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This guide is one of a series of publications intended to assist users in the preparation of financial information in accordance with accounting and regulatory requirements in Hong Kong. These include:

Hong Kong GAAP - *A Practical Guide to Generally Accepted Accounting Practice*

Hong Kong financial reporting manual written by Deloitte Touche Tohmatsu and published by Sweet & Maxwell.

2nd edition to be published in May 2001

Hong Kong GAAP - *A Guide for the Preparation of Financial Statements (2nd Edition)*

Model financial statements and presentation and disclosure checklists prepared under Hong Kong GAAP. Published by Deloitte Touche Tohmatsu.

International Accounting Standards - *A Practical Guide to Financial Reporting*

Model financial statements and presentation and disclosure checklists prepared under IAS. Published by Deloitte Touche Tohmatsu.

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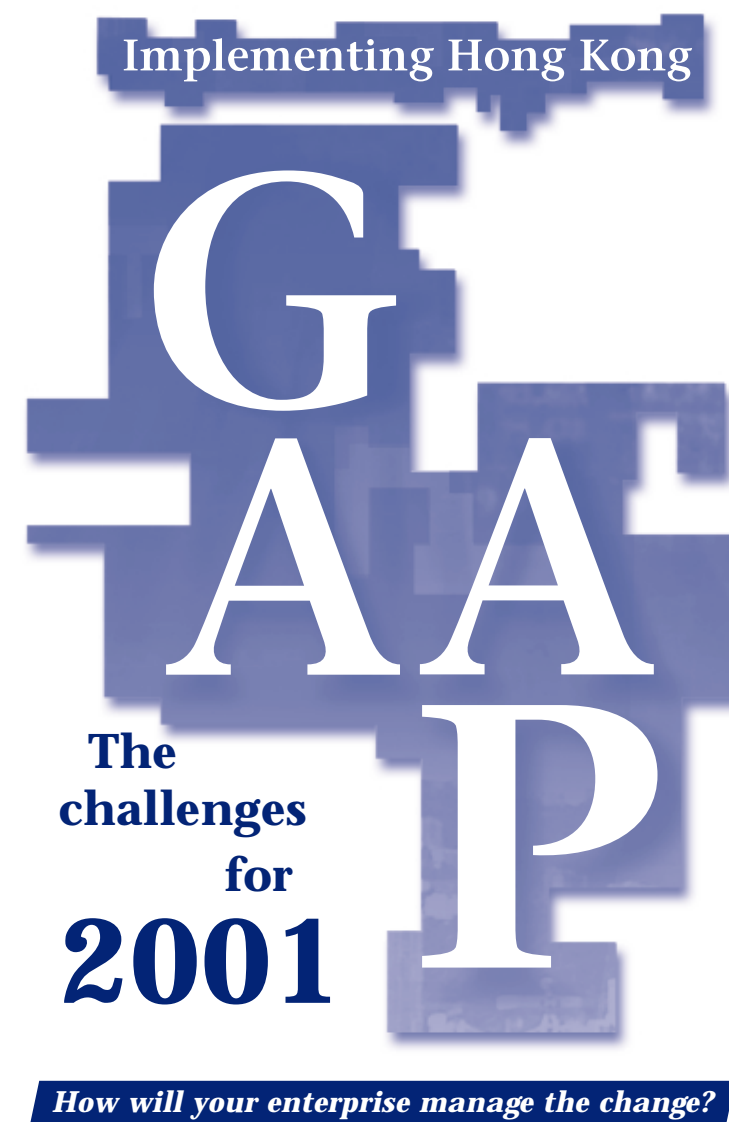
A quarterly newsletter on developments in International Accounting Standards and accounting updates for other regimes in the Asia Pacific Region.

In addition, our IAS Plus website (www.iasplus.com) provides up-to-date news on IAS developments as well as summaries of IAS and SICs and reference materials available for download.

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Deloitte Touche Tohmatsu would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. We recommend that professional advice is obtained, as this publication has been written in general terms and therefore cannot be relied on to cover specific situations. Application of the principles set out will depend upon the particular circumstances involved.



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Introduction

With the publication of its package of six new inter-related Accounting Standards this month, the Hong Kong Society of Accountants (HKSA) has taken a major step forward in its dual goals of developing a comprehensive accounting framework for Hong Kong reporting enterprises and harmonisation with International Accounting Standards (IAS). The new SSAPs, which are closely modelled on the equivalent IAS, address many significant issues that had not previously been dealt with in Hong Kong's accounting literature.

The objective of this publication is to highlight for preparers of financial statements the potential impact of these new Standards and the challenges that they present. It also provides a concise summary of each of the new Accounting Standards and SSAP 26 *Segment Reporting*, all of which are effective from 1 January 2001.

These Standards deal with difficult conceptual areas of accounting and, accordingly, are themselves lengthy, complex and very detailed. Our aim is to raise awareness at an early stage of the practical impact of these Standards. However, because of the complexities involved, preparers of financial statements will need to become familiar with the Standards themselves in order to appreciate the implications for their own particular circumstances.

In addition to providing summaries of the new Standards, we have:

- identified what we see as the key implementation issues;
- summarised all of the transitional provisions;
- identified consequential amendments to other Standards; and
- provided an update as regards the harmonisation of Hong Kong GAAP with IAS.

For additional guidance, readers should refer to the 2nd Edition of *Hong Kong GAAP - A Practical Guide to Generally Accepted Accounting Practice* to be issued shortly, which includes a more detailed discussion of the requirements of the new Standards. If you would like any additional information, or advice on specific matters, please contact a member of your client service team.

There is no doubt that the implementation of these new Standards will represent a significant challenge for preparers of financial statements. Nevertheless, we welcome their arrival and believe that they will provide a very positive contribution to the quality of financial information reported in Hong Kong.

Deloitte Touche Tohmatsu
Hong Kong
January 2001

Abbreviations

The following abbreviations have been used throughout this publication

Companies Ordinance	Hong Kong Companies Ordinance (Chapter 32 of the Laws of Hong Kong)
FASC	Financial Accounting Standards Committee of the HKSA
GAAP	Generally Accepted Accounting Practice
GEM Rules	Rules Governing the Listing of Securities on the Growth Enterprise Market of the SEHK
HKSA	Hong Kong Society of Accountants
IAS	International Accounting Standard(s)
IASC	International Accounting Standards Committee
INT	Interpretation issued by the Urgent Issues and Interpretations Sub-Committee of the HKSA
Listing Rules	Rules Governing the Listing of Securities on the SEHK
SEHK	Stock Exchange of Hong Kong Limited
SIC	Interpretation issued by the Standing Interpretations Committee of the IASC
SSAP	Statement of Standard Accounting Practice

Standards effective from 1 January 2001

The Accounting Standards effective for accounting periods commencing on or after 1 January 2001 are:

SSAP 28	Provisions, Contingent Liabilities and Contingent Assets
SSAP 29	Intangible Assets
SSAP 30	Business Combinations
SSAP 31	Impairment of Assets
SSAP 32	Consolidated Financial Statements and Accounting for Investments in Subsidiaries
SSAP 9 (Revised)	Events after the Balance Sheet Date
SSAP 26	Segment Reporting

The first six of these are a package of Standards issued by the HKSA in January 2001. These Standards deal with inter-related topics and have been released simultaneously in order to ensure that the amended literature provides a comprehensive framework for dealing with the relevant issues. These links are reflected in the requirement included in several of the Standards that, where the Standard is being adopted before its effective date, a number of the related Standards must be adopted at the same time.

SSAP 26 *Segment Reporting* was issued in February 2000 but is not effective until accounting periods beginning on or after 1 January 2001. The extended implementation period was intended to allow for the significant changes to reporting systems that SSAP 26 will require for many enterprises.

Each of the Standards listed above is summarised in the following pages - with particular reference to implementation challenges.

Comparison with IAS

The Standards are largely based on IAS. However, there are two significant differences between the new Accounting Standards and the equivalent IAS :

- SSAP 30 *Business Combinations* deals only with acquisition accounting, whereas the equivalent IAS 22 deals with both acquisition accounting and merger accounting (pooling of interests); and
- the definition used for subsidiary in SSAP 30 *Business Combinations* and SSAP 32 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* differs from the equivalent IAS insofar as Hong Kong incorporated companies are concerned.

The first of these differences arises because, with the publication of INT 7 *Application of Acquisition Accounting*, the HKSA has effectively prohibited the use of merger accounting other than in the circumstances of certain group reconstructions. This action reflects the HKSA's anticipation of future developments in this area internationally.

The second difference arises as result of legal opinion obtained by the HKSA to the effect that the definition of subsidiary to be applied in the preparation of financial statements for Hong Kong incorporated companies must be as stated in the Companies Ordinance. If consolidated financial statements were to incorporate enterprises that were not subsidiaries as defined in the Ordinance, then they would not comply with the law. Unfortunately this results in the Standards setting different rules for Hong Kong and non-Hong Kong incorporated companies - an anomaly that we hope will be addressed on a timely basis by a change in the law.

Consequential amendments to other Standards

The introduction of these new Standards has resulted in a number of consequential amendments. At the same time, the HKSA has taken the opportunity to update guidance on other areas.

The most significant changes reflected in Exposure Drafts and Standards issued to date are listed below (note: amendments made simply to reflect changes in terminology or titles of SSAPs are excluded).

SSAPs withdrawn:	SSAP 7	Group Accounts
	SSAP 8	Accounting for Contingencies
	SSAP 9	Accounting for Post Balance Sheet Events
	SSAP 16	Research and Development Costs
Accounting Guidelines withdrawn:	AG 2.204	Accounting for Goodwill
	AG 2.207	Accounting for Textile Quota Entitlements
SSAPs to be amended:	Amendments to be made:	
SSAP 10 <i>Accounting for Investments in Associates</i>	■ updating of guidance on measuring impairment to follow SSAP 31 <i>Impairment of Assets</i> ;	
	■ requiring goodwill arising on the acquisition of investments in associates to be amortised over its useful life; and	
	■ updating the accounting for investments in associates in the separate financial statements of the investor, and for excluded associates in the consolidated financial statements, to follow the requirements of SSAP 32 in relation to investments in subsidiaries.	
SSAP 21 <i>Accounting for Interests in Joint Ventures</i>	■ updating of guidance on measuring impairment to follow SSAP 31 <i>Impairment of Assets</i> ;	
	■ requiring goodwill arising on the acquisition of interests in jointly controlled entities to be amortised over its useful life; and	
	■ updating the accounting for investments in joint ventures in the separate financial statements of the investor, and for excluded joint ventures in the consolidated financial statements, to follow the requirements of SSAP 32 in relation to investments in subsidiaries.	
SSAP 17 <i>Property, Plant and Equipment</i>	■ updating of guidance on measuring impairment to follow SSAP 31 <i>Impairment of Assets</i> ;	
	■ introduction of SIC 23 <i>Property, Plant and Equipment - Major Inspection or Overhaul Costs</i> ; and	
	■ introduction of comprehensive guidance on transfers of property, plant and equipment between asset categories.	

SSAP 28 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Impact

The new recognition criteria, measurement and disclosure requirements are significantly stricter and will move practice away from a prudence bias to providing more transparent, neutral financial information, based on best estimates rather than a worst case scenario. In particular, the new rules prohibit:

- the creation of provisions where no present obligation exists;
- the setting up of general provisions to meet a pool of actual or expected liabilities. Provisions will be required to be used only for the specific expenditure for which they were originally established; and
- undisclosed releases of provisions into the income statement.

The Standard will also impact on the recognition of provisions for restructuring, as it sets out detailed conditions that must be met before such provisions can be made.

Challenges

The recognition criteria of SSAP 28 effectively provide clarification on matters already dealt with in extant Standards. For example, SSAP 1 specifies that the use of the matching concept does not justify the recognition of items in the balance sheet that do not satisfy the definition of a liability. Therefore, the recognition principles of SSAP 28 should be applied, even prior to formal implementation of the Standard.

Preparers need to be particularly alert for proposed provisions at 31 December 2000 which do not comply with all of the requirements of SSAP 28 (e.g. if a restructuring provision is raised that does not meet all of the conditions set out in SSAP 28). If the provision is made, and an expense recognised in the period ended 31 December 2000, then it will be subsequently reversed by prior period adjustment and, if the recognition criteria are met in 2001, re-charged to the income statement in that period. The effect is that the charge will have been reflected in reported results for both periods.

Steps that should be taken now

Assuming that an enterprise does not adopt SSAP 28 in advance of its effective date, the Standard will be first implemented for the 31 December 2001 year end. Accordingly, the enterprise will need to establish what its position would have been had the Standard been applied at 31 December 2000, in order to quantify the effect of the adjustment required to retained earnings at 1 January 2001. In particular, careful consideration should be given now to:

- long-standing round-sum provisions for which there is no evidence of a present obligation and which should be released under the new Standard;
- the accounting policies followed in relation to items such as repairs provisions which have previously been built up over a number of years but for which there is no present obligation;
- provisions for restoration costs for which the enterprise does have a present obligation. Rather than being built up over the life of the project, these should be accrued in full at the time the obligation arises and, if appropriate, added to the cost of the related assets;
- any onerous contracts for which provision should be made; and
- any constructive obligations for which provision should be made. For this purpose, preparers will need to question whether, in the absence of a legal obligation, past practices have raised valid expectations on the part of the third parties (e.g. employees/ customers).

Summary of SSAP 28

General

The objective of SSAP 28 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The key principle established by the Standard is that a provision should be recognised only when there is a liability i.e. a present obligation resulting from past events. The Standard thus aims to ensure that only genuine obligations are dealt with in the financial statements - planned future expenditure, even where authorised by the board of directors or equivalent governing body, is excluded from recognition.

In essence, SSAP 28 will ban three practices:

- the creation of provisions where there is no liability;
- the undisclosed use of old provisions created for one purpose to meet new expenditure for a different purpose; and
- the undisclosed release of provisions into the income statement.

Clear definitions are established, for the terms ‘provision’ and ‘contingent liability’, making it a requirement to justify the existence of an obligation at the balance sheet date to support recognition in the financial statements.

Undoubtedly, the most controversial aspect of SSAP 28 is the recognition criteria. This is not because the criteria are complex, but because they are designed to restrict existing practice.

Scope

SSAP 28 excludes from its scope provisions, contingent liabilities and contingent assets resulting from:

- financial instruments carried at fair value;
- non-onerous executory contracts;
- insurance company policy liabilities; and
- items covered by another Accounting Standard.

Definitions

A **provision** is a liability of uncertain timing or amount.

A **liability** is:

- a present obligation as a result of past events;
- the settlement of which is expected to result in an outflow of resources (payment).

A **contingent liability** is:

- a possible obligation depending on whether some uncertain future event occurs; or
- a present obligation, but payment is not probable or the amount cannot be measured reliably.

A **contingent asset** is:

- a possible asset that arises from past events; and
- whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Recognition of a provision

An enterprise should accrue a provision if, and only if:

- a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event);
- payment is probable (‘more likely than not’); and
- the amount can be estimated reliably.

A contingent liability, which is not recognised but is disclosed by way of note unless it is remote, results when one or more of the three recognition criteria for a provision is not met.

Provision	=	Present obligation from past event	+	Outflow is probable	+	Able to measure
Contingent liability	=	Possible obligation from past event	and/or	Outflow is not probable	and/or	Unable to measure

In rare cases, for example in a law suit, it may not be clear whether an enterprise has a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date. A provision should be recognised for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the enterprise should disclose a contingent liability, unless the possibility of an outflow of resources is remote.

Measurement of provisions

- Provisions for one-off events (e.g. restructuring, environmental clean-up, settlement of a lawsuit) are measured at the most likely amount.
- Provisions for large populations of events (e.g. warranties, customer refunds) are measured at a probability-weighted expected value.
- Both measurements are at discounted present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability.

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date i.e. the amount that an enterprise would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party. In reaching its best estimate, the enterprise should take into account the risks and uncertainties that surround the underlying events. Expected cash outflows should be discounted to their present values, where the effect of the time value of money is material.

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The amount recognised should not exceed the amount of the provision and should be treated as a separate asset.

In measuring provisions, future events should be dealt with as follows:

- forecast reasonable changes in applying existing technology;
- ignore possible gains on sale of assets; and
- consider changes in legislation only if virtually certain to be enacted.

Some examples

Circumstances	Action required
Restructuring by sale of an operation	Accrue a provision only after a binding sale agreement.
Restructuring by closure or reorganisation	Accrue a provision only after a detailed formal plan is adopted and announced publicly. A decision by the board of directors is not enough.
Warranty	Accrue a provision (past event was the sale of defective goods).
Land contamination	Accrue a provision if the enterprise’s policy is to clean up even if there is no legal requirement to do so (past event is the contamination and public expectation created by the enterprise’s policy).
Customer refunds	Accrue if the established policy is to give refunds (past event is the sale of the product and constructive obligation is the customer’s expectation that a refund will be available).
Offshore oil rig must be removed and sea bed restored	Accrue a provision when installed, and add to the cost of the asset.
Abandoned leasehold, four years to run	Accrue a provision.
An accounting firm must provide staff training for recent changes in tax law	No provision (there is no obligation to provide the training).
A chain of retail stores is self-insured for fire loss	No provision until an actual fire (no past event).
Self-insured restaurant, people were poisoned, lawsuits are expected but none have been filed yet	Accrue a provision (the past event is the injury to customers).
Major overhaul or repairs	No provision (no obligation).

Restructurings

SSAP 28 establishes very specific rules in respect of the recognition of restructuring provisions.

A restructuring is:

- the sale or termination of a line of business;
- the closure of business locations;
- changes in management structure; or
- the fundamental reorganisation of the reporting enterprise.

Restructuring provisions should be accrued as follows:

- for the sale of an operation, a provision should be accrued only after a binding sale agreement. If a binding sale agreement is entered into after the balance sheet date, the effect should be disclosed but not accrued;
- for closures or reorganisations, provisions should be accrued only after a detailed formal plan is adopted and announced publicly. A decision by the board of directors is not enough;
- provisions should not be recognised for future operating losses, even in a restructuring; and
- for restructurings arising on acquisitions, provisions for terminating employees, closing facilities, and eliminating product lines should be accrued if they are announced at the time of the acquisition only if a detailed formal plan is adopted 3 months after acquisition.

Restructuring provisions should include only direct expenditures caused by the restructuring, not costs that are associated with the ongoing activities of the enterprise.

What is the debit entry?

When a provision (liability) is recognised, the debit entry is not always an expense. Sometimes the provision may form part of the cost of an asset (e.g. the obligation for environmental clean-up for a new mine or offshore oil rig).

Use of provisions

Provisions should only be used for the purpose for which they were originally recognised. They should be reviewed at each balance sheet date and adjusted to reflect the current best estimate of the liability. If it is no longer probable that an outflow of resources will be required to settle the obligation, the provision should be reversed.

Contingent liabilities

SSAP 28 requires that enterprises should not recognise contingent liabilities - but should disclose them, unless the possibility of an outflow of economic resources is remote. Although this appears to be a change from SSAP 8 *Accounting for Contingencies*, because of changes in the definitions used for provisions and contingencies, in practice contingent liabilities that would have been accrued under SSAP 8 will continue to be recognised (but as provisions) under SSAP 28.

Contingent assets

Contingent assets should not be recognised - but should be disclosed where an inflow of economic benefits is probable. When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

Disclosures

A reconciliation is required for each class of provision, disclosing additional provisions/increases to existing provisions made in the period; amounts utilised during the period; unused amounts reversed during the period; and the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate

In addition, for each class of provision, a brief description is required of the nature of the obligation, the expected timing of any resulting outflows, an indication of the uncertainties about the amount or timing of those outflows, and the amount of any expected reimbursement.

For contingent liabilities, unless the possibility of any outflow is remote, the enterprise should disclose a brief description of the nature of the contingent liability, including an estimate of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow, and the possibility of any reimbursement.

For contingent assets, where an inflow of economic benefits is probable, the enterprise should provide a brief description of the nature of the contingent asset and, where practicable, an estimate of its financial effect.

The Standard allows that, in extremely rare cases, disclosure of some of the information listed above may be seriously prejudicial to the position of the enterprise. In such cases, the information disclosed may be less specific, provided that disclosure is made of the fact that, and the reason why, the information has not been disclosed.

Compliance with IAS

Compliance with SSAP 28 will ensure compliance, in all material respects, with the equivalent IAS.

SSAP 29 INTANGIBLE ASSETS**Impact**

SSAP 29 is the first Standard issued in Hong Kong on this topic, in an area where existing practice has been varied. In particular, the practice of deferring costs to match future revenue solely on the basis of the matching principle will no longer be justified. To recognise an intangible asset under the new Standard, the enterprise must have a resource that is controlled by it and that will give rise to future economic benefits. Further, such intangible assets will only be revalued where an active market exists.

On implementation, this will result in:

- derecognition of intangible items not satisfying the criteria for capitalisation;
- restatement of certain revalued intangible assets to the cost basis; and
- amortisation of intangible assets (even those with indefinite useful lives).

Challenges

The Standard provides detailed guidance to assist in the identification of items that meet the definition of an intangible asset. It also expressly prohibits the capitalisation of specific categories of expenditure. The recognition criteria are consistent with the guidance already in existence in the *Framework for the Preparation and Presentation of Financial Statements* and SSAP 1 *Presentation of Financial Statements* and, accordingly, provide additional clarification on these matters. Therefore, the recognition principles set out should be applied, even prior to formal implementation of the Standard.

The transitional provisions of SSAP 29 are complex and need to be fully understood to assess their impact on reported results. These provisions include detailed guidance which specifies when the Standard should be applied retrospectively and when it should be applied prospectively.

Steps that should be taken now

Assuming that an enterprise does not adopt SSAP 29 in advance of its effective date, it will be first implemented for the 31 December 2001 year end. Accordingly, the enterprise will need to assess its current policy and quantify the effect of any adjustment required to retained earnings at 1 January 2001. In particular:

- amounts currently recognised as intangible assets, but which do not meet the recognition criteria under SSAP 29, must be derecognised;
- the carrying amount of items currently recognised as intangible assets that have never been amortised should be restated in accordance with the amortisation requirements of SSAP 29; and
- amounts currently recognised as intangible assets for which the measurement basis does not comply with SSAP 29 (e.g. intangible assets revalued other than by reference to an active market) should be restated in accordance with SSAP 29.

Where amounts are currently recognised as intangible assets and have been previously amortised, but not in accordance with SSAP 29, no prior period adjustment is required, but future amortisation charges will need to be adjusted.

Amounts not previously recognised that would now qualify under SSAP 29 generally should not be recognised on the implementation of the new Standard. One exception is where the intangible was acquired in a business combination but not isolated from goodwill. In such circumstances, the enterprise is permitted (but not required) to recognise the intangible asset retrospectively.

Summary of SSAP 29

General

The objective of SSAP 29 is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. The Standard requires an enterprise to recognise an intangible asset if, and only if, detailed recognition criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures regarding intangible assets.

Definitions

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

An **asset** is a resource:

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

Recognition

SSAP 29 requires an enterprise to recognise an intangible asset, whether purchased or self-created (at cost) if, and only if:

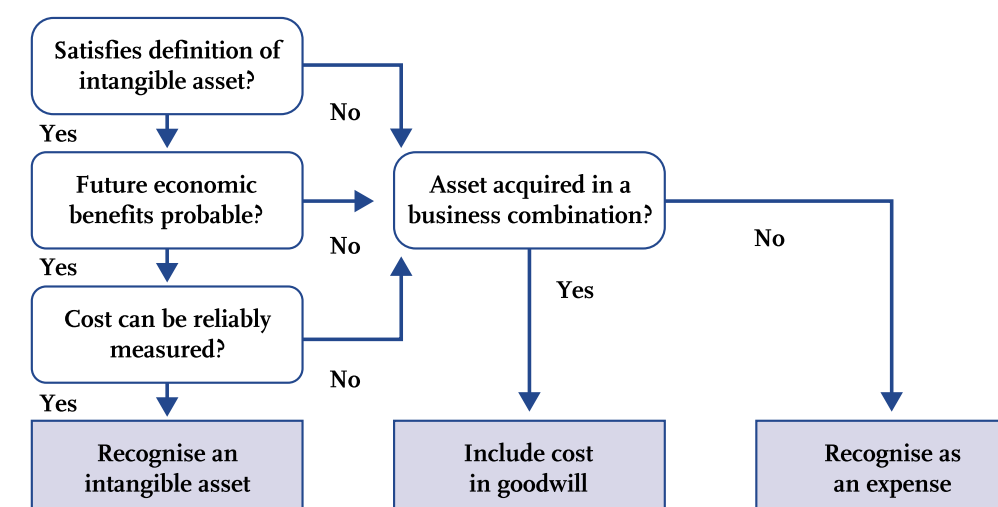
- it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- the cost of the asset can be measured reliably.

This requirement applies whether an intangible asset is acquired externally or generated internally. SSAP 29 includes additional recognition criteria for internally-generated intangible assets (see below).

If an intangible item does not meet both the definition of and the criteria for recognition as an intangible asset, SSAP 29 requires the expenditure to be recognised as an expense when it is incurred. The Standard also prohibits an enterprise from recognising this expenditure as part of the cost of an intangible asset at a later date.

In the case of a business combination, expenditure (included in the cost of acquisition) on an intangible item that does not meet both the definition of and recognition criteria for an intangible asset should form part of the amount attributed to the goodwill recognised at the acquisition date. If the intangible meets the conditions of SSAP 29, it should be recognised and measured at fair value. If fair value cannot be measured reliably, it should be included in the amount attributed to goodwill.

The following flowchart summarises the relevant decision points.



Subsequent expenditure

Subsequent expenditure on an intangible asset after its purchase or completion should be recognised as an expense when it is incurred, unless it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and the expenditure can be measured and attributed to the asset reliably.

Research and development costs/internally-generated intangibles

SSAP 29 supersedes SSAP 16 *Research and Development Costs*. Such costs now fall within the rules for internally-generated intangible assets under SSAP 29, which distinguish the research phase of a project from its development phase.

All expenditure on the research phase of a project is treated as research expenditure and should be charged as an expense.

Development costs are capitalised only after the technical and commercial feasibility of the asset for sale or use have been established.

If an enterprise cannot distinguish the research phase of an internal project to create an intangible asset from the development phase, the enterprise treats the expenditure for that project as if it were incurred in the research phase only.

Brands, mastheads, publishing titles, customer lists and items similar in substance that are internally-generated should not be recognised as assets.

Amortisation and impairment

An intangible asset should be amortised over the best estimate of its useful life. SSAP 29 does not permit an enterprise to assign an infinite useful life to an intangible asset. It includes a rebuttable presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use. If there is persuasive evidence that the useful life of an intangible asset will exceed 20 years (cases should be rare), an enterprise should amortise the intangible asset over the best estimate of its useful life and:

- test the intangible asset for impairment at least annually under SSAP 31 *Impairment of Assets*; and
- disclose the justification for rebuttal of the presumed maximum useful life for intangible assets of 20 years and also the factor(s) that played a significant role in determining the useful life of the intangible asset.

Annual impairment reviews are also required for internally-generated intangible assets during their development phase.

Measurement subsequent to initial recognition

After initial recognition, the benchmark treatment is that intangible assets should be carried at cost less any amortisation and impairment losses. The allowed alternative treatment is that the asset is carried at a revalued amount (based on fair value) less any subsequent amortisation and impairment losses. Revaluations of intangible assets are permitted only if fair value can be determined by reference to an active market. Such markets are expected to be rare for intangible assets. Examples where they might exist are:

- certain textile quota arrangements; and
- taxi licences.

Specific applications

The following must be expensed:

- internally-generated goodwill;
- start-up, pre-opening and pre-operating costs;
- training costs;
- advertising costs; and
- relocation costs.

The following rules apply to computer software:

- purchased software should be capitalised if the asset recognition criteria are met;
- the operating system for hardware should be included in hardware cost;
- internally-developed software (whether for use or sale) should be charged as an expense until its technological feasibility, probable future benefits, intent and ability to use or sell the software, resources to complete the software, and ability to measure cost are demonstrable; and
- software should be amortised over its useful life (presumption of not more than 20 years), based on the pattern of benefits (straight-line is the default).

Compliance with IAS

Under IAS, certain leasehold interests would be treated as intangible assets rather than as property interests. Under Hong Kong GAAP, such interests will be accounted for under SSAP 13 *Accounting for Investment Properties* and SSAP 17 *Property, Plant and Equipment*. Apart from this difference in scope, compliance with SSAP 29 will ensure compliance, in all material respects, with the equivalent IAS.

SSAP 30 BUSINESS COMBINATIONS

Impact

SSAP 30 clarifies and adds detailed guidance to the process of accounting for business combinations, clearly setting out the effective date of acquisition and the appropriate basis for determining fair values of assets acquired and liabilities assumed. Unlike the equivalent IAS 22, on which it is based, SSAP 30 does not permit the use of merger accounting and deals only with acquisition accounting. It also diverges from the IAS with regard to the definition of subsidiary. For Hong Kong incorporated companies, the definition used is restricted to the legal definition currently set out in the Companies Ordinance (see SSAP 32 section below for further comments). While the detailed measurement rules may result in differences arising in the calculation of goodwill as compared to the predecessor Standard SSAP 7 *Group Accounts*, the principal impact of SSAP 30 will be the subsequent accounting treatment for that goodwill.

The new Standard eliminates the current option of writing goodwill off to reserves immediately on acquisition and mandates its capitalisation and amortisation over its useful life. In assessing the useful life, SSAP 30 establishes a rebuttable presumption that the useful life of goodwill will not exceed 20 years. The treatment of negative goodwill is also amended, resulting in recognition in income based on an analysis of the circumstances from which the balance resulted.

Challenges

This new Standard is already effective for all December year end enterprises in that it applies to any business combination that has taken place since 1 January 2001. Accordingly, it is essential that enterprises understand the new rules and their impact on future reported financial performance, as this may impact on current investment decisions.

A further challenge is presented by the need to choose between alternatives available under the transitional provisions when SSAP 30 is first adopted. Where goodwill was previously written off to reserves, or where the calculation of goodwill arising on acquisition would have been different under the new rules, restatement is encouraged but not required. This choice must be made on a consistent basis for goodwill arising on all previous acquisitions.

Most Hong Kong companies have previously taken all goodwill to reserves and, accordingly, will be reluctant to restate prior periods, as this will normally result in an amortisation charge reducing future reported performance. However, those enterprises need to bear in mind that the goodwill was written off only as an accounting entry and it has not ceased to exist. Any future disposal of the acquired enterprise will result in the entire amount remaining in reserves related to the original acquisition being written back through the income statement as part of the calculation of the gain or loss on disposal. The impact of such potentially large charges on income may be more detrimental to public perception than an annual amortisation charge, which is likely to be discounted by analysts in any case.

Steps that should be taken now

The new Standard is already applicable for many enterprises and, accordingly, a thorough understanding of the new provisions is required now. In particular, enterprises should become familiar with the updated rules for determining fair values and for calculating goodwill arising on acquisition.

Enterprises should also carry out an analysis of the potential impact of the alternatives available under the transitional arrangements, having regard to their particular circumstances. Such a review will involve an assessment by the enterprise of appropriate useful lives for all of its acquired goodwill and the future plans of the enterprise.

Summary of SSAP 30

General

The objective of SSAP 30 is to prescribe the accounting treatment for business combinations. This Standard deals with acquisition accounting only. The HKSA does not permit the use of merger accounting other than in the circumstances of certain group reconstructions (see SSAP 27).

For the purposes of SSAP 30, a subsidiary is defined as an enterprise that is controlled by another enterprise. However, this widening of the definition of subsidiary will have no effect for Hong Kong incorporated companies. In preparing consolidated financial statements, such companies should only include companies meeting the definition of subsidiary under section 2(4) of the Companies Ordinance (essentially, holding the majority of shares or voting power or the ability to control the composition of the board of directors). Companies not meeting the definition of subsidiary as set out in the Companies Ordinance should be excluded from the consolidated financial statements of Hong Kong incorporated companies, irrespective of the substance of the relationship.

The principles of SSAP 30 are applicable to Hong Kong incorporated companies in all other respects, i.e. except to the extent that the Standard does not require such companies to include in their consolidated financial statements any enterprise that does not meet the definition of a subsidiary under the Companies Ordinance.

SSAP 30 deals with a number of issues that had previously been dealt with in SSAP 7 *Group Accounts*. The principles applied in the new Standard are generally consistent with those included in SSAP 7, but detailed measurement rules (e.g. as to the determination of fair values) may result in different allocations of the cost of acquisition.

Purchase method of accounting

Business combinations other than group reconstructions should be accounted for using the purchase method of accounting, i.e.:

- the income statement should incorporate the results of the acquiree from the date of acquisition; and
- the balance sheet should include the identifiable assets and liabilities of the acquiree and any goodwill or negative goodwill arising.

The date of acquisition is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer.

Cost of acquisition

The cost of the acquisition is the amount of cash paid and the fair value of the other consideration given by the acquirer, plus any costs directly attributable to the acquisition. Contingent consideration should be included in the cost of the acquisition at the date of the acquisition if payment of the amount is probable and it can be measured reliably. The cost of acquisition should be adjusted when a relevant contingency is resolved. When settlement of the consideration is deferred, the cost is the present value of such consideration and not the nominal amount.

Successive share purchases

Where the acquisition is achieved by successive share purchases, each significant transaction is treated separately for the purpose of determining the fair values of the assets/liabilities acquired and for determining the amount of goodwill arising on that transaction - comparing each individual investment with the percentage interest in the fair values of the assets and liabilities acquired at each significant step. If all of the assets and liabilities are restated to fair values at the time of each purchase, adjustments relating to the previously-held interests are accounted for as revaluations.

Measuring fair value

Guidelines are provided for the determination of fair values for specific categories of assets and liabilities. When an asset or business segment of the acquiree is to be disposed of, this is taken into consideration in determining fair value.

The carrying amounts of assets and liabilities should be adjusted when additional evidence becomes available to assist with the estimation of the fair value of assets and liabilities at the date of acquisition. Goodwill should also be adjusted if the adjustment is made by the end of the first annual accounting period commencing after the acquisition (provided that it is probable that the amount of the adjustment will be recovered from the expected future economic benefits). Otherwise, the adjustment should be treated as income or expense.

Goodwill

Goodwill arising on the acquisition should be recognised as an asset and amortised over its useful life, a period that should not usually exceed 20 years. An infinite useful life is not permitted. In rare cases, there may be persuasive evidence that the useful life of goodwill will be a specific period longer than 20 years. In such circumstances, the presumption that the useful life will not exceed 20 years can be rebutted. Where goodwill is amortised over a period in excess of 20 years:

- an annual impairment review is required; and
- disclosure is required of the justification for adopting a useful life of more than 20 years.

Amortisation will normally be on a straight-line basis. The unamortised balance should be reviewed at each period end and written down to the extent that it is no longer probable of being recovered.

Negative goodwill must always be measured and initially recognised as the difference between the acquirer's interest in the fair values of the identifiable assets and liabilities acquired less the cost of acquisition. It should be presented in the balance sheet as a deduction from positive goodwill. Negative goodwill should then be recognised in income as follows:

- to the extent that it relates to expectations of future losses and expenses that are identified in the acquirer's plan for the acquisition and can be measured reliably, negative goodwill should be recognised as income when the identified future losses and expenses occur;
- to the extent that it does not relate to such future losses and expenses, negative goodwill not exceeding the fair values of the non-monetary assets acquired should be recognised as income over the remaining average useful life of the depreciable non-monetary assets acquired; and

- negative goodwill in excess of the fair values of the non-monetary assets acquired should be recognised as income immediately.

Compliance with IAS

Except for the following, compliance with SSAP 30 will ensure compliance, in all material respects, with the equivalent IAS:

- SSAP 30 retains the Companies Ordinance definition of subsidiary for Hong Kong incorporated companies;
- SSAP 30 does not address the accounting for a uniting of interests, since the HKSA considers that an acquirer should be identifiable in every business combination; and
- SSAP 30 does not allow the IAS benchmark treatment of allocating the cost of an acquisition whereby minority interest is stated at the minority's proportion of the pre-acquisition carrying amounts of the net identifiable assets and liabilities of the subsidiary.

SSAP 31 IMPAIRMENT OF ASSETS

Impact

Many current Standards already include broadly similar requirements for the recognition and reversal of impairment losses. SSAP 31, however, introduces detailed procedures that an enterprise should apply to assess whether its assets are carried at more than their recoverable amount. Previous impairment losses or 'provisions for permanent diminution in value' may not have been calculated on that basis and, accordingly, assessing the recoverable amount in accordance with the new Standard may result in changes to previous estimates of impairment losses.

The new Standard will discourage arbitrary provisions for impairment in value. It will also require enterprises to consider annually whether relevant indicators require them to perform an impairment review and to identify the various cash-generating units which generate the underlying cash inflows for their business.

Challenges

The concept of net realisable value has been well established and applied in respect of assets held for sale. SSAP 31 requires detailed impairment reviews to be performed where impairment is indicated for other assets. In making these assessments, a number of new terms and concepts have been introduced with which preparers of financial statements will need to become familiar, including:

- the external and internal indicators that identify the need for an impairment review;
- what is meant by recoverable amount and value in use;
- the use of present value techniques to arrive at value in use; and
- the need to identify cash-generating units to determine value in use and recoverable amount, where it is not possible to determine this directly for the individual asset.

Steps that should be taken now

SSAP 31 can only be applied on a prospective basis. Therefore, on implementation, the reporting enterprise will need to perform impairment reviews in accordance with the Standard and determine whether any impairment losses should be recognised.

Enterprises should, however, prepare themselves in advance. Where impairment losses or 'provisions for permanent diminution in value' have been recognised in previous periods, enterprises should ensure that they have been dealt with in accordance with the requirements of SSAP 31 i.e. that the carrying amount of the asset has been reduced to its recoverable amount. If not, the carrying amount should be considered in line with SSAP 31 - with the effect being dealt with in the income statement or as a revaluation movement (as appropriate) in the current period.

In advance of implementing SSAP 31, we would recommend that enterprises consider all of the material asset categories that are included within the scope of the Standard and perform a high level review of recoverable amount versus carrying amount.

Summary of SSAP 31

Objective

The objective of SSAP 31 is to ensure that assets are carried at no more than their recoverable amount, and to define how recoverable amount is calculated.

Scope

SSAP 31 applies to all assets except inventories (SSAP 22), assets arising from construction contracts (SSAP 23), deferred tax assets (SSAP 12), financial assets, and investment properties (SSAP 13). Therefore, SSAP 31 applies to (among other assets):

- land;
- buildings;
- machinery and equipment;
- intangible assets;
- goodwill; and
- investments in subsidiaries, associates and joint ventures.

Identifying that an asset may be impaired

At each balance sheet date, enterprises are required to review assets to look for any indication that an asset may be impaired. An asset is impaired when its carrying amount exceeds its recoverable amount (i.e. the greater of its net selling price and its value in use). SSAP 31 has a list of external and internal indicators of impairment. If there is an indication that an asset may be impaired, then the enterprise is required to calculate the asset's recoverable amount.

Indications of impairment

External sources

- market value declines;
- negative changes in technology, markets, economy, or laws;
- increases in market interest rates; and
- company share price is below book value.

Internal sources

- obsolescence or physical damage;
- asset is part of a restructuring or held for disposal; and
- worse economic performance than expected.

These lists are not intended to be exhaustive.

Further, an indication that an asset is impaired may indicate that the asset's useful life, depreciation method or residual value may need to be reviewed and adjusted.

Recoverable amount

Recoverable amount is the higher of an asset's net selling price and its value in use.

Net selling price is the amount obtainable from the sale of the asset in a bargained transaction between knowledgeable, willing parties, less the costs of disposal.

Value in use is the discounted present value of estimated future cash flows expected to arise from:

- the continuing use of the asset; and
- its disposal at the end of its useful life.

Estimation of cash flows

In measuring value in use, cash flow projections:

- should be based on reasonable and supportable assumptions;
- should be based on recent budgets/forecasts, which should generally be restricted to a period of 5 years; and
- beyond the period covered by budgets/forecasts, should be extrapolated using an assumed steady or declining growth rate.

Discount rate

The discount rate to be applied in estimating value in use should:

- be a pre-tax rate; and
- reflect current market assumptions as to the time value of money and the risks specific to the asset.

For impairment of an individual asset, the discount rate is the rate that the enterprise would pay to borrow money to buy that specific asset.

For impairment of an investment in an entire business, the discount rate is the general borrowing rate that the investor would pay.

Recognition of an impairment loss

An impairment loss should be recognised whenever recoverable amount is below carrying amount.

The impairment loss is dealt with as an expense in the income statement, except in the case of a revalued asset, when the impairment loss is dealt with in the same manner as a revaluation decrease.

Cash-generating units

The recoverable amount should be determined for each individual asset, if possible. However, if it is not possible to determine the recoverable amount for an individual asset, then the enterprise should determine the recoverable amount of the asset's cash-generating unit (CGU). The CGU is the smallest identifiable group of assets:

- that generates cash inflows from continuing use;
 - that are largely independent of the cash inflows from other assets or groups of assets.
- SSAP 31 contains detailed guidance as to the appropriate allocation of assets to CGUs and for the allocation of any impairment loss identified between those assets.

Reversal of an impairment loss

Reversals are dealt with using the same approach as for the identification of an impairment loss. At each balance sheet date, the enterprise assesses whether there is any indication that a previously-recognised impairment loss may have decreased. If so, the recoverable amount of the asset should be calculated.

The increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognised. Any further increase in the carrying amount is a revaluation.

Reversal of an impairment loss is recognised as income in the income statement, except in the case of a revalued asset, when the reversal is dealt with as a revaluation increase.

An impairment loss previously recognised in respect of goodwill should only be reversed if the loss was caused by a specific external event of an exceptional nature that is not expected to recur. SSAP 31 indicates that these circumstances are expected to be rare.

Compliance with IAS

Compliance with SSAP 31 will ensure compliance, in all material respects, with the equivalent IAS.

SSAP 32 CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES

Impact

The key difference between SSAP 32 and SSAP 7 *Group Accounts*, which dealt with this subject matter previously, concerns the definition of a subsidiary. For Hong Kong incorporated enterprises there has been no change, although such companies should bear in mind that this exception is only short-term. The practical impact of widening the definition of subsidiary for non-Hong Kong incorporated enterprises is that a number of enterprises which previously did not fall within the definition of subsidiary, but which in substance were controlled by the reporting enterprise, will now be consolidated.

Although expressed somewhat differently, the rules for exclusion of subsidiaries from consolidated financial statements are generally consistent with those followed previously under SSAP 7. However, the appropriate accounting treatment for such excluded subsidiaries may now be different according to the circumstances of the reporting enterprise.

As regards the mechanics of consolidation, SSAP 32 contains more detailed guidance than did SSAP 7 (although the material is still not very extensive). The principal difference in this regard relates to where a subsidiary prepares its financial statements to a reporting date different to that of its parent. Although SSAP 32 allows for some difference in dates, it requires that the difference should not exceed three months.

Challenges

The new Standard moves current practice from being form-based to looking at the substance of the relationship between the investor and the investee. The key challenge for reporting enterprises will be to identify those investees that it has the power to control in the absence of majority shareholding or voting power. Such power should exist by virtue of a right held, rather than simply as a result of the observed practice of the parties concerned.

For the purpose of evaluating the enterprise’s relationships with its investees, the examples in the Standard and the indicators of control with respect to Special Purpose Entities set out in the Appendix effectively set parameters for applying the definition of subsidiary in the absence of majority control.

Steps that should be taken now

Non-Hong Kong incorporated enterprises will need to review closely their relationships with investees and determine whether control exists in the absence of majority shareholding or voting power. If so, such enterprises will need to be consolidated (with restatement of prior years). Particular attention should be paid to Special Purpose Entities.

Enterprises will also need to review the policy followed for accounting for investments in subsidiaries in the parent’s individual financial statements:

- if previously carried at cost, they may wish to consider moving to a basis consistent with other investments in securities under SSAP 24; or
- if previously carried at revalued amount (e.g. at net asset value of subsidiaries), they will need to move to either the cost basis or an appropriate fair value basis under SSAP 24).

Summary of SSAP 32

Objective

The objective of SSAP 32 is to prescribe the requirements for the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent. It also prescribes the accounting treatment for investments in subsidiaries in a parent's separate financial statements.

Identification of subsidiaries

For the purposes of SSAP 32, a **subsidiary** is defined as an enterprise that is controlled by another enterprise. Control is presumed when the parent acquires more than half of the voting rights of the enterprise. Even when more than half of the voting rights is not acquired, control may be evidenced by power:

- over more than half of the voting rights by virtue of an agreement with other investors; or
- to govern the financial and operating policies of the other enterprise under a statute or an agreement; or
- to appoint or remove the majority of the members of the board of directors; or
- to cast the majority of votes at a meeting of the board of directors.

Although encompassing the most common occurrences of a parent/subsidiary relationship, this list is not exhaustive. Given the broad general definition of subsidiary, control may exist in the absence of majority shareholding, voting power or power to appoint the majority of the board of directors. The definition is principally concerned with the substance of the relationship between the investor and the investee.

However, SSAP 32 is concerned with formal rights. Therefore, if an investor is entitled to control the investee, it will be accounted for as a subsidiary, irrespective of whether or not the investor chooses to exercise that right in practice. Conversely, if the investor is accustomed to directing the financial and operating policies with the implicit approval of the majority shareholder, this will not constitute control, since the majority shareholder can at any time exercise its legal rights and assume control of the operations.

This widening of the definition of subsidiary will have no effect for Hong Kong incorporated companies. In preparing consolidated financial statements, such companies should only include companies meeting the definition of subsidiary under section 2(4) of the Companies Ordinance (essentially holding the majority of shares or voting power or the ability to control the composition of the board of directors). Companies not meeting the definition of subsidiary under the Companies Ordinance should be excluded, irrespective of the substance of the relationship.

This exception from the general rules for Hong Kong incorporated companies arises because the HKSA has obtained legal opinion that consolidated financial statements which include companies other than those meeting the definition of subsidiary under section 2(4) of the Companies Ordinance do not meet the requirements of the statute. We anticipate that the HKSA will press for a prompt change in the law to ensure a level playing field for all enterprises reporting under Hong Kong GAAP.

Presentation of consolidated financial statements

A parent is required to present consolidated financial statements (i.e. financial statements of a group presented as those of a single enterprise) unless it is itself a wholly-owned subsidiary of another enterprise. The consolidated financial statements should include all of the parent's subsidiaries, except where:

- control is intended to be temporary, because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or
- it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

Excluded subsidiaries should be accounted for under the enterprise's usual policy for investments in securities under SSAP 24.

Special Purpose Entities (SPEs) should be consolidated where the substance of the relationship indicates that the SPE is controlled by the reporting enterprise. This may arise even where the activities of the SPE are predetermined or where the majority of voting and equity are not held by the reporting enterprise. Again, for Hong Kong incorporated companies, only investees meeting the Companies Ordinance definition of subsidiary can be consolidated.

Consolidation procedures

Intra-group balances and intra-group transactions and the resulting unrealised profits are required to be eliminated in full. Unrealised losses resulting from intra-group transactions should also be eliminated, unless cost cannot be recovered.

The difference between the dates of financial statements used for consolidation purposes should not exceed three months. If they are drawn up to different dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements.

Uniform accounting policies should be used throughout the group. If it is impracticable to do so, that fact should be disclosed, together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

Minority interests should be presented in the consolidated balance sheet separately from liabilities and the parent shareholder's equity. Minority interests in the income of the group should also be separately presented. Where losses applicable to the minority exceed the minority interest in the equity of the relevant subsidiary, the excess, and any further losses attributable to the minority, are charged to the group unless the minority has a binding obligation to, and is able to, make good the losses. Where excess losses have been taken up by the group, if the subsidiary in question subsequently reports profits, all such profits are attributed to the group until the minority's share of losses previously absorbed by the group has been recovered.

Individual financial statements of the parent

In the parent’s individual financial statements, investments in subsidiaries that are included in the consolidated financial statements should be included in the parent’s own financial statements either:

- at cost (less any impairment loss); or
- in accordance the enterprise’s accounting policy for investments in securities under SSAP 24.

Compliance with IAS

Except for the following, compliance with SSAP 32 ensures compliance, in all material respects, with the equivalent IAS:

- SSAP 32 retains the Companies Ordinance definition of subsidiary for Hong Kong incorporated companies;
- SSAP 32 does not grant any exemption from the requirement to prepare consolidated financial statements to parent enterprises that are ‘virtually’ wholly-owned;
- SSAP 32 does not allow the IAS alternative for an investment in a subsidiary to be accounted for in the parent’s separate financial statements using the equity method; and
- SSAP 32 requires that investments in subsidiaries that operate under severe long-term restrictions should be accounted for under SSAP 24 *Accounting for Investments in Securities* which, in certain circumstances, may involve their being accounted for on a cost basis. Under IAS, such interests will generally be accounted for at fair value.

SSAP 9 EVENTS AFTER THE BALANCE SHEET DATE (Revised)

Impact

The principal effect of the adoption of SSAP 9 (Revised) will be the change in treatment of dividends proposed or declared after the year end. This will have a direct impact on the presentation of the financial statements. A proposed dividend or a dividend declared after the balance sheet date does not meet the definition of a liability at the balance sheet date and therefore no liability should be recognised. The proposed amount can still be presented for disclosure purposes in the income statement, but in the balance sheet it should be included within shareholders’ funds as a separate component of equity.

Challenges

The Standard is clear that, if a reporting enterprise wishes to change that treatment in advance of the effective date of SSAP 9 (Revised), it is entitled to do so. However, preparers who wish to commence implementation of the new Standards and who view SSAP 9 (Revised) as a ‘quick fix’ should appreciate the significance of the requirement to adopt two other very complex Standards at the same time.

Steps that should be taken now

In the absence of specific transitional provisions, SSAP 9 (Revised) should be applied retrospectively. Therefore, the opening balance of retained earnings will need to be adjusted for the effect of proposed dividends accrued at the previous period end. Comparative amounts will also be required to be restated.

Summary of SSAP 9 (Revised)

General

With respect to events after the balance sheet date, the basic concepts of the previous version of SSAP 9 have been retained, namely:

- financial statements are adjusted for events after the balance sheet date that provide further evidence of conditions that existed at the balance sheet date, including events that indicate that the going concern assumption in relation to the whole or part of the enterprise is not appropriate; and
- financial statements are not adjusted for events or conditions that arose after the balance sheet date. These events should be disclosed if they are of such importance that non-disclosure would affect the ability of users to make proper evaluations and decisions.

The revised Standard makes the following limited changes to the previous requirements as regards events occurring after the balance sheet date:

- it will no longer be acceptable to make adjustments for events occurring after the balance sheet date which, although not meeting the definition of an adjusting event, had previously been adjusted for because of convention (e.g. dividends declared or proposed after the balance sheet date); and
- the requirement to adjust financial statements where an event after the balance sheet date indicates that the going concern assumption is not appropriate for part of the enterprise has been removed. The requirement to prepare financial statements other than on a going concern basis in the event of a post-year end decision to liquidate the enterprise or to cease trading entirely has been retained.

Definitions

SSAP 9 (Revised) defines **events after the balance sheet date** as those events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements were authorised for issue. Therefore, the only difference between this and the definition of ‘post balance sheet event’ under the previous version of the Standard is the reference to the date on which the financial statements were authorised for issue rather than when they were approved by the board of directors.

For practical purposes, in a Hong Kong context, this is the same date. The date of approval by the board of directors is generally the date the financial statements are authorised for issue. The revised Standard makes it clear that, where an enterprise is required to submit its financial statements to its shareholders for approval after the financial statements have already been issued, the financial statements are authorised for issue on the date of the original issuance, not on the date when the shareholders approve the financial statements.

Therefore, essentially, the Standards are concerned with the same events and transactions.

Dividends

The revised Standard specifically requires that dividends to holders of equity instruments that are proposed or declared after the balance sheet date should not be recognised as a liability at the balance sheet date.

This requirement is based on the principle that an item should not be included in the balance sheet as a liability if the enterprise does not have a present obligation at the balance sheet date in respect of that item. Although, by convention, proposed dividends have traditionally been accrued in the accounting period to which they relate, there has never been a sound theoretical argument to justify the recognition of a liability. Rather, the preferred (and now mandatory) approach is to address the issue by disclosure. SSAP 9 (Revised) requires enterprises to disclose the amount of dividends that were proposed or declared after the balance sheet date but before the financial statements were authorised for issue as a separate component of equity.

Going concern

An enterprise should not prepare its financial statements on a going concern basis if management determines after the balance sheet date either that it intends to liquidate the enterprise or to cease trading, or that it has no realistic alternative but to do so.

Deterioration in operating results and financial position after the balance sheet date may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that SSAP 9 (Revised) requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

Compliance with IAS

Compliance with SSAP 9 (Revised) will ensure compliance, in all material respects, with the equivalent IAS.

SSAP 26 SEGMENT REPORTING

Impact

Based on IAS 14, SSAP 26 is the first Accounting Standard in Hong Kong on this topic. Prior to the release of SSAP 26, listed enterprises were required to report segment information under the Listing Rules/GEM Rules. The new Standard introduces more detailed, complex and onerous requirements for reporting enterprises, as well as bringing the analyses provided within the scope of audit verification. The scope of SSAP 26 is also wider, and applies to those entities in the process of listing and those that provide segment information on a voluntary basis.

The requirements of the new Standard are more demanding than those of the Listing Rules/GEM Rules and, generally, compliance with SSAP 26 will result in compliance with those rules. However, there is one aspect where the requirements of the current rules go beyond those of SSAP 26. For reporting enterprises that have diverse operations both as regards their activities and their geographical locations, the Listing Rules/GEM Rules require presentation of an analysis of contribution to trading results on the basis of both activities and geographical segments. Under SSAP 26, a segmental analysis of results is not required for the enterprise’s secondary reporting format.

Challenges

SSAP 26 was released in February 2000 but is not effective until accounting periods beginning on or after 1 January 2001. The extended implementation period has been allowed to facilitate any modifications found to be necessary to financial reporting systems as a result of SSAP 26 - particularly for enterprises with diverse activities and widespread geographical interests. Not only are the specified disclosures more comprehensive than enterprises have previously been required to report under the Listing Rules/GEM Rules, but there are now specific rules for the identification and disclosure of segments.

Steps that should be taken now

SSAP 26 requires the disclosure of comparative information. This means that the information for the period prior to implementation (for most enterprises with December year ends, this is the year ended 31 December 2000) is captured on a timely basis. Reporting enterprises should therefore:

- review segments reported internally and ensure that they provide an appropriate basis for reporting externally under SSAP 26;
- if the segments reported internally do not provide an appropriate basis for reporting under SSAP 26 (e.g. because information is reported internally by legal entity without consideration of the risk/reward profile of the underlying products/geographical areas), identify appropriate segments to be reported externally;
- determine which basis of segmentation (business or geographical) is to be their primary and which their secondary basis, according to which has the predominant influence on risks and rates of return earned;
- identify those segments that are reportable using the numerical thresholds set out in SSAP 26; and
- make whatever modifications are necessary to their reporting systems to ensure that the information specified for disclosure under SSAP 26 is available.

Although SSAP 26 does provide that, on implementation of the Standard, comparative segment data need not be restated if it is impracticable to do so, enterprises are not entitled to avail of this exemption unless they have made a reasonable effort to restate the information. In addition, the exemption from restatement of comparatives is not repeated in the Listing Rules.

Summary of SSAP 26

General

The objective of SSAP 26 is to establish principles for reporting financial information by line of business and by geographical area. It applies to enterprises whose equity or debt securities are publicly traded and to enterprises in the process of issuing securities to the public. In addition, any enterprise voluntarily providing segment information should comply with the requirements of the Standard.

In general, the requirements of SSAP 26 are more comprehensive than those specified by the Listing Rules/GEM Rules and, therefore, compliance with SSAP 26 will result in compliance with the rules of the SEHK. There are two exceptions to this:

- for certain enterprises, the Listing Rules/GEM Rules require the presentation of an analysis of contribution to trading results on the basis of both activities and geographical segments. This goes beyond the requirements of SSAP 26, which does not require the presentation of a segmental analysis of results for the enterprise's secondary reporting format (see below); and
- SSAP 26 allows that, in the first year of implementation, comparative segment data need not be restated, if such restatement is impracticable. The Listing Rules allow no such exemption and, therefore, for Main Board enterprises, availing of the SSAP 26 relief will constitute a breach of the Listing Rules.

Identifying business and geographical segments

The reporting enterprise should initially identify its business segments and geographical segments (as defined). Business segments are groups of related products or services and geographical segments are countries or groups of countries. SSAP 26 includes detailed guidance for identifying segments. In particular, an enterprise must look to its organisational structure and internal reporting system to identify reportable segments. Only if internal segments are not along either product/service or geographical lines is further disaggregation appropriate. This is a 'management approach' to segment definition.

Geographical segments may be based either on where the enterprise's assets are located or on where its customers are located. Whichever basis is used, several items of data must be presented on the other basis if significantly different.

Which segments are reportable?

The enterprise's reportable segments are its business and geographical segments for which a majority of their revenue is earned from sales to external customers and for which:

- revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments; or
- segment result, whether profit or loss, is 10% or more the combined result of all segments in profit or the combined result of all segments in loss, whichever is greater in absolute amount; or
- assets are 10% or more of the total assets of all segments.

If total external revenue attributable to reportable segments identified using the 10% thresholds outlined above is less than 75% of the total consolidated or enterprise revenue, additional segments should be identified as reportable segments until at least 75% of total consolidated or enterprise revenue is included in reportable segments. Segments deemed too small for separate reporting may be combined with each other, if related, but they may not be combined with other significant segments for which information is reported internally.

Primary and secondary segments

For most enterprises, one basis of segmentation is primary and the other is secondary, with considerably less disclosure required for secondary segments. The enterprise should determine whether business or geographical segments are to be used for its primary segment reporting format, based on whether the enterprise's risks and returns are affected predominantly by the products and services it produces or by the fact that it operates in different geographical areas. The basis for identification of the predominant source and nature of risks and differing rates of return facing the enterprise will usually be the enterprise's internal organisational and management structure and its system of internal financial reporting to senior management.

What must be disclosed?

SSAP 26 has detailed guidance as to which items of revenue and expense are included in segment revenue and segment expense. All enterprises will report a standardised measure of segment result - basically operating profit before interest, taxes, and head office expenses. For an enterprise's primary segments, SSAP 26 requires disclosure of:

- sales revenue (distinguishing between external and inter-segment);
- result;
- assets;
- the basis of inter-segment pricing;
- liabilities;
- capital additions;
- depreciation;
- non-cash expenses other than depreciation; and
- equity method income.

Segment revenue includes 'sales' from one segment to another. Under SSAP 26, these inter-segment transfers must be measured on the basis that the enterprise actually used to price the transfers.

For secondary segments, the enterprise is required to disclose:

- revenue;
- assets; and
- capital additions.

Where there has been a change in the identification of segments, prior year information should be restated. If this is not practicable, segment data should be reported for both the old and new bases of segmentation in the year of change.

Compliance with IAS

Compliance with SSAP 26 will ensure compliance, in all material respects, with the equivalent IAS.

Effective Dates and Transitional Provisions

Standard Number	Title	Effective Date	Standards and Guidelines superseded	Transitional Provisions
SSAP 9 (Revised)	Events After the Balance Sheet Date	1 January 2001 Earlier adoption encouraged	SSAP 9 <i>Accounting for Post Balance Sheet Events</i>	<p>None specified. Therefore, retrospective application is required under SSAP 2 <i>Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies</i>.</p> <p>If SSAP 9 (Revised) is adopted early: ■ disclose that fact; and ■ adopt SSAP 28 and SAAP 30 at the same time.</p>
SSAP 26	Segment Reporting	1 January 2001 Earlier adoption encouraged	None	<p>Restate prior period segment information unless it is impracticable to do so, in which case the enterprise should disclose that fact.</p> <p>But - there is no such exemption from restatement under Listing Rules.</p>
SSAP 28	Provisions, Contingent Liabilities and Contingent Assets	1 January 2001 Earlier adoption encouraged	SSAP 8 <i>Accounting for Contingencies</i>	<p>The effect of adopting the Standard should be reported as an adjustment to the opening balance of retained earnings for the period in which SSAP 28 is first adopted.</p> <p>Enterprises are encouraged, but not required, to adjust amounts reported for the prior period.</p> <p>If SSAP 28 is adopted early: ■ disclose that fact; and ■ adopt SSAP 9 (Revised), and SAAP 31 at the same time.</p>
SSAP 29	Intangible Assets	1 January 2001 Earlier adoption encouraged	SSAP 16 <i>Research and Developments Costs</i> AG 2.207 <i>Accounting for Textile Quota Entitlements</i>	<p>Comprehensive transitional tables provided.</p> <p>Briefly:</p> <ul style="list-style-type: none">■ retrospective application is required to eliminate items that do not qualify for recognition under SSAP 29 (e.g. internally-generated brands) or if the previous measurement basis did not comply with SSAP 29 (e.g. if an intangible was revalued otherwise than by reference to an active market);■ prospective application of the recognition requirements is generally required - i.e. if an item meets the recognition criteria under SSAP 29, but was not previously recognised, it should generally not be recognised on implementation of SSAP 29. An exception to this rule is where the item in question was acquired in a business combination and previously included within goodwill, in which case retrospective recognition of the intangible asset is encouraged, but not required; and■ where an asset was previously recognised (and meets the recognition criteria under SSAP 29) and amortised, but the amortisation charged was different to that which would have been determined under SSAP 29 - the carrying amount is amortised under the rules of SSAP 29 over the remainder of the asset's useful life. No prior period adjustment arises. <p>Where SSAP 29 permits a choice of treatment on transition, the enterprise is required to disclose which alternative it has selected.</p> <p>If SSAP 29 is adopted early: ■ disclose that fact; and ■ adopt SSAP 30 and SSAP 31 at the same time.</p>

Standard Number	Title	Effective Date	Standards and Guidelines superseded	Transitional Provisions
SSAP 30	Business Combinations	1 January 2001 Earlier adoption encouraged	AG 2.204 <i>Accounting for Goodwill</i> SSAP 10 <i>Accounting for Investments in Associates</i> and SSAP 21 <i>Accounting for Interests in Joint Ventures</i> will be amended to require goodwill arising on the acquisition of investments in associates and joint ventures to be amortised over its useful life.	Comprehensive transitional tables provided. Briefly: <ul style="list-style-type: none">■ restatement of goodwill or negative goodwill previously eliminated against reserves is encouraged but not required. However, if the enterprise chooses to restate the goodwill - it must do so for all previous acquisitions;■ if the amount determined for goodwill (negative goodwill) does not comply with SSAP 30, the enterprise is encouraged but not required, to recalculate the goodwill (negative goodwill) using the principles of SSAP 30;■ if goodwill (negative goodwill) was previously included on the balance sheet, but not subsequently amortised or released to income, the amount should be restated retrospectively in accordance with the principles of SSAP 30; and■ if goodwill (negative goodwill) previously recognised was amortised or released to income, but not as would have been required under SSAP 30, the carrying amount is amortised/released under the rules of SSAP 30 over the remaining useful life of the goodwill. No prior period adjustment arises. Where SSAP 30 permits a choice of treatment on transition, the enterprise is required to disclose which alternative it has selected. If SSAP 30 is adopted early: <ul style="list-style-type: none">■ disclose that fact; and■ adopt SSAPs 9 (Revised), 28, 29, 31 and 32 at the same time.
SSAP 31	Impairment of Assets	1 January 2001 Earlier adoption encouraged	None SSAP 10 <i>Accounting for Investments in Associates</i> , SSAP 17 <i>Property, Plant and Equipment</i> and SSAP 21 <i>Accounting for Interests in Joint Ventures</i> will be amended to update the guidance on measuring impairment included therein.	Standard to be applied on a prospective basis only. Impairment losses (reversals) that arise on adoption of SSAP 31 are dealt with in the income statement in the current period, unless the asset is carried at a revalued amount, in which case they should be treated in the same manner as revaluation decreases (increases). If SSAP 31 is adopted early: <ul style="list-style-type: none">■ disclose that fact; and■ adopt SSAPs 28, 29 and 32 at the same time.
SSAP 32	Consolidated Financial Statements and Accounting for Investments in Subsidiaries	1 January 2001 Earlier adoption encouraged	SSAP 7 <i>Group Accounts</i>	None specified. Therefore, retrospective application is required under SSAP 2 <i>Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies</i> . If SSAP 32 is adopted early: <ul style="list-style-type: none">■ disclose that fact; and■ adopt SSAP 30 at the same time.

Harmonisation with IAS

In January 2001, an international survey of national accounting rules in 53 regimes, including Hong Kong, was published by the large accountancy firms (the GAAP 2000 Study). It provided an overview of some of the differences between national accounting rules and selected features of International Accounting Standards (IAS). It was a ‘status report’ of a key aspect of financial reporting convergence as at December 2000.

The release of the HKSA’s package of Standards in January 2001 addressed the majority of the divergences between Hong Kong GAAP and IAS noted in the GAAP 2000 Study. The table below repeats the differences noted in the survey and, to the extent that they have not been dealt with by the new Accounting Standards, sets out the HKSA’s plans for addressing the issues raised. It therefore provides a summary of significant progress in the HKSA’s programme of harmonisation with IAS.

References to the plans of the FASC are based on the article “FASC Gets to Work” published in the November 2000 issue of the HKSA’s Hong Kong Accountant magazine.

Issue identified by GAAP 2000 Study	IAS Ref.	Divergence eliminated by	Comment
Hong Kong accounting may differ from that required by IAS because of the absence of specific Hong Kong rules in the following areas:			
■ impairment of assets	IAS 36	SSAP 31	
■ intangible assets	IAS 38	SSAP 29	
■ employee benefits	IAS 19	-	FASC intends to commence work on a Standard based on IAS 19 in the near future.
■ business combinations arising from uniting of interests other than from transactions among enterprises under common control	IAS 22	-	As set out in the Appendix to SSAP 30, the HKSA has determined that the use of the pooling of interests method is inappropriate except in the case of certain group reconstructions.
■ the consolidation of special purpose entities.	SIC 12	SSAP 32	Issue persists for Hong Kong incorporated companies - see below.
There are no specific rules requiring disclosure of:			
■ fair values of financial assets and liabilities	IAS 32.77	-	Although a Hong Kong Exposure Draft on IAS 32 has been in issue since 1995, the HKSA has not given any indication when it will be formalised as a Standard.
■ related party relationships where there are no transactions, except that the name of the ultimate holding company must be disclosed	IAS 24.20	-	Divergence continues.
■ segment assets and liabilities.	IAS 14.55/56	SSAP 26	

Issue identified by GAAP 2000 Study	IAS Ref.	Divergence eliminated by	Comment
There are inconsistencies between Hong Kong and IAS rules that are likely to lead to differences for many enterprises in certain areas. Under Hong Kong rules:			
■ provisions in the context of business combinations are made from the perspective of the acquirer	IAS 22.31	SSAP 30	
■ goodwill may be directly eliminated against equity	IAS 22.41	SSAP 30	No longer acceptable under SSAP 30 - but goodwill arising from earlier combinations may be dealt with in reserves until the enterprise is disposed of.
■ there is no requirement for an annual impairment test on goodwill with a depreciable life of over 20 years	IAS 22.56	SSAP 30	
■ more extensive provisions may be made	IAS 37.14	SSAP 28	
■ provisions are not required to be discounted	IAS 37.45	SSAP 28	
■ dividends proposed or declared after the balance sheet date are accrued	IAS 10.11	SSAP 9 (Revised)	
■ deferred tax is calculated on the basis of timing differences rather than temporary differences, and balances are only recognised if they are expected to crystallise	IAS 12.15	-	FASC has indicated that it will start work on a Standard on income taxes, based on the equivalent IAS, very shortly.
■ the recognition of deferred tax assets is more restrictive	IAS 12.34	-	FASC has indicated that it will start work on a Standard on income taxes, based on the equivalent IAS, very shortly.
■ an issuer's financial instrument is generally classified based on the legal form rather than on the basis of whether or not it is in substance a liability, and compound instruments are not split on this basis	IAS 32.18/23	-	Although a Hong Kong Exposure Draft based on IAS 32 has been in issue since 1995, the HKSA has not given any indication when it will be formalised as a Standard.
■ disclosures relating to discontinuing operations may begin later than required under IAS	IAS 35.16	-	FASC intends to commence work on a SSAP based on IAS 35 in the near future. This will replace the current requirements contained in SSAP 2 concerning disclosure of discontinued operations.
■ a primary/secondary basis is not used for segment reporting	IAS 14.26	SSAP 26	
■ the format of the cash flow statement and certain disclosures and the definition of cash equivalents are different	IAS 7	-	FASC plans to revise Hong Kong's SSAP 15 in the near future. This will mainly involve changes to terminology.
■ interests in leasehold properties in Hong Kong are not accounted for as leases as the lessee normally receives all the risk and rewards incident to ownership of the properties. These are accounted for as property, plant and equipment (carried at cost less accumulated depreciation or revalued amount) or investment properties (carried at revalued amount).	IAS 17.11	-	Divergence continues.

Issue identified by GAAP 2000 Study	IAS Ref.	Divergence eliminated by	Comment
In certain enterprises, these other issues could lead to differences from IAS:			
■ some enterprises that are controlled by the reporting enterprise but do not meet the definition of subsidiary under the Hong Kong Companies Ordinance may be excluded from consolidation	IAS 27.6	SSAP 32	Because of legal issues, Hong Kong incorporated companies cannot consolidate enterprises that would not meet the legal definition of subsidiary. Therefore, pending a change in the law, divergent treatment will continue for such enterprises.
■ certain subsidiaries with dissimilar activities can be excluded from consolidation	IAS 27.13/14	SSAP 32	
■ a balance sheet would be adjusted for a post balance sheet event which causes a material part of the reporting enterprise to cease to be a going concern	IAS 10.7/8/13	SSAP 9 (Revised)	
■ lessors recognise finance income on the basis of the net cash investment	IAS 17.30	SSAP 14	
■ disclosures relating to discontinuing operations may begin later	IAS 35.16	-	FASC intends to commence work on a Standard based on IAS 35 in the near future. This will replace the current requirements contained in SSAP 2 concerning disclosure of discontinued operations.
■ there are no specific rules concerning the translation of the financial statements of hyperinflationary subsidiaries	IAS 21.36	-	Divergence continues.
■ the income statement of the foreign enterprise may be translated either at the closing rate or at an average rate for the period	IAS 21.30	-	FASC has issued an Exposure Draft based on IAS 21, but finalisation as a Standard has been delayed.
■ there are no specific rules regarding the treatment of the cumulative amount of deferred exchange differences in equity relating to a foreign entity on disposal of that entity	IAS 21.37	SSAP 32	
■ there are also no specific rules concerning own (treasury) shares	SIC 16	-	For Hong Kong incorporated companies and entities listed on the Hong Kong Stock Exchange, own securities are cancelled upon re-purchase.
■ the date of acquisition/disposal of a subsidiary is the earlier of the date on which consideration passes and the date on which an offer becomes or is declared unconditional.	IAS 22.20	SSAP 30	

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