

# HKAS 31 and 38 and HK(SIC)–Int 13

5 August 2006



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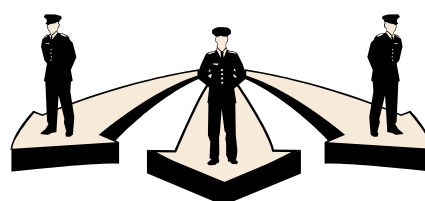
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## Today's Agenda

Simple but  
Comprehensive

Contentious  
and key issues

Real Life  
Cases and  
Examples



Interests in Joint Ventures  
(HKAS 31)

HK(SIC) Interpretation 13

Intangible Assets  
(HKAS 38)

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## Interests in Joint Ventures (HKAS 31)

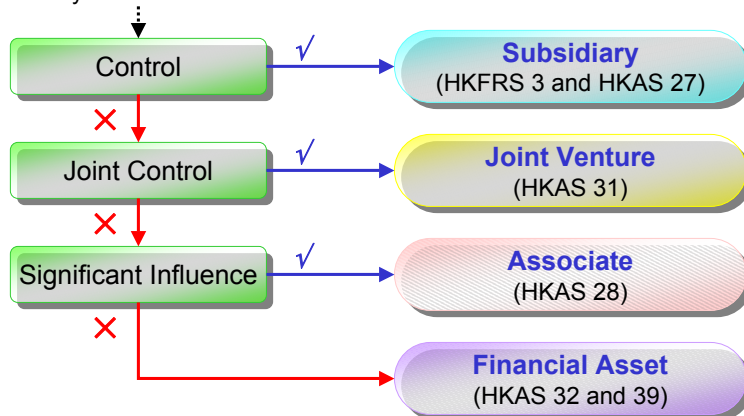


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## Interests in Joint Ventures (HKAS 31)

An entity shall consider whether all of its financial assets in respect of another entity demonstrate



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# Agenda for HKAS 31

1. Scope of HKAS 31
2. Definition
3. Forms of joint venture
  - a. Jointly controlled operations
  - b. Jointly controlled assets
  - c. Jointly controlled entities
4. Separate financial statements
5. Transactions between a venturer and a joint venture
6. Investor and Operator in a Joint Venture
7. Disclosure

## 1. Scope

- HKAS 31 *Interests in Joint Ventures* shall be applied in
  - a) accounting for interests in joint ventures and
  - b) the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors,
    - regardless of the structures or forms under which the joint venture activities take place.

# 1. Scope

## Example

- Peter Inc., a venture capital company, has investments over 30 technological manufacturing companies.
- The investment of Peter Inc. in those companies are in the form of convertible bonds.
- Peter Inc. plans to realise the gain from the flotation exercise of those companies in future, mostly within 2 to 3 years.
- At that time, it can convert the bonds into shares and dispose of them with a huge margin.
- According to the experience of Peter Inc., the gain on a particular flotation exercise can cover the loss incurred on at least 5 investments.
- All the investments provide Peter Inc. a joint control in order to monitor the business and growth of those companies.
- However, Peter Inc. would not look for the operating profits or assets enhancement from those investments.
- Discuss the proper accounting treatment.

# 1. Scope

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



# 1. Scope

- A venturer with an interest in a jointly controlled entity is also exempted from complying HKAS 31 when it meets the following conditions:
  - a) the investment is classified as held for sale in accordance with HKFRS 5;
  - b) the exception in HKAS 27, allowing a parent that has an interest in a jointly controlled entity not to present consolidated financial statements, applies; or
  - c) all of the following apply:
    - i) the investor is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners do not object to such non-application;
    - ii) the investor's debt or equity instruments are not traded in a public market;
    - iii) the investor did not file, nor is it in the process of filing, its financial statements for issuing any class of securities in a public market; and
    - iv) the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with HKFRSs/IFRSs.

# 1. Scope



Implication

## Same as HKAS 28

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

# 1. Scope

- A venturer is a party to a joint venture and has joint control over that joint venture.
- An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.



# 2. Definition

- A joint venture is a contractual arrangement whereby 2 or more parties undertake an economic activity that is subject to joint control.
- The following characteristics are common to all joint ventures:
  - a) 2 or more venturers are bound by a contractual arrangement; and
  - b) the contractual arrangement establishes joint control.

Contractual  
Arrangement

Joint Control

## 2. Definition

- The existence of a [contractual arrangement](#) distinguishes interests that involve joint control from investments in associates in which the investor has significant influence.
  - Activities that have no contractual arrangement to establish joint control are not joint ventures for the purposes of HKAS 31.
  - The contractual arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers.
  - In some cases, the arrangement is incorporated in the articles or other by-laws of the joint venture.

Contractual Arrangement

## 2. Definition

### In **HKAS 31**

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

### In **SSAP 21**

- [Joint control](#) is the contractually agreed sharing of control over an economic activity

Additional in HKAS 31

Joint Control

- [Control](#) is the power to [govern](#) the financial and operating policies of an economic activity so as to obtain benefits from it.
- What is [joint control](#)?

## 2. Definition

### Example

The following entities are owned by A (35%), B (35%), C (15%) and D (15%) with different strategic decision arrangement as follows:

1. Entity OB's strategic decision requires 100% approval from A, B, C and D

A, B, C and D share joint control and OB would be classified as a jointly controlled entity for all of them

2. Entity Vader's strategic decision requires a simple majority vote

Vader is not controlled or jointly controlled by A, B, C and D. Depending on the extent of influence, it may be an associate to A and B

3. Entity Yoda's strategic decision requires 70% approval

A and B share joint control and would classify it as joint venture. C and D may only be an investor in this case

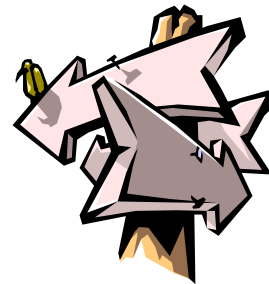
## 3. Forms of Joint Venture

- HKAS 31 identifies 3 broad types of joint ventures :

Jointly controlled operations

Jointly controlled assets

Jointly controlled entities





## 3a. Jointly Controlled Operations

### Jointly controlled operation

- refers to the operation of some joint ventures that
  - involves the use of the assets and other resources of the venturers
  - rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves.
- In a jointly controlled operation
  - Each venturer uses its own PPE and carries its own inventories.
  - It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations.
  - The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities.
  - The joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.



## 3a. Jointly Controlled Operations

### **Recognition of jointly controlled operations:**

- In respect of its interests in jointly controlled operations,
  - a venturer shall recognise in its financial statements:
    - a) the assets that it controls and the liabilities that it incurs; and
    - b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.



## 3b. Jointly Controlled Assets

- Jointly controlled assets are some joint ventures that involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.
  - The assets are used to obtain benefits for the venturers.
  - Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.
  - These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves.
  - Each venturer has control over its share of future economic benefits through its share of the jointly controlled asset.



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## 3b. Jointly Controlled Assets

### Recognition of jointly controlled assets:

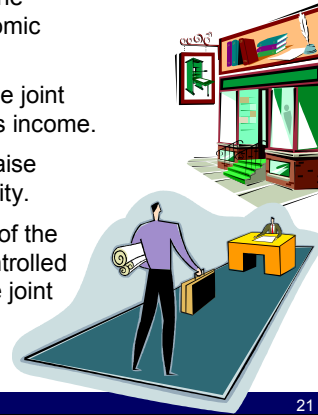
- In respect of its interest in jointly controlled assets, a venturer shall recognise in its financial statements:
  - a) its share of the jointly controlled assets, classified according to the nature of the assets;
  - b) any liabilities that it has incurred;
  - c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;
  - d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and
  - e) any expenses that it has incurred in respect of its interest in the joint venture.

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## 3c. Jointly Controlled Entities

- A **jointly controlled entity** is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest.
  - The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.
  - A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income.
  - It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity.
  - Each venturer is entitled to a share of the profits of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.



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## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

- A venturer shall recognise its interest in jointly controlled entity using either
    - Proportionate Consolidation
  - or
  - Equity Method
- When proportionate consolidation is used, one of the two reporting formats identified in HKAS 31 shall be used.

An entity has a choice



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## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Proportionate Consolidation

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

## 3c. Jointly Controlled Entities

### Case

### Recognition of jointly controlled entities:

#### Proportionate Consolidation

Not really new in HK!

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



## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Proportionate Consolidation

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Proportionate Consolidation

- When **Proportionate Consolidation** is used, One of the Two Reporting Formats shall be used, the venturer may:
    1. **Combine** its share of each of the assets, liabilities, income and expenses of the jointly controlled entity **with the similar items, line by line**, in its financial statements, or alternatively
    2. **Include separate line items** for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its financial statements
- Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in [HKAS 27](#).

## 3c. Jointly Controlled Entities

Recognition of jointly controlled entities:

Proportionate Consolidation

Two Reporting Format

Proportionate Consolidation  
Reporting Format 1  
(PCRF 1)

1. Combine with the similar items line by line

2. Include separate line items

Proportionate Consolidation  
Reporting Format 2  
(PCRF 2)

## 3c. Jointly Controlled Entities

Example

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

	<u>VT</u>	<u>JCE</u>
<b>Non-current assets</b>		
Property, plant & equipment	1,000	2,000
Interest in JCE	<u>500</u>	<u>0</u>
	<u>1,500</u>	<u>2,000</u>
<b>Current assets</b>		
Account receivables	100	500
Cash at bank	<u>100</u>	<u>100</u>
	<u>200</u>	<u>600</u>
<b>Current liabilities</b>		
Account payables	<u>(100)</u>	<u>(600)</u>
<b>Net current assets</b>	<u>100</u>	<u>0</u>
<b>Net assets</b>	<u>1,600</u>	<u>2,000</u>

- Prepare the balance sheet of VT by using:
  1. Equity method and
  2. Proportionate consolidation
- Compare the differences of equity method and proportionate consolidation

## 3c. Jointly Controlled Entities

### Example

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

	VT	JCE	Equity Method	PCRF 1	PCRF 2	
<b>Non-current assets</b>						
Property, plant & equipment	1,000	2,000	1,000	2,000	1,000	PPE-VT
Interest in JCE	<u>500</u>	<u>0</u>	<u>1,000</u>	<u>0</u>	<u>1,000</u>	PPE-JCE
	<u>1,500</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>		
<b>Current assets</b>						
Account receivables	100	500	100	350	100	A/R-VT
Cash at bank	<u>100</u>	<u>100</u>	<u>100</u>	<u>150</u>	<u>250</u>	A/R-JCE
	<u>200</u>	<u>600</u>	<u>200</u>	<u>500</u>	<u>100</u>	Cash-VT
					<u>50</u>	Cash-JCE
<b>Current liabilities</b>						
Account payables	<u>(100)</u>	<u>(600)</u>	<u>(100)</u>	<u>(400)</u>	<u>(100)</u>	A/P-VT
					<u>(300)</u>	A/P-JCE
<b>Net current assets</b>	<u>100</u>	<u>0</u>	<u>100</u>	<u>100</u>		
<b>Net assets</b>	<u>1,600</u>	<u>2,000</u>	<u>2,100</u>	<u>2,100</u>	<u>2,100</u>	

## 3c. Jointly Controlled Entities

### Example

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

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

## 3c. Jointly Controlled Entities

### Example

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



### PCRF

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

## 3c. Jointly Controlled Entities

### Some problematic issues:

- JV purchases from venturers
- JV sells to venturers
- Minority interests in JV's financial statements under proportionate consolidation .....

} Discussed later



## 3c. Jointly Controlled Entities

### Example

#### [Think about this case](#)

- JCE's assets represent JCE's 80% interest in a subsidiary, which has assets of \$125

	<u>Venturer</u>	<u>JCE</u>
Assets		125
Investment in JCE	<u>50</u>	<u>125</u>
	<u>50</u>	<u>125</u>
Equity	50	100
Minority interests		<u>25</u>
	<u>50</u>	<u>125</u>

## 3c. Jointly Controlled Entities

### Case



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

2004 Annual Report states:

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

## 3c. Jointly Controlled Entities

### Case



2004 Annual Report states:

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

Proportionate Consolidation

Two Reporting Formats

Proportionate Consolidation  
Reporting Format 1  
(PCRF 1)

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Proportionate Consolidation

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



## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Equity Method

- As an alternative to proportionate consolidation described above, a venturer shall recognise its interest in a jointly controlled entity using the [equity method](#)
  - that is a method of accounting (same as described in HKAS 28) whereby
    - an interest in a jointly controlled entity is initially recorded at cost and
    - adjusted thereafter for the post-acquisition change in the venturer's share of net assets of the jointly controlled entity.
  - The profit or loss of the venturer includes the venturer's share of the profit or loss of the jointly controlled entity.
- A venturer recognises its interest in a jointly controlled entity using the equity method
  - [irrespective of](#) whether it also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Equity Method

- The use of the equity method is supported
  - by those who argue that it is inappropriate to combine controlled items with jointly controlled items and
  - by those who believe that venturers have significant influence, rather than joint control, in a jointly controlled entity.
- A venturer shall discontinue the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, a jointly controlled entity.

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

#### Equity Method

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

Proportionate Consolidation ↔ Equity Method

Can an entity used proportionate consolidation fall back to use equity method?

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

Proportionate Consolidation ↔ Equity Method

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

Such recommendation in HKAS 31 implies that

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

Proportionate Consolidation

Equity Method

#### **Exceptions to Proportionate Consolidation and Equity Method**

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

## 3c. Jointly Controlled Entities

### Recognition of jointly controlled entities:

Proportionate Consolidation

Equity Method

#### **Exceptions to Proportionate Consolidation and Equity Method**

- From the date on which a jointly controlled entity becomes a subsidiary of a venturer
  - the venturer shall account for its interest in accordance with HKAS 27.
- From the date on which a jointly controlled entity becomes an associate of a venturer
  - the venturer shall account for its interest in accordance with HKAS 28.

## 3c. Jointly Controlled Entities

### Example

- Entity Jedi acquired 30% interest in Neo in Year 0 at \$20,000 without any goodwill in the acquisition and accounted it as jointly controlled entities.
- In July of Year 0, Jedi decided to sell Neo and classified it as held for sale. Then, for Year 0, Neo reported a loss of \$10,000.
- Fair value less cost to sale of Neo was \$20,000 in Year 0 and Year 1.
- At the end of Year 1, Neo reported a further loss of \$10,000.
- By reviewing the criteria in HKFRS 5, Neo can no longer be classified as held for sale at the end of Year 1.
- Jedi's balance sheet in Year 0 while Neo was classified as held for sale:

	Year 0
Investment in JCE held for sale	\$20,000

- Jedi's balance sheet in Year 1:

	Year 1	Year 0 (Restated)
Interests in JCE (by equity method)	\$14,000	\$17,000
	<small>(\$17,000 - \$10,000 x 30%)</small>	<small>(\$20,000 - \$10,000 x 30%)</small>

## 4. Separate Financial Statements

### Same contents as in HKAS 27

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



## 4. Separate Financial Statements

Same contents as in HKAS 27

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



## 4. Separate Financial Statements

Same contents as in HKAS 27

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

At cost

or

In accordance with HKAS 39

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





## 4. Separate Financial Statements

Same contents as in HKAS 27

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

At cost

or

In accordance with HKAS 39

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

## 4. Separate Financial Statements

Same contents as in HKAS 27

FA at FV through P/L

at Fair Value through profit or loss

AFS financial assets

at Fair Value through equity at Cost

HTM investments

at Amortised Cost

Loans and receivables

at Amortised Cost

In accordance with HKAS 39

## 5. Transactions Between Venturer and JV

### Example

Assume Venturer holds 50% interests in JCE and they have the following statements:

	Venturer	JCE	Proportionate consolidation
Property A	10		10
Investment in JCE	50		
Cash	1,000	100	1,050
	<u>1,060</u>	<u>100</u>	<u>1,060</u>
Share capital	1,000	100	1,000
Reserves	60		60
	<u>1,060</u>	<u>100</u>	<u>1,060</u>

What's the effect of equity method?

1. If JCE purchases Property A from Venturer at y.e. at a fair value of \$20.
2. If JCE purchases Property A from Venturer at y.e. at a fair value of \$8.

## 5. Transactions Between Venturer and JV

- When a venturer contributes or sells assets to a joint venture,
  - recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction.

- While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership

At Profit

- the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers.

At loss

- The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

## 5. Transactions Between Venturer and JV

- HK(SIC) Interpretation 13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers* clarifies that:

- In applying the previous requirement (HKAS 31.48) to non-monetary contributions to a JCE in exchange for an equity interest in the JCE,
  - a venturer shall recognise in profit and loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
    - a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE;
    - b) the gain or loss on the non-monetary contribution cannot be measured reliably; or
    - c) the contribution transaction lacks commercial substance, as that term is described in HKAS 16 Property, Plant and Equipment.

## 5. Transactions Between Venturer and JV

- HK(SIC) Interpretation 13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers* clarifies that:

- If the above exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit and loss unless the following situation also applies.
- If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.
- Unrealised gains or losses on non-monetary assets contributed to JCEs shall be eliminated
  - against the underlying assets under the proportionate consolidation method or
  - against the investment under the equity method.
- Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated balance sheet.

## 5. Transactions Between Venturer and JV

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- Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated balance sheet.

## 5. Transactions Between Venturer and JV

### Example

Assume Venturer holds 50% interests in JCE and they have the following statements:

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>
Property A	10		10
Investment in JCE	50		
Cash	<u>1,000</u>	<u>100</u>	<u>1,050</u>
	<u>1,060</u>	<u>100</u>	<u>1,060</u>
Share capital	1,000	100	1,000
Reserves	<u>60</u>		<u>60</u>
	<u>1,060</u>	<u>100</u>	<u>1,060</u>

1. If JCE purchases Property A from Venturer at y.e. at a fair value of \$20.
2. If JCE purchases Property A from Venturer at y.e. at a fair value of \$8.

## 5. Transactions Between Venturer and JV

### Example

Balance sheets of Venture and JCE after Situation 1 (at \$20):

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>	<u>J#1</u>	<u>Proportionate consolidation (adjusted)</u>
Property A		20	10	(5)	5
Investment in JCE	50				
Cash	1,020	80	1,060		1,060
	<u>1,070</u>	<u>100</u>	<u>1,070</u>		<u>1,065</u>
Share capital	1,000	100	1,000		1,000
Reserves	70		70	5	65
	<u>1,070</u>	<u>100</u>	<u>1,070</u>		<u>1,060</u>

The venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers, i.e. only \$5  $[(\$20 - \$10) \div 2]$ . In consequence, a gain of \$5 is eliminated.

## 5. Transactions Between Venturer and JV

### Example

Balance sheets of Venture and JCE after Situation 2 (at \$8):

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>
Property A		8	4
Investment in JCE	50		
Cash	1,008	92	1,054
	<u>1,058</u>	<u>100</u>	<u>1,058</u>
Share capital	1,000	100	1,000
Reserves	58		58
	<u>1,058</u>	<u>100</u>	<u>1,058</u>

**Any adjustment required?**

No, when the sale (at loss) provides evidence of :

- a reduction in the NRV of current assets or an impairment loss.

## 5. Transactions Between Venturer and JV

- When a venturer purchases assets from a joint venture
  - the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party.
  - A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.

At Profit

At loss

## 5. Transactions Between Venturer and JV

Example

Assume Venturer holds 50% interests in JCE and they have the following statements:

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>
Property A		10	5
Investment in JCE	50		
Cash	<u>1,000</u>	<u>90</u>	<u>1,045</u>
	<u>1,050</u>	<u>100</u>	<u>1,050</u>
Share capital	1,000	100	1,000
Reserves	<u>50</u>		<u>50</u>
	<u>1,050</u>	<u>100</u>	<u>1,050</u>

1. If JCE sells Property A to Venturer at y.e. at a fair value of \$20.
2. If JCE sells Property A to Venturer at y.e. at a fair value of \$8.

## 5. Transactions Between Venturer and JV

### Example

Balance sheets of Venture and JCE after Situation 1 (at \$20):

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>	<u>J#1</u>	<u>Proportionate consolidation (adjusted)</u>
Property A	20		20	(5)	15
Investment in JCE	50				
Cash	980	110	1,035		1,035
	<u>1,050</u>	<u>110</u>	<u>1,055</u>		<u>1,050</u>
Share capital	1,000	100	1,000		1,000
Reserves	50	10	55	5	50
	<u>1,050</u>	<u>100</u>	<u>1,055</u>		<u>1,050</u>

The venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party, i.e. 50% of \$10 should not be recognised.

## 5. Transactions Between Venturer and JV

### Example

Balance sheets of Venture and JCE after Situation 2 (at \$8):

	<u>Venturer</u>	<u>JCE</u>	<u>Proportionate consolidation</u>	<u>J#1</u>	<u>Proportionate consolidation (adjusted)</u>
Property A	8		8	1	9
Investment in JCE	50				
Cash	992	98	1,041		1,041
	<u>1,050</u>	<u>98</u>	<u>1,049</u>		<u>1,050</u>
Share capital	1,000	100	1,000		1,000
Reserves	50	(2)	49	(1)	50
	<u>1,050</u>	<u>98</u>	<u>1,049</u>		<u>1,050</u>

**Any adjustment required?**

Adjusted in the same way as profits except that the losses represent a reduction in the NRV of current assets or an impairment loss.

## 6. Investor and Operator in a Joint Venture

- **An investor** in a joint venture that does not have joint control shall account for that investment
  - in accordance with HKAS 39 or,
  - if it has significant influence in the joint venture, in accordance with HKAS 28.
- **Operators** or **managers** of a joint venture shall account for any fees in accordance with HKAS 18.



## 7. Disclosure

### Contingent liabilities

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



## 7. Disclosure

### Commitments

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

## 7. Disclosure

### Other disclosure – Including New Disclosure Imposed

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

## 7. Disclosure

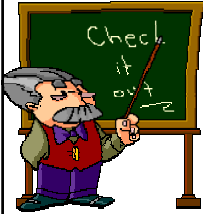
### Example

	<u>2005</u>	<u>2004</u>
<u>Income statement (extract)</u>		
Share of profits less losses of jointly controlled entities (net of tax expenses)	X	X
<u>Notes to financial statements</u>		
<i>Summary financial information on jointly controlled entities related to the company's interests:</i>		
- Non-current assets	X	X
- Current assets	X	X
- Non-current liabilities	X	X
- Current liabilities	<u>X</u>	<u>X</u>
- Net assets	<u>X</u>	<u>X</u>
- Income	X	X
- Expenses	<u>X</u>	<u>X</u>
- Profit/(Loss)	<u>X</u>	<u>X</u>

## Intangible Assets (HKAS 38)



# Agenda for HKAS 38



1. Objective and Scope
2. Definition of intangible asset
3. Recognition and measurement
4. Recognition of expense
5. Measurement after recognition
6. Useful life
7. Intangible assets with finite useful lives
8. Intangible assets with indefinite useful lives
9. Impairment
10. Retirements and disposals
11. Disclosure



## 1. Objective and Scope

- HKAS 38 *Intangible Assets*
  - is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard
  - requires an entity to recognise an intangible asset if, and only if, specified criteria are met
  - specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.
- Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting
  - any accumulated amortisation and
  - accumulated impairment losses thereon

# 1. Objective and Scope

- HKAS 38 shall be applied in accounting for intangible assets, except:
  - a) intangible assets that are within the scope of another HKFRSs;
  - b) financial assets, as defined in HKAS 39 *Financial Instruments: Recognition and Measurement*;
  - c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6 *Exploration for and Evaluation of Mineral Resources*); and
  - d) expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

Another  
HKFRSs

# 1. Objective and Scope

Example

How can an intangible asset held under finance lease be accounted for ?

- In the case of a finance lease, the underlying asset may be either
  - tangible or
  - intangible.
- After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with HKAS 38.
- Besides, HKAS 17 specifically excludes rights under licensing agreements for items such as
  - motion picture films,
  - video recordings,
  - plays,
  - manuscripts,
  - patents and
  - copyrights

They are within the scope of HKAS 38.

## 2. Definition of Intangible Assets

An **intangible asset** is

- an identifiable non-monetary asset without physical substance.

Identifiability

An **asset** is a resource:

- a) controlled by an entity as a result of past events; and
- b) from which future economic benefits are expected to flow to the entity.

Control

Future economic benefit

**Monetary assets** are

- money held and assets to be received in fixed or determined amounts of money

In SSAP 29, an intangible asset is defined as

- an identifiable non-monetary asset without physical substance
- held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.



Now, the use of the intangible asset is irrelevant.

## 2. Definition of Intangible Assets

More clarification on its meaning

Identifiability

- An asset meets the Identifiability Criterion in the definition of an intangible asset when it:
  - a) **is separable**
    - i.e. is capable of being separated or divided from the entity, and
    - sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
  - b) **arises from contractual or other legal rights**
    - regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

### 3. Recognition and Initial Measurement

#### General principle

- The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
  - a) the **definition** of an intangible asset (as discussed); and
  - b) the **recognition criteria**
- This requirement applies to
  - costs incurred initially to acquire or internally generate an intangible asset (i.e. initial cost) and
  - those incurred subsequently to add to, replace part of, or service it (i.e. subsequent expenditure).

Implies both initial and subsequent costs with same recognition criteria

### 3. Recognition and Initial Measurement

Recognition criteria (capitalisation) for

Initial Cost

Subsequent Expenditure

**In SSAP 29** Criteria not the same

- Probable that future economic benefits that are attributable to the asset will flow to the enterprise
- Cost measured reliably

- Probable that will enable to generate future economic benefits in excess of its originally assessed standard of performance
- expenditure can be measured and attributed to the asset reliably.

**In HKAS 38** Same criteria

- Probable that the expected future economic benefits that are attributable to the asset will flow to the entity
- Cost measured reliably

**Same criteria applied to both costs**

Expenditure not fulfilling the recognition criteria will be charged to P/L

### 3. Recognition and Initial Measurement

Intangible assets may arise from



1. Separate acquisition
2. Acquisition as part of a business combination
3. Acquisition by way of a government grant
4. Exchange of assets
5. Internally generated goodwill
6. Internally generated intangible assets

### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

- In accordance with HKFRS 3 Business Combinations, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its **fair value** at the acquisition date.
  - The fair value of an intangible asset reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity.
  - In other words, the effect of probability is reflected in the fair value measurement of the intangible asset.
  - Therefore, the probability recognition criterion is always considered to be satisfied for intangible assets acquired in business combinations.

## 3. Recognition and Initial Measurement

### 2. Acquisition as part of a business combination

In accordance with HKAS 38 and HKFRS 3

- an acquirer recognises at the acquisition date separately from goodwill an intangible asset of the acquiree
  - if the asset's fair value can be measured reliably,
  - irrespective of whether the asset had been recognised by the acquiree before the business combination.



Some items, like in-process R&D project,

- that were ineligible for recognition in the acquiree's books if it is generally internally,
- may be recognised by the acquirer (separately from goodwill) in the business combination if the item
  - meets the definition of an intangible asset, and
  - The asset's fair value can be measured reliably.

## 3. Recognition and Initial Measurement

### Case



- Intangible assets should be recognised separately from goodwill in a business combination
  - where they arise from contractual or other legal rights, or
  - if separable .....
- Intangible assets include
  - the value of in-force long-term assurance business,
  - computer software,
  - trade names,
  - mortgage servicing rights,
  - customer lists,
  - core deposit relationships,
  - credit card customer relationships and
  - merchant or other loan relationships.



### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

Fair Value

- The fair value of intangible assets acquire in business combinations can normally be measured with sufficient reliability to be recognised separately from goodwill.
- If it has a finite useful life,
  - there is a rebuttable presumption that its fair value can be measured reliably.



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### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

Fair Value

- The only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination are
  - when the intangible asset arises from legal or other contractual rights and
  - either:
    - a) is not separable; or
    - b) is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would be dependent on immeasurable variables.



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### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

In initially measuring the fair value of an intangible asset

##### Active market exist

- Quoted market prices in an active market provide the most reliable estimate of the fair value of an intangible asset
- The appropriate market price is usually the current bid price.
- If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value,
  - provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

### 3. Recognition and Initial Measurement

#### 2. Acquisition as part of a business combination

In initially measuring the fair value of an intangible asset

##### No active market

- Fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm's length transaction between knowledgeable and willing parties, on the basis of the best information available.
- In determining this amount, an entity considers the outcome of recent transactions for similar assets.

## 3. Recognition and Initial Measurement

### 2. Acquisition as part of a business combination

In initially measuring the fair value of an intangible asset

#### Other Methods

- For example:
  - multiples of revenue, market shares or profit, or
  - discounting estimated future net cash flows
- May be used for initial measurement of an intangible asset acquired in a business combination
  - if the objective is to estimate fair value and
  - if they reflect current transactions and practices in the industry to which the asset belongs.

Can these methods be used in estimating the fair value under the Revaluation Model in subsequent measurement?

**No** ..... Why not?

## 3. Recognition and Initial Measurement



### Beijing Enterprises Holdings Ltd.

- Has early adopted all new HKFRS in 2004 Annual Report and stated its accounting policy on intangible assets as follows:
  - Intangible assets acquired
    - separately are capitalised at cost and
    - from a business acquisition are capitalised at fair value as at the date of acquisition.
  - Following initial recognition, the cost model is applied to the class of intangible assets.
  - Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the year in which the expenditure is incurred.

## 3. Recognition and Initial Measurement

2. Acquisition as part of a business combination

1. Separate acquisition

Both may result in the recognition of an in-process R&D project

- But how should the subsequent expenditure on such acquired in-process R&D project be recognised?
  - Such [research or development expenditure](#) that is incurred after the acquisition of that in-process R&D project shall be accounted for
    - in the same practice as other research or development expenditure (or internally generated intangible assets), i.e. the practice to be discussed later in →

6. Internally generated intangible assets

## 4. Recognition of Expense

Example

- The intangible assets of Issue are the data purchase and data capture costs of internally developed databases and are capitalised as development expenditure and written off over 4 years.
- HKAS 38 sets out the criteria that should be met in order to recognise an internally generated intangible asset.
- As regards development costs, the company is required to demonstrate that the intangible asset will generate net cash inflows in excess of the cash outflows (future economic benefit!).
- Also development costs of an asset, which have been recognised, are subject to an impairment test under HKAS 36 Impairment of Assets.
- The criteria to recognise these costs used by Issue will need to be scrutinised but it appears at first sight that these costs should have been written off.

(ACCA 2003.06)

## 4. Recognition of Expense

- Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:
  - a) it forms part of the cost of an intangible asset that meets the recognition criteria; or
  - b) the item is acquired in a business combination and cannot be recognised as an intangible asset.



If this is the case, this expenditure (included in the cost of the business combination) shall form part of the amount attributed to goodwill at the acquisition date.

- Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

## 5. Measurement after Recognition

- An entity shall choose either:

**Cost Model**

**Revaluation Model**

as its accounting policy

- If an intangible asset is accounted for using the revaluation model,
  - all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.

An active market is a market in which all the following conditions exist:

- a) the items traded in the market are homogeneous;
- b) willing buyers and sellers can normally be found at any time; and
- c) prices are available to the public.

## 5. Measurement after Recognition

### Cost Model

- After initial recognition, an intangible asset shall be carried at its cost

### Revaluation Model

- less any accumulated depreciation and any accumulated impairment losses
- After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation,
  - less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.
- For the purpose of revaluations under IAS 38, fair value shall be determined by reference to an active market.
- Revaluations shall be made with such regularity that at the balance sheet date the carrying amount of the asset does not differ materially from its fair value.

## 6. Useful Life

- No matter, which of the following model is used by an entity:

Cost Model

or

Revaluation Model

- HKAS 38 sets out that an entity shall assess whether the useful life of an intangible asset is

Finite

or

Indefinite

New Concept

If finite

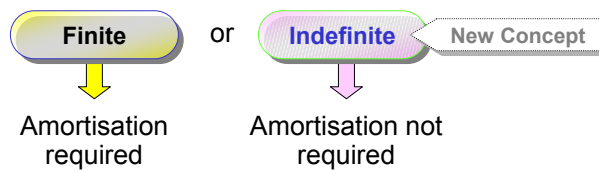
- the length of, or number of production or similar units constituting, that useful life.

An intangible asset has an indefinite useful life when

- based on an analysis of all of the relevant factors
- there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

## 6. Useful Life

- The accounting for an intangible asset is based on its useful life.
  - Many factors are considered in determining the useful life of an intangible asset.



## 6. Useful Life

- The term 'indefinite' does not mean 'infinite'.
- The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level.



- A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

## 6. Useful Life

### Intangible asset arising from contractual or other legal rights

- The useful life of such intangible asset
  - shall not exceed the period of the contractual or other legal rights,
  - but may be shorter depending on the period over which the entity expects to use the asset.



- If the contractual or other legal rights can be renewed, the useful life of the intangible asset shall include the renewal period only if
  - there is evidence to support renewal by the entity without significant cost.

## 6. Useful Life

### Example

- A direct-mail marketing company
  - acquires a customer list and
  - expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years.

- The customer list would be amortised over management's best estimate of its useful life (say 18 months).
- Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired.
- The customer list also would be reviewed for impairment in accordance with HKAS 36 *Impairment of Assets*
  - by assessing at each reporting date whether there is any indication that the customer list may be impaired.



## 6. Useful Life

### Example

- An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

- The copyright would be amortised over its 30-year estimated useful life.
- The copyright also would be reviewed for impairment in accordance with HKAS 36
  - by assessing at each reporting date whether there is any indication that it may be impaired.

## 7. Finite Useful Life

### Amortisation

- The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.
  - Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.
- **Amortisation**
  - shall begin when the asset is available for use,
    - i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.
  - shall cease at the earlier of
    - the date that the asset is classified as held for sale (or included in a disposal group held for sale) in accordance with HKFRS 5 and
    - the date that the asset is derecognised.

## 7. Finite Useful Life

Amortisation

Amortisation Method

- The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
  - If that pattern cannot be determined reliably, the straight-line method shall be used.
- The amortisation charge for each period shall be recognised in profit or loss unless this or another Standard permits or requires it to be included in the carrying amount of another asset.

Say PPE or Inventories

## 7. Finite Useful Life

Amortisation

Amortisation Method

Residual Value

- The residual value of an intangible asset is the estimated amount that
  - an entity would currently obtain from disposal of the asset,
  - after deducting the estimated costs of disposal, if the asset were
    - already of the age and
    - in the condition expected at the end of its useful life.
- The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:
  - a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
  - b) there is an active market for the asset and:
    - i) residual value can be determined by reference to that market; and
    - ii) it is probable that such a market will exist at the end of the asset's useful life

## 7. Finite Useful Life

- The residual value is reviewed at least at each financial year-end.
  - A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with HKAS 8.
- In addition, the amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end.
  - If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly.
  - If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortization method shall be changed to reflect the changed pattern.
  - Such changes shall be accounted for as changes in accounting estimates in accordance with HKAS 8.

Amortisation

Amortisation Method

Residual Value

## 8. Indefinite Useful Life

- An intangible asset with an indefinite useful life shall not be amortised.
- In accordance with HKAS 36 *Impairment of Assets*
  - an entity is required to test an intangible asset with an indefinite life for impairment by comparing its recoverable amount with its carrying amount
    - a) annually, and
    - b) whenever there is an indication that the intangible asset may be impaired.

Indefinite

New Concept

## 8. Indefinite Useful Life

- The useful life of such intangible asset shall be reviewed each period
  - to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset.
  - If they do not (support an indefinite useful life assessment for that asset)
    - such change in the useful life assessment shall be accounted for as a change in an accounting estimate in accordance with HKAS 8

Indefinite

New Concept

Be careful .....

- In accordance with HKAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired.
  - As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with HKAS 36, with its carrying amount, and recognising any impairment loss.

## 8. Indefinite Useful Life

Example

### Assessing the useful lives of intangible assets

- The broadcasting licence is renewable every 10 years if the entity
  - provides at least an average level of service to its customers and
  - complies with the relevant legislative requirements.
- The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition.
- The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so.
- Historically, there has been no compelling challenge to the licence renewal.
- The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future.
- Therefore, the licence is expected to contribute to the entity's net cash inflows indefinitely.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- The broadcasting licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's net cash inflows indefinitely.
- Therefore, the licence would not be amortised until its useful life is determined to be finite.
- The licence would be tested for impairment in accordance with HKAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- Same as previous example
- The licensing authority subsequently decides that it will no longer renew broadcasting licences, but rather will auction the licences.
- At the time the licensing authority's decision is made, the entity's broadcasting licence has three years until it expires.
- The entity expects that the licence will continue to contribute to net cash inflows until the licence expires.

- Because the broadcasting licence can no longer be renewed, its useful life is no longer indefinite.
- Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment in accordance with HKAS 36.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- The route authority may be renewed every 5 years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal.
- Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations.
- The acquiring entity
  - expects to provide service indefinitely between the 2 cities from its hub airports and
  - expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority.
- An analysis of demand and cash flows supports those assumptions.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life.
- Therefore, the route authority would not be amortised until its useful life is determined to be finite.
- It would be tested for impairment in accordance with HKAS 36
  - annually and
  - whenever there is an indication that it may be impaired.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- Entity A has a trademark with a remaining legal life of 5 years but it is renewable every 10 years at little cost.
- Entity A intends to renew the trademark continuously and evidence supports its ability to do so.
- An analysis of
  - 1) product life cycle studies,
  - 2) market, competitive and environmental trends, and
  - 3) brand extension opportunitiesprovides evidence that the trademarked product will generate net cash inflows for Entity A for an indefinite period.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

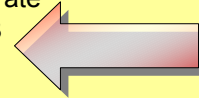
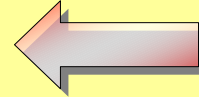
- The trademark would be treated as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely.
- Therefore, the trademark would not be amortised until its useful life is determined to be finite.
- It would be tested for impairment in accordance with HKAS 36 annually and whenever there is an indication that it may be impaired.

## 8. Indefinite Useful Life

### Example

#### Assessing the useful lives of intangible assets

- Entity B has a trademark with a remaining legal life of 5 years but it is renewable every 10 years through an open bidding process.
- Entity B intends to renew the trademark continuously and evidence supports its ability to win in the open bidding process.
- An analysis of
  - 1) product life cycle studies,
  - 2) market, competitive and environmental trends, and
  - 3) brand extension opportunitiesprovides evidence that the trademarked product will generate cash inflows for Entity B for an indefinite period (if Entity B can win in the open bidding process).



## 8. Indefinite Useful Life

### Case

ESPRIT

#### Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003
- Begin to adopt all the new/revised IFRS in 2004 Annual Report
  - On the first time adoption of IFRS, the Group reassessed the useful life of previously recognised intangible assets.
  - As a result of this assessment, the acquired Esprit trademarks were classified as an indefinite-lived intangible asset in accordance with IAS 38 *Intangible Assets*.
  - This conclusion is supported by the fact that Esprit trademark legal rights are capable of being renewed indefinitely at insignificant cost and therefore are perpetual in duration, relate to a well known and long established fashion brand since 1968, and based on future financial performance of the Group, they are expected to generate positive cash flows indefinitely.



## 9. Impairment Losses

- To determine whether an intangible asset is impaired, an entity applies HKAS 36 *Impairment of Assets*, that explains
  - when and how an entity reviews the carrying amount of its assets,
  - how it determines the recoverable amount of an asset and
  - when it recognises or reverses an impairment loss.
- In HKAS 36, under normal situation

### Triggering events

- An entity shall assess at each reporting date whether there is any indication that an asset may be impaired.
- If any such indication exists, the entity shall estimate the recoverable amount of the asset.

## 9. Impairment Losses

- However, irrespective of whether there is any indication of impairment, an entity shall also:
  - a) test
    - an intangible asset with an indefinite useful life, or
    - an intangible asset not yet available for use

for impairment annually by comparing its carrying amount with its recoverable amount.

### Triggering events

## 9. Impairment Losses

### Case



- Assets that have an indefinite useful life
  - are tested for impairment annually.
- Assets that are subject to depreciation and amortisation
  - are reviewed to determine whether there is any indication that the carrying value of these assets may not be recoverable and have suffered an impairment loss.
- If any such indication exists
  - the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.
  - The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.
  - Such impairment loss is recognised in the consolidated profit and loss account
    - except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that asset, in which case it is treated as a revaluation decrease.

## 9. Impairment Losses



### Timing of impairment test on intangible assets

- This impairment test may be performed at any time during an annual period
  - provided it is performed at the same time every year.
- Different intangible assets may be tested for impairment at different times.
- However, if such an intangible asset was initially recognised during the current annual period
  - that intangible asset shall be tested for impairment before the end of the current annual period.

## 9. Impairment Losses

### Case



- Intangible assets that have an indefinite useful life, or are not yet ready for use
  - are tested for impairment annually.
- This impairment test
  - may be performed at any time during an annual period,
  - provided it is performed at the same time every year.
- An intangible asset recognised during the current period
  - is tested before the end of the current annual period.

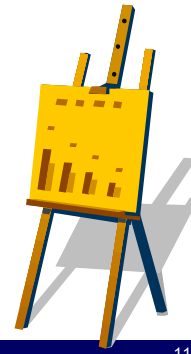
## 10. Retirements and Disposals

- An intangible asset shall be derecognised:
  - a) on disposal; or
  - b) when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset.
- It shall be recognised in profit or loss when the asset is derecognised (unless HKAS 17 *Leases* requires otherwise on a sale and leaseback).
- Gains shall not be classified as revenue.



## 11. Disclosures

- HKAS 38 introduces some additional disclosure requirements
- Changes are mainly amendments for the changes on finite and indefinite useful life
- Disclosures can be divided into disclosures for:
  - General aspects for all intangible assets
  - Intangible assets measured at revalued amount
  - Research and development expenditure
  - Other information

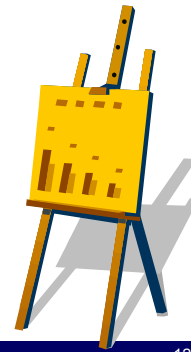


## 11. Disclosures

### General aspects

An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

- a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used;
- b) the amortisation methods used for intangible assets with finite useful lives;
- c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- d) the line item(s) of the income statement in which any amortisation of intangible assets is included;
- e) a reconciliation of the carrying amount at the beginning and end of the period showing details of movements



# 11. Disclosures

## General aspects

An entity shall also disclose:

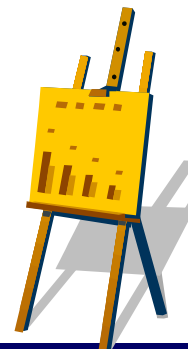
- a) for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life.  
In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.
- b) a description, the carrying amount and remaining amortisation period of any individual material intangible asset.
- c) the details for intangible assets acquired by way of a government grant and initially recognised at fair value.
- d) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.
- e) the amount of contractual commitments for the acquisition of intangible assets.



# 11. Disclosures

## Intangible assets measured at revalued amount

- If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:
  - a) by class of intangible assets:
    - i) the effective date of the revaluation;
    - ii) the carrying amount of revalued intangible assets; and
    - iii) the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model;
  - b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders; and
  - c) the methods and significant assumptions applied in estimating the assets' fair values.



# 11. Disclosures

## Research and development expenditure

- An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

## Other Information

- An entity is encouraged, but not required, to disclose the following information:
  - a) a description of any fully amortised intangible asset that is still in use; and
  - b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in HKAS 38 (or because they were acquired or generated before the version of SSAP 29 Intangible Assets issued in 2001 was effective).



# 11. Disclosures

## Case

ESPRIT

### Esprit Holdings Limited

- Adopted HK GAAP to 30 June 2003
- Begin to adopt all the new/revised IFRS in 2004 Annual Report
  - On the first time adoption of IFRS, the Group reassessed the useful life of previously recognised intangible assets.
  - As a result of this assessment, the acquired Esprit trademarks were classified as an indefinite-lived intangible asset in accordance with IAS 38 *Intangible Assets*.
  - This conclusion is supported by the fact that Esprit trademark legal rights are capable of being renewed indefinitely at insignificant cost and therefore are perpetual in duration, relate to a well known and long established fashion brand since 1968, and based on future financial performance of the Group, they are expected to generate positive cash flows indefinitely.

## 11. Disclosures

### Case

ESPRIT

#### Esprit Holdings Limited

- This view is supported by an independent professional appraiser, who has been appointed by the Group to perform an assessment of the useful life of Esprit trademarks in accordance with the requirements set out in IAS 38.
- Having considered the factors specific to the Group, the appraiser opined that Esprit trademarks should be regarded as an intangible asset with an indefinite useful life.
- Under IAS 38, the Group reevaluates the useful life of Esprit trademarks each year to determine whether events or circumstances continue to support the view of indefinite useful life for this asset.

Only these ..... those required by HKAS 36 for impairment testing should be disclosed too

## 11. Disclosures

### Case

ESPRIT

#### Esprit Holdings Limited

- In accordance with IAS 36, the Group completed its annual impairment test for Esprit trademarks by comparing their recoverable amount to their carrying amount as at June 30, 2004.
- The Group appointed independent professional valuers to conduct a valuation of the Esprit trademarks as one corporate asset based on value-in-use calculation.
- The resulting value of the Esprit trademarks as at June 30, 2004 was significantly higher than their carrying amount.

Only these .....

## 11. Disclosures

### Case

ESPRIT

#### Esprit Holdings Limited

- This valuation uses cash flow projections based on financial estimates covering a three-year period, expected royalty rates deriving from the Esprit trademarks in the range of 3% to 8% and a discount rate of 14%.
- The cash flows beyond the three-year period are extrapolated using a steady 3% growth rate.
- This growth rate does not exceed the long-term average growth rate for apparel markets in which the Group operates.
- Management has considered the above assumptions and valuation and also taken into account the business expansion plan going forward, the current wholesale order books and the strategic retail expansion worldwide and believes that there is no impairment in the Esprit trademarks.
- Management believes that any reasonably foreseeable change in any of the above key assumptions would not cause the aggregate carrying amount of trademarks to exceed the aggregate recoverable amount.

## 11. Disclosures

### Case

ESPRIT

#### Esprit Holdings Limited

- In 2004, as a result of the adoption of IFRS 3, IAS 36 and IAS 38
  - Depreciation reduced (profit increased) by **HK\$ 106 million**
  - Trademarks increased by **HK\$ 86 million**
  - Goodwill arising on the acquisition of Red Earth fully impaired with a loss of **HK\$ 15 million**



# HKAS 31 and 38 and HK(SIC)–Int 13

5 August 2006

Full version of slides in PDF can be found in [www.NelsonCPA.com.hk](http://www.NelsonCPA.com.hk)



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