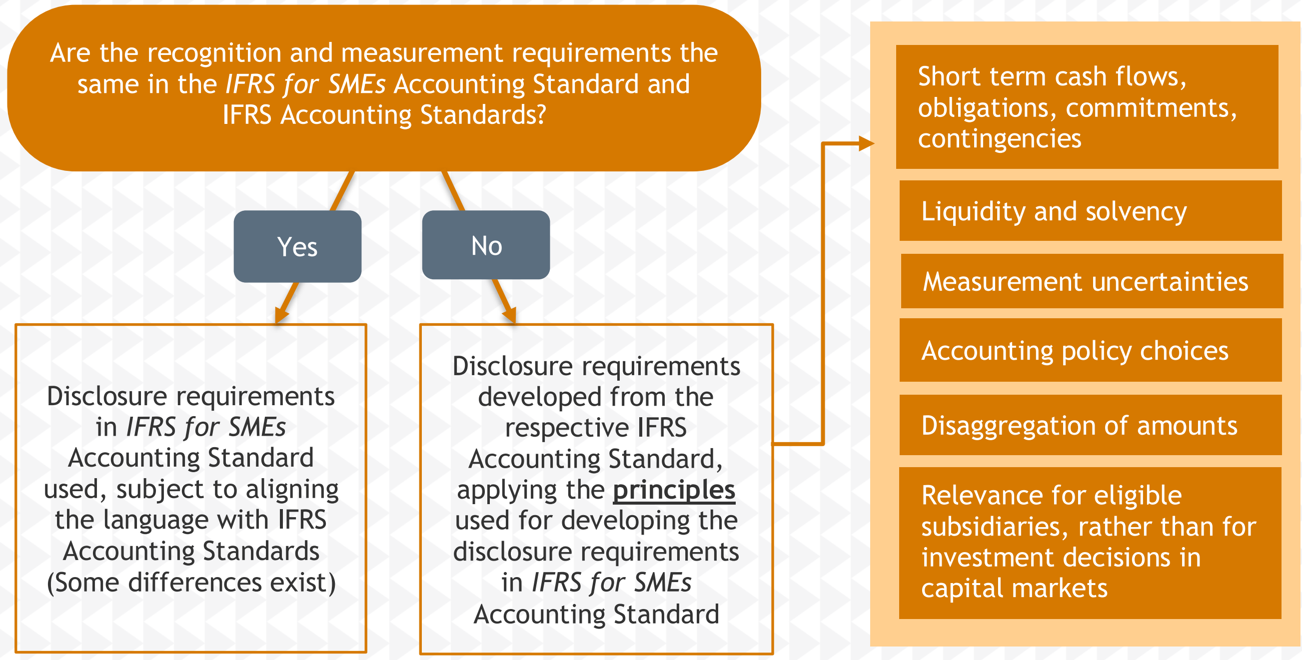
Thus, if a group of entities is located in a jurisdiction where it is required to apply HKFRS/IFRS Accounting Standards, but the ultimate or intermediate parents in the group are not publicly accountable and their financial statements are not available for public use, the subsidiaries or intermediate parents will not be able to apply HKFRS/IFRS 19.

The structure of HKFRS/IFRS 19 and the approach followed by the IASB in developing the disclosure requirements

The disclosure requirements in HKFRS/IFRS 19 are organised into subsections relating to each HKFRS/IFRS Accounting Standard. A subsidiary applying HKFRS/IFRS 19 will apply an HKFRS/IFRS Accounting Standard to a transaction, other event or condition for the purpose of recognition, measurement and presentation and then apply the disclosure requirements set out under the subheading of that HKFRS/IFRS Accounting Standard in HKFRS/IFRS 19.

In developing the disclosures in IFRS 19 relating to each IFRS Accounting Standard, the IASB adopted the following approach:

- If the recognition and measurement requirements were the same in the *IFRS for SMEs* Accounting Standard and IFRS Accounting Standards, the disclosure requirements in the *IFRS for SMEs* Accounting Standard are used in IFRS 19, subject to updating the language for consistency with other IFRS Accounting Standards.
- If recognition and measurement requirements in the *IFRS for SMEs* Accounting Standard differed from those in IFRS Accounting Standards, disclosure requirements in IFRS 19 were developed directly from IFRS Accounting Standards, applying the principles used for developing the disclosure requirements in the *IFRS for SMEs* Accounting Standard.



Disclosure requirements from HKFRS/IFRS Accounting Standards that continue to apply

The Standard does not provide reduced disclosure requirements for HKFRS/IFRS 8 *Operating Segments*, HKFRS/IFRS 17 *Insurance Contracts* and HKFRS/IAS 33 *Earnings per Share*. If an entity electing to apply HKFRS/IFRS 19 is required to or elects to apply HKFRS/IFRS 8, HKFRS/IFRS 17 or HKAS/IAS 33, the entity is required to apply all the disclosure requirements in those Standards.

Some disclosure requirements in HKFRS/IFRS Accounting Standards remain applicable to entities applying HKFRS/IFRS 19. Such disclosure requirements are specified under the subheading of each HKFRS/IFRS Accounting Standard. Some of the reasons for the IASB to conclude on retaining the applicability of these disclosure requirements were:

- the disclosure requirements are easier for preparers to consider in situ because the paragraphs that follow them contain requirements about their application;
- the disclosure requirements are embedded in paragraphs that include recognition, measurement or presentation requirements; and
- the disclosure requirements use the term 'disclosure' in a broad sense, encompassing items presented in the primary financial statements.

Application of disclosure requirements referred to in other than disclosure paragraphs of other HKFRS/IFRS Accounting Standards

In some cases, paragraphs other than disclosure paragraphs of HKFRS/IFRS Accounting Standards contain statements about or references to the disclosure requirements. An entity applying HKFRS/IFRS 19 is not required to apply such statements or references to the disclosure requirements in other HKFRS/IFRS Accounting Standards, unless specifically required by HKFRS/IFRS 19.

For example, paragraph 35 of HKAS/IAS 12 *Income Taxes* provides the following (***<u>emphasis</u>*** added):

The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. ***<u>In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.</u>***

Thus, HKAS/IAS 12.35 contains requirements about the criteria for recognising a deferred tax asset arising from the carryforward of unused tax losses and tax credits. But it also refers to HKAS/IAS 12.82 which provides the disclosure requirements in such circumstances. For an entity applying HKFRS/IFRS 19, the disclosure requirements in HKAS/IAS 12.82 are not applicable. Such an entity is not required to apply the statement at the end of HKAS/IAS 12.35 about HKAS/IAS 12.82.

Example of reduced disclosure requirements

As mentioned earlier, the disclosure requirements in HKFRS/IFRS 19 are organised into subsections relating to each HKFRS/IFRS Accounting Standard. A subsidiary applying HKFRS/IFRS 19 will apply an HKFRS/IFRS Accounting Standard to a transaction, other event or condition for the purpose of recognition, measurement and presentation and then apply the disclosure requirements set out under the subheading of that HKFRS/IFRS Accounting Standard in HKFRS/IFRS 19, instead of the disclosure requirements of that HKFRS/IFRS Accounting Standard.

For example, under HKFRS/IFRS 19, an entity that has transactions within the scope of HKFRS/IFRS 2 *Share-based Payment* would not apply the disclosure requirements in HKFRS/IFRS 2.44-52, which are extensive. Instead, an entity would disclose only the information contained in paragraphs 31-34 of HKFRS/IFRS 19, which include a description of share-based payment arrangements, the number and weighted average exercise prices of share options, how an entity measures the fair value of equity-settled share-based payment transactions and other general information about transactions in the scope of HKFRS/IFRS 2.

As an indication of the scope of the reduction in disclosure requirements, IFRS 2 currently contains 991 words in its disclosure requirements, whereas IFRS 19 contains only 250 words relating to IFRS 2 disclosures.

Materiality consideration and additional disclosures in accordance with HKFRS/IFRS 18 *Presentation and Disclosure in Financial Statements*

IFRS 18 *Presentation and Disclosure in Financial Statements*, issued by the IASB in April 2024, replaced IAS 1 *Presentation of Financial Statements*. The HKICPA published the equivalent standard, HKFRS 18, on 9 July 2024. HKFRS/IFRS 18.19 permits an entity to not provide a specific presentation or disclosure if the information resulting from that presentation or disclosure is not material. This requirement also applies to the disclosure requirements in HKFRS/IFRS 19, meaning that an entity applying HKFRS/IFRS 19 need not provide a specific disclosure required by the Standard if the information resulting from that disclosure would not be material.

Similarly, an entity is required to consider whether to provide additional disclosures, when compliance with the specific requirements of HKFRS/IFRS 19 is insufficient to enable users of financial statements to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance.

Statement of compliance with HKFRS/IFRS Accounting Standards

HKAS/IAS 1 requires an entity whose financial statements comply with HKFRS/IFRS Accounting Standards to make an explicit and unreserved statement of such compliance in the notes. After the issue of HKFRS/IFRS 18, this requirement is incorporated into the amended HKAS/IAS 8 *Basis of Preparation of Financial Statements*.

For an entity that elects to apply HKFRS/IFRS 19, when its financial statements comply with HKFRS/IFRS Accounting Standards and the requirements in HKFRS/IFRS 19, the entity is required to make an explicit and unreserved statement of such compliance in the notes. As part of that unreserved statement, the entity is required to state that it has applied HKFRS/IFRS 19.

Comparative information

An entity that applies HKFRS/IFRS 19 in the current reporting period but not in the immediately preceding period is required to provide comparative information for all amounts reported in the current period's financial statements, unless HKFRS/IFRS 19 or another HKFRS/IFRS Accounting Standard permits or requires otherwise.

An entity that applied HKFRS/IFRS 19 in the preceding reporting period, but elects not to (or is no longer eligible to) apply it in the current period and continues applying HKFRS/IFRS Accounting Standards, is required to provide comparative information with respect to the preceding period for all amounts reported in the current period's financial statements, unless another HKFRS/IFRS Accounting Standard permits or requires otherwise.

Effective date

HKFRS/IFRS 19 is effective for annual reporting periods beginning on or after 1 January 2027 with earlier application permitted.

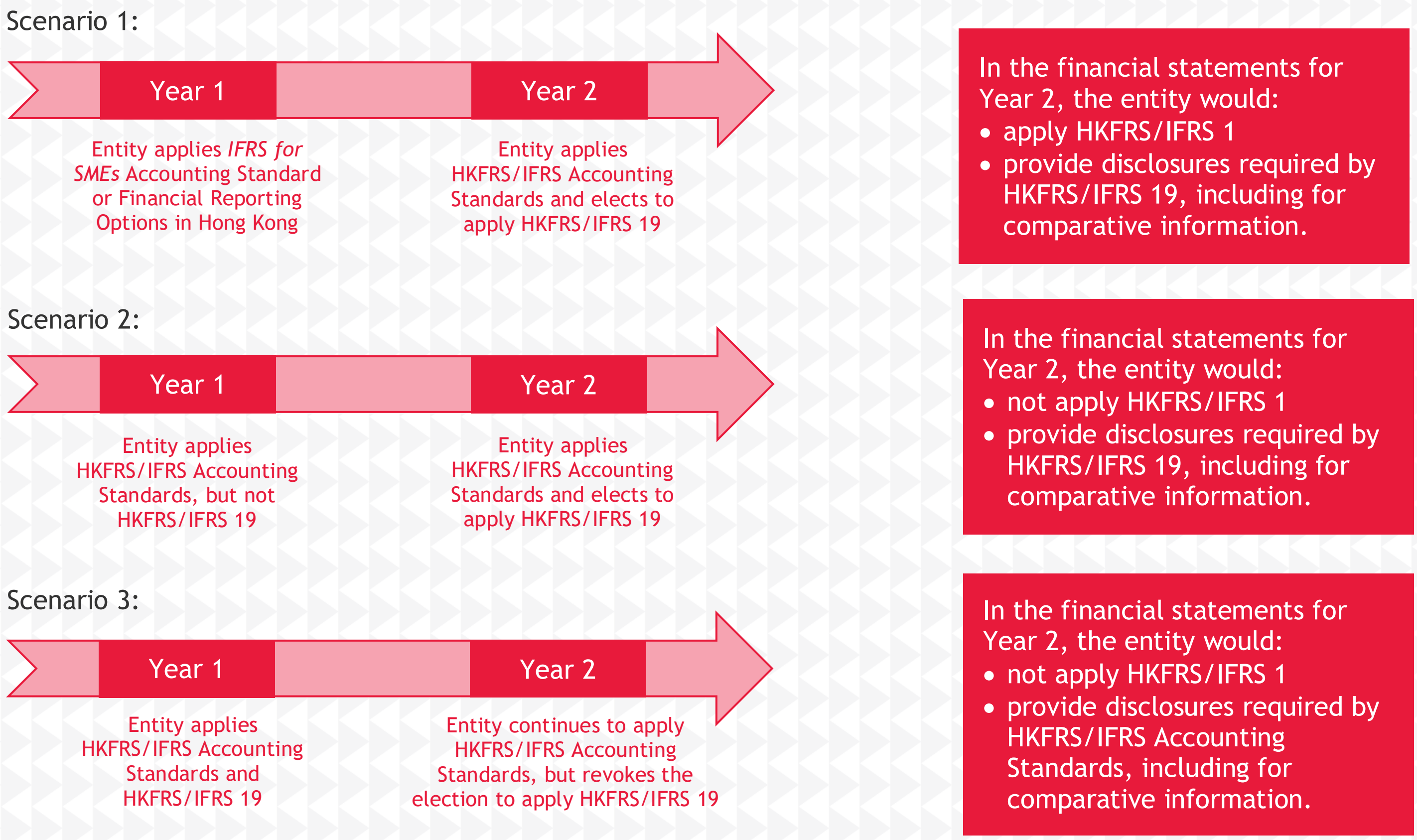
Transition requirements

Interaction with HKFRS/IFRS 1 *First-time Adoption of Hong Kong/International Financial Reporting Standards*

HKFRS/IFRS 19.21-30 provide the reduced disclosure requirements for HKFRS/IFRS 1 *First-time Adoption of Hong Kong/International Financial Reporting Standards* that an entity is required to apply if it elects to apply HKFRS/IFRS 19 when it prepares its first financial statements in accordance with HKFRS/IFRS Accounting Standards.

Electing or revoking an election to apply HKFRS/IFRS 19 does not, on its own, result in an entity meeting the definition of a first-time adopter of HKFRS/IFRS Accounting Standards in HKFRS/IFRS 1.

The following diagram depicts various scenarios of application of HKFRS/IFRS 19 and the requirement to apply HKFRS/IFRS 1.



Interaction with HKFRS/IFRS 18

IFRS 18, issued by the IASB in April 2024, replaced IAS 1. The HKICPA published the equivalent standard, HKFRS 18, in July 2024. HKFRS/IFRS 18 is effective for annual reporting periods beginning on or after 1 January 2027, with earlier application permitted. Thus, both HKFRS/IFRS 18 and HKFRS/IFRS 19 are effective for annual reporting periods beginning on or after 1 January 2027, with earlier application permitted.

An entity may elect to apply HKFRS/IFRS 19 before it applies HKFRS/IFRS 18, subject to endorsement in an entity's jurisdiction, if applicable (eg the European Union). Appendix B of HKFRS/IFRS 19 provides the reduced disclosure requirements from HKAS/IAS 1 that an entity is required to apply if it applies HKFRS/IFRS 19 before applying HKFRS/IFRS 18.

Interaction with HKAS/IAS 8 *Basis of Preparation of Financial Statements* with respect to changes in accounting policies

The requirements for changes in accounting policies in HKAS/IAS 8 do not apply to electing or revoking an election to apply HKFRS/IFRS 19.

The requirement to provide a third statement of financial position

HKFRS/IFRS 18.37 requires an entity to present a third statement of financial position as at the beginning of the preceding period if:

a. it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
b. the retrospective application, retrospective restatement or reclassification has a material effect on the information in the statement of financial position as at the beginning of the preceding period.

The IASB, in its deliberations, decided that the requirements in IAS 8 related to changes in accounting policies would not apply to a subsidiary's election to apply IFRS 19 or to the revocation of that election (Basis for Conclusions - BC103). The IASB also noted that applying IFRS 19 does not change the recognition or measurement of items or amounts presented in the primary financial statements (Basis for Conclusions - BC104). Therefore, an entity that elects or revokes the election to apply HKFRS/IFRS 19 is not required to present a third statement of financial position as at the beginning of the preceding period.

Entities affected by the standard

Eligible subsidiaries will benefit from reduced costs and reporting simplifications from the reduced disclosure regime. Some eligible subsidiaries were applying the *IFRS for SMEs* Accounting Standard, the other Financial Reporting Options in Hong Kong or another national set of standards for their own financial statements to benefit from fewer disclosure requirements and maintaining dual accounting records for the purposes of reporting to the parent entity. Such subsidiaries would now be able to apply HKFRS/IFRS Accounting Standards for their own financial statements and elect to apply HKFRS/IFRS 19, which will eliminate the need for dual accounting records.

BDO's support and assistance on HKFRS/IFRS Accounting Standards

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