Financial Reporting Update 2015

9 October 2015

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Today's Agenda

- Update of Amendments to HKFRSs Effective after 2014 Dec. Year-end
- Update of New Companies Ordinance Relevant to Financial Reporting

Effective for 2014 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) *Investment Entities*	➢ 1 Jan. 2014
• Amendments to HKAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*	➢ 1 Jan. 2014
• Amendments to HKAS 36 *Recoverable Amount Disclosures for Non-Financial Assets (Impairment of Assets)*	➢ 1 Jan. 2014
• Amendments to HKAS 39 *Novation of Derivatives and Continuation of Hedge Accounting*	➢ 1 Jan. 2014
• HK(IFRIC) – Int 21 *Levies*	➢ 1 Jan. 2014
• Preface to HKFRSs	➢ Effective upon issue

Effective for 2015 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKAS 19 (2011) *Employee Benefits – Defined Benefit Plans: Employee Contributions*	➢ 1 Jul. 2014
• Annual Improvements 2010-2012 Cycle	➢ 1 Jul. 2014 (or other)
• Annual Improvements 2011-2013 Cycle	➢ 1 Jul. 2014 (or other)
• SME-FRF and SME-FRS (Revised 2014) (pursuant to the New Companies Ordinance (Cap. 622) effective from 3 Mar. 2014)	➢ 3 Mar. 2014 (e Brief application not allowed)
• Accounting Bulletin 5 *Guidance for the Preparation of a Business Review under the Hong Kong Companies Ordinance Cap. 622*	
• Accounting Bulletin 6 *Guidance on the Requirements of Section 436 of the Hong Kong Companies Ordinance Cap. 622*	**A specific ADF seminar on 3 Nov. 2015 (Tue)**

Effective after 2015 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after
• Amendments to HKFRS 11 *Accounting for Acquisitions of Interests in Joint Operations*	➢ 1 Jan. 2016
• Amendments to HKAS 16 and HKAS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation*	➢ 1 Jan. 2016
• Amendments to HKAS 16 and HKAS 41 *Agriculture: Bearer Plants*	➢ 1 Jan. 2016
• Amendments to HKAS 27 *Equity Method in Separate Financial Statements*	➢ 1 Jan. 2016
• Amendments to HKFRS 10 and HKAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*	➢ 1 Jan. 2016
• Annual Improvements to HKFRSs 2012-2014 Cycle	➢ 1 Jan. 2016 (or other)
• Amendments to HKAS 1 *Disclosure Initiative*	➢ 1 Jan. 2016
• Amendments to HKFRS 10, 11 and 12 *Investment Entities: Applying the Consolidation Exception*	➢ 1 Jan. 2016
• HKFRS 14 *Regulatory Deferral Accounts*	➢ 1 Jan. 2016

Effective after 2015 Dec. Year-End

Selected new interpretations and amendments to HKFRSs	Effective for periods beginning on/after	
• HKFRS 15 *Revenue from Contracts with Customers*	~~➢ 1 Jan. 2017~~	Update
• HKFRS 9 (2014) *Financial Instruments*	➢ 1 Jan. 2018	Update
• Amendments to HKFRS 15 *Effective Date of HKFRS 15 Revenue from Contracts with Customers*	➢ 1 Jan. **2018**	
• Amendments to HKFRS for Private Entities	➢ 1 Jan. 2017	Brief

Today's Agenda

Update of Amendments to HKFRSs Effective after 2014 Dec. Year-end

Today's Agenda

HKFRS 15 *Revenue from Contracts with Customers* (2014)

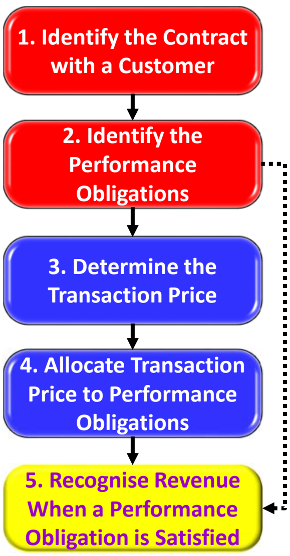
HKFRS 9 *Financial Instruments* (2014)

SME-FRF and FRS and Relevant Requirements in New Co. Ord.

HKFRS 15 Revenue

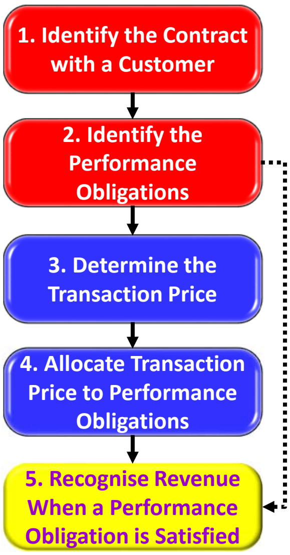
from Contracts with Customers

HKFRS 15 Issued in 2014



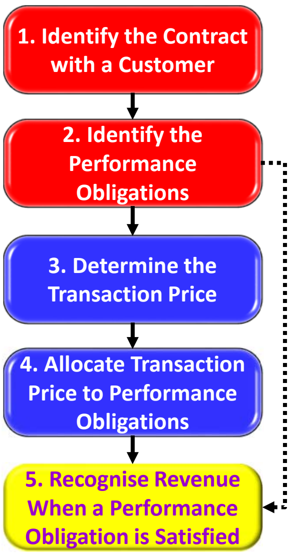
- HKFRS 15
  - establishes a comprehensive framework for determining
    - when to recognise revenue and
    - how much revenue to recognise.
- The core principle in that framework is that an entity recognises revenue
  - to depict the transfer of promised goods or services to customers
  - in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services
- Under HKFRS 15, an entity applies a **5-step approach** in recognising revenue

HKFRS 15 Issued in 2014



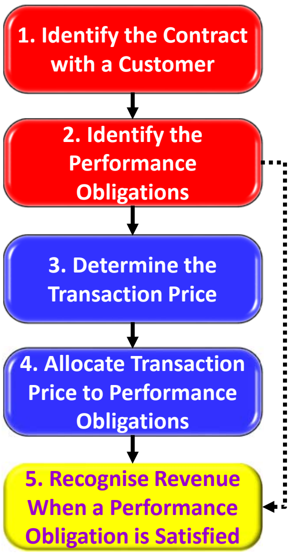
- Effective Date
  - An entity shall apply HKFRS 15 for annual reporting periods beginning on or after 1 January ~~2017~~ **2018**. (HKICPA Update No. 174)
  - Earlier application is permitted.
  - If an entity applies HKFRS 15, it shall disclose that fact.

HKFRS 15 Issued in 2014



- HKFRS 15 supersedes the following Standards:
  a. HKAS 11 *Construction Contracts*
  b. HKAS 18 *Revenue*
  c. HK(IFRIC)-Int 13 *Customer Loyalty Programmes*
  d. HK(IFRIC)-Int 15 *Agreements for the Construction of Real Estate*
  e. HK(IFRIC)-Int 18 *Transfers of Assets from Customers*
  f. HK(SIC)-Int 31 *Revenue — Barter Transactions Involving Advertising Services*

Contents in HKFRS 15 Issued in 2014



A. Objective

B. Scope

C. Recognition
- Identifying the contract (Step 1)
- Identifying performance obligations (Step 2)
- Satisfaction of performance obligations (Step 5)

D. Measurement
- Determining the transaction price (Step 4)
- Allocating the transaction price to performance obligations (Step 5)

E. Contract costs (not to be discussed today)

F. Presentation (not to be discussed today)

G. Disclosure (not to be discussed today)

Brief Summary of Changes

Existing Practice	IFRS 15
• Using IAS 11 and 18, IFRIC Int. 13, 15, and 18, and SIC 31	• Using IFRS 15, one standard only
• Inconsistent and diversified practices	• Single and unified 5-step revenue recognition model
• Risk and reward approach in satisfying recognition	• Control approach in satisfying the performance obligation
• Limited guidance on multiple element arrangements, variable consideration, licences and etc.	• More guidance on separating elements, allocating the transaction price, licences, and etc.
	• New estimates and judgements required
	• New set of disclosure requirements

A. Objective

- The objective of HKFRS 15 is
  - to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer (HKFRS 15.1)
- To meet the objective
  - The core principle of HKFRS 15 is that an entity shall recognise revenue
    - to depict the transfer of promised goods or services to customers
    - in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. (HKFRS 15.2)
- When applying HKFRS 15, an entity shall
  - consider the terms of the contract and all relevant facts and circumstances
  - apply HKFRS 15, including the use of any practical expedients, consistently to contracts with similar characteristics and in similar circumstances. (HKFRS 15.3)

A. Objective

- HKFRS 15 specifies the accounting for an individual contract with a customer
  - However, as a practical expedient, an entity may apply HKFRS 15 to a portfolio of contracts (or performance obligations) with similar characteristics
    - if the entity reasonably expects that the effects on the financial statements of applying HKFRS 15 to the portfolio would not differ materially from applying HKFRS 15 to the individual contracts (or performance obligations) within that portfolio
  - When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio. (HKFRS 15.4)

B. Scope

- An entity shall apply HKFRS 15 to all contracts with customers, except the following:
  - <u>lease contracts</u> within the scope of HKAS 17 Leases;
  - <u>insurance contracts</u> within the scope of HKFRS 4 Insurance Contracts;
  - <u>financial instruments and other contractual rights or obligations</u> within the scope of
    - HKFRS 9 *Financial Instruments*, (or HKAS 39 if HKFRS 9 not yet applied)
    - HKFRS 10 *Consolidated Financial Statements*, HKFRS 11 *Joint Arrangements*, HKAS 27 *Separate Financial Statements* and HKAS 28 *Investments in Associates and Joint Ventures*; and
  - <u>non-monetary exchanges</u> between <u>entities in the same line of business</u> to <u>facilitate sales</u> to customers or potential customers
    - For example, HKFRS 15 would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis. (HKFRS15.5)

C. Recognition and D. Measurement

1. Identify the Contract with a Customer
2. Identify the Performance Obligations
3. Determine the Transaction Price
4. Allocate Transaction Price to Performance Obligations
5. Recognise Revenue When a Performance Obligation is Satisfied

C. Recognition

1. Identify the Contract with a Customer

2. Identify the Performance Obligations

5. Recognise Revenue When a Performance Obligation is Satisfied

- **Step 1: Identifying the Contract(s)**
  - Combination of contracts
  - Contract modifications
- **Step 2: Identifying Performance Obligations**
  - Promises in contracts with customers
  - Distinct goods or services
- **Step 5: Satisfaction of performance obligations**
  - Performance obligations satisfied over time
  - Performance obligations satisfied at a point in time
  - Measuring progress towards complete satisfaction of a performance obligation

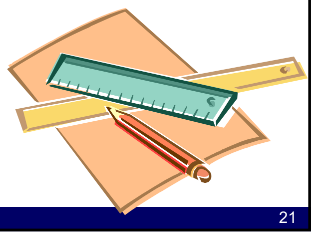
Step 1: Identify the Contract(s)

1. Identify the Contract with a Customer

- **Step 1: Identifying the Contract(s)**
  - A contract is an agreement between two or more parties that creates enforceable rights and obligations.
  - The requirements of HKFRS 15 apply to each contract that has been agreed upon with a customer and meets specified criteria.
    - In some cases, HKFRS 15 requires an entity to combine contracts and account for them as one contract.
    - HKFRS 15 also provides requirements for the accounting for contract modifications. (HKFRS 15.IN7)

Step 1: Identify the Contract(s)

- An entity shall account for a contract with a customer that is within the scope of HKFRS 15 only when all of the following criteria (i.e. **contract criteria**) are met:
  a. the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
  b. the entity can identify each party's rights regarding the goods or services to be transferred;
  c. the entity can identify the payment terms for the goods or services to be transferred;
  d. the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and



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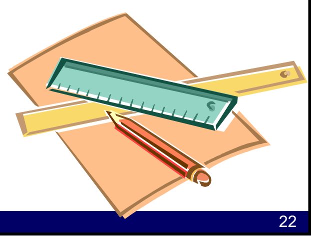
Step 1: Identify the Contract(s)

- An entity shall account for a contract with a customer that is within the scope of HKFRS 15 only when all of the following criteria (i.e. **contract criteria**) are met:
  e. it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.
     - In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due.
     - The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see HKFRS 15.52) (HKFRS 15.9)



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Step 1: Identify the Contract(s)

1. Identify the Contract with a Customer

Combination of Contracts

Contract Modification

- An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:
  a. the contracts are negotiated as a package with a single commercial objective;
  b. the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
  c. the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with HKFRS 15.22–30. (HKFRS 15.17)

Step 1: Identify the Contract(s)

1. Identify the Contract with a Customer

Combination of Contracts

Contract Modification

- An entity shall account for a contract modification as a separate contract if both of the following conditions are present:
  a. the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with HKFRS 15.26–30); and
  b. the price of the contract increases by
     - an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and
     - any appropriate adjustments to that price to reflect the circumstances of the particular contract. (HKFRS 15.20)

Separate Contract

Step 1: Identify the Contract(s)

1. Identify the Contract with a Customer

Contract Modification

- If a contract modification is not accounted for as a separate contract in accordance with HKFRS 15.20 (as set out in last slide),
  - an entity shall account for the promised goods or services not yet transferred at the date of the contract modification (i.e. the remaining promised goods or services) in whichever of the following ways is applicable:
    a. as if it were a termination of the existing contract and the creation of a new contract if ……
    b. as if it were a part of the existing contract if ……
    c. a combination of (a) and (b) ……

Separate Co

New Contract

Part of Existing Contract

C. Recognition and D. Measurement

1. Identify the Contract with a Customer

2. Identify the Performance Obligations

3. Determine the Transaction Price

4. Allocate Transaction Price to Performance Obligations

5. Recognise Revenue When a Performance Obligation is Satisfied

Step 2: Identify Performance Obligations

2. Identify the Performance Obligations

- **Step 2: Identifying the Performance Obligations in the Contract**
  - A contract includes promises to transfer goods or services to a customer.
  - If those goods or services are distinct, the promises
    - are performance obligations and
    - are accounted for separately
  - A good or service is distinct if
    - the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and
    - the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. (HKFRS 15.IN7)

Step 2: Identify Performance Obligations

- At contract inception, an entity shall
  - assess the goods or services promised in a contract with a customer, and
  - identify as a **performance obligation** each promise to transfer to the customer either:
    a. a good or service (or a bundle of goods or services) that is distinct; or
    b. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see HKFRS 15.23) (HKFRS 15.22)

HKFRS 15 defines **performance obligation** as:

- A promise in a contract with a customer to transfer to the customer either:
  a. a good or service (or a bundle of goods or services) that is distinct; or
  b. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Step 2: Identify Performance Obligations

- A good or service that is promised to a customer is distinct if both of the following criteria are met:
  a. the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
  b. the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the good or service is distinct within the context of the contract). (HKFRS 15.27)

Step 2: Identify Performance Obligations

- If a promised good or service is not distinct,
  - an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.
    - In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation. (HKFRS 15.30)

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Incidental Obligations and Sales Incentives (see more in Step 2)	
• Some companies may not separately recognise revenue for the transfer to the customer of goods or services that some consider to be sales incentives or otherwise incidental or ancillary to the other promised goods or services in the contract. • That practice results in a company recognising all of the transaction price as revenue even though it has remaining performance obligations to satisfy. • This sometimes occurs in the **automotive industry** when a manufacturer sells a car along with an incentive such as maintenance that will be provided at a later date.	• A company will assess whether the promised goods or services arising from incidental obligations and sales incentives are goods or services that are distinct. • If the goods or services are distinct, the company will recognise revenue when (or as) each distinct good or service is transferred to the customer.

Adapted from the IASB's Project Summary issued in May 2014

C. Recognition and D. Measurement

1. Identify the Contract with a Customer
2. Identify the Performance Obligations
3. Determine the Transaction Price
4. Allocate Transaction Price to Performance Obligations
5. Recognise Revenue When a Performance Obligation is Satisfied

D. Measurement

3. Determine the Transaction Price

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4. Allocate Transaction Price to Performance Obligations

- **Step 3: Determining the Transaction Prices**
  - Variable consideration
  - The existence of a significant financing component in the contract
  - Non-cash consideration
  - Consideration payable to a customer
- **Step 4: Allocating the Transaction Price to Performance Obligations**
  - Allocation based on stand-alone selling prices
  - Allocation of a discount
  - Allocation of variable consideration
  - Changes in the transaction price

Step 3: Determine Transaction Price

3. Determine the Transaction Price

- **Step 3: Determining the Transaction Prices**
  - The transaction price
    - is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer
    - can be a fixed amount of customer consideration, but it may sometimes include
      - variable consideration or
      - consideration in a form other than cash
    - is also adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. (HKFRS 15.IN7)

Step 3: Determine Transaction Price

3. Determine the Transaction Price

- **Step 3: Determining the Transaction Prices**
  - If the consideration is variable, an entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services.
  - The estimated amount of variable consideration will be included in the transaction price
    - only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. (HKFRS 15.IN7)

Step 3: Determine Transaction Price

HKFRS 15 defines **transaction price** as:

- The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

- To determine the transaction price, an entity shall consider
  - the terms of the contract and
  - its customary business practices.
    - The consideration promised in a contract with a customer may include
      - fixed amounts,
      - variable amounts, or
      - both. (HKFRS 15.47)

Step 3: Determine Transaction Price

- The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price.
- When determining the transaction price, an entity shall consider the effects of all of the following:
  a. variable consideration (see HKFRS 15.50–55 and 59);
  b. constraining estimates of variable consideration (see HKFRS 15.56–58);
  c. the existence of a significant financing component in the contract (see HKFRS 15.60–65);
  d. non-cash consideration (see HKFRS 15.66–69); and
  e. consideration payable to a customer (see HKFRS 15.70–72). (HKFRS 15.48)

Variable Consideration

Constraining Estimates of Variable Con.

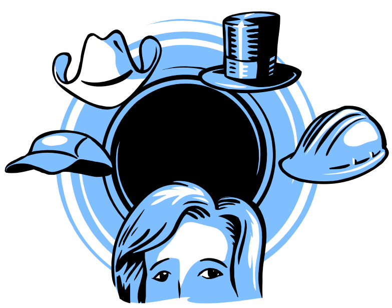
Significant Financing Component

Non-cash Consideration

Consideration Payable to Customer

Step 3: Determine Transaction Price

- If the consideration promised in a contract includes a variable amount,
  – an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. (HKFRS 15.50)



Variable Consideration

Step 3: Determine Transaction Price

- An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:
  - **a.** **The expected value** — the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts.
    - An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large no. of contracts with similar characteristics.
  - **b.** **The most likely amount** — the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract).
    - The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (e.g. an entity either achieves a performance bonus or does not). (HKFRS 15.53)

Variable Consideration
- Expected Value
- Most Likely Amount

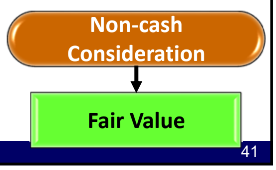
Step 3: Determine Transaction Price

- An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with HKFRS 15.53
  - only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. (HKFRS 15.56)
- In assessing such highly probable circumstance,
  - an entity shall consider both the likelihood and the magnitude of the revenue reversal.

Constraining Estimates of Variable Con.

Step 3: Determine Transaction Price

- To determine the transaction price for contracts in which a customer promises consideration in a form other than cash,
  - an entity shall measure the non-cash consideration (or promise of non-cash consideration) at **fair value**. (HKFRS 15.66)
    - If an entity cannot reasonably estimate the fair value of the non-cash consideration,
      - the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration. (HKFRS 15.67)



Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Estimates of Variable Consideration (see more in Step 3)	
• Revenue requirements do not include detailed guidance for measuring the amount of revenue that should be recognised when the consideration is variable	• If the consideration promised by a customer is variable, a company will estimate it using either the expected value or the most likely amount, depending on which amount better predicts the amount of consideration to which the company will be entitled. • Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Significant Financing Components (see more on Step 3)	
• If a customer pays for goods or services in advance or in arrears, some companies may not consider the effects of any financing components in the contract when determining the amount of revenue to be recognised.	• A company is required to consider the effects of any significant financing components in the determination of the transaction price (and thus the amount of revenue recognised). • This may affect long-term contracts in which payment by the customer and performance by the company occur at significantly different times.

C. Recognition and D. Measurement

1. Identify the Contract with a Customer
2. Identify the Performance Obligations
3. Determine the Transaction Price
4. Allocate Transaction Price to Performance Obligations
5. Recognise Revenue When a Performance Obligation is Satisfied

Step 4: Allocate Transaction Price to PO

4. Allocate Transaction Price to Performance Obligations

- **Step 4: Allocating the Transaction Price to Performance Obligations**
  - An entity typically allocates the transaction price to each performance obligation on the basis of the <u>relative stand-alone selling prices of each distinct good or service promised</u> in the contract.
    - If a stand-alone selling price is not observable, an entity <u>estimates it</u>.
  - Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract.
    - HKFRS 15 specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations (or distinct goods or services) in the contract. (HKFRS 15.IN7)

Step 4: Allocate Transaction Price to PO

Based on Stand-alone Selling Price (SASP)

Allocation of a Discount

Allocation of Variable Consideration

4. Allocate Transaction Price to Performance Obligations

- The objective when <u>allocating the transaction price</u> is
  - for an entity <u>to allocate the transaction price to each performance obligation</u> (or distinct good or service) <u>in an amount that depicts the amount of consideration</u> to which the entity <u>expects to be entitled in exchange for</u> transferring the promised goods or services to the customer. (HKFRS 15.73)

Step 4: Allocate Transaction Price to PO

Based on Stand-alone Selling Price (SASP)

Allocation of a Discount

Allocation of Variable Consideration

4. Allocate Transaction Price to Performance Obligations

- To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on **a relative stand-alone selling price basis** in accordance with HKFRS 15.76–80, except as specified in
  - HKFRS 15.81–83 (for allocating discounts) and
  - HKFRS 15.84–86 (for allocating consideration that includes variable amounts). (HKFRS 15.74)

Step 4: Allocate Transaction Price to PO

HKFRS 15 defines **stand-alone selling price** as:

- The price at which an entity would sell a promised good or service separately to a customer..

Based on Stand-alone Selling Price (SASP)

- To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall
  - determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and
  - allocate the transaction price in proportion to those stand-alone selling prices. (HKFRS 15.76)

Step 4: Allocate Transcation Price to PO

Based on Stand-alone Selling Price (SASP)

- The best evidence of a stand-alone selling price is
  - the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
    - A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service. (HKFRS 15.77)

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Step 4: Allocate Transcation Price to PO

Based on Stand-alone Selling Price (SASP)

- If SASP is not directly observable,
  - an entity shall estimate the SASP at an amount that would result in the allocation of the transaction price meeting the allocation objective in HKFRS 15.73.
- When estimating SASP,
  - an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity.
  - In doing so, an entity shall
    - maximise the use of observable inputs and
    - apply estimation methods consistently in similar circumstances. (HKFRS 15.78)

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Step 4: Allocate Transaction Price to PO

Based on Stand-alone Selling Price (SASP)

- Suitable methods for estimating SASP of a good or service include (not limited to):
  a. **Adjusted market assessment approach**
  b. **Expected cost plus a margin approach**
  c. **Residual approach**
  d. **Combination of the above**

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Contingent Revenue Cap (see more in Step 4)	
• Some practices for allocating the transaction price limit the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future. • That practice is commonly used to account for **telecommunications contracts** that bundle the sale of a mobile phone with the provision of network services for a specified period (often for one or two years).	• IFRS 15 does not permit the transaction price to be allocated to performance obligations on a basis that is consistent with the contingent revenue cap. • Instead, IFRS 15 requires a company to allocate the transaction price—which would be any amount that the customer pays on entering into the contract and the monthly payments for the network services—to the mobile phone and the network services on the basis of the relative stand-alone selling prices of each item.

Adapted from the IASB's Project Summary issued in May 2014

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
No Observable Selling Price (see more in Step 4)	
• For some contracts, revenue requirements preclude a company from recognising revenue on the transfer of a good or service to a customer if there is no observable evidence of the stand-alone selling prices of each of the goods or services promised in the contract. • This often results in the deferral of revenue recognition because revenue could not be recognised when the first of the promised goods or services transfers to the customer. • This regularly occurs in the **software industry** when observable prices are not available for upgrades and additional functionality for computer software.	• If observable prices of the promised goods or services are not available, a company would allocate the transaction price on the basis of estimated stand-alone selling prices of those goods or services. • The company will recognise revenue as each distinct good or service is transferred to the customer.

Adapted from the IASB's Project Summary issued in May 2014

C. Recognition and D. Measurement

1. Identify the Contract with a Customer
2. Identify the Performance Obligations
3. Determine the Transaction Price
4. Allocate Transaction Price to Performance Obligations
5. Recognise Revenue When a Performance Obligation is Satisfied

Step 5: Satisfy Performance Obligations

5. Recognise Revenue When a Performance Obligation is Satisfied

- **Step 5: Satisfaction of performance obligations**
  - A an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer
    - which is when the customer obtains control of that good or service.
  - The amount of revenue recognised is the amount allocated to the satisfied performance obligation. (HKFRS 15.IN7)

Step 5: Satisfy Performance Obligations

5. Recognise Revenue When a Performance Obligation is Satisfied

- **Step 5: Satisfaction of performance obligations**
  - A performance obligation may be satisfied
    - at a point in time (typically for promises to transfer goods to a customer) or
    - over time (typically for promises to transfer services to a customer).
  - For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation. (HKFRS 15.IN7)

Step 5: Satisfy Performance Obligations

- An entity shall recognise revenue
  - when (or as) the entity **satisfies a performance obligation** by **transferring** a promised good or service (i.e. an asset) to a customer.
- An asset is transferred
  - when (or as) the customer obtains **control** of that asset (HKFRS 15.31)

Step 5: Satisfy Performance Obligations

- For each performance obligation identified in accordance with HKFRS 15.22–30,
  - an entity shall determine at contract inception whether it
    - satisfies the performance obligation over time (in accordance with HKFRS 15.35–37) or
    - satisfies the performance obligation at a point in time (in accordance with HKFRS 15.38).
      - If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. (HKFRS 15.32)

Over Time

At a Point in Time

Step 5: Satisfy Performance Obligations

- Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services).
- Control of an asset
  - refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.
  - includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.
- When evaluating whether a customer obtains control of an asset,
  - an entity shall consider any agreement to repurchase the asset (see HKFRS 15.B64–B76). (HKFRS 15.33)

Over Time

At a Point in Time

Step 5: Satisfy Performance Obligations

- An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

Over Time

a. the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see HKFRS 15.B3–B4);

b. the entity's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced (see HKFRS 15.B5); or

c. the entity's performance does not create an asset with an alternative use to the entity (see HKFRS 15.36) and the entity has an enforceable right to payment for performance completed to date (see HKFRS 15.37). (HKFRS 15.35)

Step 5: Satisfy Performance Obligations

- If a performance obligation is not satisfied over time in accordance with HKFRS 15.35–37, an entity satisfies the performance obligation at a point in time.
- To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation,
  - the entity shall consider the **requirements for control** in HKFRS 15.31–34. (HKFRS 15.38)

At a Point in Time

Step 5: Satisfy Performance Obligations

- In addition, an entity shall consider **indicators of the transfer of control**, which include, but are not limited to, the following:
  a. The entity has a present right to payment for the asset
  b. The customer has legal title to the asset
  c. The entity has transferred physical possession of the asset
  d. The customer has the significant risks and rewards of ownership of the asset
  e. The customer has accepted the asset

At a Point in Time

Step 5: Satisfy Performance Obligations

Measuring Progress → Over Time

Measuring Progress Towards Complete Satisfaction of a Performance Obligation

- For each performance obligation satisfied over time in accordance with HKFRS 15.35–37,
  - an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation.
- The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity's performance obligation). (HKFRS 15.39)

Step 5: Satisfy Performance Obligations

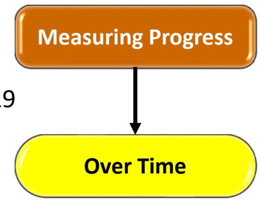
Measuring Progress → Over Time

Measuring Progress Towards Complete Satisfaction of a Performance Obligation

- An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances.
- At the end of each reporting period,
  - an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time. (HKFRS 15.40)

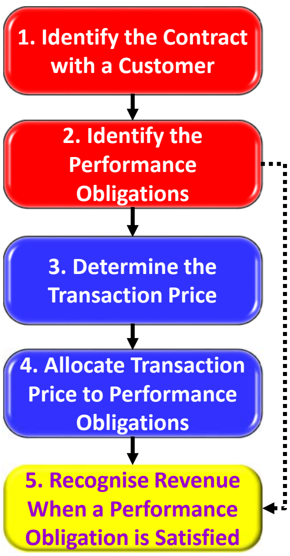
Step 5: Satisfy Performance Obligations

Methods for Measuring Progress



– Appropriate methods of measuring progress include **output methods** and **input methods** (HKFRS 15.B14–B19 provide guidance)
– In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer. (HKFRS 15.41)
– When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer.
– Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation. (HKFRS 15.42)

C. Recognition and D. Measurement



- When (or as) a performance obligation is satisfied,
  – an entity shall recognise as revenue
    - the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with HKFRS 15.56–58) that is allocated to that performance obligation. (HKFRS 15.46)

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Timing of Revenue Recognition (see more in Step 5)	
• Because of a lack of clear and comprehensive guidance, there is some diversity in practice in determining whether a company should recognise revenue for some goods or services at a point in time or over time. • Some companies selling **residential real estate in multi-unit developments** have difficulty determining whether the construction of such assets is - a service that is provided over time (revenue is recognised over time) or - a good that is transferred to the customer when construction is complete (revenue is recognised at that point in time)	• A company will be able to recognise revenue over time only if the criteria specified in IFRS 15 are met. • In all other cases, a company will recognise revenue at the point in time when the customer obtains control of the promised good or service.

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Licences	
• The revenue recognition guidance on accounting for licences of intellectual property is broad. • Different interpretations of that guidance has led to significant diversity in the accounting for licences.	• IFRS 15 provides application guidance on how to apply the revenue framework to different types of licences of intellectual property.

Existing Practice vs HKFRS 15

Existing Practice	HKFRS 15
Disclosure	
• Disclosure of information about revenue is inadequate and lacks cohesion with the disclosure of other items in the financial statements. • For example, many investors have said that some companies present revenue in isolation, which means that investors cannot relate revenue to the company's financial position.	• IFRS 15 includes a comprehensive set of disclosure requirements that require a company to disclose qualitative and quantitative information about its contracts with customers to help investors **understand** the nature, amount, timing and uncertainty of revenue.

Adapted from the IASB's Project Summary issued in May 2014

HKFRS 9 Financial Instruments

HKFRS 9 Issued in 2014

- Effective Date
  - An entity shall apply HKFRS 9 for annual periods beginning on or after <u>1 January 2018</u>.
  - Earlier application is permitted.
  - If an entity elects to apply HKFRS 9 early, it must disclose that fact and apply all of the requirements in HKFRS 9 at the same time (but see also paragraphs 7.1.2, 7.2.21 and 7.3.2).
  - It shall also, at the same time, apply the amendments in Appendix C. (para. 7.1.1)

HKFRS 9 Issued in 2014

1. Objective
2. Scope
   - Transferred from HKAS 39
3. Recognition and Derecognition
4. Classification
   - Debt instruments can now be measured at fair value through other comprehensive income
5. Measurement
   - Initial measurement of trade receivable
   - New impairment requirements
6. Hedge Accounting
   - Changes mainly on hedge conditions
7. Effective Date and Transition

HKFRS 9 Issued in 2014

1. Objective
2. Scope
3. Recognition and Derecognition
4. Classification
5. Measurement
6. Hedge Accounting
7. Effective Date and Transition

Chapter 4.1 Classification of FA

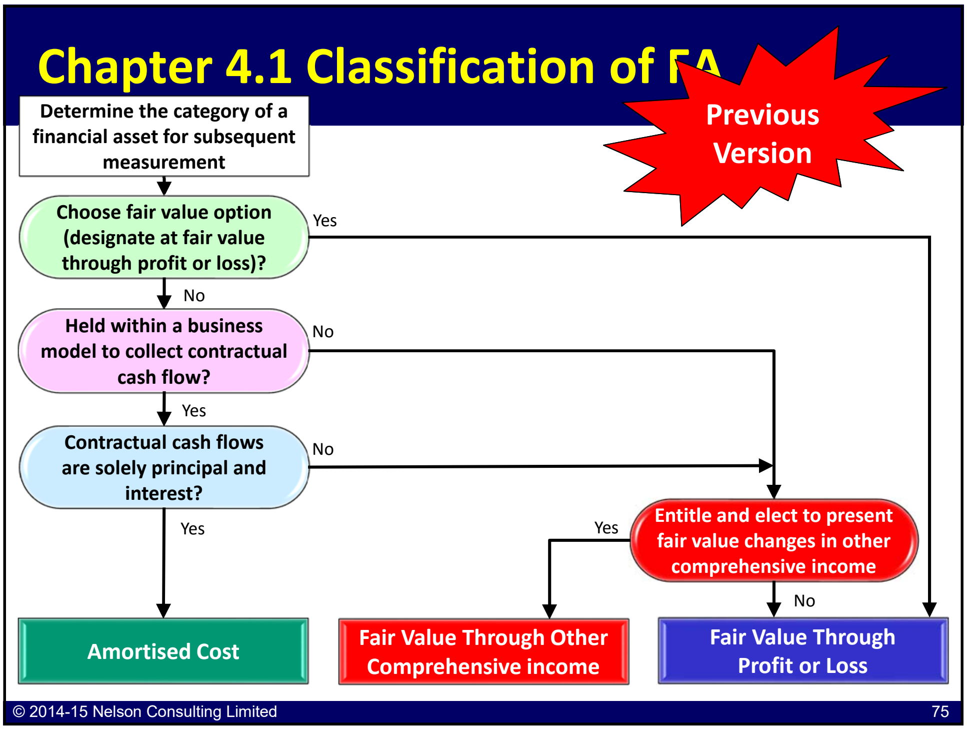
- Unless para. 4.1.5 of HKFRS 9 (so-called "fair value option") applies, an entity shall classify financial assets as subsequently measured at either
  - amortised cost,
  - fair value through other comprehensive income, or
  - fair value through profit or loss

  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 Through Other Comprehensive income	Fair Value Through Profit or Loss


Chapter 4.1 Classification of FA
Previous Version
Determine the category of a financial asset for subsequent measurement
Choose fair value option (designate at fair value through profit or loss)?
Yes
No
Held within a business model to collect contractual cash flow?
No
Yes
Contractual cash flows are solely principal and interest?
No
Yes
Entitle and elect to present fair value changes in other comprehensive income
Yes
No
Amortised Cost
Fair Value Through Other Comprehensive income
Fair Value Through Profit or Loss
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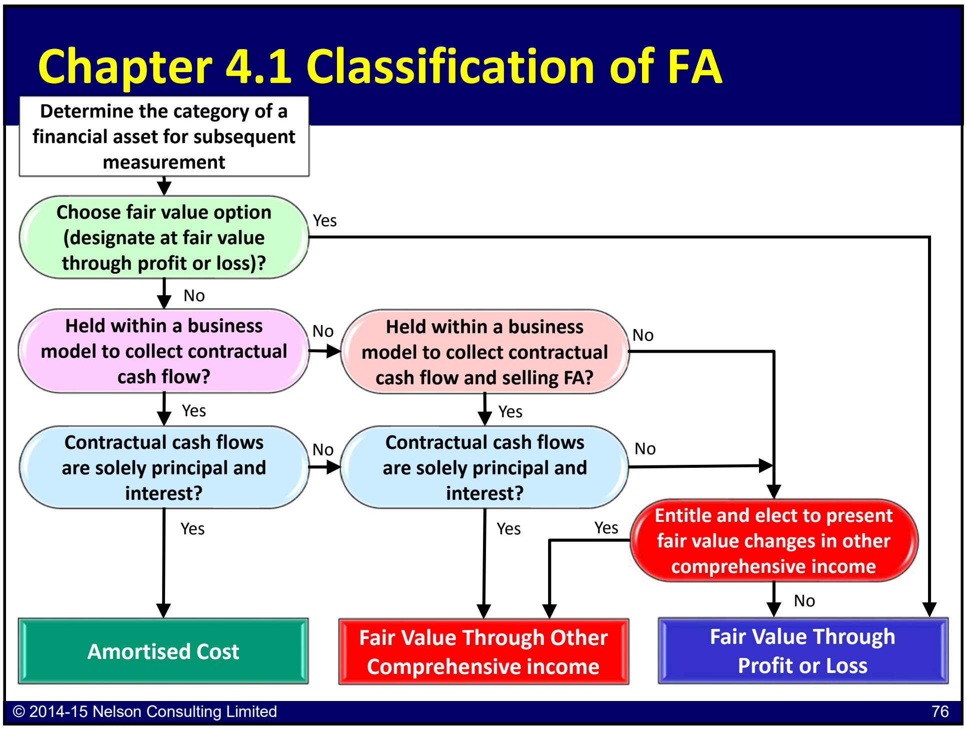
Chapter 4.1 Classification of FA
Determine the category of a financial asset for subsequent measurement
Choose fair value option (designate at fair value through profit or loss)?
Yes
No
Held within a business model to collect contractual cash flow?
No
Held within a business model to collect contractual cash flow and selling FA?
No
Yes
Yes
Contractual cash flows are solely principal and interest?
No
Contractual cash flows are solely principal and interest?
No
Yes
Yes
Yes
Entitle and elect to present fair value changes in other comprehensive income
No
Amortised Cost
Fair Value Through Other Comprehensive income
Fair Value Through Profit or Loss
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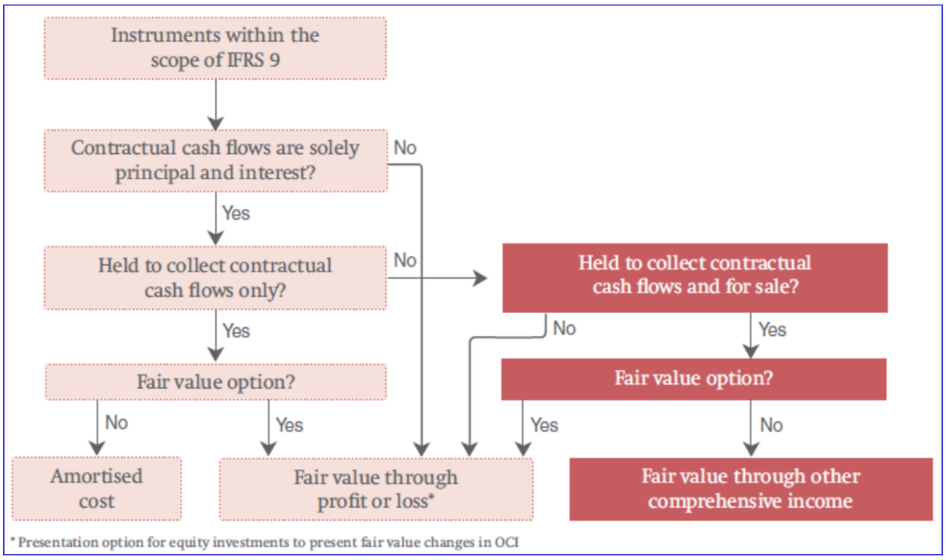
Chapter 4.1 Classification of FA



 Adapted from the IASB's Project Summary issued in July 2014

Chapter 4.1 Classification of FA

- A financial asset shall be measured **at fair value through other comprehensive income** if both of the following conditions are met:
  a. the financial asset is held within a business model whose objective is achieved by both
     - collecting contractual cash flows and selling financial assets, and

  Held within a business model to collect contractual cash flow and selling FA?

  b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
     - Para. B4.1.1–B4.1.26 provide guidance on how to apply these conditions.
       (para. 4.1.2A)

Fair Value Through Other Comprehensive income

Chapter 4.1 Classification of FA

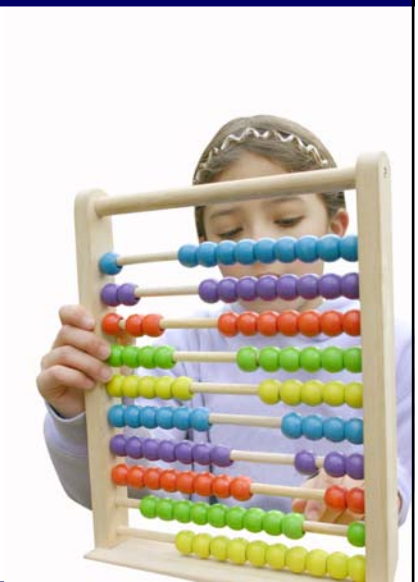
- For the purpose of applying para. 4.1.2(b) and 4.1.2A(b):
  a. principal is the fair value of the financial asset at initial recognition. Para. B4.1.7B provides additional guidance on the meaning of principal.
  b. interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. (Para. B4.1.7A and B4.1.9A–B4.1.9E provide additional guidance on the meaning of interest) (para. 4.1.3)

Contractual cash flows are solely principal and interest? → Yes → **Amortised Cost**

Contractual cash flows are solely principal and interest? → Yes → **Fair Value Through Other Comprehensive income**

HKFRS 9 Issued in 2014

1. Objective
2. Scope
3. Recognition and Derecognition
4. Classification
5. Measurement
6. Hedge Accounting
7. Effective Date and Transition



Chapter 5 Measurement

Initial measurement

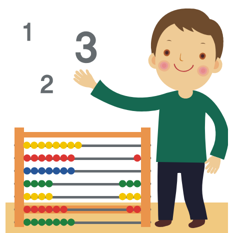
- Except for trade receivables within the scope of para. 5.1.3,
  - at initial recognition, an entity shall measure a financial asset or financial liability
    - **at its fair value**
    - plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, **transaction costs** that are directly attributable to the acquisition or issue of the financial asset or financial liability. (para. 5.1.1)
- However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply para. B5.1.2A. (para. 5.1.1A)

Initial Measurement
Fair Value
+
Transaction Cost

Chapter 5 Measurement

Subsequent Measurement of Financial Assets

- After initial recognition, an entity shall measure a financial asset in accordance with para. 4.1.1–4.1.5 at:
  - a. **amortised cost**;
  - b. **fair value through other comprehensive income**; or
  - c. **fair value through profit or loss**. (para. 5.2.1)

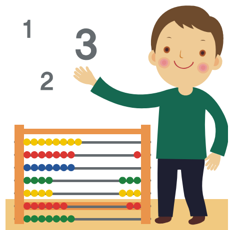


Amortised Cost | Fair Value Through Other Comprehensive income | Fair Value Through Profit or Loss

Chapter 5 Measurement

Subsequent Measurement of Financial Assets

- An entity shall apply **the impairment requirements** in Section 5.5
  - to financial assets that are measured at amortised cost in accordance with para. 4.1.2 and
  - to financial assets that are measured at fair value through other comprehensive income in accordance with para. 4.1.2A. (para. 5.2.2)



New Impairment Requirements

Amortised Cost

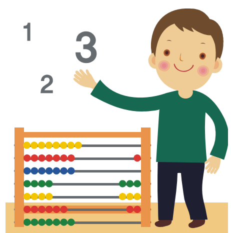
Fair Value Through Other Comprehensive income

Fair Value Through Profit or Loss

Chapter 5 Measurement

Subsequent Measurement of Financial Assets

- An entity shall apply **the hedge accounting requirements** in para. 6.5.8–6.5.14 (and, if applicable, para. 89–94 of HKAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item. (para. 5.2.3)



Amortised Cost

Fair Value Through Other Comprehensive income

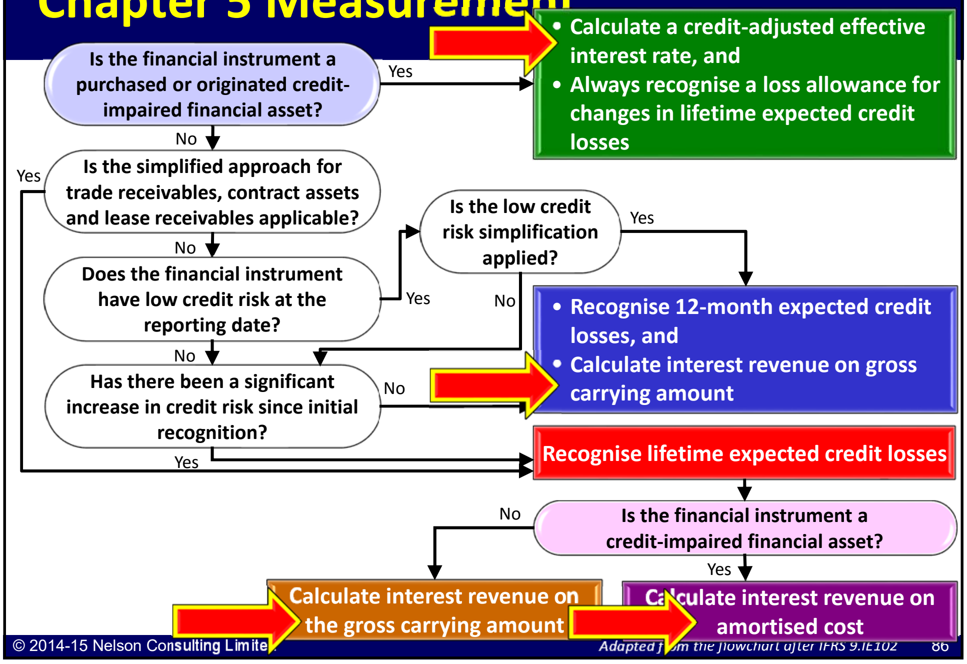
Fair Value Through Profit or Loss

Chapter 5 Measurement

Amortised Cost Measurement on Financial Assets

- Interest revenue shall be calculated by using the effective interest method (see Appendix A and para. B5.4.1–B5.4.7).
  - This shall be calculated by applying the **effective interest rate** to the **gross carrying amount** of a financial asset except for:
    - ***a. purchased or originated credit-impaired financial assets***
      - For those financial assets, the entity shall apply the **credit-adjusted effective interest rate** to the amortised cost of the financial asset from initial recognition.
    - *b. financial assets that are not purchased or originated credit-impaired financial assets but subsequently* ***have become credit-impaired financial assets***
      - For those financial assets, the entity shall apply the effective interest rate to the **amortised cost** of the financial asset in subsequent reporting periods. (para. 5.4.1)

Chapter 5 Measurement



Chapter 5.5 Impairment

Topics Covered

1. Recognition of Expected Credit Losses
   - General approach
   - Determining significant increases in credit risk
   - Modified financial assets
   - Purchased or originated credit-impaired financial assets
2. Simplified Approach for Trade Receivables, Contract Assets and Lease Receivables
3. Measurement of Expected Credit Losses

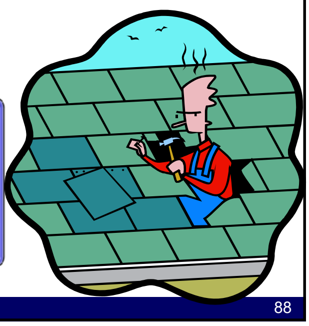
Chapter 5.5 Impairment

Recognition of Expected Credit Losses – General Approach

- An entity shall recognise a loss allowance for expected credit losses on
  - a financial asset that is measured in accordance with para. 4.1.2 or 4.1.2A,
  - a lease receivable,
  - a contract asset or
  - a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with para. 2.1(g), 4.2.1(c) or 4.2.1(d). (para. 5.5.1)

HKFRS 9 defines **expected credit losses** as:

- The weighted average of credit losses with the respective risks of a default occurring as the weights.



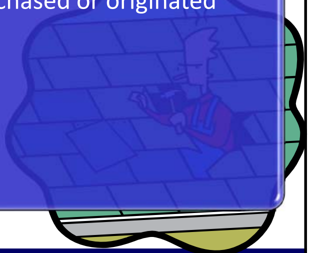
Chapter 5.5 Impairment

Recognition of Expected Credit Losses – General Approach

HKFRS 9 defines **credit losses** as:

- The difference between
  - all contractual cash flows that are due to an entity in accordance with the contract and
  - all the cash flows that the entity expects to receive

  (i.e. all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

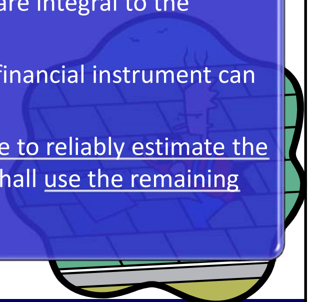


Chapter 5.5 Impairment

Recognition of Expected Credit Losses – General Approach

HKFRS 9 defines **credit losses** as:

- An entity shall estimate cash flows by considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument.
- The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.
- There is a presumption that the expected life of a financial instrument can be estimated reliably.
- However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.

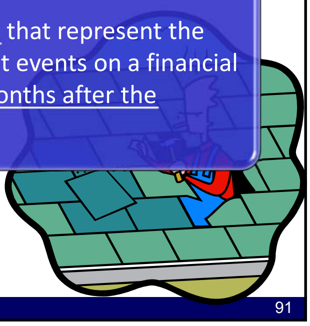


Chapter 5.5 Impairment

Recognition of Expected Credit Losses – General Approach

HKFRS 9 defines

- **Lifetime expected credit losses** as:
  - The expected credit losses that result from all possible default events over the expected life of a financial instrument.
- **12-month expected credit losses** as:
  - The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.



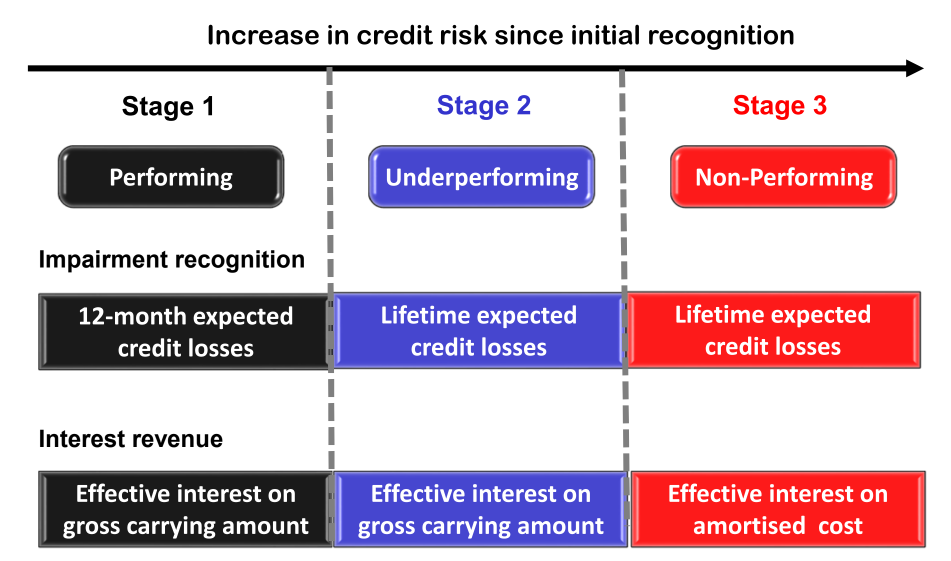
Chapter 5.5 Impairment

What are the stages?

Stage 1	Stage 2	Stage 3
As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established. This serves as a proxy for the initial expectations of credit losses. For financial assets, interest revenue is calculated on the gross carrying amount (ie without adjustment for expected credit losses).	If the credit risk increases significantly and the resulting credit quality is not considered to be low credit risk, full lifetime expected credit losses are recognised. Lifetime expected credit losses are only recognised if the credit risk increases significantly from when the entity originates or purchases the financial instrument. The calculation of interest revenue on financial assets remains the same as for Stage 1.	If the credit risk of a financial asset increases to the point that it is considered credit-impaired, interest revenue is calculated based on the amortised cost (ie the gross carrying amount adjusted for the loss allowance). Financial assets in this stage will generally be individually assessed. Lifetime expected credit losses are still recognised on these financial assets.
Initial recognition	Credit risk increases significantly	Credit impaired

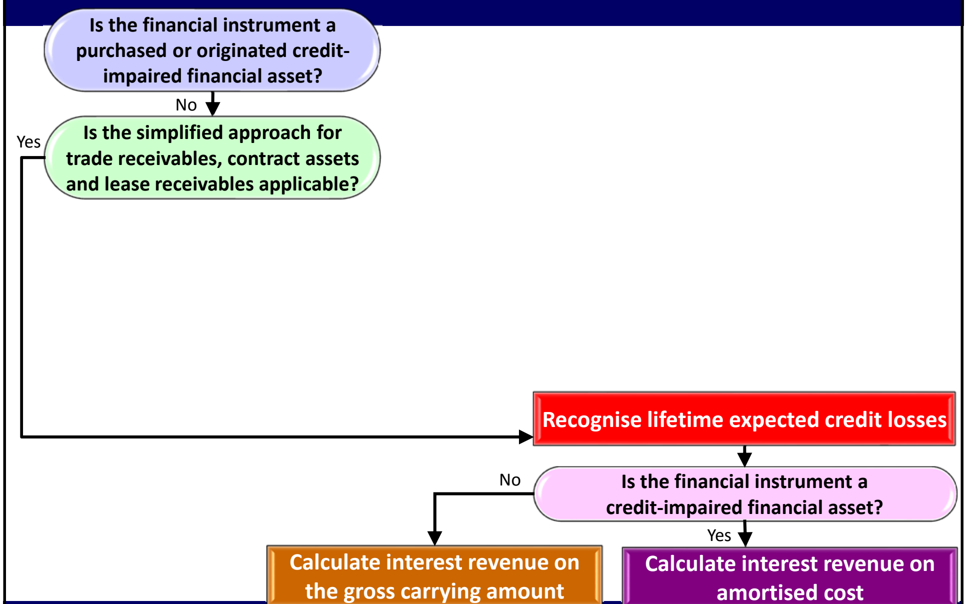
Adapted from the IASB's Project Summary issued in July 2014

Chapter 5.5 Impairment



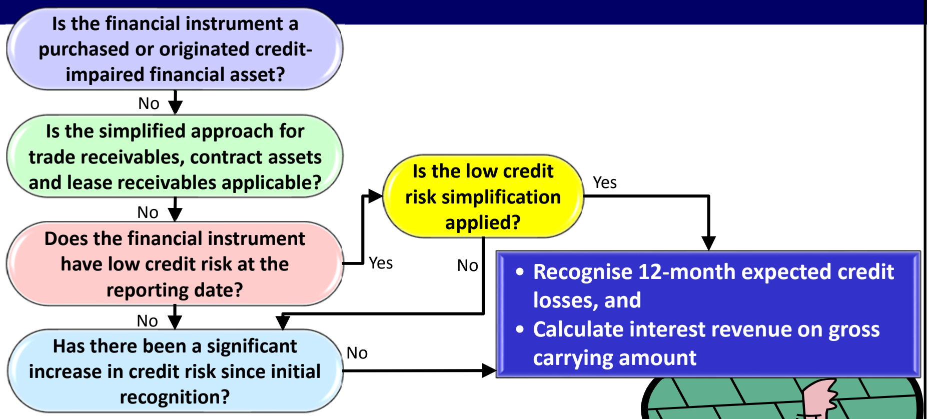
Adapted from the IASB's Project Summary issued in July 2014

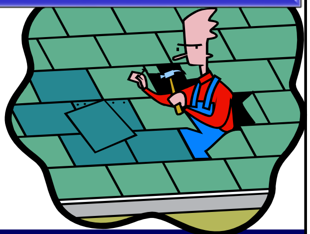
Chapter 5.5 Impairment – Simplified



Adapted from the flowchart after IFRS 9.IE102

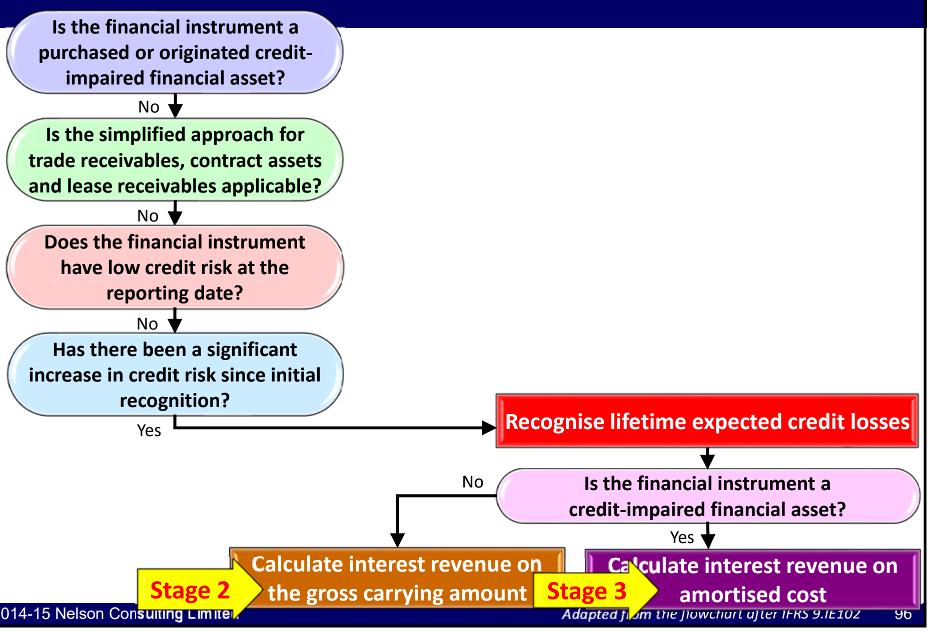
Chapter 5.5 Impairment – Stage 1





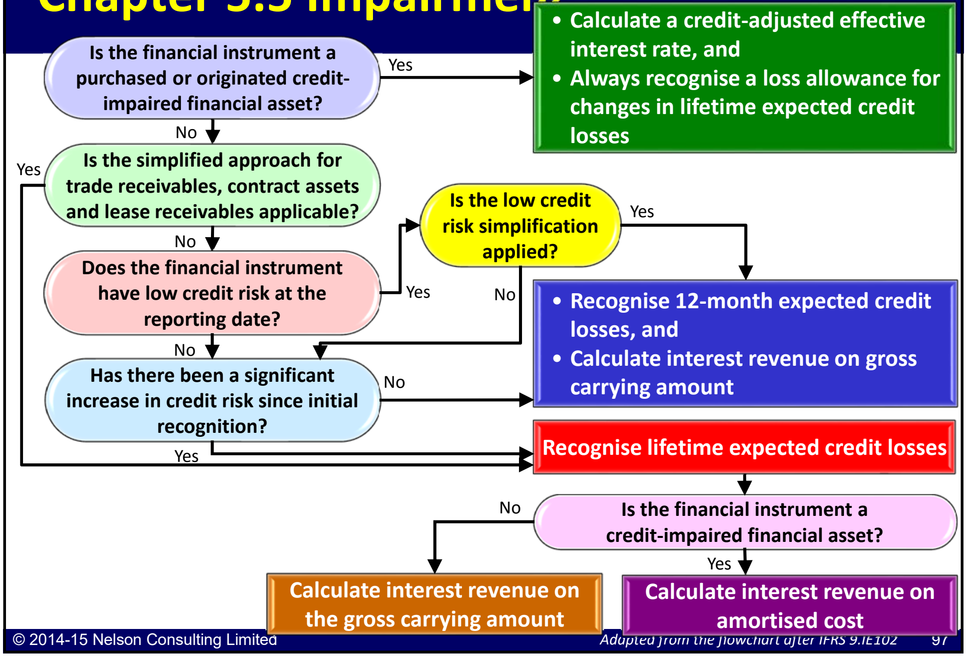
Adapted from the flowchart after IFRS 9.IE102

Chapter 5.5 Impairment – Stage 2 & 3



Adapted from the flowchart after IFRS 9.IE102

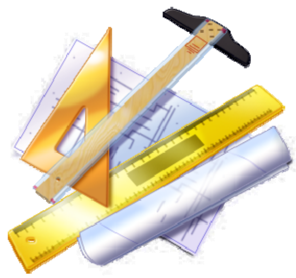
Chapter 5.5 Impairment



Chapter 5.5 Impairment

Measurement of Expected Credit Losses

- An entity shall measure expected credit losses of a financial instrument in a way that reflects:
  a. an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
  b. the time value of money; and
  c. reasonable and supportable information that is available without undue cost or effort at the reporting date about
     - past events,
     - current conditions and
     - forecasts of future economic conditions.
     (para. 5.5.17)



Chapter 5.5 Impairment

Example

Amortised Cost on Low Interest Loan

- Advance Finance Inc. granted a 3-year loan of $50,000 to an important new customer in 1 Jan. 2018.
  - The interest rate on the loan is 4%
  - The current market lending rates for similar loans is 6%
- At initial recognition, Entity A recognised $47,327.
- End of first year, the amortised cost was $48,167.
- The repayment schedule:

	Balance b/f	Effective interest (6%)	Interest received (4%)	Balance c/f
31.12.2018	$ 47,327	$ 2,840	($ 2,000)	$ 48,167
31.12.2019	$ 48,167	$ 2,890	($ 2,000)	$ 49,057
31.12.2020	$ 49,057	$ 2,943	($ 2,000)	$ 50,000

- At 2 Jan. 2019, Advance agreed a loan restructure, and waived all the interest payments in 2019 and 2020.

Chapter 5.5 Impairment

Example

	Cash to be received as estimated at 2.1.2019	Discount factor	Present value
31.12.2019	$ 0	$1 / (1 + 6\%)^1$	$ 0
31.12.2020	$ 50,000	$1 / (1 + 6\%)^2$	$ 44,500

Carrying amount (per the balance as at 31.12.2019)	$ 48,167
Present Value of estimated future cash flows discounted at original effective interest rate as at 2.1.2019	44,500
Impairment loss	$ 3,667

Dr	Impairment loss (in income statement)	$3,667	
Cr	Allowance on impairment loss (alternatively, Loans and receivables)		$3,667

How will it be affected by HKFRS 9?

Example

Amortised Cost on Low Interest Loan

- Advance Finance Inc. granted a 3-year loan of $50,000 to an important new customer in 1 Jan. 2018.
  - The interest rate on the loan is 4%
  - The current market lending rates for similar loans is 6%
- At initial recognition, Entity A recognised $47,327.
- End of first year, the amortised cost was $48,167.
- The repayment schedule:

Stage 1

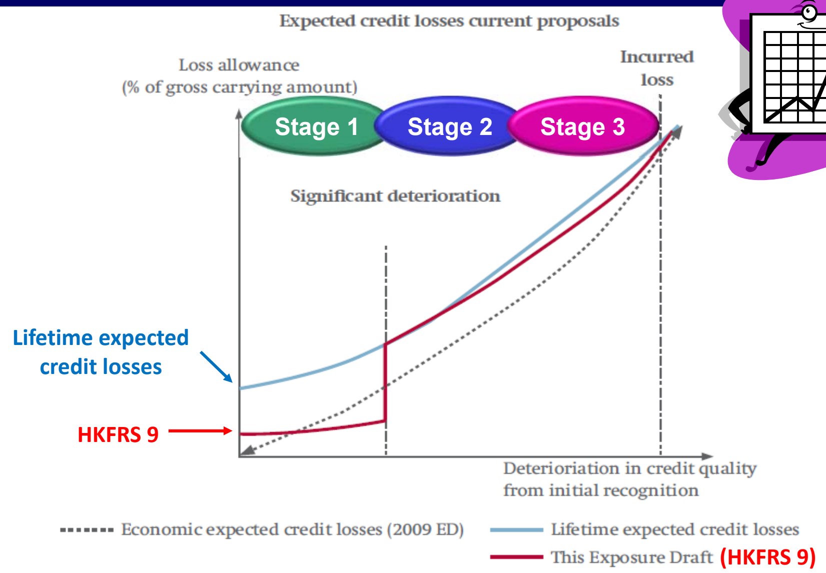
Stage 2?

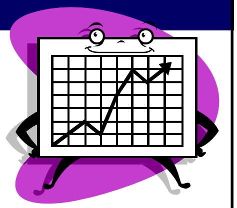
	Balance b/f	Effective interest (6%)	Interest received (4%)	Balance c/f
31.12.2018	$ 47,327	$ 2,840	($ 2,000)	$ 48,167
31.12.2019	$ 48,167	$ 2,890	($ 2,000)	$ 49,057
31.12.2020	$ 49,057	$ 2,943	($ 2,000)	$ 50,000

- At 2 Jan. 2019, Advance agreed a loan restructure, and waived all the interest payments in 2019 and 2020.

Stage 3?

How will it be affected by IFRS 9?





Chapter 6 Hedge Accounting

- More principles-based to align hedge accounting more closely with risk management
- Conditions for hedge accounting rewritten
- Hedge effectiveness assessment is forward-looking only and no arbitrary bright line effectiveness range,
- Credit risk is not expected to dominate the value change in the hedge relationship
- No changes on 3 types of hedging accounting, fair value, cash flow and net investment hedge

Hedging – Hedge Accounting Conditions

HKFRS 9 has a choice for an entity to use the hegding model in HKFRS 9 or HKAS 39

HKFRS 9 retains the mechanics of 3 types of hedge accounting

Hedging Instrument | **Hedged Item**

→ **Hedging Relationship**

⇅ **Conditions for Hedge Accounting**

Hedging Relationship → **Fair Value Hedge** / **Cash Flow Hedge** / **Hedge of Net Investment in a Foreign Operation**

A **Hedging Relationship** qualifies for **Hedge Accounting** if and only if all the **Conditions for Hedge Accounting** are met

HKFRS for Private Entities

Key Changes (HKICPA Update No. 175)

- Allowing an option to use the revaluation model for property, plant and equipment; and
- Replacing the modified text in section 29 *Income Tax* of HKFRS for PE with the revised section 29 of the amendments to the IFRS for SMEs.
  - As a result of this change, the recognition and measurement requirements for deferred income taxes of HKFRS for PE, IFRS for SMEs and IAS 12 *Income Taxes* are now aligned.
- The other amendments
  - clarify the existing requirements or add supporting guidance,
  - instead of changing the underlying requirements in the standard.

SME-FRF and FRS and Co. Ord. (Cap. 622)

Scope – HK Incorporated Entity

- The new HK Companies Ordinance (Cap. 622) ("new CO")
  - becomes effective on 3 March 2014,
  - contains an optional reporting exemption for certain private companies and companies limited by guarantee which satisfy the conditions set out in section 359 of the new CO.
- The Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard which are effective for annual periods beginning on or after 3 March 2014 (the "SME-FRF and FRS (2014)")
  - are the accounting standards issued by the HKICPA that are to be followed in accordance with section 380(4) by those HK incorporated companies which are entitled to, and decide to, take advantage of this reporting exemption in the new CO (SME-FRF para. 1)

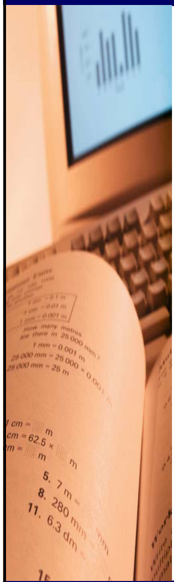
Scope – Non-HK Incorporated

- In accordance with para. 23 of the SME-FRF (2014), an entity which is not a company incorporated under either the new CO or the predecessor CO (Cap. 32), subject to any specific requirements imposed by the law of the entity's place of incorporation and subject to its constitution,
  - qualifies for reporting under the SME-FRF when the entity meets the same requirements that a HK incorporated entity is required to meet under section 359 of the new CO (SME-FRF para. 2)

Scope – Effective Date

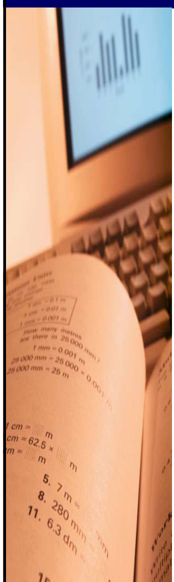
- Consistent with section 358 of the new CO,
  - this revised SME-FRF becomes effective for a Qualifying Entity's financial statements that cover a period beginning on or after 3 March 2014, the commencement date of the new CO
- Earlier application of this revised SME-FRF is not permitted (SME-FRF para. 53)

Key Changes from Old SME-FRF and FRS



1. A summary of the criteria for "qualifying entities" with cross-references to the new CO included
   SME-FRF (2014) Para. 22-43
2. New specific disclosure requirements to cover the first year that a company transitions from a different GAAP to SME-FRS
   SME-FRF (2014) Para. 44-45
3. New guidance on the concept of "realized profits and losses"
   SME-FRF (2014) Para. 46-52
4. New sections to cover business combinations, consolidated financial statements, joint arrangements and associates
   SME-FRS (2014) Section 18-21
5. New guidance on presenting a cash flow statement (optional)
   SME-FRS (2014) Section 22

Key Changes from Old SME-FRF and FRS



6. Additional disclosure requirements in the Income Taxes section for disclosure of applicable tax rates and unused tax losses
   SME-FRS (2014) Section 14.9
7. New guidance on determining the "reporting currency" (same as functional currency)
   SME-FRS (2014) Section 15
8. The definition of "related party" aligned with the definition in full HKFRS
   SME-FRS (2014) Definitions
9. The definitions of "active market" & "fair value" updated to be consistent with HKFRS 13
   SME-FRS (2014) Definitions
10. New guidance on determining whether an entity is acting as an agent or principal
    SME-FRS (2014) Appendix 1
11. Additional guidance on the non-exempted disclosure requirements in the new CO and certain other provisions
    SME-FRS (2014) Appendix 1

Criteria for Qualifying Entities

- Follows the new CO with some further explanations on "**Reporting Exemption**" for easy reference
- Meeting the size tests in the first year that the new CO applies
  - In accordance with sub-section (2) of each of sections 361 to 366 of the new CO (as applicable), the entity will qualify for the reporting exemption for the first financial year beginning on or after 3 March 2014 if it meets the relevant size tests:
    - (a) in that first financial year; and/or
    - (b) in the immediately preceding financial year.
  - If the entity qualifies in the first financial year in accordance with the above, it will continue to qualify until it is disqualified in accordance with sub-section (4) (as set out in para. 32 of SME-FRS). (SME-FRF para. 30)

Criteria for Qualifying Entities

- Meeting the size tests in all subsequent financial years
  - In accordance with sub-section (3) of each of ss. 361 to 366 of the new CO (as applicable), an entity which was **previously disqualified** on the grounds of its size
    - will need to meet the size tests for two consecutive reporting periods, before it will qualify for the reporting exemption in the third reporting period, regardless of its size in that period (SME-FRF para. 31)

Previously disqualified	Meet the size test	Can use reporting exemption
2015	×	×
2016	√	×
2017	√	×
2018	×	√
2019	×	√

Criteria for Qualifying Entities

- Meeting the size tests in all subsequent financial years
  - In accordance with sub-section (4) of each of ss. 361 to 363, or sub-section (5) of each of ss. 364 to 366, of the new CO (as applicable), where an entity has **previously qualified** for the reporting exemption in terms of its size,
    - the entity will continue to qualify for the reporting exemption even when it no longer meets the relevant size tests, unless the entity has failed the size tests for two consecutive reporting periods
    - it will then fail to qualify for the reporting exemption in the third reporting period, regardless of its size in that period. (SME-FRF para. 32)

Previously qualified	Meet the size test	Can use reporting exemption
2015	√	√
2016	×	√
2017	×	√
2018	√	×

Criteria for Qualifying Entities

- An **exception to this two year grace period** for losing entitlement is where a new company enters the group.
  - In this case, in accordance with sub-section (4) of each of sections 364 to 366 of the new CO (as applicable),
    - if the new subsidiary is such that the group fails the size tests in that year,
      - the group will no longer be eligible for the reporting exemption in the year in which the new company enters the group (SME-FRF para. 33)

Criteria for Qualifying Entities

Company	Qualifying Conditions
A. A private co. is a "small private co.", or A private co. is the holding co. of a group of "small private companies"	➢ Size test, meeting any 2 of the following: i. Revenue less than \$100M, ii. Assets less than \$100M, iii. Employee less than 100
B. An eligible private co., or An eligible private co. is the holding co. of a "group of eligible private companies"	➢ Size test, meeting any 2 of the following: i. Revenue less than \$200M, ii. Assets less than \$200M, iii. Employee less than 100 ➢ 75% members' approval without any member objection
C. A "small guarantee co.", or A guarantee co. is the holding co. of a "group of small guarantee companies"	➢ Size test, revenue less than \$25M
D. Option similar to s. 141D of Cap. 32	➢ S. 359(1)(b)

Criteria for Qualifying Entities

- **Size tests for group** of small guarantee companies, small private companies, and eligible private companies
  - each company in the group must meet the size tests; and
  - the aggregate amounts for the group in total must meet the size tests (SME-FRF para. 35, 37 ad 39)

Criteria for Qualifying Entities

- **Shareholder Approval**
  - In accordance with section 360 of the new CO, the shareholder approval requirements for the larger **"eligible" category of private companies or groups** are as follows:

    a) to gain exemption as a larger "eligible" private company at least 75% of all the members must pass a resolution at a general meeting that the company is to fall within the reporting exemption for the financial year, with none objecting; and

    b) to gain exemption for a group of larger "eligible" private companies all the companies in the group individually, as well as the parent of the group, must have obtained the necessary shareholder approval
      - except for those subsidiaries within the group that fall within the "small private company" category

Criteria for Qualifying Entities

- **Shareholder Approval**
  - The 75% vote is calculated as a percentage of the entire shareholding of a company, not simply as a percentage of the shareholders who attend the general meeting.

  - The resolution is **defeated** if any member objects either
    - at the meeting or
    - at any time by giving notice in writing to the company,

    provided that the written notice is given at least 6 months before the end of the financial year to which the objection relates. (SME-FRF para. 42)
  - For s. 359(1)(b) (i.e. new version of s.141D) exemption, in order to qualify it,
    - The company obtain 100% approval from their shareholders each year
    - This approval must be in writing and can only be given for one year at a time (SME-FRF para. 43)

Criteria for Qualifying Entities

- **Shareholder Approval**
  - The New CO FAQ Q8 of the Companies Registry also clarifies that:
    - Sections 360(1) and (2) require a resolution passed by the members holding at least 75% of the voting rights in the company, i.e. 75% of the voting rights of all members of the company.

Criteria for Qualifying Entities

- **A parent with one or more subsidiaries incorporated outside HK**
  - The New CO FAQ Q5 of the Companies Registry clarifies that:
    - To fall within the reporting exemption as a group, each company in the group must be a company formed and registered under the CO (Cap. 622) or a former CO.
    - Take the example of a group of small private companies, to qualify as a group, sections 364(1) & (2) and section 1(7) of Schedule 3 require that each company in the group be qualified as a small private company.
      - Under section 361, a company qualifies as a small private company if it is a private company formed and registered under the CO or a former CO and the specified conditions are met. A company incorporated outside Hong Kong cannot be a small private company within section 361.
      - Hence section 1(7) of Schedule 3 cannot be satisfied if any company in the group is not a Hong Kong company.
    - The same rationale applies to a group of eligible private companies and a group of small guarantee companies respectively under sections 365 and 366.

Criteria for Qualifying Entities

- **Is there any requirement to deliver a copy of the agreement (Section 359(1)(b)(iii)) or the resolution (Sections 360(1) and (2)) to the Registrar of Companies for registration?**
  - The New CO FAQ Q9 of the Companies Registry clarifies that:
    - Yes.
    - A company must deliver a copy of
      - an agreement made for the purposes of section 359(1)(b)(iii) or
      - a resolution passed for the purposes of section 360(1) or (2)

      to the Registrar for registration respectively within 15 days after it is made or passed pursuant to sections 622(1)(e) and (f) of the new CO.

Companies Registry
The Government of the Hong Kong Special Administrative Region

New Sections in SME-FRS

- New sections to cover business combinations, consolidated financial statements, joint arrangements and associates

Section 18	*Business Combinations and Goodwill*
Section 19	*Consolidated and Company-level Financial Statements*
Section 20	*Investments in Associates*
Section 21	*Interests in Joint Ventures and Other Forms of Joint Arrangements*

Guidance on Non-Exempted Disclosure

- Appendix 1 Section D
  - As explained in para. 21 of the SME-FRF, unless specifically exempt from a particular requirement,
    - the financial statements and directors' report prepared by a qualifying entity are required to follow the same requirements in the new CO as apply to full financial statements and directors' reports.
  - These non-exempt disclosure requirements which apply under the new CO are set out below:
    - S. 383 (disclosure of directors' emoluments)
    - Sch. 4 Part 1.1 (aggregate amount of authorized loans)
    - Sch. 4 Part 1.2 (company-level balance sheet disclosed in notes)
    - Sch. 4 Part 1.3 (subsidiary's financial statements must contain particulars of ultimate parent undertaking)
    - Sch. 4 Part 1.4 (compliance with applicable acc. standards)
    - S. 387 (approved by the directors and signed by 2 directors)

Today's Agenda

Update of New Companies Ordinance Relevant to Financial Reporting

Update of New CO Relevant to Fin. Rep.

- May not be exhaustive and
- May be updated from time to time

Update of New Companies Ordinance Relevant to Financial Reporting

Impact on Financial Statements | Impact on Directors' Report | Business Review

Impact on Financial Statements

- Lengthy list of disclosure in Tenth Schedule of the old CO (Cap. 32) fully deleted
- Schedule 4 to the New CO (Cap. 622)
  - Part 1 (for all companies, as also relevant to and discussed in the revised SME-FRS)
  - Part 2 (for companies without reporting exemption): remuneration of auditor
    1. Financial statements must state, under a separate heading, the amount of the remuneration of the auditor
    2. In this section— remuneration (酬金), in relation to an auditor of a company, includes any sum paid by the company in respect of the auditor's expenses.

Impact on Financial Statements

Impact on Financial Statements

- Reporting exemption under section 359
- Clarifying the **financial year** and **accounting reference period**
  - Determination of the financial year of a company which is the same as the accounting reference period
    - Unless exempted under sections 612 or 613, companies are required to hold an AGM within
      - 6 months (for public companies) or
      - 9 months (for private companies or companies limited by guarantee)

      after the end of the accounting reference period

Impact on Financial Statements

Impact on Financial Statements

- **Financial year** and **accounting reference period**
  - Section 367 provides for the beginning and end of a company's **first financial year** after the new CO comes into operation, and that of subsequent financial years, by reference to a company's first **accounting reference period**
    - The **accounting reference period** is the period by reference to which the company's financial statements are to be prepared.
  - Every subsequent accounting reference period is
    - a period of 12 months beginning immediately after the end of the previous accounting reference period and ending on its accounting reference date,
      - unless it is shortened or extended by alteration of the **accounting reference date** (section 368(3))

Impact on Financial Statements

Impact on Financial Statements

- **Accounting reference date**
  - Defined in section 370
    - It can be altered by a directors' resolution pursuant to section 371.
    - In the case of alteration of an accounting reference date of a public company or a company limited by guarantee,
      - notice of the new accounting reference date must be delivered to the Registrar for registration within 15 days after the date of the directors' resolution (section 371(2))

Impact on Financial Statements

Impact on Financial Statements

- Disclosure of emoluments and other matters relating to directors
  - Section 383 requires the information prescribed by the relevant Regulation about the following items to be disclosed in the notes:
    a. the directors' emoluments;
    b. the directors' retirement benefits;
    c. payments made or benefit provided in respect of the termination of the service of directors (in the directors or other capacity while directors);
    d. loans, quasi-loans and other dealings in favour of (i) directors of the company and a holding company of the company; (ii) bodies corporate controlled by such directors; (iii) entities connected with such directors;
    e. material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group of companies;
    f. consideration provided to or receivable by third parties for making available the services of a person as a director or in any other capacity while director.

Impact on Financial Statements

Impact on Financial Statements

- Disclosure of emoluments and other matters relating to directors
  - The relevant Regulation (for section 383) is the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G)
  - In addition, section 1 of Schedule 4 to the new CO requires that the financial statements for a financial year must contain, under separate headings, the aggregate amount of any outstanding loans made under the authority of sections 280 and 281 during the financial year.
    - While directors are explicitly excluded from the scope of section 281, loans made to them for the purposes of employee share schemes may fall under the scope of section 280.
  - In the case of a holding company that has to prepare consolidated financial statements and a consolidated directors' report, there is no requirement to make the disclosures on a consolidated basis.
    - These disclosures are limited to the directors of the holding company only.

Impact on Financial Statements

Impact on Financial Statements

- Section 380(4): Legal backing to HKFRSs (with pros and cons)

> Section 380. General requirements for financial statements
>
> (4) The financial statements for a financial year must also comply with—
>
> (a) any other requirements of this Ordinance in relation to the financial statements; and
>
> (b) the **accounting standards** applicable to the financial statements.

Impact on Financial Statements

Impact on Financial Statements

- Exemptions from preparing consolidated financial statements
  - Section 379(3)(a): a wholly owned subsidiary of another body corporate
  - Section 379(3)(b): if—
    - a partially owned subsidiary of another body corporate;
    - at least 6 months before year end, notify the members in writing of the intention not to prepare consolidated statements for that year only; and
    - 3 months before year end, no member has responded a written request for the preparation of consolidated statements for that year

Impact on Financial Statements

Impact on Financial Statements

- **Can a parent which is a wholly owned subsidiary of another body corporate prepare consolidated financial statements instead of company level financial statements?**
  - The New CO FAQ Q13 of the Companies Registry clarifies that:
    - The law does not require the wholly owned subsidiary to prepare company level financial statements and consolidated financial statements for the same financial year.
    - If the holding company is a wholly owned subsidiary of another body corporate at the end of the financial year, the company is not required to prepare consolidated financial statements.
    - However, the company may prepare consolidated statements so long as the consolidated statements comply with sections 380 and 383 and in every respect with the accounting requirements applicable to consolidated statements.
    - In such event, the company is not required to prepare company level financial statements.

Impact on Financial Statements

- **Can a parent which is a wholly owned subsidiary of another body corporate prepare consolidated financial statements instead of company level financial statements?**
  - The New CO FAQ Q13 of the Companies Registry clarifies that:
    - If the consolidated statements do not comply in every respect with the accounting requirements applicable to consolidated statements, then the company is required to prepare company level financial statements.
    - In such event, any additional consolidated statements or consolidated financial information that the company chooses to prepare in respect of the full financial year will be regarded as "non statutory accounts" within the meaning of section 436 and the requirements in the new CO in relation to financial statements, for example, the auditing, laying, sending and filing of financial statements, apply to the company level financial statements and not the consolidated statements.

Accounting Bulletin 6 addresses section 436

New CO Impact on Financial Reporting

- Terminology updated to HKFRSs
  - Accounts → Financial statements
  - Group accounts → Consolidated financial statements
  - Profit and loss account → Statement of comprehensive income
  - Balance sheet → Statement of financial position

Impact on Financial Statements

Impact on Directors' Report

- The disclosure requirements for the directors' report under the new CO (Cap. 622) are contained in the following locations:
  a. Sections 388 to 391 and 543(2)
  b. Schedule 5 "Contents of Directors' Report: Business Review" (unless exempt under section 388(3)); and
  c. Companies (Directors' Report) Regulation (Cap. 622D)
- In addition, section 391 sets out the requirements relating to the approval and signature of the directors' report.

Impact on Directors' Report

Impact on Directors' Report

- Changes in the directors' report summarised as follows:
  - The names of all the directors in the group must be disclosed in a consolidated directors' report, and the disclosure should extend to the date of approving the directors' report
  - Disclosure of significant transactions, arrangements or contracts entered into by the company, where a director has a material interest, has been moved to the financial statements and will therefore be subject to audit
  - New disclosure requirements:
    - reasons for a director resigning or not seeking re-appointment, if related to the affairs of the company;
    - permitted indemnity provisions; and
    - equity-linked agreements

Impact on Directors' Report

Impact on Directors' Report

- Changes in the directors' report summarised as follows:
  - Certain disclosure requirements have been dropped from the directors' report (as moved to notes to financial statements)
  - Unless the company is exempt, a new "business review" section must be included in the directors' report

Impact on Directors' Report

Business Review

Business Review

Exemption for business review and election of SME-FRS can be an independent issue

- Section 388(3) sets out 3 situations under which a company is exempt from including a business review in the directors' report in compliance with Schedule 5. These are:
  a. the company falls within the reporting exemption;
  b. the company is a wholly owned subsidiary of another body corporate in the financial year; or
  c. the company is a private company that does not fall within the reporting exemption for the financial year, and a special resolution is passed by members to the effect that the company is not to prepare a business review required by that Schedule for the financial year.
     - Section 388(4) requires that the resolution must be passed at least 6 months before the year end
     - Section 622(2) requires the delivery of a copy of the resolution to the Companies Registrar for registration within 15 days after it is made or passed

Business Review

Business Review – Contents

- Schedule 5 "Contents of Directors' Report: Business Review":
  1. A directors' report for a financial year must contain a business review that consists of—
     a. a fair review of the company's business;
     b. a description of the principal risks and uncertainties facing the company;
     c. particulars of important events affecting the company that have occurred since the end of the financial year; and
     d. an indication of likely future development in the company's business.

Business Review

Business Review – Contents

- Schedule 5 "Contents of Directors' Report: Business Review":
  2. To the extent necessary for an understanding of the development, performance or position of the company's business, a business review must include
     a. an analysis using financial key performance indicators;
        – key performance indicators (關鍵表現指標) means factors by reference to which the development, performance or position of the company's business can be measured effectively.
     b. a discussion on—
        i. the company's environmental policies and performance; and
        ii. the company's compliance with the relevant laws and regulations that have a significant impact on the company; and
     c. an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company and on which the company's success depends.

Business Review

Update of New CO Relevant to Fin. Rep.

- May not be exhaustive and
- May be updated from time to time

Personal Sharing

Update of New Companies Ordinance Relevant to Financial Reporting

Impact on Financial Statements

Impact on Directors' Report

Business Review

Financial Reporting Update 2015

9 October 2015

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Financial Reporting Update 2015

9 October 2015

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