Financial Reporting Update 2012

11 December 2012

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Effective for 2012 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets*	➢ 1 Jul. 2011
• Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards — Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*	➢ 1 Jul. 2011
• Amendments of HKAS 12 *Deferred Tax: Recovery of Underlying Assets*	➢ 1 Jan. 2012

Effective for 2013 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• HKFRS 10 *Consolidated Financial Statements*	➢ 1 Jan.2013
• HKFRS 11 *Joint Arrangements*	➢ 1 Jan.2013
• HKFRS 12 *Disclosure of Interests in Other Entities*	➢ 1 Jan.2013
• HKFRS 13 *Fair Value Measurement*	➢ 1 Jan.2013
• HKAS 1 (revised) *Presentation of Items of OCI*	➢ 1 Jul. 2012
• HKAS 19 (revised) *Employee Benefits*	➢ 1 Jan. 2013
• HK(IFRIC) – Int 20 *Stripping Costs in the Production Phase of a Surface Mine*	➢ 1 Jan. 2013
• Amendments to HKFRS 7 *Financial Instruments: Disclosures – Disclosures - Offsetting Financial Assets and Financial Liabilities*	➢ 1 Jan. 2013
• Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards – Government Loans*	➢ 1 Jan. 2013
• Annual Improvements 2009-2011 Cycle	➢ 1 Jan. 2013
• Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance	➢ 1 Jan. 2013

Effective after 2013 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• HKFRS 9 *Financial Instruments*	➢ 1 Jan.2015
• Amendments to HKAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*	➢ 1 Jan.2014
• Amendments to HKFRS 9 *Financial Instruments and HKFRS 7 – Mandatory Effective Date of HKFRS 9 and Transition Disclosures*	➢ 1 Jan.2015

Today's Agenda

Recap of Amendments to HKFRS effective for 2012/13

Update of Amendments to HKFRS/IFRS effective after y.e. 31 December 2013

Recovery of Underlying Asset

(Amendments to HKAS 12 Income Tax)

Introduction

- HKAS 12 *Income Taxes* requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through
  - use or sale.
- It can be difficult and subjective to assess whether recovery will be through use or through sale
  - when the asset is measured using the fair value model in HKAS 40 Investment Property.
- The amendment provides a practical solution to the problem
  - by introducing a presumption that recovery of the carrying amount will, normally be, be through sale.

No such exemption for PPE using revaluation model under HKAS 16

Recovery of Underlying Asset

- If a deferred tax liability or asset arises from investment property that is measured using the **fair value model** in HKAS 40,
  - there is a **rebuttable presumption** that the carrying amount of the investment property will be recovered through sale.
- Accordingly, unless the presumption is rebutted,
  - the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property **entirely through sale**. (HKAS 12.51C)

i.e. no deferred tax is required when tax on sale is zero!

- This presumption is rebutted if the investment property
  - is depreciable and
  - is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.
- If the presumption is rebutted, the requirements of HKAS 12. 51 and 51A shall be followed.

Effective Date and Transition

- An entity shall apply the amendments for annual periods beginning on or after 1 January 2012.
- Earlier application is permitted.
- If an entity applies the amendments for an earlier period, it shall disclose that fact.

IFRS/HKFRS Issued in 2011

On 12 May 2011

- The IASB issued 4 new IFRS ……
  - IFRS 10 *Consolidated Financial Statements*
  - IFRS 11 *Joint Arrangements*
  - IFRS 12 *Disclosure of Interests in Other Entities*
  - IFRS 13 *Fair Value Measurement*

On 16 June 2011

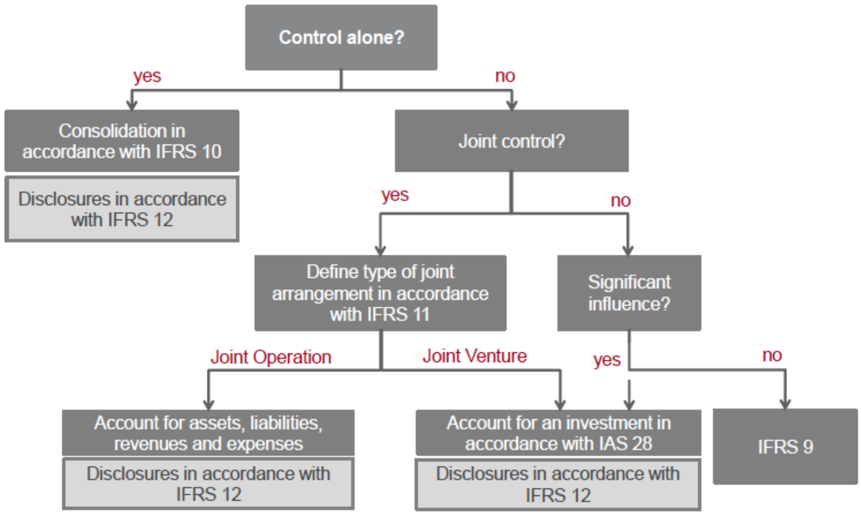
- The IASB amended 2 other IFRS
  - IAS 1 Presentation of Financial Statements
  - IAS 19 Employee Benefits

On 24 June and 14 July 2011

- The HKICPA issued the same in HKFRS and HKAS

Briefing on HKFRS 10, 11 and 12

Interaction between IFRS/HKFRS 10, 11 and 12 and IAS/HKAS 28



HKFRS 10 Consol. Financial Statements

Case

Cheung Kong (Holdings) Limited

- 長實換核數師　擬準備重組
  (《爽報》2012.04.11)
  – 長實（001）昨發通函，建議委任羅兵咸為公司新核數師，取代已沿用了逾40年的德勤，而羅兵咸則一直是同系和黃（013）的核數師 。
  – 有資深執業會計師估計(?)，此舉措不排除是為整個長和系重組作準備。
  – 資深執業會計師林智遠表示，由於新會計準則《香港財務報告準則10號》將於明年1月1日生效，而該新準則主要是要同系上市公司之間的關係釐清，而長實與和黃一直是聯營公司關係，所以是次長實換了與和黃同一核數師，不排除就是為該新準則生效前作重組而準備。
  – 不過，長實副董事總經理葉德銓昨傍晚於電話會議中表示，目前並無計劃將長實與和黃進行重組，更換核數師並非為了易於重組，也不擔心兩公司起用同一核數師會影響兩者的透明度及獨立性。

Consolidated Financial Statements
(HKFRS 10)

HKFRS 10 Consol. Financial Statements

- The IASB explains that
  - The application of IAS 27 and SIC-12 revealed inconsistent application in a number of areas:
    - Applying the definition of control: the perceived conflict of emphasis between
      - IAS 27 (power to govern financial and operating policies) and
      - SIC-12 (risks and rewards)

      led to inconsistent application of the definition of control for different types of entities.
    - Control without a majority of voting rights: because IAS 27 does not provide explicit guidance in this area, similar relationships between entities were being accounted for differently.
    - Agency relationships: the lack of guidance for these relationships meant that similar transactions (e.g. those involving funds or investment conduits) were being accounted for differently.
  - Instead, IFRS 10 contains a single consolidation model that identifies control as the basis for consolidation for all types of entities
    - Also providing additional application guidance, will increase consistent application in these areas.

HKFRS 10 Consol. Financial Statements

- While HKFRS 10 become effective,
  - HKAS 27 becomes "separate financial statements"
- Indicator still refers to "**control**" but ……
- An investor, regardless of the nature of its involvement with an entity (the investee),
  - shall determine whether it is a parent by assessing whether it controls the investee. (HKFRS 10.5)
- An investor controls an investee when
  - it is exposed, or has rights, to variable returns from its involvement with the investee and
  - has the ability to affect those returns through its power over the investee. (HKFRS 10.6)

Control

- Thus, an investor controls an investee if and only if the investor has all the following:
  - **a.** **power** over the investee;
  - **b.** **exposure**, or **rights**, to **variable returns** from its involvement with the investee; and
  - c. the **ability to use its power** over the investee to **affect** the amount of the investor's **returns** (HKFRS 10.7)

Power is defined as "existing rights that give the current ability to direct the *relevant activities*"

relevant activities are "activities of the investee that significantly affect the investee's returns"

Rights include
- voting rights, potential voting rights, proportionate voting rights, substantive rights, removal rights, decision-making rights, protective rights, contractual rights ……

Control

- An investor shall consider all facts and circumstances when assessing whether it controls an investee.
  - The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed as above. (HKFRS 10.8)

Power

Returns

Link between Power & Returns

Control

- Consideration of the following factors may assist in making the determination whether an investor controls an investee:
  a. the purpose and design of the investee;
  b. what the relevant activities are and how decisions about those activities are made;
  c. whether the rights of the investor give it the current ability to direct the relevant activities;
  d. whether the investor is exposed, or has rights, to variable returns from its involvement with the investee; and
  e. whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns. (HKFRS 10.B3)

Power

Returns

Link between Power & Returns

Control

- An investor has power over an investee when the investor has existing rights that give it the current ability to direct the ***relevant activities***,
  - i.e. the activities that significantly affect the investee's returns (HKFRS 10.10)
- Power arises from rights.
  - Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings.
  - In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements (HKFRS 10.11)

Power

Existing Rights

Current Ability

relevant activities

Control

Example

- Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:
  a. selling and purchasing of goods or services;
  b. managing financial assets during their life (including upon default);
  c. selecting, acquiring or disposing of assets;
  d. researching and developing new products or processes; and
  e. determining a funding structure or obtaining funding. (HKFRS 10.B11)

Power

relevant activities

Control

Example

- Examples of <u>decisions</u> about relevant activities include but are not limited to:
  a. establishing <u>operating and capital decisions</u> of the investee, including budgets; and
  b. <u>appointing and remunerating</u> an investee's <u>key management personnel</u> or service providers and <u>terminating</u> their services or employment. (HKFRS 10.B12)

Power

relevant activities

Control

- Power arises from rights.
- The rights that may give an investor power can differ between investees. (HKFRS 10.B14)

Power

Existing Rights

Control

Example

Power

Existing Rights

- Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:
  a. rights in the form of voting rights (or potential voting rights) of an investee;
  b. rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
  c. rights to appoint or remove another entity that directs the relevant activities;
  d. rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
  e. other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.
  (HKFRS 10.B15)

Control

Example

Power

Existing Rights

- Examples of evidence that the investor's rights are sufficient to give it power over the investee:
  a. Appoint or approve the investee's key management personnel (KMP) who have the ability to direct the relevant activities.
  b. Direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor.
  c. Dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
  d. KMP are related parties of the investor (e.g. the same CEO of the investee and of the investor).
  e. The majority of the members of the investee's governing body are related parties of the investor.
  (HKFRS 10.B18)

Greater weight is given to the list of evidence when considering power

Control

Example

Power

Existing Rights

- The following indicator suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:
  a. The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor.
  b. The investee's operations are dependent on the investor, such as in the following situations:
     i. The investee depends on the investor to fund a significant portion of its operations.
     ii. The investor guarantees a significant portion of the investee's obligations.
     iii. The investee depends on the investor for critical services, technology, supplies or raw materials.

Control

Example

Power

Existing Rights

iv. The investor controls assets such as licences or trademarks that are critical to the investee's operations.

v. The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.

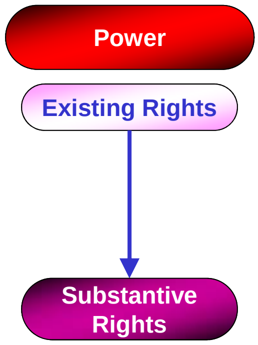
c. A significant portion of the investee's activities either involve or are conducted on behalf of the investor.

d. The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights.

e.g. there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee. (HKFRS 10.B19)

Control

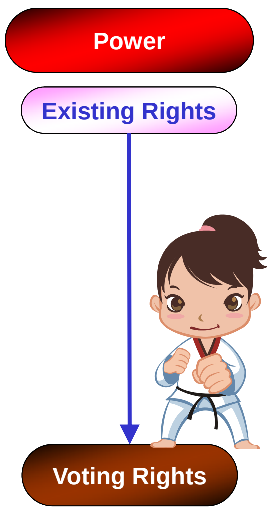
- An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others).
- For a right to be substantive,
  - the holder must have the practical ability to exercise that right. (HKFRS 10.B22)



Control

Example

- An investor acquires 48% of the voting rights of an investee.
- The remaining voting rights are held by thousands of shareholders, none individually holding more than 1% of the voting rights.
- None of the shareholders has any arrangements to consult any of the others or make collective decisions.
- When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48% interest would be sufficient to give it control.
- In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power. (HKFRS 10 Example 4)



Control

Case

Cheung Kong (Holdings) Limited

Group Structure (as at 30.9.2012)

Control

- When assessing whether an investor has control of an investee,
  - the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.
- An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance.
  - The investor's returns can be only positive, only negative or both positive and negative (HKFRS 10.15)

Power

Returns

Control

- An investor controls an investee if the investor
  - not only has power over the investee and exposure or rights to variable returns from its involvement with the investee,
  - but also has the ability to use its power to affect the investor's returns from its involvement with the investee (HKFRS 10.17)
- Thus, an investor with decision-making rights shall determine whether it is
  - a **principal** or
  - an **agent**.
    - An investor that is an agent in accordance with HKFRS 10.B58–B72 does not control an investee when it exercises decision-making rights delegated to it (HKFRS 10.18)

Power

Returns

Link between Power & Returns

Control

Case

Cheung Kong (Holdings) Limited

- 瑞信:長實換核數師純為迎接新會計準則 (《信報》 2012.04.12)
  - 長實日前宣布棄用德勤，改用跟和黃(00013)一樣的核數師羅兵咸，瑞信認為是為明年生效的新會計準則作準備，屆時和黃的負債亦要全面併入長實，故採用同一核數師會更有效率。
  - 瑞信指出，基於和黃負債高，在新會計準則下，長實的淨負債比率會被扯高，以上年度為例，會由8%升至53%，該行初步認同長實管理層早前講法，相信借貸成本不會因而上升，但實際情況仍要視乎債權人反應。
  - 瑞信認為，淨負債比率在新例下急升，不足以驅使長實進行架構重組，反而股價較資產淨值大幅折讓逾60%，遠高於歷史平均值的30%，或成為重組誘因。

Control

Case

Cheung Kong (Holdings) Limited

- 瑞信:長實換核數師純為迎接新會計準則 (《信報》 2012.04.12)
  - 該行指，要縮窄股價對資產淨值折讓幅度，長實或把持有的和黃股份直接分派予股東，又或把地產業務分拆並派送予股東，但就相信架構重組短期內不會發生。
  - 不過，基於存在重組機會，加上長實今年有多個新盤推售，和黃業務表現又強勁，瑞信重申，長實是本地地產股中的首選。

Control

Case

Cheung Kong (Holdings) Limited

- 瑞信：長實換核數師料為新會計準則 (《經濟日報》 2012.04.12)
  - 長實（00001）周二宣布，建議將聘用近40年的德勤·關黃陳方會計師行換走，改用羅兵咸永道，與和黃（00013）看齊。消息令長實連日受壓，今早仍逆市微挫0.15%。雖然更換核數師令市場不安，但瑞信認為，此舉可能只是為新會計準則作準備。
  - 瑞信指出，在新會計準則HKFRS10之下，和黃的資產負債表將併入長實，而兩家公司用同一家核數師行，將便利資產負債表合併。該行補充指，新會計準則將於2013年1月生效，該準則將看重母公司的「控制」多於其於子公司取得多少經濟利益。

?

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Control as the basis for consolidation • HKAS 27 identifies control as the basis for consolidation and focuses on the power to govern the financial and operating policies for assessing control of typical operating entities. • In contrast, HK(SIC)-Int 12 focuses on risks and rewards for assessing control of special purpose entities.	**HKFRS 10 identifies control as the single basis for consolidation for all types of entities.** • There is no separate guidance with a different consolidation model for special purposes entities (as incorporated into the single consolidation model in IFRS 10) • The new control definition reflects that an investor <u>can achieve power over an investee in many ways</u>, <u>not just through governing financial and operating policies</u>. • The investor must assess whether it has <u>rights to direct the relevant activities</u>. • Although exposure to risks and rewards is an indicator of control, it is not the sole focus for consolidation for any type of entity.

The table is adapted from the IASB

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Control without a majority of voting rights • Although the idea that an investor could control an investee while holding less than 50% of the voting rights was implicit in HKAS 27, it was not explicitly stated.	**HKFRS 10 states that an investor can control an investee with less than 50% of the voting rights of the investee.** • HKFRS 10 <u>provides specific application</u> guidance for assessing control in such cases.

The table is adapted from the IASB

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Potential voting rights • Only *currently exercisable* potential voting rights are considered when assessing control.	**Potential voting rights need to be considered in assessing control, but only if they are *substantive*.** • Potential voting rights are substantive – when the holder has the practical ability to exercise its rights and – when those rights are exercisable when decisions about the direction of the relevant activities need to be made. – Deciding whether potential voting rights are substantive requires judgement. • Potential voting rights may need to be considered even if they are not currently exercisable.

HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Agency relationships • HKAS 27 has no specific guidance regarding situations when power is delegated by a principal to an agent.	**HKFRS 10 contains specific application guidance for agency relationships.** • When decision-making authority has been delegated by a principal to an agent, an agent in such a relationship does not control the entity. • The principal that has delegated the decision-making authority would consolidate the entity. • The application guidance offers a range of factors to consider and contains examples.

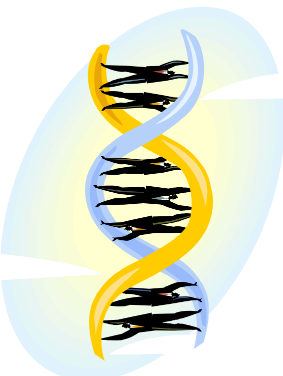
HKFRS 10 Summary of Key Changes

HKAS 27 & HK(SIC)-Int 12	HKFRS 10 (and 12)
Disclosures • HKAS 27 and HK(SIC)-Int 12 contain limited disclosure requirements for consolidated entities and no disclosure requirements for unconsolidated structured entities.	**HKFRS 12 expands the disclosure requirements for both consolidated entities and unconsolidated structured entities.** • The disclosure objectives in HKFRS 12 will give preparers flexibility to tailor their individual disclosures to meet these objectives. • HKFRS 12 presents a single disclosure standard for reporting entities with special relationships with other entities, including subsidiaries, joint ventures, associates and unconsolidated structured entities.

The table is adapted from the IASB

HKFRS 10: Accounting Requirements

- A parent shall prepare **consolidated financial statements**
  - using uniform accounting policies for like transactions and other events in similar circumstances (HKFRS 10.19)
- Consolidation of an investee shall
  - begin from the date the investor obtains control of the investee and
  - cease when the investor loses control of the investee (HKFRS 10.20)
- HKFRS 10.B86–B93 set out guidance for the preparation of consolidated financial statements (HKFRS 10.21)



HKFRS 10: Effective Date

- An entity shall apply HKFRS 11 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- If an entity applies HKFRS 10 earlier, it shall disclose that fact and apply HKFRS 11, HKFRS 12 , HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) at the same time.
(HKFRS 10.C1)

HKFRS 10: Real Case

Case

Cheung Kong (Holdings) Limited

- 公司重新分類 影響入帳方式
(《經濟日報》《三十七計》楊青峰 2012.04.18)
  - 根據長實的財務報表附錄二，長實間接擁有和黃已發行普通股股權的49.9%，故分類和黃為長實的聯營公司 … 根據《香港會計準則27》通常指那些被母公司持有50%以上表決權的公司，這另一公司就是母公司的附屬公司，母公司是要把所有附屬公司的財務報告，逐項逐項合併入母公司的綜合財務報告（consolidated financial statements）內。
  - 可是，由於《香港財務報告準則10》將於明年開始生效，代替大部分原《香港會計準則27》的要求，母公司不可再單純以擁有一間公司50%以上的表決權，去決定這間公司是受母公司「控制」。故此，長實雖然並沒有擁有和黃50%以上的表決權，但分析員普遍估計和黃有可能被當為受長實的「控制」，而和黃亦可能被重新分類為長實的附屬公司（subsidiary）。

HKFRS 10: Real Case

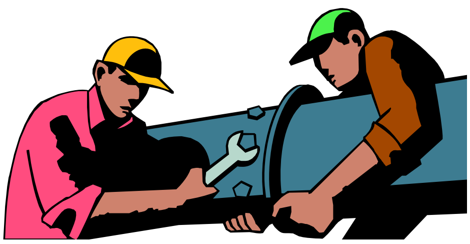
Case

Cheung Kong (Holdings) Limited

- 公司重新分類 影響入帳方式
  (《經濟日報》《三十七計》楊青峰 2012.04.18)
  – 假設長實不能把和黃分類為聯營公司，要重新分類和黃為附屬公司，結果就如分析員的估計一樣，和黃的負債要全面併入長實的綜合財務報表。2011年底，長實的總負債是589億港元，和黃的總負債是3,218億港元，綜合財務狀況表的總負債將上升五倍以上。

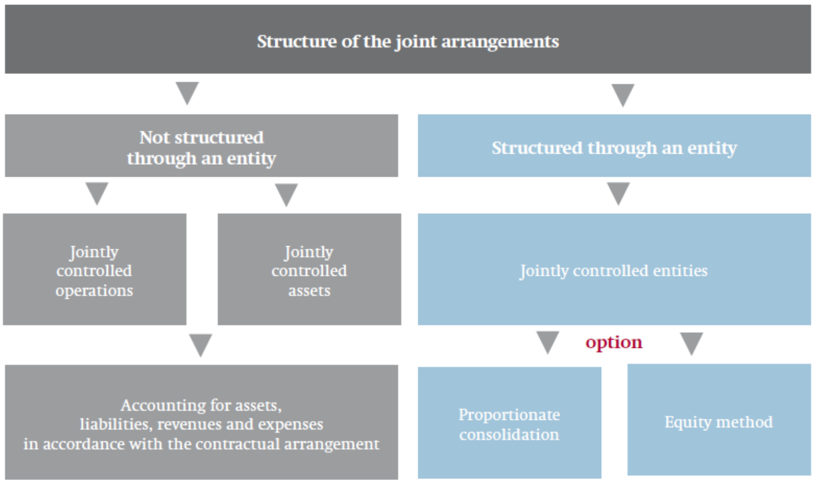
Joint Arrangement

(HKFRS 11)



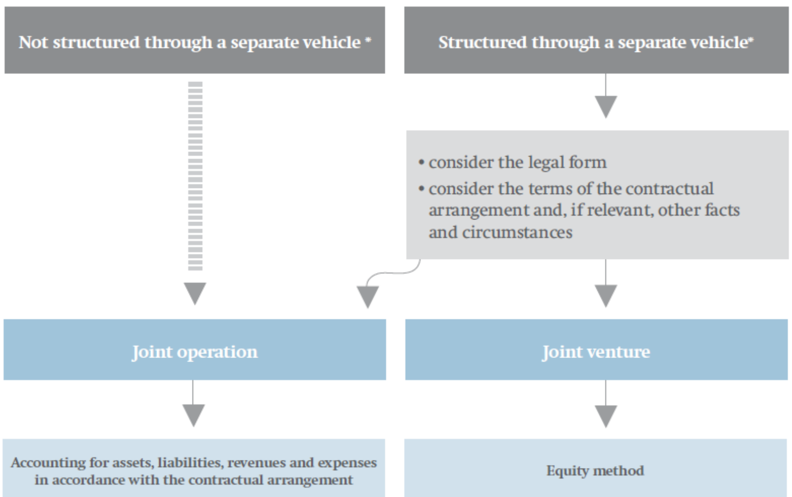
HKFRS 11 Joint Arrangements

Previously in HKAS 31



HKFRS 11 Joint Arrangements

Introduced and amended in HKFRS 11



HKFRS 11 Joint Arrangements

- **Joint Arrangement**,
  - a new name to subrogate joint venture, simultaneously, joint venture has another meaning now
  - is defined to be an arrangement of which two or more parties have **joint control**.
  - has the following characteristics:
    a. The parties are bound by a contractual arrangement .
    b. The contractual arrangement gives two or more of those parties joint control of the arrangement.
    (HKFRS 11.4-5)

Joint control is defined as
- the contractually agreed sharing of control of an arrangement,
- which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

HKFRS 11 Joint Arrangements

- In consequence, joint arrangement is a new name to subrogate joint venture,
  - simultaneously, joint venture has another meaning now
- A new structure in classification, a joint arrangement is either
  (HKFRS 11.6)

Joint Operation

Joint Venture

- An entity shall determine the type of joint arrangement in which it is involved.
- The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.
  (HKFRS 11.14)

HKFRS 11 Joint Arrangements

Joint Operation

Joint Venture

- When making assessment the rights and obligations arising from the arrangement, an entity shall consider the following:
  a. the structure of the joint arrangement
  b. when the joint arrangement is structured through a separate vehicle:
     i. the legal form of the separate vehicle;
     ii. the terms of the contractual arrangement; and
     iii. when relevant, other facts and circumstances. (HKFRS 11.B15)

HKFRS 11 Joint Arrangements

Joint Operation

Joint Venture

A joint operation is

- a joint arrangement whereby the parties that have joint control of the arrangement have rights to ***the assets, and obligations for the liabilities***, relating to the arrangement.

Those parties are called joint operators (HKFRS 11.15).

A joint venture is

- a joint arrangement whereby the parties that have joint control of the arrangement have rights to the ***net assets*** of the arrangement.

Those parties are called joint venturers (HKFRS 11.16).

HKFRS 11 Joint Arrangements

Joint Operation

- A joint operator shall recognise in relation to its interest in a joint operation:
  a. its assets, including its share of any assets held jointly;
  b. its liabilities, including its share of any liabilities incurred jointly;
  c. its revenue from the sale of its share of the output arising from the joint operation;
  d. its share of the revenue from the sale of the output by the joint operation; and
  e. its expenses, including its share of any expenses incurred jointly. (HKFRS 11.20)

HKFRS 11 Joint Arrangements

Joint Venture

- A joint venturer
  - shall recognise its interest in a joint venture ***as an investment*** and
  - shall account for that investment using ***the equity method*** in accordance with HKAS 28 *Investments in Associates and Joint Ventures*
    - unless the entity is exempted from applying the equity method as specified in HKAS 28 (HKFRS 11.24).
- HKAS 28 is renamed as "*Investments in Associates and Joint Ventures*"

HKFRS 11: Effective Date

- An entity shall apply HKFRS 11 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- If an entity applies HKFRS 11 earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 12, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) at the same time.
  (HKFRS 11.C1)

Discl. Interests in Other Entities
(HKFRS 12)

HKFRS 12 Discl. of Interest in Other Entities

- The objective of HKFRS 12 is to require an entity to disclose information that enables users of its financial statements to evaluate:
  a. the nature of, and risks associated with, its interests in other entities; and
  b. the effects of those interests on its financial position, financial performance and cash flows (HKFRS 12.1).

HKFRS 12 Discl. of Interest in Other Entities

- To meet the objective of HKFRS 12, an entity shall disclose:
  a. the significant judgements and assumptions it has made
     - in determining the nature of its interest in another entity or arrangement, and
     - in determining the type of joint arrangement in which it has an interest; and
  b. information about its interests in:
     i. subsidiaries;
     ii. joint arrangements and associates; and
     iii. structured entities that are not controlled by the entity (unconsolidated structured entities) (HKFRS 12.2).

What is Structured Entity?

HKFRS 12 Discl. of Interest in Other Entities

- Structured entity is defined as:
  - An entity that has been designed so that
    - voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and
    - the *relevant activities* are directed by means of contractual arrangements.
- HKFRS 12.B22–B24 provide further information about structured entities.

What is Structured Entity?

HKFRS 12 Discl. of Interest in Other Entities

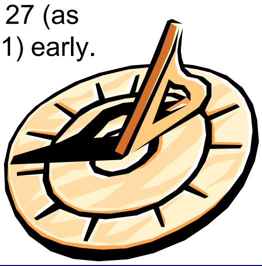
- Structured entity often has some or all of the following features or attributes:
  a. restricted activities.
  b. a narrow and well-defined objective, such as
     - to effect a tax-efficient lease,
     - to carry out research and development activities,
     - to provide a source of capital or funding to an entity or
     - to provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.
  c. insufficient equity to permit the structured entity to finance its activities without subordinated financial support.
  d. financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches). (HKFRS 12.B22).

Examples include:
a. securitisation vehicles,
b. asset-backed financings.
c. some investment funds.

What is Structured Entity?

HKFRS 12: Effective Date

- An entity shall apply HKFRS 12 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- An entity is encouraged to provide information required by HKFRS 12 earlier than annual periods beginning on or after 1 January 2013.
- Providing some of the disclosures required by HKFRS 12 does not compel the entity to comply with all the requirements of HKFRS 12 or to apply HKFRS 10, HKFRS 11, HKAS 27 (as amended in 2011) and HKAS 28 (as amended in 2011) early. (HKFRS 12.C1)



Fair Value Measurement

(HKFRS 13)

Introduction – Fair Value Debate

- In the global financial crisis, accountants and their accounting standards had been pleaded as guilty to create the financial tsunami
- To be accountable for the global financial stability, the IASB and FASB were forced to tak measures to address the issues and to amend their respective accounting standards
- IFRS 13 *Fair Value Measurement* is one of the consequences to provide converged guidance on fair value measurement.

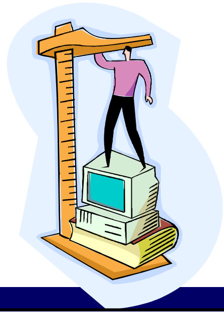
Introduction

- HKFRS 13 is a single standard to address the measurement fair value used in many other HKFRSs:
  a. defines fair value;
  b. sets out in a single HKFRS a framework for measuring fair value; and
  c. requires disclosures about fair value measurements. (HKFRS 13.1)

Definition of Fair Value

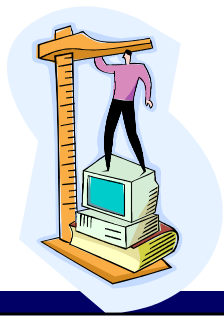
Single Framework for FV Measurement

Disclosure



1. Applicable Standard and Scope

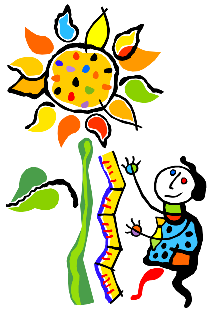
- With effective from annual periods beginning on or after 1 January 2013, except in specified circumstances as set out below, an entity is required to apply HKFRS 13, when another HKFRS requires or permits
  1. Fair value measurements, or disclosures about fair value measurements; and
  2. Measurements, such as fair value less costs to sell, based on fair value, or disclosure about those measurements. (HKFRS 13.5)



2. Definition of Fair Value

Definition of Fair Value

- Fair value is defined in HKFRS 13 as
  - the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (HKFRS 13.9)
  - i.e. an exit price
    - It is a market-based measurement, not an entity-specific measurement
- Historically, fair value is normally defined as:
  - The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

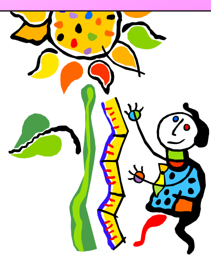


2. Definition of Fair Value

The IASB considered the previous definition of fair value:

a. did not specify whether an entity is buying or selling the asset;
b. was unclear about what is meant by settling a liability because it did not refer to the creditor, but to knowledgeable, willing parties; and
c. did not state explicitly whether the exchange or settlement takes place at the measurement date or at some other date (HKFRS 13.BC30)

- Historically, fair value is normally defined as:
  - The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.



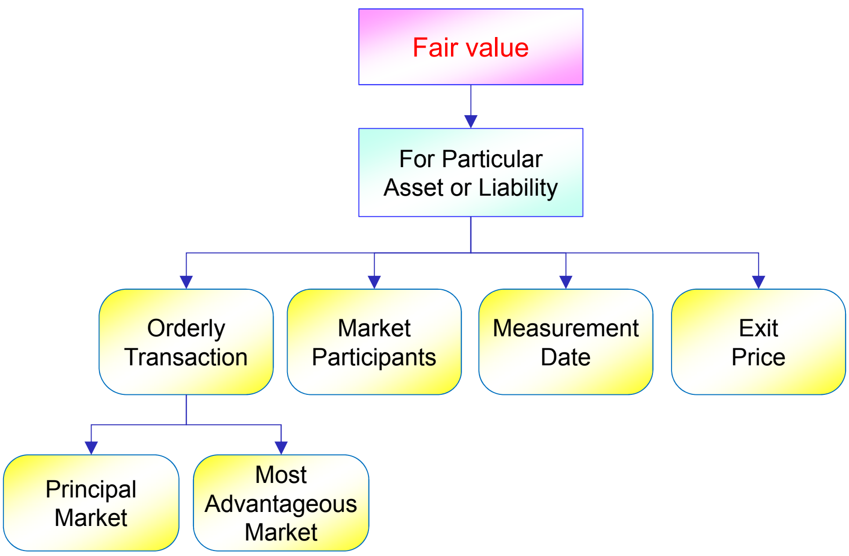
3. Fair Value Measurement

- HKFRS 13 explains that a fair value measurement requires an entity to determine the following:
  a. the particular asset or liability being measured;
  b. for a non-financial asset, the highest and best use of the asset and whether the asset is used
     - in combination with other assets or
     - on a stand-alone basis;
  c. the market in which an orderly transaction would take place for the asset or liability; and
  d. the appropriate valuation technique(s) to use when measuring fair value.
     - The valuation technique(s) used should maximise the use of relevant observable inputs and minimise unobservable inputs.
     - Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability. (HKFRS 13.IN10)

Single Framework for FV Measurement

Fair Value Hierarchy (3 levels)

3. Fair Value Measurement



 Source: Intermediate Financial Reporting, 2nd (2012) by Nelson Lam & Peter Lau

4. Application to Specific Situations

- In applying the fair value measurement, HKFRS 3 introduces the concepts of highest and best use and valuation premise for non-financial assets, but it also explains that they would not apply to financial assets or to liabilities.
- Together with the application to non-financial assets, IFRS 3 addresses application to at least three groups of items:
  1. Application to non-financial assets;
  2. Application to liabilities and an entity's own equity instruments; and
  3. Application to financial instruments within a portfolio, i.e. the financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk.

5. Fair Value at Initial Recognition

- HKFRS 13 specifies the consideration when fair value is required or permitted to use in initial recognition of an asset or a liability.
  – HKFRS 13 has not specified whether fair value should be used for initial recognition of an asset or a liability
  – An asset or a liability is initially recognised at a basis in accordance with the corresponding HKFRS and.
- Historically, HKFRS commonly addresses that the **fair value** on initial recognition is normally the **transaction price**.
- However, HKFRS 13 uses the phrase "in many cases" to substitute the word "normally" in describing the relationship between the fair value and transaction price.
  – The change represents that a fair value is defined as a current exit price in HKFRS 13
  – but a transaction price is considered as an entry price.

6. Valuation Techniques

- In selecting and using valuation techniques in fair value measurement, an entity is required to use
  - Valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value.
  - The techniques maximising the use of relevant observable inputs and minimising the use of unobservable inputs. (HKFRS 13.61)
- HKFRS 13
  - sets out <u>three valuation approaches</u> to guide the selection and use of valuation techniques;
  - imposes <u>requirements on the inputs to be used</u> in each technique and then it in turn also affects the selection and use of valuation techniques.

6. Valuation Techniques

- HKFRS 13 sets out the following three <u>valuation approaches</u> to guide the selection and usage of valuation techniques and
  1. Market approach,
  2. Cost Approach, and
  3. Income Approach.
- An entity is required to use valuation techniques consistent with one or more of the valuation approaches to measure fair value.

6. Valuation Techniques

- In fair value measurement,
  - an entity is not only required to use the valuation techniques consistent with one or more of the three valuation approaches, but also required to use the techniques,
    1. Maximising the use of <u>relevant observable inputs</u> and
    2. Minimising the use of <u>unobservable inputs</u> (HKFRS 13.67)

6. Valuation Techniques

- <u>Present value techniques</u> are the valuation techniques consistent with income approach to measure fair value and are specified in the application guidance of HKFRS 13.
- The application guidance of HKFRS 13 sets out
  - the <u>general principles</u> in using present value techniques and
  - the consideration of <u>risk</u> and <u>uncertainty</u>.
- HKFRS 13 also specifies the following two present value techniques:
  1. Discount rate adjustment technique; and
  2. Expected present value technique.

In order to understand them, HKFRS 13 also explains the portfolio theory, unsystematic (diversifiable) risk, systematic (non-diversifiable) risk ……

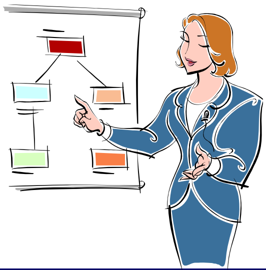
HKFRS 13: Effective Date

- An entity shall apply HKFRS 13 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- HKFRS 13 shall be applied prospectively as of the beginning of the annual period in which it is initially applied.
- The disclosure requirements of HKFRS 13 need not be applied in comparative information provided for periods before initial application of HKFRS 13. (HKFRS 13.C1)

Presentation of Financial Statements
(HKAS 1 Revised)

Presentation of Financial Statements

- In June 2011, the IASB further amended IAS 1 for annual periods beginning on or after 1 July 2012 in order to
  - Distinguish different items of other comprehensive income, and
  - Align with the accounting practices in US.
- The presentation of other comprehensive income in IFRS and accounting practices in US will be aligned.
- HKICPA issued the same amendment in July 2011.



Presentation of Financial Statements

- The main amendment of HKAS 1 requires an entity to
  - Classify line items for amounts of other comprehensive income (OCI) in a period by nature,
  - Group and present them in accordance with other HKFRSs into:
    1. Those items of OCI that will not be reclassified subsequently to P/L; and
    2. Those items of OCI that will be reclassified subsequently to P/L when specific conditions are met (HKAS 1.82A).

OCI not reclassified

OCI may be reclassified

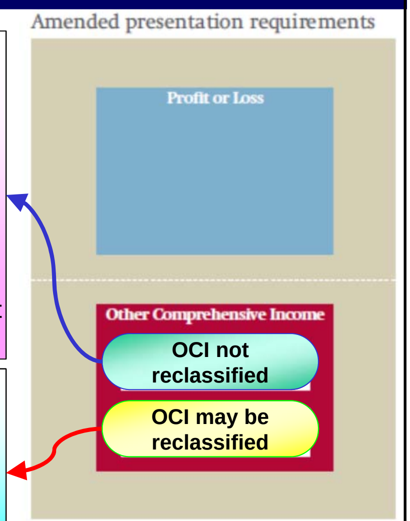
Presentation of Financial Statements

Those items of OCI that will not be reclassified subsequently to P/L include:

- Changes in revaluation surplus of PPE recognised under HKAS 16;
- Changes in revaluation surplus of intangible assets under HKAS 38;
- Actuarial gains and losses on defined benefit plans under HKAS 19; and
- FV changes of investment in equity instrument recognised in OCI under HKFRS 9.

Those items of OCI that may be reclassified subsequently to P/L include:

- Translation reserves under HKAS 21;
- FV changes on available-for-sale financial assets under HKAS 39; and
- Cash flow hedge reserves under HKAS 39.



The graph is sourced from the IASB

Presentation of Financial Statements

- In addition to the main amendment, HKAS 1 is also amended and updated with the following points:
  1. A new statement title, **statement of profit or loss and other comprehensive income**, is introduced and it can be used to distinguish from statement of comprehensive income which may be used to present comprehensive income only (HKAS 1.10 revised in 2011);
  2. Similar to the above title, another new statement title, **statement of profit or loss**, is also introduced to formally replace income statement, or separate income statement, to present items of profit or loss only (HKAS 1.10A);
  3. Components of other comprehensive income is formally described as items of other comprehensive income; and
  4. A term, i.e. comprehensive income, is formally introduced and represents the total of profit or loss and other comprehensive income (HKAS 1.81A).

HKAS 1: Effective Date

- *Presentation of Items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraphs 7, 10, 82, 85–87, 90, 91, 94, 100 and 115, added paragraphs 10A, 81A, 81B and 82A, and deleted paragraphs 12, 81, 83 and 84.
- An entity shall apply those amendments for annual periods beginning on or after 1 July 2012.
- Earlier application is permitted.
- If an entity applies the amendments for an earlier period it shall disclose that fact.(HKAS 1.139J)

Financial Instruments

(HKFRS 9)

Chapters

1 Objective
2 Scope
3 Recognition and Derecognition
4 Classification
5 Measurement
6 Hedge Accounting *(not used yet)*
7 Effective Date and Transition

Background

- The three main phases of the project to replace HKAS 39 are:
  a) Phase 1: Classification and measurement of financial assets and financial liabilities.
  b) Phase 2: Impairment methodology.
  c) Phase 3: Hedge accounting.
- HKFRS 9 issued so far includes only the chapters relating to Phase 1 (classification and measurement of financial assets and financial liabilities).

Additions of Financial Liabilities issued on 25 Nov. 2010 in HK

Chapter 3 Recognition & Derecognition

- An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when,
  – the entity becomes party to the contractual provisions of the instrument.

  Same as before
- When an entity first recognises a financial asset, it shall
  – **classify** it in accordance with paragraphs 4.1.1-4.1.5 and

  Amended (Ch. 4 of HKFRS 9)

  – **measure** it in accordance with paragraph 5.1.1 and 5.1.2.

  Amended (Ch. 5 of HKFRS 9)
- When an entity first recognises a financial liability, it shall
  – **classify** it in accordance with paragraphs 4.2.1 and 4.2.2 and

  Similar to HKAS 39

  – **measure** it in accordance with paragraph 5.1.1. (para. 3.1.1)

  Same para. as financial assets

Chapter 4.1 Classification of FA

- Unless para. 4.1.5 of HKFRS 9 (so-called "fair value option") applies, an entity shall classify financial assets as subsequently measured at either
  - **amortised cost** or
  - **fair value**

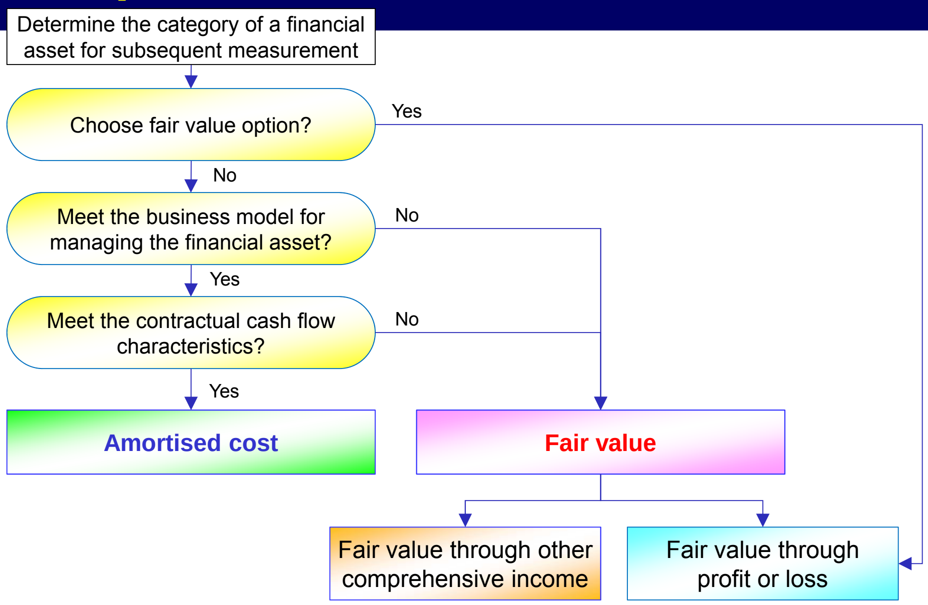
  on the basis of both:

  a) the entity's **business model** for managing the financial assets; and

  b) the **contractual cash flow characteristics** of the financial asset.
  (para. 4.1.1)

Amortised cost | **Fair value**

Chapter 4.1 Classification of FA



Source: Intermediate Financial Reporting, 2nd (2012) by Nelson Lam & Peter Lau

Chapter 7 Effective Date & Transition

Effective date

- An entity shall apply HKFRS 9 for annual periods beginning on or after 1 January 2013.
- Earlier application is permitted.
- However, if an entity elects to apply HKFRS 9 early and has not already applied HKFRS 9 issued in 2009, it must apply all of the requirements in HKFRS 9 at the same time (but see also para. 7.3.2).

Amendments to HKFRS 9 Financial Instruments defer its mandatory effective date from 1 January 2013 to 1 January 2015. The deferral will make it possible for all phases of the project to have the same mandatory effective date.

Financial Reporting Update 2012

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