

# Practical Application Issues: HKFRS & CO

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## Today's Agenda

Recap & Update of New CO Relevant  
to Financial Reporting & SME-FRS

Update of HKFRS 9, 15 and 16



More Presentations and Sample Financial Statements  
can be found in:

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## Practical Issues on New Co. Ordinance

- Impact on Financial Statements
  - Adoption of SME-FRS
  - Section 379: Directors must prepare financial statements (and consolidation exemption)
  - Section 380: General requirements for financial statements
  - Section 383: Disclosure of emoluments and other matters relating to directors
  - Schedule 4 and Section 387
- Impact on Directors' Report
- Business Review and AG5
- Section 436 and AG6



## Adoption of SME-FRS: Criteria

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)

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## Adoption of SME-FRS: Criteria

### • Shareholder Approval

- The New CO FAQ Q7 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.



**Q7.** An eligible private company / holding company of a group of eligible private companies may prepare simplified reports if it meets the higher size criteria and has 75% approval from members. Does the 75% mean 75% of the voting rights of ALL members of the company OR 75% of the voting rights of those members attending a general meeting to pass a resolution for such purpose?

**Answer:** 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.

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Source: CR website (Last revision date: 27 April 2016)

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## Adoption of SME-FRS: Criteria

- **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 Q8 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.

**Q8.** Is there any requirement to deliver a copy of the agreement or the resolution mentioned in Q6 and Q7 above to the Registrar of Companies for registration?

Answer: 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.

## Impact on Financial Statements

- No-par or no nominal value regime (effective on 3 March 2014)
- Terminology updated to HKFRSs
  - Financial statements, consolidated financial statements, statement of comprehensive income, statement of financial position ...
- **Section 379.** Director must prepare financial statements
  - **Section 379(1):** A company's directors must prepare for each financial year statements that comply with sections 380 and 383.
  - **Section 379(2):** Despite subsection (1), if the company is a holding company at the end of the financial year, the directors must instead prepare for the financial year consolidated statements that comply with sections 380, 381 and 383.

## 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

### Example

- Section 380. General requirements for financial statements
  - Legal backing to HKFRSs (with pros and cons)
  - Lengthy list of disclosure in Tenth Schedule of the old CO (Cap. 32) fully deleted

#### 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

- Q&A relating to consol. and co. level financial statements prepared under Part 9 of the new CO (dated 25.1.16 by HKICPA)
  - **Topic 1 Application of section 379** – Question 1.5: Identifying the relevant accounting standards when a holding company prepares company level financial statements in accordance with section 379(3)
    - The holding company can exempt from preparation of consolidated financial statements under section 379(3), but for example, the criteria in HKFRS 10.4(a)(iv) would not be met in the following situations:
      - (a) the holding co. is a wholly owned subsidiary of a private HK incorporated co. which is not required to file its financial statements on public record; or
      - (b) the holding co. is a wholly owned subsidiary of a US parent which issues US GAAP financial statements but does not issue IFRS financial statements.
        - » In such cases which accounting standards are the “applicable accounting standards” for the purposes of complying with s380(4)(b) of the CO if the company follows the requirements of s379(3)?

## Impact on Financial Statements

- Summary of answers:
  - **s379** determines which type of financial statements need to be prepared (company level or consolidated) and
  - **s380** then contains the “general requirements for financial statements” being the requirements for the contents of those financial statements (company level or consolidated) as are required to be prepared under s379
  - (as a result) the company, as a holding company, shall account for investments in subsidiaries either at cost or in accordance with HKFRS 9 in its company level financial statements if the company does not elect to account for the investments using the equity method as permitted by paragraph 10(c) of HKAS 27 *Separate Financial statements*.
  - In addition, as the financial statements are prepared in respect of the holding company only, the disclosures required by HKFRS 12 *Disclosures of Interests in Other Entities* are not applicable
  - For details, please refer to original Q&A in HKICPA’s website

## Impact on Financial Statements

**Q13.** Notwithstanding Q11 bullet 3 above, can a holding company which is a wholly owned subsidiary of another body corporate prepare consolidated financial statements instead of company level financial statements?

**Answer:** 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.

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.

## Impact on Financial Statements

- **Section 381.** Subsidiary undertakings to be included in annual consolidated financial statements
  - **Section 381(1):** Subject to subsections (2) and (3), the annual consolidated financial statements for a financial year must include all the subsidiary undertakings of the company.
  - **Section 381(2):** Where the company falls within the reporting exemption for the financial year, one or more subsidiary undertakings may be excluded from the annual consolidated financial statements in compliance with the accounting standards applicable to the statements.

## Impact on Financial Statements

- **Section 381.** Subsidiary undertakings to be included in annual consolidated financial statements
  - **Section 381(3):** Where the company does not fall within the reporting exemption for the financial year—
    - (a) one subsidiary undertaking may be excluded from the annual consolidated financial statements if the inclusion of the subsidiary undertaking is not material for the purpose of giving a true and fair view of the financial position, and of the financial performance, mentioned in section 380(2)(a) and (b); and
    - (b) more than one subsidiary undertaking may be excluded from the annual consolidated financial statements if the inclusion of those subsidiary undertakings taken together is not material for the purpose of giving a true and fair view of the financial position, and of the financial performance, mentioned in section 380(2)(a) and (b).

## Impact on Financial Statements

**Q10.** Section 381(2) provides that where the company falls within the reporting exemption for the financial year, one or more subsidiary undertakings may be excluded from the annual consolidated financial statements in compliance with the accounting standards applicable to the statements. Can a company apply the “expense and delay out of proportion to the value to members” exception provided in the Small and Medium-sized Entity – Financial Reporting Standard (“SME-FRS”) to exclude its subsidiaries from the group for the purpose of determining the eligibility for reporting exemption? *(New)*

Answer: When determining the eligibility of the holding company of a group of companies for the reporting exemption under section 359(2) or (3), the size of the group as a whole is relevant. The relief provided in the SME-FRS is relevant for the purpose of excluding one or more subsidiary undertakings from the annual consolidated financial statements pursuant to section 381(2) only. In other words, the size of the group must satisfy the size criteria, and the exception in the SME-FRS should not be taken into account in determining eligibility for reporting exemption.



## Impact on Financial Statements

- Disclosure of emoluments and other matters relating to directors
  - **Section 383(1)** 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.

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## Impact on Financial Statements

Case



Lenovo Group Limited (incorporated in HK)  
Note 11a (extract) to Annual Report as at 31 March 2015

### 11 EMOLUMENTS OF DIRECTORS AND HIGHEST PAID INDIVIDUALS

#### (a) Directors' and senior management's emoluments

Directors' emoluments comprise payments by the Group to directors of the Company in connection with the management of the affairs of the Company and its subsidiaries. The remuneration of each director and the chief executive who is also a director, for the years ended March 31, 2015 and 2014 is set out below:

Name of Director	2015							Total US\$'000
	Fees US\$'000	Salaries US\$'000	Discretionary bonuses (note i) US\$'000	Long-term incentive awards (note ii) US\$'000	Retirement payments and employer's contribution to pension schemes US\$'000	Housing allowance US\$'000	Other benefits- in-kind US\$'000	
<i>Executive director</i>								
Mr. Yang Yuanqing (CEO)	-	1,338	5,740	11,921	134	286	22	19,441
<i>Non-executive directors</i>								
Mr. Zhu Lihan	88	-	-	193	-	-	-	281
Mr. Zhao John Huan	88	-	-	190	-	-	-	278
<i>Independent non-executive directors</i>								

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## Impact on Financial Statements

### Case



### China Motor Bus Company, Limited (incorporated in HK) Note 6a (extract) to Annual Report as at 30 June 2015

Directors' fees are set with reference to the articles of association of the company and are approved by the shareholders at Ordinary Yearly Meetings of the company.

Directors' bonus is calculated on the basis provided in the articles of association of the company.

Directors' emoluments disclosed pursuant to section 383 of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:-

Name	Directors' fees	Salaries, allowances and benefits in kind	Bonus in accordance with article 155	Group's contributions to retirement scheme	Total
	\$000's	\$000's	\$000's	\$000's	\$000's
<b>2015</b>					
Ngan Kit-ling	125	2,907	-	316	3,348
Dr. Ngan Kit-keung	65	1,471	-	133	1,669
Dr. Henry Ngan	65	600	-	-	665
Fritz Helmreich	65	600	-	-	665
Dr. Liu Lit-mo	60	-	-	-	60
Anthony Grahame Stott	120	-	-	-	120
Tse Yiu-wah	45	-	-	-	45
Stephen Tan	60	-	-	-	60
	<u>605</u>	<u>5,578</u>	<u>-</u>	<u>449</u>	<u>6,632</u>

## Impact on Financial Statements

- Introduce 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 Exemptions)

## Impact on Financial Statements

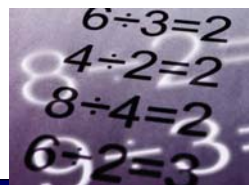
- **Schedule 4 “Accounting Disclosures” – Part 1 “Disclosures for Companies whether or not Falling within Reporting Exemption”**

### 1. Aggregate amount of authorized loans

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 (i.e. exception for employee share schemes, blanket added) and
- 281 (i.e. exception for loans to employees, blanket added)

during the financial year.



## Impact on Financial Statements

- **Schedule 4 “Accounting Disclosures” – Part 1 “Disclosures for Companies whether or not Falling within Reporting Exemption”**

### 2. Statement of financial position to be contained in notes to annual consolidated financial statements

- (1) The annual consolidated financial statements for a financial year—
  - (a) must contain, in the notes to the statements, the holding company’s statement of financial position for the financial year; and
  - (b) must include a note disclosing the movement in the holding company’s reserves.
- (2) Despite section 380(4), the holding company’s statement of financial position to be contained in the notes to the annual consolidated fin. statements for a financial year **is not required to contain any notes**.
- (3) That statement of financial position must be in the format in which that statement would have been prepared if the holding company had not been required to prepare any annual consolidated financial statements for the financial year.

# Impact on Financials

## Case

Lenovo Group Limited  
 Note 30a (extract) to  
 Annual Reports  
 2015 and 2016



### 30 BALANCE SHEET AND MOVEMENT OF RESERVES OF THE COMPANY

(a) Balance sheet of the Company

	At March 31	
	2016 US\$'000	2015 US\$'000
<b>Non-current assets</b>		
Property, plant and equipment	2,392	3,049
Construction-in-progress	-	296
Intangible assets	13,725	141,325
Interest in an associate	1,887	1,887
Investments in subsidiaries	8,207,833	8,100,648
Available-for-sale financial assets	56,064	31,801
	<b>8,288,096</b>	<b>8,278,006</b>
<b>Current assets</b>		
Deposits, prepayments and other receivables	96,099	54,252
Amounts due from subsidiaries	2,877,063	3,183,046
Cash and cash equivalents	44,404	15,440
	<b>3,017,566</b>	<b>3,252,738</b>
<b>Total assets</b>	<b>11,305,152</b>	<b>11,531,744</b>
Share capital	2,699,882	2,699,882
Reserves (Note 30c))	354,443	835,504
<b>Total equity</b>	<b>3,044,325</b>	<b>3,535,386</b>
<b>Non-current liabilities</b>		
Borrowings	2,505,112	1,866,848
Deferred revenue	114	4,806
Other non-current liabilities	1,384,857	1,652,981
	<b>3,894,883</b>	<b>3,524,635</b>
<b>Current liabilities</b>		
Derivative financial liabilities	7,082	131
Other payables and accruals	309,384	90,671
Borrowings	692,814	961,121
Deferred revenue	4,692	35,393
Amounts due to subsidiaries	3,353,272	3,340,697
	<b>4,367,044</b>	<b>4,458,013</b>
<b>Total liabilities</b>	<b>8,261,927</b>	<b>8,011,358</b>
<b>Total equity and liabilities</b>	<b>11,305,152</b>	<b>11,531,744</b>

On behalf of the Board

*Yang Yuanqing*

Yang Yuanqing  
 Chairman and Chief Executive Officer

*Ma Xuzheng*

Ma Xuzheng  
 Director

2015/16 Annual Report Lenovo Group Limited 227

# Impact on Financials

## Case



China Motor Bus  
 Company, Limited  
 (incorporated in HK)  
 Note 23 (extract) to  
 Annual Report as at  
 30 June 2015

### 23. STATEMENT OF FINANCIAL POSITION OF THE COMPANY

	NOTE	2015 \$'000's	2014 \$'000's
<b>NON-CURRENT ASSETS</b>			
FIXED ASSETS		24,861	825,021
INTEREST IN SUBSIDIARIES	11	1,018,356	1,018,356
		<b>1,043,217</b>	<b>1,843,377</b>
<b>CURRENT ASSETS</b>			
ASSET HELD FOR SALE		850,000	-
DEBTORS, DEPOSITS AND PREPAYMENTS		468	461
AMOUNTS DUE FROM SUBSIDIARIES		437,898	424,347
DEPOSITS WITH BANKS		81,319	86,608
CASH AT BANKS AND IN HAND		14,077	7,198
		<b>1,383,762</b>	<b>518,014</b>
<b>CURRENT LIABILITIES</b>			
CREDITORS AND ACCRUALS		14,020	8,797
AMOUNTS DUE TO SUBSIDIARIES		767,279	566,970
DEFINED BENEFIT OBLIGATION		1,119	806
		<b>782,418</b>	<b>576,573</b>
<b>NET CURRENT ASSETS/(LIABILITIES)</b>		<b>601,344</b>	<b>(78,559)</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<b>1,644,561</b>	<b>1,764,818</b>
<b>NON-CURRENT LIABILITY</b>			
DEFERRED TAXATION		3,066	3,036
<b>NET ASSETS</b>		<b>1,641,495</b>	<b>1,761,782</b>
<b>CAPITAL AND RESERVES</b>	20(a)		
SHARE CAPITAL		92,537	92,537
OTHER RESERVES		1,548,958	1,669,245
<b>TOTAL EQUITY</b>		<b>1,641,495</b>	<b>1,761,782</b>

Approved and authorized for issue by the board of directors on 23rd September, 2015

NGAN Kikling } Director

Dr. NGAN Kikkeung } Director

## Impact on Financial Statements

**Q15.** If the company level statement of financial position of a holding company is contained in the notes to the company's consolidated financial statements in accordance with section 2 of Part 1 of Schedule 4 to the new CO, are the holding company's directors required to approve and sign the statement of financial position pursuant to section 387?

**Answer:** Yes. Section 387 of the new CO provides that the directors must approve and sign a statement of financial position that forms part of any financial statements. As section 2 of Part 1 of Schedule 4 to the new CO requires the company level statement of financial position of the holding company to be contained in the notes to the company's consolidated financial statements, the requirements in section 387 apply to that company level statement of financial position.



**Companies Registry**

The Government of the Hong Kong Special Administrative Region

## Impact on Financial Statements

- **Schedule 4 “Accounting Disclosures” – Part 1 “Disclosures for Companies whether or not Falling within Reporting Exemption”**

### **3. Subsidiary's financial statements must contain particulars of ultimate parent undertaking**

- (1) This section applies if, at the end of a financial year, a company is the subsidiary of another undertaking.
- (2) The company's financial statements for the financial year must contain, in the notes to the statements—
  - (a) the name of the undertaking regarded by the directors as being the company's ultimate parent undertaking; and
  - (b) the following information relating to that undertaking as known to the directors—
    - (i) if that undertaking is a body corporate, the country in which it is incorporated;
    - (ii) if that undertaking is not a body corporate, the address of its principal place of business.

## Impact on Financial Statements

- **Schedule 4 “Accounting Disclosures” – Part 1** “Disclosures for Companies whether or not Falling within Reporting Exemption”

### 4. Compliance with applicable accounting standards

The financial statements for a financial year must state—

- whether they have been prepared in accordance with the applicable accounting standards within the meaning of section 380; and
- if they have not been so prepared, the particulars of, and the reasons for, any material departure from those standards.



## Impact on Financial Statements

- **Schedule 4 “Accounting Disclosures” – Part 2** “Disclosures for Companies not Falling within Reporting Exemption”

### 1. Remuneration of auditor

- (1) A company’s financial statements for a financial year 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

### Case



China Motor Bus Company, Limited (incorporated in HK)  
Note 5b (extract) to Annual Report as at 30 June 2015

#### OPERATING PROFIT

Operating profit is arrived at

	2015 \$000's	2014 \$000's
after charging:-		
(b) Other items:		
Auditor's remuneration		
– audit services	3,680	3,393
– tax services	552	460
– other audit-related services	1,750	450

## Impact on Financial Statements

- **Section 387.** Statement of financial position to be approved and signed
  - (1) A statement of financial position that forms part of any financial statements—
    - (a) must be **approved** by the directors; and
    - (b) must be **signed**—
      - (i) by **2 directors** on the directors' behalf; or
      - (ii) **in the case of a company having only one director**, by **the director**.
  - (2) Every copy of a statement of financial position that forms part of any financial statements laid before a company in general meeting under section 429, or sent to a member under section 430 or otherwise circulated, published or issued by the company, **must state the name of the person who signed the statement on the directors' behalf.**

## Today's Agenda



Update of HKFRS 9, 15 and 16

More Presentations and Sample Financial Statements  
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## HKFRS 9 Financial Instruments



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## HKFRS 9 Issued in 2014

- Effective Date
  - An entity shall apply HKFRS 9 for annual periods beginning on or after 1 January 2018.
  - 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)



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## HKFRS 9 Issued in 2014

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

Transferred from HKAS 39

Debt instruments can now be measured at fair value through other comprehensive income

Initial measurement of trade receivable

New impairment requirements

Changes mainly on hedge conditions



## 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

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

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

No

Yes

Contractual cash flows are solely principal and interest?

No

Yes

Contractual cash flows are solely principal and interest?

No

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

## Chapter 4.1 Classification of FA

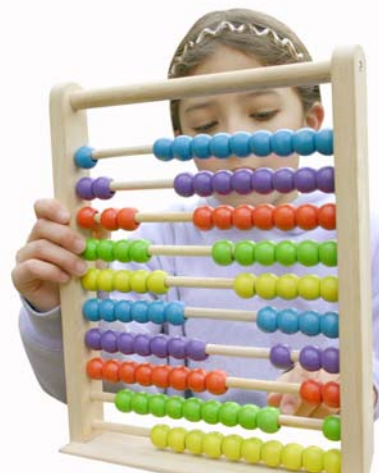
- A financial asset shall be measured **at fair value through other comprehensive income** if both of the following conditions are met:
  - a. the financial asset is held within a business model whose objective is achieved by both
    - collecting contractual cash flows and selling financial assets,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

## HKFRS 9 Issued in 2014

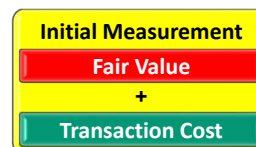
1. Objective
2. Scope
3. Recognition and Derecognition
4. Classification
5. Measurement
6. Hedge Accounting
7. Effective Date and Transition



## Chapter 5 Measurement

### Initial measurement

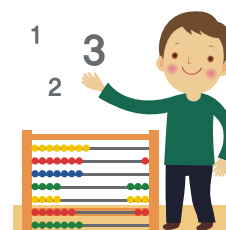
- Except for trade receivables within the scope of para. 5.1.3,
  - at initial recognition, an entity shall measure a financial asset or financial liability
    - **at its fair value**
      - plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, **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)



## 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

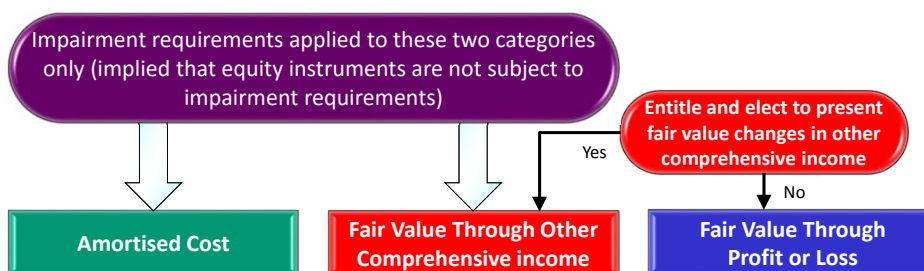
Fair Value Through Other  
Comprehensive Income

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 (i.e. under the “*hold to collect*” business model) and
  - to financial assets that are measured at fair value through other comprehensive income in accordance with para. 4.1.2A (i.e. under the “*hold to collect and sell*” business model). (para. 5.2.2)



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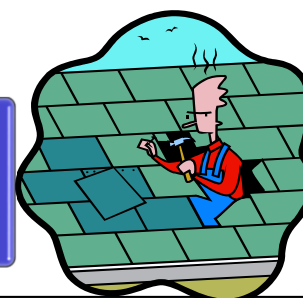
## Chapter 5.5 Impairment

### 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.



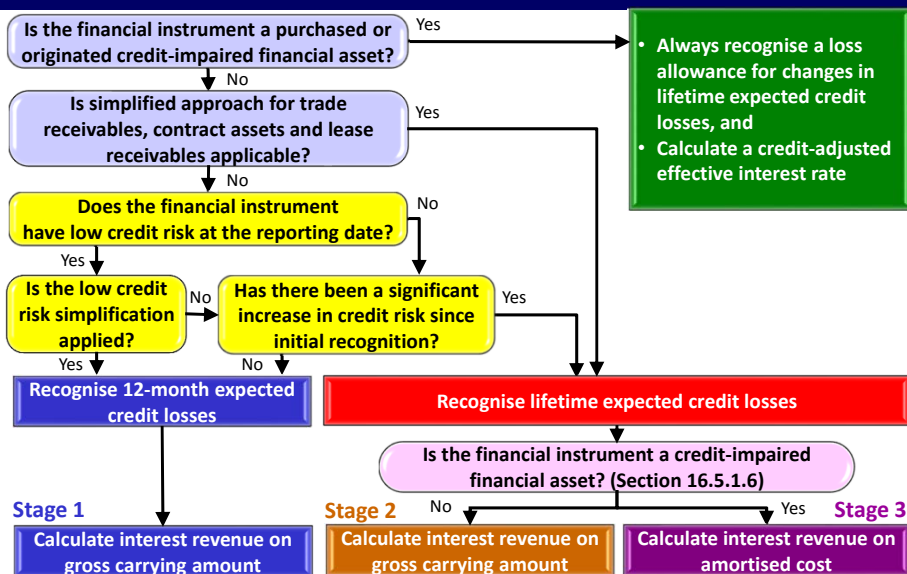
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## Chapter 5.5 Impairment

- To understand and apply these requirements, an entity has to ascertain
  - the scope of the impairment in HKFRS 9,
  - the concept of expected credit losses,
  - the approach in recognition of expected credit losses,
  - the financial instruments with the scope in recognition of expected credit losses but not falling within the three-stage model,
  - the assessment of the credit risk on a financial instrument since initial recognition,
  - the determination of financial instruments being credit-impaired, and
  - the three-stage model in such recognition.

## Chapter 5.5 Impairment



## Chapter 5.5 Impairment

### Scope in Recognition of Expected Credit Losses

- In HKFRS 9, not only financial assets but also some financial instruments may fall within the scope in recognition of expected credit losses.
- HKFRS 9 specifically requires to an entity to recognise a loss allowance for expected credit losses on the following financial assets:
  1. Financial asset at amortised cost;
  2. Financial asset (not being investment in equity instrument) at fair value through other comprehensive income ;
  3. Lease receivable,
  4. Contract asset, or
  5. Loan commitment and financial guarantee contract to which the impairment requirements apply in accordance with HKFRS 9

## Chapter 5.5 Impairment

### The Concept of Expected Credit Losses

- The main change of the impairment requirements in HKFRS 9 is the introduction of the expect credit loss to replace the incurred loss model.
- The IASB considered that, for those financial assets being the debt instruments, the effect of changes in credit risk are more relevant to an investor's understanding of the likelihood of the collection of future contractual cash flows than the effects of other changes, for example changes in market interest rates.
- The expected credit losses can be further divided into two types:
  - 12-month expected credit losses (recognised in Stage 1 of the impairment stages); and
  - lifetime expected credit losses (recognised in Stage 2 and 3 of the impairment stages and for specific financial instruments)

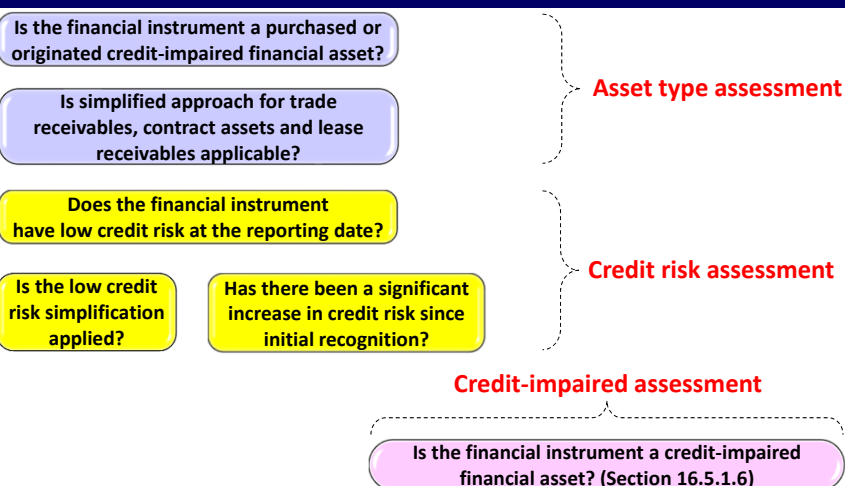


## Chapter 5.5 Impairment

### Approach in Recognition of Expected Credit Losses

- To achieve the objective and comply the impairment requirements in HKFRS 9, an entity is required to have the following 3 kinds of assessment:
  1. **“Asset type assessment”** – to assess the type of the financial asset and determine whether it is
    - a) purchase or originated credit-impaired financial assets;
    - b) trade receivables, contract assets and lease receivables for which the entity applies simplified approach; or
    - c) other financial assets.
  2. **“Credit risk assessment”** – To assess the credit risk on the financial asset; and
  3. **“Credit-impaired assessment”** To determine whether the financial asset is credit impaired.

## Chapter 5.5 Impairment



## Chapter 5.5 Impairment

Is the financial instrument a purchased or originated credit-impaired financial asset?

↓ No

Is simplified approach for trade receivables, contract assets and lease receivables applicable?

Asset type assessment

### Asset type assessment

- The financial instruments with the scope in recognition of expected credit losses but not falling within the three-stage model
- Before having credit risk assessment, an entity is required to directly recognise lifetime expected credit losses for two types of financial instruments:
  1. Purchase or originated credit-impaired financial assets; and
  2. Trade receivables, contract assets and lease receivables for which the entity applies simplified approach; or

## Chapter 5.5 Impairment

Is the financial instrument a purchased or originated credit-impaired financial asset?

Yes

↓ No

Is simplified approach for trade receivables, contract assets and lease receivables applicable?

Yes

- Always recognise a loss allowance for changes in lifetime expected credit losses, and
- Calculate a credit-adjusted effective interest rate

Recognise lifetime expected credit losses

Is the financial instrument a credit-impaired financial asset? (Section 16.5.1.6)

Stage 2

No

Calculate interest revenue on gross carrying amount

Yes

Stage 3

Calculate interest revenue on amortised cost

## Chapter 5.5 Impairment

### Example

Is simplified approach for trade receivables, contract assets and lease receivables applicable?

- Bonnie Corporation is a manufacturer and has a portfolio of trade receivables of \$30 million in 2015 and operates only in Singapore. Bonnie determines that:
  - The customer base consists of a large number of small clients.
  - The trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms.
  - The trade receivables do not have a significant financing component in accordance with HKFRS 15.

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## Chapter 5.5 Impairment

### Example

- In accordance with HKFRS 9, the loss allowance for such trade receivables is always measured at an amount equal to lifetime time expected credit losses.
- To determine the expected credit losses for the portfolio, Bonnie uses a provision matrix.
- The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates.
- At every reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case, it is forecast that economic conditions will deteriorate over the next year.

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## Chapter 5.5 Impairment

### Example

- On that basis, Bonnie estimates the following provision matrix:

	<u>Current</u>	<u>1–30 days past due</u>	<u>31–60 days past due</u>	<u>61–90 days past due</u>	<u>Over 90 days past due</u>
Default rate	1%	3%	5%	10%	15%

- Trade receivables from the large number of small customers amount to \$30 million and are measured using the provision matrix as follows:

	<u>Gross carrying amount</u>	<u>Default rate</u>	<u>Lifetime expected credit loss allowance</u>
Current	\$15,000,000	1%	\$150,000
1–30 days past due	7,500,000	3%	225,000
31–60 days past due	4,000,000	5%	200,000
61–90 days past due	2,500,000	10%	250,000
Over 90 days past due	<u>1,000,000</u>	15%	<u>150,000</u>
	\$30,000,000		\$975,000

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## Chapter 5.5 Impairment

Does the financial instrument have low credit risk at the reporting date?

Is the low credit risk simplification applied?

Has there been a significant increase in credit risk since initial recognition?

Credit risk assessment

### Credit risk assessment

- At each reporting date, for all financial instruments, other than purchased or originated credit-impaired financial assets, or financial assets that simplification approach is applied,
  - an entity is required to assess whether the credit risk on a financial instrument has increased significantly since initial recognition.

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## Chapter 5.5 Impairment

### Credit risk assessment

- Risk of Default and Past Due Information
  - HKFRS 9 incorporates two rebuttable presumptions in assessing significant increases in credit risk and risk of default:
    - i. 30 Days past due rebuttable resumption in respect of significant increases in credit risk
      - Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due (HKFRS 9.5.5.11).
    - ii. 90 Days past due rebuttable resumption in respect of default occurred
      - In defining default, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

## Chapter 5.5 Impairment

Credit-impaired assessment – the determination of financial instruments being credit-impaired,

- In HKFRS 9, after assessing credit risk and ascertaining past due information, an entity has to determine whether the financial instrument is credit impaired.

### Credit-impaired assessment

Is the financial instrument a credit-impaired financial asset? (Section 16.5.1.6)

## Chapter 5.5 Impairment

### Three-Stage Model

- By applying such impairment approach in HKFRS 9 to a financial instrument and based on the result of credit risk assessment, an entity may, as explained by the IASB, divide the impairment requirements into three impairment stages:

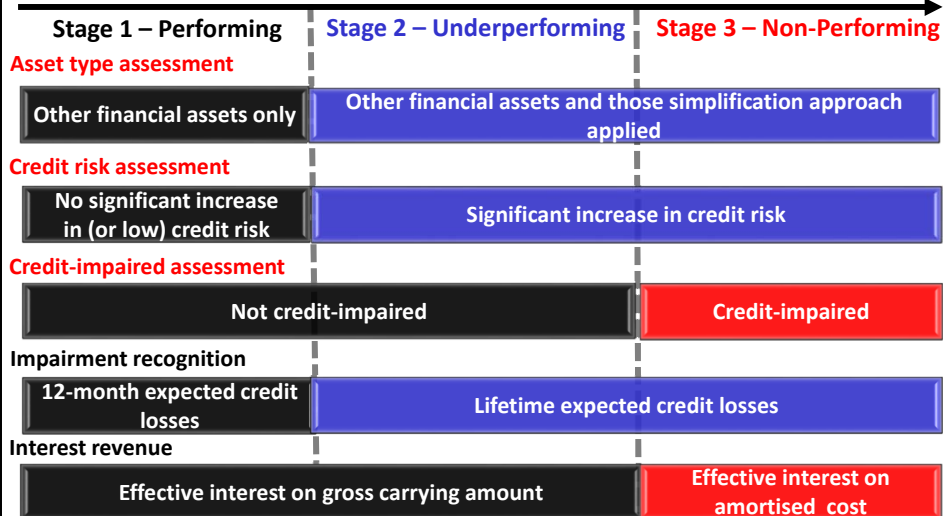
Stage 1 – Performing financial instrument stage;

Stage 2 – Underperforming financial instrument stage; and

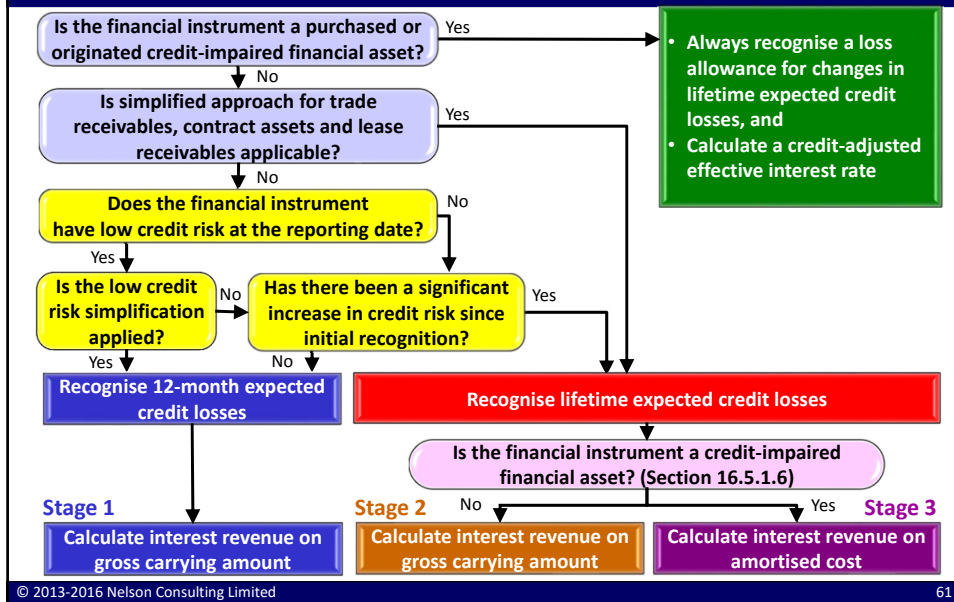
Stage 3 – Non-performing financial instrument stage.

## Chapter 5.5 Impairment

Increase in credit risk since initial recognition →



# Chapter 5.5 Impairment



## HKFRS 15 Revenue

### from Contracts with Customers



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## 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 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

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## 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:**

- HKAS 11 *Construction Contracts*
- HKAS 18 *Revenue*
- HK(IFRIC)-Int 13 *Customer Loyalty Programmes*
- HK(IFRIC)-Int 15 *Agreements for the Construction of Real Estate*
- HK(IFRIC)-Int 18 *Transfers of Assets from Customers*
- HK(SIC)-Int 31 *Revenue — Barter Transactions Involving Advertising Services*



## Contents in HKFRS 15 Issued in 2014

A. Objective

B. Scope

C. Recognition

Today's update

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

D. Measurement

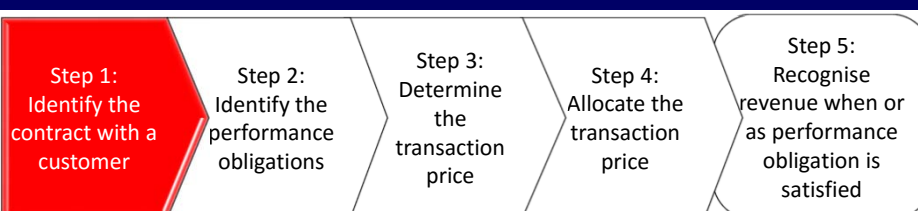
- Determining the transaction price (Step 4)
- Allocating the transaction price to performance obligations (Step 5)

E. Contract costs

F. Presentation

G. Disclosure

## Step 1: Identify the Contract(s)

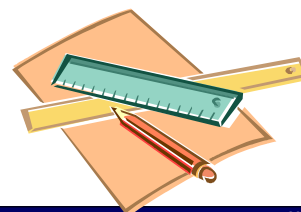


### • Step 1: Identifying the Contract(s)

- 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)

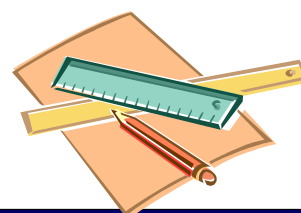
## Step 1: Identify the Contract(s)

- 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

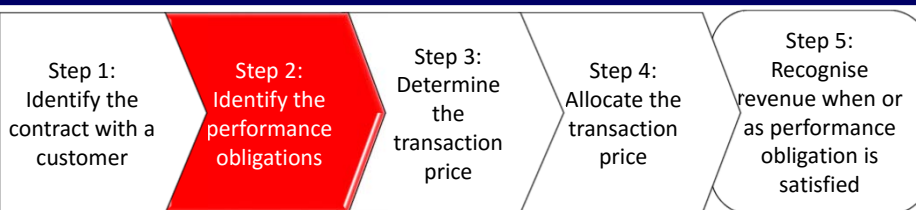


## Step 1: Identify the Contract(s)

- 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)



## Step 2: Identify 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)



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## Step 2: Identify Performance Obligations

### Case

Select options for		MAX RANGE	MAX PERFORMANCE
<b>70D</b> 70 kWh Battery All-Wheel Drive  385 km range (EPA) 5.4 seconds 0-100 kph 225 kph top speed	<b>90D</b> 90 kWh Battery All-Wheel Drive  460 km range (EPA est.) 4.4 seconds 0-100 kph 250 kph top speed	<b>P90D</b> 90 kWh Performance All-Wheel Drive  435 km range (EPA est.) 3.3 seconds 0-100 kph 3.0 seconds with Ludicrous Speed Upgrade 250 kph top speed	Cash <b>\$ 794,300</b> After Incentives & Gas Savings  -\$ 81,000 Estimated gas and license fee savings over 5 years <a href="#">Learn more</a>  <b>\$ 875,300</b> Cash Price

### Resale value guarantee

- Tesla guarantees the resale value of your Model S.
- After three years, you can trade in your Model S for 70% of the original base price plus 60% of options.
- Not available to vehicles registered outside of HK.

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Source from [http://www.teslamotors.com/en\\_HK/](http://www.teslamotors.com/en_HK/) 74

## Step 3: Determine 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)

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## Step 3: Determine 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)

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## 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

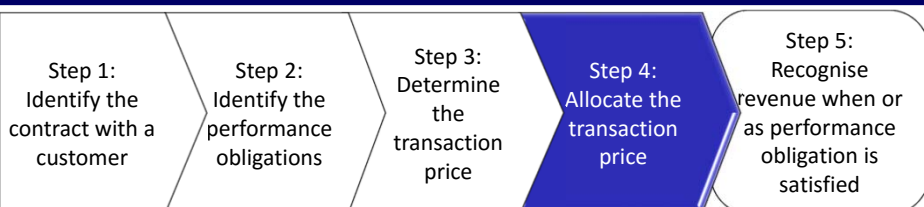
- An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:
  - a. **The expected value** — the expected value is the sum of probability-weighted 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 4: Allocate Transaction Price to PO



### • 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 relative stand-alone selling prices of each distinct good or service promised in the contract.
  - If a stand-alone selling price is not observable, an entity estimates it.
- 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)

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## Step 4: Allocate Transaction Price to PO

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

Based on Stand-alone  
Selling Price (SASP)

Allocation of a  
Discount

Allocation of Variable  
Consideration



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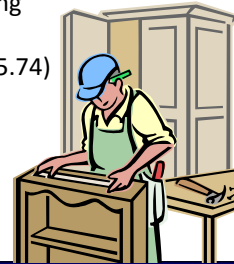
## Step 4: Allocate Transaction Price to PO

Based on Stand-alone  
Selling Price (SASP)

Allocation of a  
Discount

Allocation of Variable  
Consideration

- 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)



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## Step 4: Allocate Transaction Price to PO

Based on Stand-alone  
Selling Price (SASP)

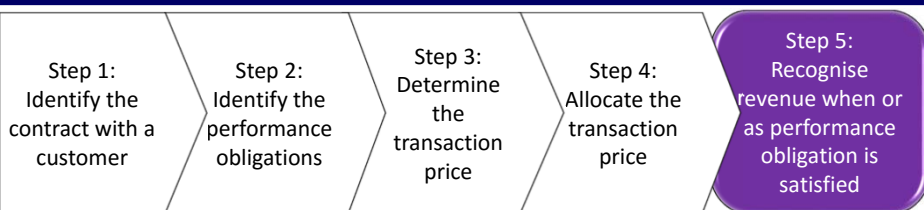
- Suitable methods for estimating SASP of a good or service include (not limited to):
  - Adjusted market assessment approach**
  - Expected cost plus a margin approach**
  - Residual approach**
  - Combination of the above**



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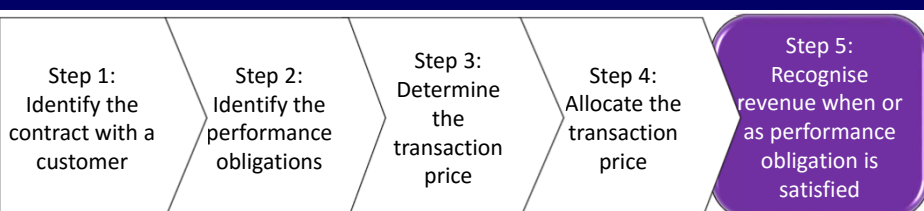
## Step 5: Satisfy Performance Obligations



### • Step 5: Satisfaction of performance obligations

- 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



### • 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



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## 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:
  - 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)

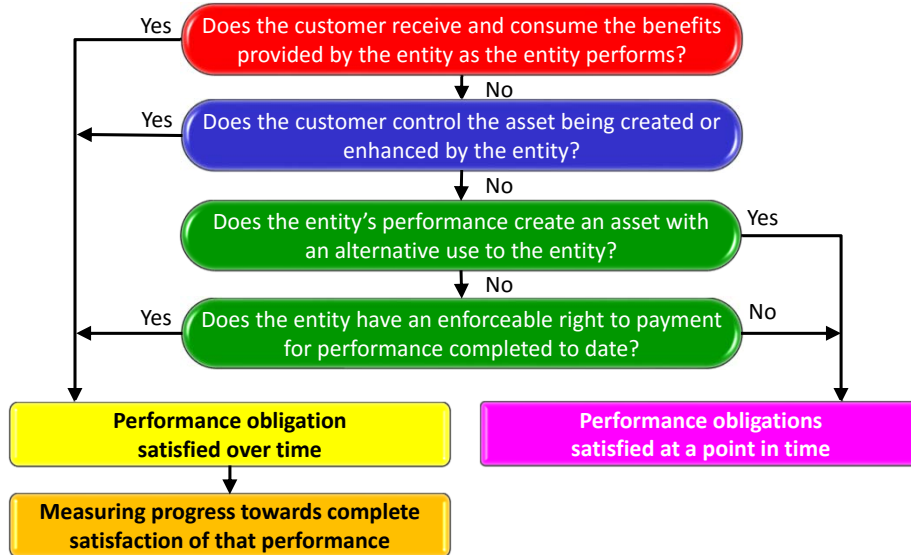
Over Time



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## Step 5: Satisfy Performance Obligations



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## 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)

Measuring Progress

Over Time



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## 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



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## 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



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## 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

### Case

- HKFRS 15.B70 states that:
  - If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset,
    - the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right.
  - The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time.
  - Therefore, if the customer has a significant economic incentive to exercise that right, the entity shall account for the agreement as a lease in accordance with IAS 17.

## Existing Practice vs HKFRS 15

### Case

- Tesla (financial statements of 2015):
  - We offer resale value guarantees or similar buy-back terms to all customers .....
  - Although we receive full payment for the vehicle sales price at the time of delivery, we are required to account for these as operating leases.
    - The amount of sale proceeds equal to the residual value guarantee is deferred until the guarantee expires or is exercised.
    - The remaining sale proceeds are deferred and recognized on a straight line basis over the stated guarantee period.
    - The guarantee period expires at the earlier of the end of the guarantee period or the pay-off of the initial loan.
    - We capitalize the cost of these vehicles to leased vehicles on our Consolidated Balance Sheets and depreciate their value, less salvage value, to cost of automotive revenue over the same period.





## HKFRS 16 Leases



## Introduction



- IFRS 16 Leases was issued in January 2016
- Lessee accounting
  - IFRS 16 introduces **a single lessee accounting model** and requires a lessee to **recognise assets and liabilities for all leases** with a term of more than 12 months, unless the underlying asset is of low value.
  - A lessee is required to **recognise** (initially measure on a present value basis)
    - a **right-of-use asset** representing its right to use the underlying leased asset and
    - a **lease liability** representing its obligation to make lease payments.
- Lessor accounting
  - IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, and accordingly, a lessor continues
    - to **classify its leases as operating leases or finance leases**, and
    - to account for those two types of leases differently.

## Introduction

- HKFRS 16 issued in May 2016
- Effective Date of IFRS/HKFRS 16
  - An entity shall apply HKFRS 16 for annual reporting periods beginning on or after 1 January 2019.
  - Earlier application is permitted for entities that apply HKFRS 15 *Revenue from Contracts with Customers* at or before the date of initial application of HKFRS 16.
  - If an entity applies HKFRS 16 earlier, it shall disclose that fact.



## Introduction

- HKFRS 16 supersedes the following Standards and Interpretations:
  - (a) HKAS 17 *Leases*;
  - (b) HKFRIC 4 *Determining whether an Arrangement contains a Lease*;
  - (c) HK(SIC)-15 *Operating Leases—Incentives*; and
  - (d) HK(SIC)-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.



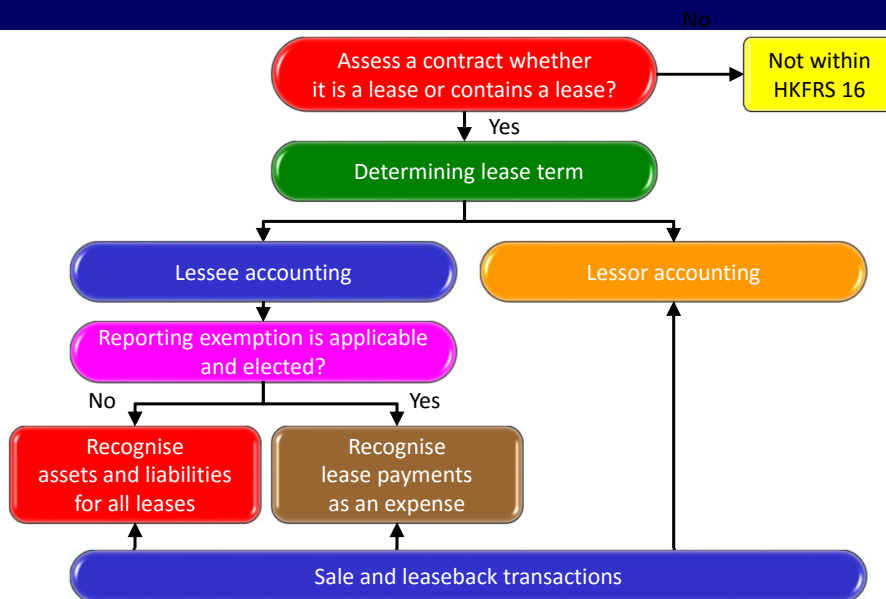
# HKFRS 16 – Contents

1. Objective
2. Scope
3. Recognition Exemptions
4. Identifying a Lease
5. Lease Term
6. Lessee
7. Lessor
8. Sales and Leaseback Transactions
9. Effective Date and Transition

**Today's update**



# HKFRS 16



### 3. Reporting Exemptions

- A lessee may elect not to apply the requirements in HKFRS 16 (HKFRS 16.22–49) to:
  - (a) short-term leases; and
  - (b) leases for which the underlying asset is of low value (as described in HKFRS 16.B3–B8).

HKFRS 16 defines short-term lease as:

- A lease that, at the commencement date, has a lease term of 12 months or less.
- A lease that contains a purchase option is not a short-term lease.

### 3. Reporting Exemptions

- Leases for which the underlying asset is of low value
  - A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased. (HKFRS 16.B3)
  - The assessment of whether an underlying asset is of low value is performed on an absolute basis.
    - Leases of low-value assets qualify for the accounting treatment in HKFRS 16.6 regardless of whether those leases are material to the lessee.
    - The assessment is not affected by the size, nature or circumstances of the lessee.
    - Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value. (HKFRS 16.B4)

### 3. Reporting Exemptions

- **Leases for which the underlying asset is of low value**
  - An underlying asset can be of low value only if:
    - (a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
    - (b) the underlying asset is not highly dependent on, or highly interrelated with, other assets. (HKFRS 16.B5)

### 3. Reporting Exemptions

#### Example

- **Leases for which the underlying asset is of low value**
  - A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value.
    - For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value. (HKFRS 16.B6)
  - If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset. (HKFRS 16.B7)
  - Examples of low-value underlying assets can include
    - tablet and personal computers,
    - small items of office furniture and
    - telephones. (HKFRS 16.B8)

## 4. Identifying a Lease



- At inception of a contract, an entity shall assess whether the contract is, or contains, a lease.
- A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

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## 4. Identifying a Lease



HKFRS 16 defines lease as:

- A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.
- HKFRS 16.B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease (HKFRS 16.9)
  - A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce)
  - An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed (HKFRS 16.10-11)

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## 4. Identifying a Lease

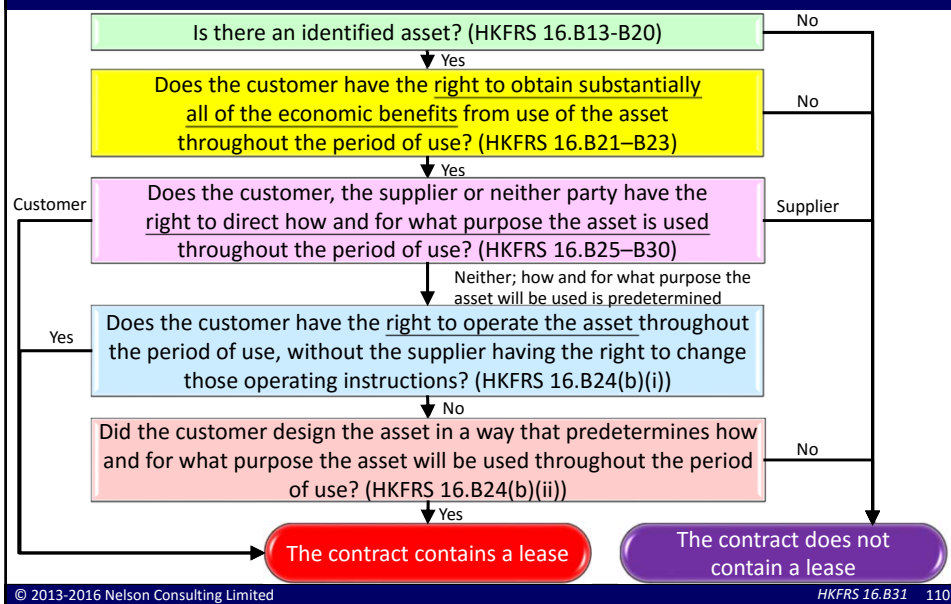


- To assess whether a contract conveys the right to control the use of an identified asset (see HKFRS 16.B13–B20) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
  - the right to obtain substantially all of the economic benefits from use of the identified asset (as described in HKFRS 16.B21–B23); and
  - the right to direct the use of the identified asset (as described in HKFRS 16.B24–B30) (HKFRS 16.B9)

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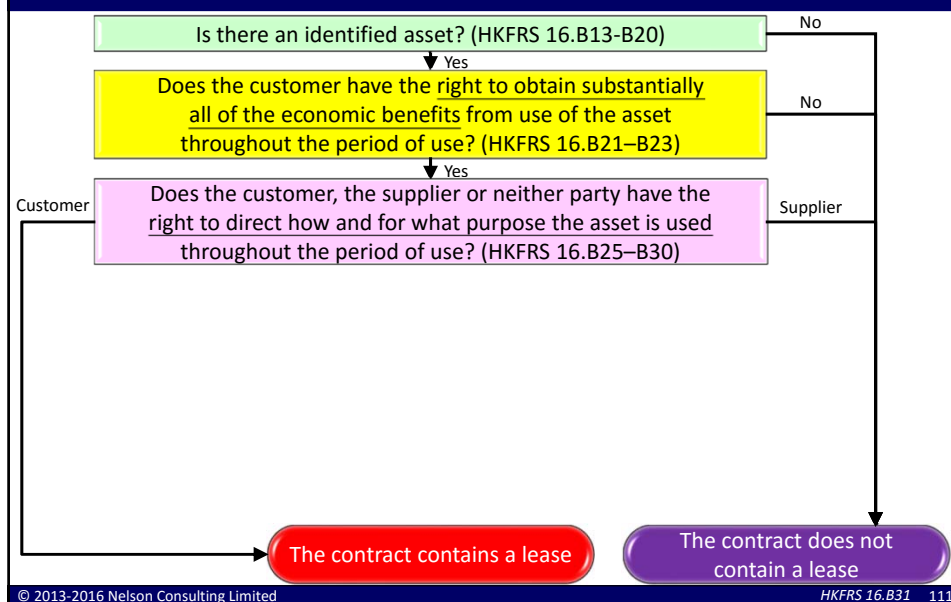
## 4. Identifying a Lease



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HKFRS 16.B31 110

## 4. Identifying a Lease



## 5. Lease Term

- An entity shall determine the lease term as the non-cancellable period of a lease, together with both:
  - (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
  - (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
    - In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in HKFRS 16.B37-B40.



## 6. Lessee – Recognition

- **Recognition**

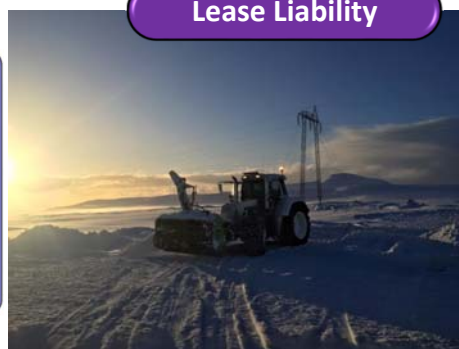
- At the commencement date, a lessee shall **recognise**
  - a **right-of-use asset**, and
  - a **lease liability**. (HKFRS 16.22)

Right-of-Use Asset

Lease Liability

HKFRS 16 defines **right-of-use asset** as:

- An asset that represents a lessee's right to use an underlying asset for the lease term.



## 6. Lessee – Initial Measurement

- **Initial Measurement of the Right-of-Use Asset**

- At the commencement date, a lessee shall **measure** the right-of-use asset at **cost**. (HKFRS 16.23)

Right-of-Use Asset

HKFRS 16 defines **commencement date** of a lease as:

- The date on which a lessor makes an underlying asset available for use by a lessee.



## 6. Lessee – Initial Measurement

- The **cost** of the right-of-use asset shall comprise:
  - (a) the amount of the initial measurement of the lease liability, as described in HKFRS 16.26;
  - (b) any lease payments made at or before the commencement date, less any lease incentives received;
  - (c) any initial direct costs incurred by the lessee; and
  - (d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.
    - The lessee incurs the obligation for those costs either
      - at the commencement date or
      - as a consequence of having used the underlying asset during a particular period. (HKFRS 16.24)

## 6. Lessee – Initial Measurement

- **Initial Measurement of the Lease Liability**
  - At the commencement date, a lessee shall measure the lease liability at the **present value** of the lease payments that are not paid at that date.
    - The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. Lease Liability
    - If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate. (HKFRS 16.26)

## 6. Lessee – Initial Measurement

- At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:
  - (a) fixed payments (including in-substance fixed payments as described in HKFRS 16.B42), less any lease incentives receivable;
  - (b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in HKFRS 16.28);
  - (c) amounts expected to be payable by the lessee under residual value guarantees;
  - (d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in HKFRS 16.B37–B40); and
  - (e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

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## 6. Lessee – Subsequent Measurement

- **Subsequent Measurement of the Right-of-Use Asset**
  - After the commencement date, a lessee shall measure the right-of-use asset
    - applying a cost model,
    - unless it applies either of the measurement models described in HKFRS 16.34 and 35. (HKFRS 16.29)

Right-of-Use Asset

Cost  
Model

Measurement  
Models

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## 6. Lessee – Subsequent Measurement

- To apply a cost model, a lessee shall measure the right-of-use asset at cost:
  - less any accumulated depreciation and any accumulated impairment losses; and
  - adjusted for any remeasurement of the lease liability specified in HKFRS 16.36(c).

Right-of-Use Asset

Cost Model

## 6. Lessee – Subsequent Measurement

- If a lessee applies the fair value model in IAS 40 Investment Property to its investment property, the lessee **shall** also apply that **fair value model** to right-of-use assets that meet the definition of investment property in IAS 40.
- If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IAS 16, a lessee **may elect to apply** that **revaluation model** to all of the right-of-use assets that relate to that class of property, plant and equipment.

Right-of-Use Asset

Measurement Models

## 6. Lessee – Subsequent Measurement

- **Subsequent Measurement of the Lease Liability**
  - After the commencement date, a lessee shall measure the lease liability by:
    - (a) increasing the carrying amount to reflect interest on the lease liability;
    - (b) reducing the carrying amount to reflect the lease payments made; and
    - (c) remeasuring the carrying amount
      - to reflect any reassessment or lease modifications specified in HKFRS 16.39–46, or
      - to reflect revised in-substance fixed lease payments (see HKFRS 16.B42). (HKFRS 16.36)

Lease Liability

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## Summary – Effect on Fin. Position

IFRS

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Assets	→ 🏠	---	→ 🏠 → 🚗 → 🚗 → 🚗 🏠 🏠 🏠
Liabilities	\$\$	---	\$\$\$\$\$\$\$\$
Off balance sheet rights / obligations	---	→ 🚗 → 🚗 → 🏠 → 🏠 \$\$\$\$	---

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## Summary – Effect on Profit or Loss



	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Revenue	x	x	x
Operating costs (excluding depreciation and amortisation)	---	Single expense	---
EBITDA			↑↑
Depreciation and amortisation	Depreciation	---	Depreciation
Operating profit			↑
Finance costs	Interest	---	Interest
Profit before tax			↔

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# Practical Application Issues: HKFRS & CO

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