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Implementing Hong Kong Financial Reporting Standards

The challenge for 2005

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Abbreviations

s2(4)	Section 2(4) of the Hong Kong Companies Ordinance
EPS	Earnings Per Share
HK – Int	Hong Kong Interpretation
HKAS	Hong Kong Accounting Standard
HK (SIC) – Int	Hong Kong (SIC) Interpretation
HKFRS(s)	Hong Kong Financial Reporting Standard(s)
HK (IFRIC) – Int	Hong Kong (IFRIC) Interpretation
HKICPA	Hong Kong Institute of Certified Public Accountants
IAS(s)	International Accounting Standard(s)
IASB	International Accounting Standards Board
IFRS(s)	International Financial Reporting Standard(s)
PRC	People's Republic of China
SIC and	Standing Interpretations Committee of the International Accounting Standards Committee Interpretations issued by that Committee
SSAP	Statement of Standard Accounting Practice

Introduction

1 January 2005 marked the beginning of a new era for the setting of Hong Kong Financial Reporting Standards (HKFRSs). On that date, the suite of Accounting Standards in Hong Kong became fully harmonised with International Financial Reporting Standards (IFRSs), except for a few minor differences (listed below).

All but a few of the existing Statements of Standard Accounting Practice (SSAPs) and Interpretations have been renamed as Hong Kong Accounting Standards (HKASs) and Hong Kong (SIC) Interpretations (HK (SIC)-Ints), and their numbering has been aligned with the equivalent International Accounting Standards (IASs) and Interpretations issued by the Standing Interpretations Committee (SICs), respectively. One existing Standard, SSAP 27 *Accounting for group reconstructions,* has not yet been withdrawn. There is currently an Exposure Draft for an accounting guideline on merger accounting which, on adoption, will result in the withdrawal of SSAP 27. There are four new home-grown Hong Kong Interpretations (HK- Int 1–4) that have not been redesignated as there are no corresponding International Interpretations.

In addition, the new International Financial Reporting Standards (IFRSs) and Interpretations of IFRSs issued by the International Financial Reporting Interpretations Committee (IFRICs) are mirrored by equivalent HKFRSs and HK (IFRIC)-Ints. The majority of the Standards and Interpretations are effective for financial periods beginning on or after 1 January 2005.

The term "Hong Kong Financial Reporting Standards" (HKFRSs) includes all HKFRSs, HKASs and Interpretations. Interpretations refer to Hong Kong (IFRIC) Interpretations (HK (IFRIC) – Ints), Hong Kong (SIC) Interpretations (HK (SIC) – Ints) and the four Hong Kong Interpretations (HK- Ints) mentioned above. Interpretations give authoritive guidance on issues that may otherwise lead to divergent or unacceptable treatment. A table showing the new references for the Accounting Standards, Interpretations, corresponding equivalent International Standards and Interpretations, and the previous Hong Kong Accounting Standards and Interpretations is set out in Appendix 1. Appendix 1 also provides a list of Exposure Drafts and Draft Interpretations.

A number of the new HKFRSs (including HKFRS 2 *Share-based Payment*, HKFRS 3 *Business Combinations,* HKAS 17 *Leases,* HKAS 32/39 *Financial Instruments*, HKAS 40 *Investment Property* and HK-Ints 2 and 3) are expected to result in significant changes for Hong Kong entities. For example:

- Share-based payment transactions must be recognised as expenses in the income statement.
- Goodwill is no longer amortised and instead must be tested at least annually for impairment.
- All derivatives, and other financial instruments, must be recognised on the balance sheet with changes in fair value taken to the income statement (unless they are designated and effective hedging instruments).
- If the fair value basis is used for investment property, fair value movements must be reported in the income statement, not equity.
- Leasehold interests in land will need to be classified as operating leases unless the interest meets the criteria to be, and is, classified as an investment property and the fair value model is adopted.
- Owner-operated hotel property must be accounted for as property, plant and equipment and be subject to depreciation.
- The stage of completion method can no longer be used to recognise revenue arising from pre-completion contracts for the sale of development properties.

The only significant textual differences between the HKFRSs published so far and the comparable IFRSs are as follows:

- In HKAS 1 *Presentation of Financial Statements*, the terms "fair presentation" and "present fairly" used in IAS 1 *Presentation of Financial Statements* are replaced by the terms "true and fair view" and "give a true and fair view". The difference in terminology has no significance in respect of measurement or disclosure in the financial statements.
- To carry forward a transitional arrangement included in the previous SSAP 17 *Property, plant and equipment*, HKAS 16 *Property, Plant and Equipment* contains a transitional provision which relieves certain entities that carried their property, plant and equipment at revalued amounts before 30 September 1995 from making regular revaluations.
- HKAS 26 *Accounting and Reporting by Retirement Benefit Plans* includes additional guidance on preparing the financial statements of schemes falling within the scope of the Mandatory Provident Fund Schemes Ordinance and the Occupational Retirement Schemes Ordinance.
- HKAS 27 *Consolidated and Separate Financial Statements* contains additional paragraphs (21A, 21B and 42A) to reflect the requirements of the Hong Kong Companies Ordinance, i.e. that for Hong Kong incorporated companies, only companies falling within the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance (s2(4)) may be consolidated. This represents a divergence from IAS 27 *Consolidated and Separate Financial Statements,* which requires all entities that are controlled by the parent to be consolidated. The HKICPA requires disclosure of what the effect would have been if entities controlled by the parent, but not falling within the s2(4) definition, were consolidated.
- HKFRS 3 *Business Combinations* contains additional paragraphs (6A, 6B, 23A and 77A), that include background on why Hong Kong incorporated companies are required to use the definition of a subsidiary as set out in s2(4) rather than that of IFRS 3 *Business Combinations* and give specific additional disclosures for companies falling within the scope of the IFRS 3 definition, but outside the scope of s2(4). HKFRS 3 recognises that, in preparing consolidated financial statements, a company incorporated under the Hong Kong Companies Ordinance may not consolidate an entity that does not meet the definition of a subsidiary under that Ordinance. This treatment represents a divergence from IFRS 3. Also, the transitional provisions of HKFRS 3 are different from IFRS 3 as HKFRS 3 only applies to business combinations for which the agreement date is on or after 1 January 2005, instead of on or after 31 March 2004 as stated in IFRS 3.

For each new Standard, this publication sets out a summary of its content, the key changes it makes to accounting in Hong Kong, the most significant implications on its adoption, and related anticipated future developments. This publication also provides a brief summary of each new Interpretation and its impact on entities.

In this publication, we have split the new Standards and Interpretations into three sections, by classifying them as "major", "moderate" and "minor", based on our expectation of their impact on financial reporting in Hong Kong. However, the impact of Standards will vary widely depending on an entity's own unique set of circumstances. Although the key changes are covered in this publication, there may be other changes (covering significant recognition and measurement, and presentation and disclosure changes) that are not discussed or covered in detail and that may also affect specific reporting entities. Therefore, we recommend that where a new HKFRS (Standard or Interpretation) is relevant to an entity's specific circumstances, a detailed review of that HKFRS is performed in order to identify all changes that may impact the organisation.

Additionally, although HKAS 34 *Interim Financial Reporting* is included in the minor impact section, as there are no significant changes introduced by that Standard, interim statements must be drawn up on the basis of the accounting policies that will be applied in the next annual accounts. Therefore, interim financial statements will be significantly impacted as they will be the first set of financial statements to reflect all the changes from the other accounting Standards.

These new HKFRSs may significantly change the reported result and/or net asset position of entities, and they may also impact the systems and employee knowledge required to enable the entity to prepare its financial statements. Some of the wider implications of applying the new suite of Standards and Interpretations are as follows.

Changes in share prices and credit ratings

- Where the impact of transition is not transparent, it could make it difficult to assess underlying performance, leading to damaging market speculation. Therefore it is essential that the impact is effectively communicated to stakeholders.

Impact on key performance indicators (KPIs)

- The market may expect KPIs across sectors to be comparable, even though the new HKFRSs may affect individual companies in different ways. It is essential that any such differences, and the reasons for them, are explained to stakeholders.

Impact on gearing and liquidity ratios

- Loan covenants based on ratios from financial statements may be broken, or become much tighter, leading to uncertainty about the availability of finance. A timely review of agreements should be performed to identify and rectify potential issues.

Increased volatility

- The new requirements require greater use of fair values and such measurement will lead to increased volatility in results. Entities will need to explain this to stakeholders.

Systems and controls

- Systems will need to capture data which may not have been required under the previous Standards. The necessary modifications and other requirements must be identified early to enable implementation and testing before full reporting is required.

Training

- Accounting staff, and other members of staff making operational decisions, and those charged with governance will need to have sufficient knowledge and understanding of the new requirements under HKFRSs. Sufficient training will be required.

Distributions and dividend policy

- New requirements may affect the ability of an entity to make distributions. Entities will need to assess the impact on their dividend policy and communicate this clearly to shareholders.

Taxation

- The new HKFRSs may have an impact on the amount of tax payable. An accurate assessment of the full tax implications may be difficult to perform until precise details of the taxation authorities treatment of these changes are known.
- We trust that readers will find this publication of practical assistance in understanding the implications for their financial statements of the new HKFRSs.

Deloitte's IFRS e-learning Modules	Deloitte has developed high quality e-learning modules on IFRSs. As the new HKFRSs are identical to IFRSs, completing the e-learning material is an effective way of developing an understand of the new HKFRSs. There is one e-learning module for each IAS and IFRS and the Framework, with self-tests. The modules are all available without charge on **www.iasplus.com**

HKFRS having a major impact

The Standards and Interpretations within this section are:

- HKFRS 2 Share-based Payment
- HKFRS 3 Business Combinations
- HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations
- HKAS 17 Leases
- HKAS 32 Financial Instruments: Disclosure and Presentation
- HKAS 36 Impairment of Assets
- HKAS 38 Intangible Assets
- HKAS 39 Financial Instruments: Recognition and Measurement
- HKAS 40 Investment Property
- HK – Int 2 The Appropriate Policies for Hotel Properties
- HK – Int 3 Revenue – Pre-completion Contracts for the Sale of Development Properties
- HK – Int 4 Leases – Determination of the Length of Lease Term in Respect of Hong Kong Land Leases

This section provides an overview of the HKFRSs that are expected to have the most significant impact on Hong Kong entities, in general, due to the commercial effect and implementation effort required. Some of the key changes introduced by these HKFRSs are described below.

HKFRS 2 requires entities to recognise share-based payment transactions as expenses (and hence may significantly reduce earnings), using complex valuation techniques in order to value the transactions, and to deal with significant new disclosure requirements.

HKFRS 3, and the resulting changes to HKAS 36 and HKAS 38, prohibit the amortisation of goodwill and instead require an annual impairment test to be performed, potentially leading to greater volatility in the income statement. HKFRS 3 also requires contingent liabilities acquired in a business combination to be recognised, potentially increasing goodwill and leading to complex and highly subjective valuations. HKFRS 3 also requires any excess of the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities over cost (previously called negative goodwill) to be recognised immediately in profit or loss.

HKASs 32 and 39 are the first comprehensive Accounting Standards in Hong Kong dealing with financial instruments. HKAS 32 introduces significant new disclosure requirements that may be extremely time consuming to prepare, and may require entities to provide information on sensitive matters. For most entities, HKAS 39 will result in fundamental changes to the accounting treatment of investment securities and other financial instruments. For example, the need to recognise all derivatives, and other financial instruments, on a fair value basis and the specific requirements for hedge accounting are likely to result in extra volatility into the financial statements.

HKAS 40 permits an entity to choose between a cost basis for investment property, and depreciate the assets, or use a fair value basis. If the fair value basis is used, fair value movements must be reported in the income statement, not equity.

Under HKAS 17, interests in land that are held as leasehold (which will be the case for most land in Hong Kong and the People's Republic of China (PRC)) will be classified as operating leases, and hence not accounted for as property, plant and equipment, unless the leasehold interest meets the criteria to be, and is, classified as an investment property and the fair value model is adopted for that property. However, if the lease payments for a lease of land and buildings cannot be allocated reliably between the land and building elements (and it is clear that both elements are not operating leases), then the entire lease is classified as a finance lease and hence the appropriate accounting treatment will be dictated by the model selected by the entity for similar freehold property.

HK – Int 2 requires a hotel property to be classified and accounted for as either investment property or as property plant and equipment, according to the purpose for which it is held. An owner-operated hotel property must be accounted for in accordance with the requirements of HKAS 16 *Property, Plant and Equipment*. Specifically, this will no longer allow the previous practice of not depreciating some hotel properties.

HK – Int 3 states that pre-completion contracts for the sale of development properties do not meet the definition of construction contracts if the contracts in question are not specifically negotiated for the construction of the properties. As a result, the stage of completion method can no longer be used to recognise revenue arising from such contracts. Instead, revenue is recognised only when the conditions in HKAS 18 *Revenue* for the sale of goods are met.

HKFRS 2 Share-based Payment (issued March 2004)

Objective

To prescribe the accounting for a transaction in which an entity receives or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity.

Entities Most Likely to be Affected by Changes

Entities that have employee share or option schemes, or make other payments in, or based on, their equity instruments.

HKFRS 2 Requirements at a Glance

Scope of HKFRS 2	Transactions in which an entity receives goods or services as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's equity instruments.
Recognition	Recognised as an expense over the vesting period, if any.
Different types of transactions	Equity-settled Cash-settled Equity settled with cash alternatives
Equity-settled measurement	Fair value measured at grant date only.
Cash-settled measurement	Fair value measured at each balance sheet date.
Counterparty can choose cash or equity	Equity component measured at grant date only. Cash component measured at each balance sheet date.

Key Changes under HKFRS 2

- This is the first Accounting Standard on share-based payment transactions in Hong Kong

Implications of Changes

An extensive exercise will need to be undertaken to **identify all share-based transactions** (including share option schemes) to which HKFRS 2 applies.

Share-based payments must be **recognised as expenses** in the income statement, with corresponding increases in equity for the issuance of shares (or rights to shares), or the recognition of a liability for cash payments dependent upon a share price. Before HKFRS 2, entities were not required to recognise such expenses. Therefore, for companies that regularly use share-based payments to provide remuneration or to acquire goods or other services, the changes are likely to significantly affect reported results, as well as introducing increased volatility.

The use of **valuation techniques** will require a high level of expertise due to the need to use complex calculation methodologies and understand the key variables. If an entity has complicated share-based payment transactions or employee share options with complex terms, an expert with financial instrument valuation knowledge may need to be engaged to measure the transactions. HKFRS 2 contains significant guidance dealing with application and implementation. However, as there is no single model for estimating the fair value of share-based payments, nor any consensus for quantifying the unique features of particular share-based payment arrangements in valuation models, the use of **considerable judgement** will be an essential part of the valuation process. A minor change in a variable such as volatility or expected life of an instrument could have a quantitatively material impact on the fair value of the instruments granted.

Entities will need to assess their existing share and option schemes under HKFRS 2 to determine the accounting outcomes and determine whether changes need to be made to **employee compensation packages** in the light of HKFRS 2, e.g. with regards to the impact on results, and other key performance indicators, and any tax implications. Previously share options may have been considered a good way to compensate employees without adversely affecting reported profits.

Entities will also need to deal with the extensive **disclosure requirements** of HKFRS 2.

Summary of HKFRS 2

Definition

A share-based payment transaction is a transaction in which the entity receives or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity.

The accounting requirements for a share-based payment transaction depend on whether it is classified as (a) equity-settled, (b) cash-settled or (c) equity settled with cash alternatives.

Scope

The concept of share-based payment transactions is broader than employee share options. HKFRS 2 encompasses the issuance of shares, or rights to shares, in return for services and goods. Examples of items included in the scope of HKFRS 2 are share appreciation rights, employee share purchase plans, employee share ownership plans, share option plans and plans where the issuance of shares (or rights to shares) may depend on market or non-market related conditions.

HKFRS 2 applies to all entities. There is no exemption for private or smaller entities. Furthermore, subsidiaries using their parent's or fellow subsidiary's equity as consideration for goods or services are within the scope of the Standard.

There are two exemptions to the general scope principle.

- The issuance of shares in a business combination should be accounted for under HKFRS 3 *Business Combinations*. However, care should be taken to distinguish share-based payments related to the acquisition from those related to employee services.
- HKFRS 2 does not address share-based payments within the scope of paragraphs 8-10 of HKAS 32 *Financial Instruments: Disclosure and Presentation*, or paragraphs 5-7 of HKAS 39 *Financial Instruments: Recognition and Measurement*. Therefore, HKAS 32 and 39 should be applied for commodity-based derivative contracts that may be settled in shares or rights to shares.

HKFRS 2 does not apply to share-based payment transactions other than for the acquisition of goods and services. Therefore, share dividends, the purchase of treasury shares, and the issuance of additional shares are outside its scope.

Recognition and measurement

The issuance of shares or rights to shares requires an increase in a component of equity. HKFRS 2 requires the offsetting debit entry to be expensed when the payment for goods or services does not represent an asset. The expense should be recognised as the goods or services are consumed. For example, the issuance of shares or rights to shares to purchase inventory would be presented as an increase in inventory and would be expensed only when the inventory is sold or impaired.

The issuance of fully vested shares, or rights to shares, is presumed to relate to past service, requiring the full amount of the grant-date fair value to be expensed immediately. The issuance of shares to employees with, say, a three-year vesting period is considered to relate to services over the vesting period. Therefore, the fair value of the share-based payment, determined at the grant date, should be expensed over the vesting period.

Equity-settled transactions with employees (and others providing similar services):

- Measure the transaction at the fair value of the equity instruments granted.
- The fair value is measured at grant date. HKFRS 2 provides guidance on estimating the fair value of shares and share options granted.
- Non-market performance conditions are not included in the grant date valuation but are instead taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount (called a "true-up"), so that ultimately, the transaction amount is based on the number of equity instruments that eventually vest.
- Market conditions are taken into account when estimating the fair value of the equity instruments granted. Since the conditions are included in the grant date fair value the "true-up" model doesn't apply.

Equity-settled transactions with other parties:

- Measure the transaction at the fair value of the goods or services received.
- The fair value is estimated at the date of receipt of those goods or services.
- Only if the fair value of the goods or services cannot be measured reliably would the fair value of the equity instruments granted be used.

The following example provides an illustration of a typical equity-settled share-based payment.

Illustration – Recognition of employee share option grant

Company grants a total of 100 share options to 10 members of its executive management team (10 options each) on 1 January 2005. These options vest at the end of a three-year period. The company has determined that each option has a fair value at the date of grant equal to 15. The company expects that all 100 options will vest and therefore records the following entry at 30 June 2005 - the end of its first six-month interim reporting period.

Dr. Share Option Expense 250

Cr. Share Option Expenses 250

[(100 x 15)*1/6 periods]

If all 100 shares vest, the above entry would be made at the end of each 6-month reporting period. However, if one member of the executive management team leaves during the second half of 2006, therefore forfeiting the entire amount of 10 options, the following entry at 31 December 2006 would be made:

Dr. Share Option Expense 150

Cr. Equity 150

[(90 x 15)*4/6 periods]-[250+250+250]

Cash-settled transactions:

- Share-based payment transactions that will be settled in cash or other assets (rather than with an entity's own equity instruments) are measured at the fair value of the liability at each reporting date.
- The payments are only recognised to the extent the related goods or services have been acquired or received.
- The liability continues to be remeasured until it is settled.
- Changes in the liability are recognised in the income statement, unless the goods or services acquired are recognised as assets.

Equity-settled transactions with cash alternatives:

Both the liability (the right to demand cash or other assets) and equity (the obligation to transfer equity instruments rather than cash) components are individually measured and recognised.

- The liability component follows a similar treatment to cash-settled share-based payment transactions.
- For the equity component, the entity recognises the goods and services received, and an increase in equity, as the counterparty provides the goods or services in the same manner as other equity-settled share-based payment transactions.
- At the settlement date, the liability is remeasured to fair value and either reduced to zero if the cash is paid, or reclassified to equity if equity instruments are issued. Any amount already recognised in equity remains within equity (reclassifications within equity are allowed).
- Once the split between the liability component and the equity component is performed at issuance, that split should not be subsequently revised.

Modification

If the fair value of the new instruments is more than the fair value of the old instruments, the incremental amount is recognised over the remaining vesting period in a manner similar to the original amount. If the modification occurs after the vesting period, the incremental amount is recognised immediately.

If the fair value of the new instruments is less than the fair value of the old instruments, the original fair value of the equity instruments granted is expensed as if the modification never occurred.

Cancellation or settlement

The cancellation or settlement of equity instruments is accounted for as an acceleration of the vesting period and therefore any amount unrecognised that would otherwise have been charged should be recognised immediately. Any payments made with the cancellation or settlement (up to the fair value of the equity instruments) should be accounted for as the repurchase of an equity interest. Any payment in excess of the fair value of the equity instruments granted is recognised as an expense

Replacement

New equity instruments granted may be identified as a replacement of cancelled equity instruments. In those cases, the replacement equity instruments should be accounted for as a modification. The fair value of the replacement equity instruments is determined at grant date, while the fair value of the cancelled instruments is determined at the date of cancellation, less any cash payment on cancellation that is accounted for as a deduction from equity.

Disclosure

Required disclosures include:

- The nature and extent of share-based payment arrangements that existed during the period.
- How the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined.
- The effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.

Transitional provisions

HKFRS 2 applies to grants of shares, share options or other equity instruments that were granted after 7 November 2002 and had not yet vested at the effective date of the HKFRS (periods beginning on or after 1 January 2005). It applies retrospectively to liabilities arising from share-based payment transactions existing at the effective date.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKFRS 2	None
Specific Deloitte publications	• Guide to IFRS 2 Share-based Payment • IFRS 2 e-learning module

Illustrative disclosures

	Equity-settled share option scheme
HKFRS 2.45(a)	The Company has a share option scheme for all employees of the Group. Options are exercisable at a price equal to the average quoted market price of the Company's shares on the date of grant. The vesting period is 3 years. If the options remain unexercised after a period of 5 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Group before the options vest. Details of the share options outstanding during the year are as follows:
HKFRS 2.45(b)	(see table below)
HKFRS 2.45(c),(d)	The weighted average share price at the date of exercise for share options exercised during the year was HKD7.1. The options outstanding at the end of the year have a weighted average remaining contractual life of 3.4 years (2004: 3.6 years).

	2005		2004	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
		HKD		HKD
Outstanding at the beginning of the year	4,500,000	3.03	2,210,000	1.62
Granted during the year	1,700,000	6.49	2,300,000	4.37
Forfeited during the year	(1,000)	1.50	(10,000)	1.50
Exercised during the year	(650,000)	1.38	-	
Expired during the year	(60,000)	1.00	-	
Outstanding at the end of the year	5,489,000	4.14	4,500,000	3.03
Exercisable at the end of the year	1,489,000		1,000,000	

HKFRS 2.47(a)

In 2005, options were granted on 31 March, 30 June and 31 October. The estimated fair values of the options granted on those dates are HKD1.84, HKD2.35 and HKD2.84 respectively. In 2004, options were granted on 30 June and 1 December. The estimated fair values of the options granted on those dates are HKD1.22 and HKD2.22 respectively.

These fair values were calculated using The Black-Scholes pricing model. The inputs into the model were as follows:

	2005	2004
Weighted average share price	HKD5.45	HKD4.37
Weighted average exercise price	HKD5.39	HKD4.25
Expected volatility	40%	35%
Expected life	4	4
Risk free rate	3.5%	3.0%
Expected dividend yield	2%	Nil

HKFRS 2.47(d)

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous 4 years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferrability, exercise restrictions and behavioural considerations.

HKFRS 2.47(c)

During 2005, the Company repriced certain of its outstanding options. The exercise price was reduced from CU6.2 to the then current market price of CU5.0. The incremental fair value of CU0.256 million will be expensed over the remaining vesting period of 2 years. The Company used the inputs noted above to measure the fair value of the old and new options.

HKFRS 2.51(a)

The Group recognised total expenses of CU2.86 million (2004: CU1.202 million) related to equity-settled share-based payment transactions during the year.

Cash-settled share-based payments

HKFRS 2.45(a)

The Group issued to certain employees share appreciation rights (SARs) that require the Group to pay the intrinsic value of the SAR to the employee at the date of exercise. At 31 December 2005, the Group has recorded liabilities of CU6.528 million (2004: CU3.516 million). The fair value of the SARs is determined using the Black-Scholes pricing model using the assumptions noted above. The Group recorded total expenses of CU3.012 million (2004: CU3.516 million) during the year in respect of SARs. At 31 December 2005, the total intrinsic value of the vested SARs was Nil (2004:Nil).

	Other share-based payment plan
HKFRS 2.45(a)	Under the Company's employee share purchase plan, all employees may purchase the Company's shares at 85% of the closing market price on the date of grant during a two-week period each year. Employees may purchase shares having a value not exceeding 15% of their gross compensation during the offering period. The shares so purchased are generally placed in the employees share savings plan and will only be released to employees who remain in the Company's employment for a period of three years from the date of grant. Pursuant to the plan, the Company issued 1,000,000 shares during the year, at an average share price of CU6. The discount of CU0.9 million will be expensed over the vesting period of 3 years.

Compliance with IFRSs

There are no significant differences between HKFRS 2 and IFRS 2 *Share-based Payment.*

Future Developments

The IFRIC has released two Draft Interpretations, D16 *Scope of IFRS 2* and D17 *Group and Treasury Share Transactions*. D16 clarifies that transactions within the scope of IFRS 2 include those in which the entity cannot specifically identify some or all of the goods or services received. D17 provides guidance on whether particular types of transactions should be accounted for as cash-settled or equity-settled share-based payment transactions under IFRS 2.

HKFRS 3 Business Combinations (issued August 2004)

Objective

To prescribe the financial reporting by an entity when it undertakes a business combination

Entities Most Likely to be Affected by Changes

- Entities with past or planned business combinations.
- Entities in industries where contingent liabilities or restructurings often occur with business combinations.
- Entities in industries that commonly have significant intangible assets.

HKFRS 3 Requirements at a Glance

Method of accounting	Must use acquisition/purchase method. Merger accounting is prohibited.
Assets and liabilities recognised	All identifiable assets, liabilities and contingent liabilities acquired are measured at 100% of fair values.
Goodwill	Not amortised, but tested for impairment at least annually.
Negative goodwill	Recognised in profit and loss immediately.
Restructuring costs	Only recognised to the extent that a liability exists at acquisition date.

Key Changes under HKFRS 3

- Prohibits the amortisation of goodwill and intangible assets with indefinite useful lives. They must be tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment.
- Requires all business combinations within its scope to be accounted for using the acquisition/purchase method. HKFRS 3 specifically excludes from its scope business combinations involving entities or businesses that are under common control both prior to, and following, the transaction.
- HKFRS 3 provides a definition of common control. The definition focuses on control, rather than actual shareholdings, so the minority interests in each of the combining entities before and after the combination is not relevant in determining whether a combination involves entities under common control. SSAP 27 *Accounting for group reconstructions* required that there be no change in the relative rights of shareholders, and that minority interests should remain unchanged. In practice, this may result in more acquisitions falling outside the scope of HKFRS 3, because they are under common control, which allows for them to be merger accounted.
- Requires the recognition of intangible items acquired in a business combination as assets separately from goodwill if they meet the definition of an asset, are either separable or arise from contractual or other legal rights, and their fair value can be measured reliably. SSAP 30 *Business combinations* required an intangible asset to be recognised if, and only if, it was probable that the future economic benefits attributable to the asset would flow to the entity, and its cost could be measured reliably. The first criterion

(the probability criterion) was removed because it is always considered to be satisfied for intangible assets acquired in a business combination. HKFRS 3 also clarifies that the fair value of an intangible asset acquired in a business combination can normally be measured with sufficient reliability for separate recognition.

- Prohibits the recognition of a liability for costs expected to be incurred to restructure an acquiree's activities unless the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. SSAP 30 required an acquirer to recognise as part of allocating the cost of a business combination, a provision for terminating or reducing the activities of the acquiree that was not a liability of the acquiree at the acquisition date, provided that the acquirer satisfied specified criteria.
- Requires an acquirer to recognise separately the acquiree's contingent liabilities (as defined in HKAS 37) at the acquisition date as part of allocating the cost of a business combination, provided that their fair values can be measured reliably. Such contingent liabilities were, in accordance with SSAP 30, subsumed within the amount recognised as goodwill or negative goodwill.
- Requires the acquirer to reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination if, at the acquisition date, the acquirer's interest in the net fair value of those items exceeds the cost of the combination. Any excess remaining after that reassessment must be recognised by the acquirer immediately in profit or loss. SSAP 30 allowed the excess to be deferred (negative goodwill). Any negative goodwill that was previously included in the balance sheet will need to be derecognised at the beginning of the first accounting period beginning on or after 1 January 2005, with the corresponding adjustment being made to the opening balance of retained earnings.
- Requires, if an entity previously recognised goodwill as a deduction from equity, that it shall not recognise that goodwill in profit or loss when it disposes of all or part of the business to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired. Entities are not permitted to restate goodwill previously eliminated against reserves.
- Introduces significant new disclosure requirements.

Implications of Changes

Prohibiting the amortisation of goodwill will lead to an overall reduction to amortisation in the income statement. Also, the requirement to perform **annual impairment tests** for goodwill and certain other intangible assets, regardless of whether there are any indications of impairment, will be time consuming and will probably lead to impairment losses being recorded more frequently. This may be the case as the new requirements could lead to assets being assessed at a more detailed level. Also, where goodwill has been allocated to a cash generating unit, that cash generating unit must be **tested annually** for impairment. Entities are likely to see increased volatility in the income statement due to the removal of amortisation and the new impairment test requirements.

The new requirements for recognising intangibles that are acquired in a business combination will lead to **more intangibles being recognised** on the balance sheet and a lower value being assigned to goodwill. Identifying and measuring intangible assets can be a subjective process, in some cases requiring the expertise of a professional valuer.

Any **excess of an acquirer's interest** in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost (previously known as negative goodwill) can no longer be deferred. If an excess exists, the acquirer must reassess the fair values determined, and the measurement of the cost of acquisition. Having reassessed this information any excess remaining is recognised as income immediately in the income statement in the current year, rather than deferred over a number of years. Any negative goodwill existing at the date that HKFRS 3 is adopted is eliminated against opening reserves.

The separate recognition of the **contingent liabilities** acquired in a business combination will increase the amount of goodwill recognised. As for purchased intangible assets, the recognition and measurement of contingent liabilities can be highly subjective. In setting timelines for completing and accounting for acquisitions, additional time should be built in for these new requirements.

The recognition of **liabilities for restructuring costs** (e.g. redundancies and closures) will be much more difficult, leading to the recognition of restructuring expenditure as an expense in the period after the combination.

Summary of HKFRS 3

Scope

HKFRS 3 applies to all business combinations (the bringing together of separate entities or businesses into one reporting entity), except combinations of entities under common control, combinations of mutual entities, combinations by contract without exchange of ownership interest and formations of joint ventures.

All business combinations within the scope of HKFRS 3 must be accounted for using the acquisition/purchase method. The pooling of interests method (also known as merger accounting) is prohibited.

Cost of the business combination

The acquirer measures the cost of a business combination at the sum of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, plus any costs directly attributable to the combination.

If the cost is subject to adjustment which is contingent on future events, the acquirer includes the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably.

Identifiable assets, liabilities and contingent liabilities

The acquirer recognises separately, at the acquisition date, the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the following recognition criteria at that date, regardless of whether they had been previously recognised in the acquiree's financial statements:

- An asset other than an intangible asset is recognised if it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably.
- A liability other than a contingent liability is recognised if it is probable that an outflow of resources will be required to settle the obligation, and its fair value can be measured reliably.
- An intangible asset or a contingent liability is recognised if its fair value can be measured reliably.

The identifiable assets acquired, and liabilities and contingent liabilities incurred or assumed, must be initially measured at full fair value, including any minority interest's share of the acquired item.

An acquirer must not recognise provisions for future losses or restructuring costs expected to be incurred as a result of the business combination.

An intangible item acquired in a business combination, including an in-process research and development project, must be recognised as an asset separately from goodwill if it meets the definition of an asset (it is controlled and provides economic benefits), is either separable or arises from contractual or other legal rights, and its fair value can be measured reliably.

In applying the acquisition/purchase method, an acquirer must recognise contingent liabilities assumed in the business combination, if their fair value is reliably measurable. A contingent liability recognised under HKFRS 3 continues to be recognised in subsequent periods even though it does not qualify for recognition under HKAS 37.

Goodwill

Goodwill is recognised by the acquirer as an asset and is initially measured as the excess of the cost of the business combination over the acquirer's share of the net fair values of the acquiree's identifiable assets, liabilities and contingent liabilities. Goodwill is not amortised, but it must be tested for impairment at least annually. In addition, it must be tested before the end of the current period if it was acquired in a business combination during the period.

If the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities, and contingent liabilities exceeds the cost, the excess (previously called negative goodwill) after performing a reassessment is recognised as an immediate gain.

Disclosures

HKFRS 3 prescribes significant disclosures for each business combination that was effected during the period including the following:

- Cost of the combination (with separate disclosure of the number and fair values of equity instruments issued and how the fair values were determined).
- Amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities, and contingent liabilities, and, unless impracticable, the carrying amounts of each of those classes, determined in accordance with HKFRSs, immediately before the combination.
- Details about the factors that contributed to the recognition of goodwill.
- Amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable.
- Revenue and profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period, unless impracticable.

Transitional provisions

HKFRS 3 is effective for business combinations for which the agreement date is on or after 1 January 2005. Entities may choose to apply HKFRS 3 from any date prior to 1 January 2005 to all business combinations occurring on or after the chosen application date providing that they have sufficient information (obtained at the date of the initial accounting for that business combination) to apply the Standard to past business transactions, and that they also apply the revised versions of HKAS 36 *Impairment of Assets* and HKAS 38 *Intangible Assets* with the same effective date.

Where goodwill has been previously recognised in business combination transactions an entity is required to:

- Discontinue amortising goodwill in the first period beginning on or after 1 January 2005.
- Eliminate the carrying amount of accumulated goodwill amortisation against the carrying amount of goodwill at the beginning of the first reporting period beginning on or after 1 January 2005.
- Test the carrying amount of goodwill for impairment in accordance with HKAS 36 from the beginning of the first annual reporting period beginning on or after 1 January 2005.

Any negative goodwill from business combinations agreed prior to 1 January 2005 included in the balance sheet is derecognised at the beginning of the first reporting period beginning on or after 31 January 2005 with the corresponding adjustment being made to the opening balance of retained earnings.

Effective date	Annual periods beginning on or after 1 January 2005 and business combinations where the agreement date is on or after 1 January 2005.
Related Interpretations	None
Existing pronouncements replaced by HKFRS 3	SSAP 30 *Business combinations* Interpretation 12 *Business combinations – Subsequent adjustment of fair values and goodwill initially reported* Interpretation 13 *Goodwill – Continuing requirements for goodwill previously eliminated against/credited to reserves* Interpretation 15 *Business combinations – "Date of exchange" and fair value of equity instruments*
Specific Deloitte publications	• Guide to IFRS 3 Business Combinations • IFRS 3 e-learning module

Illustrative disclosures for the acquisition of a subsidiary

Note: For illustrative disclosures relating to goodwill and impairment of goodwill see HKAS 36.

Reference	
	Acquisition of subsidiary
HKFRS 3.66 **HKFRS 3.67(a) to (d)**	On 1 August 2005, the Group acquired 100 per cent of the issued share capital of Subfive Limited for cash consideration of HKD7.9 million. This transaction has been accounted for by the purchase method of accounting.
HKFRS 3.67(f)	The net assets acquired in the transaction, and the goodwill arising, are as follows:

		Acquiree's carrying amount before combination	Fair value adjustments	Fair value
		HKD'000	HKD'000	HKD'000
	Net assets acquired:			
	Property, plant and equipment	8,140	767	8,907
	Trademarks	-	870	870
	Deferred tax asset	-	351	351
	Inventories	2,393	461	2,854
	Trade receivables	12,520	-	12,520
HKAS 7.40(c)	Bank and cash balances	4,272	-	4,272
	Retirement benefit obligation	(2,436)	-	(2,436)
	Trade payables	(21,220)	(48)	(21,268)
	Deferred tax liability	(150)	-	(150)
	Contingent liability	-	(21)	(21)
		3,519	2,380	5,899
	Goodwill			2,043
HKAS7.40(a)	Total consideration, satisfied by cash			7,942
	Net cash outflow arising on acquisition:			
HKAS7.40(b)	Cash consideration paid			(7,942)
	Cash and cash equivalents acquired			4,272
				(3,670)

HKFRS 3.67(h)	The goodwill arising on the acquisition of Subfive Limited is attributable to the anticipated profitability of the distribution of the Group's products in the new markets and the anticipated future operating synergies from the combination.
HKFRS 3.67(i)	Subfive Limited contributed HKD15.3 million revenue and HKD1.2 million to the Group's profit before tax for the period between the date of acquisition and the balance sheet date.
HKFRS 3.70	If the acquisition had been completed on 1 January 2005, total group revenue for the period would have been HKD1,249 million, and profit for the year would have been HKD102.5 million.

Compliance with IFRSs

HKFRS 3 recognises that, in preparing consolidated financial statements, a company incorporated under the Hong Kong Companies Ordinance may not consolidate an entity that does not meet the definition of a subsidiary under that Ordinance. This treatment is not consistent with IFRS 3 *Business Combinations*. HKFRS 3 contains additional paragraphs (6A, 6B, 23A and 77A) which give background on why Hong Kong incorporated companies should use the definition of a subsidiary as set out in s 2(4) of the Companies Ordinance rather than that of IFRS 3. It also provides for specific additional disclosures for such companies.

Also, the transitional provisions of HKFRS 3 are different from IFRS 3 as HKFRS 3 only applies to business combinations for which the agreement date is on or after 1 January 2005, instead of on or after 31 March 2004 as stated in IFRS 3.

There are no other significant differences between HKFRS 3 and IFRS 3.

Future Developments

There is a current IASB Exposure Draft which proposes to add to the scope of IFRS 3 combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest; and business combinations involving mutual entities. Including these transactions in IFRS 3 would mean that an acquirer must be identified in each case and the acquirer must account for the combination using the acquisition/purchase method. The Exposure Draft would not change the IFRS 3 scope exclusion for combinations involving entities under common control.

IFRS 3 resulted from Phase I of the IASB's Business Combinations project. Phase II is currently an active IASB project. Phase II has several components, including:

- Issues related to the application of the acquisition/purchase method.
- Issues that were excluded from Phase I, including business combinations involving entities (or operations of entities) under common control.
- Minority interests
- Intangibles

There is also currently a Hong Kong Exposure Draft for a *Proposed Accounting Guideline on Merger Accounting,* which, when released, will replace SSAP 27 *Accounting for group reconstructions.*

HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations (issued August 2004)

Objective

To prescribe the accounting for assets held for sale and the presentation and disclosure of discontinued operations.

Entities Most Likely to be Affected by Changes

Entities planning to sell or having disposed of assets/groups of assets

HKFRS 5 Requirements at a Glance

Definition of a discontinued operation	Similar to SSAP 33 *Discontinuing operations*.
Classify as discontinued operation	When operation is disposed of or meets "held for sale" criteria
Non-current assets (disposal group) held for sale	Write down to fair value less costs to sell. Depreciation is not permitted Presented separately in the balance sheet as a current asset (any liabilities in a disposal group will be presented separately as current liabilities)
Results and cash flows of discontinued operations	Presented separately in the income and cash flow statements

Key Changes under HKFRS 5

- HKFRS 5 introduces the new concepts "held for sale" and "disposal groups", and specifies
  - Assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell.
  - An asset classified as held for sale, or included within a disposal group that is classified as held for sale, is not depreciated.
  - An asset classified as held for sale, and the assets and liabilities included within a disposal group classified as held for sale, are presented separately on the face of the balance sheet.
- The definition of a discontinued operation is very much the same as the definition of a discontinuing operation in SSAP 33. However, HKFRS 5 changes the timing of the classification of an operation as discontinued. SSAP 33 classified an operation as discontinuing at the earlier of the entity entering into a binding sale agreement and the board of directors approving and announcing a formal disposal plan.

HKFRS 5 classifies an operation as discontinued at the date the operation meets the criteria to be classified as held for sale or when the entity has disposed of the operation.

- HKFRS 5 requires the results of discontinued operations to be presented as a single amount on the face of the income statement.
- HKFRS 5 expands the reconciliation of segment result to operating profit/net profit, under HKAS 14 *Segment Reporting,* by requiring an entity to reconcile.
  - segment result from continuing operations to operating profit/net profit from continuing operations, and
  - segment result from discontinued operations to entity profit or loss from discontinued operations

Implications of Changes

All entities with held for sale items and/or discontinued operations will be impacted by the changes to the **format** of the financial statements from HKFRS 5 and HKAS 1 *Presentation of Financial Statements* and the increased disclosure. In particular, the new requirements will change the **face of the income statement** for entities with discontinued operations as turnover, costs etc. will no longer include the amounts relating to discontinued operations. Entities will need to redraft their financial statements, in particular to ensure that the disclosure requirements of other Standards are met (e.g. disclosure of total staff costs, total research and development expense, etc).

Entities will also need to change the **format of the balance sheet** to present assets classified as held for sale, and the assets and liabilities included within a disposal group classified as held for sale, separately on the face.

Entities will need to **identify** which operations should be classified as held for sale and which are discontinued operations. Some items not meeting the definition of discontinuing under SSAP 33 may qualify. Also, some items meeting the definition of discontinuing under SSAP 33 may not qualify.

Summary of HKFRS 5

Scope

The classification and presentation requirements of HKFRS 5 apply to all recognised non-current assets and all disposal groups of an entity. The measurement requirements of HKFRS 5 apply to all recognised non-current assets and disposal groups, except for the following assets which shall continue to be measured in accordance with the Standard noted.

- Deferred tax assets (HKAS 12 *Income Taxes*).
- Assets arising from employee benefits (HKAS 19 *Employee Benefits*).
- Financial assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement.*
- Non-current assets that are accounted for in accordance with the fair value model in HKAS 40 *Investment Property*.
- Non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with HKAS 41 *Agriculture.*
- Contractual rights under insurance contracts as defined in HKFRS 4 *Insurance Contracts.*

Held for sale classification

HKFRS 5 introduces the new classification 'held for sale'. An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, in general the following conditions must be met

- the asset (or disposal group) must be available for immediate sale in its present condition; and
- its sale must be *highly probable*, meaning:
  - management is committed to a plan to sell;
  - an active programme to locate a buyer has been initiated;
  - actively marketed at a reasonable price;
  - sale will take place within 12 months (subject to limited exceptions); and
  - actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.

To be classified as held for sale, the asset (or disposal group) needs to be disposed of through sale. Therefore, operations that are expected to be wound down or abandoned would not meet the definition (but may be classified as discontinued once abandoned).

A 'disposal group' is a group of assets, possibly with some associated liabilities, which an entity intends to dispose of in a single transaction.

Measurement of held for sale items

Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable HKFRSs.

On subsequent remeasurement non-current assets or disposal groups that are classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. The carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this HKFRS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with applicable HKFRSs before the fair value less costs to sell of the disposal group is remeasured.

Impairment losses are recognised in profit or loss for initial and subsequent write-down of the asset or disposal group to fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the non-current assets in the disposal group in the order of allocation required by HKAS 36 *Impairment of Assets*.

If assets are carried at fair value prior to initial classification the requirement to deduct costs to sell from fair value will result in an immediate charge to profit or loss.

A gain for any subsequent increase in fair value less costs to sell of an asset can be recognised in the profit or loss to the extent that it is not in excess of the cumulative impairment loss that has been recognised in accordance with HKFRS 5 or previously in accordance with HKAS 36.

Non-current assets or disposal groups that are classified as held for sale shall not be depreciated.

Presentation and disclosure

Non-current assets classified as held for sale and the assets of a disposal group classified as held for sale must be disclosed separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale must also be disclosed separately from other liabilities in the balance sheet.

There are also several other additional disclosures, including a description of the nature of assets held and the facts and circumstances surrounding the sale.

Discontinued operations

A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale, and

- represents a separate major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale.

The sum of the post-tax profit or loss of the discontinued operation and the post-tax gain or loss recognised on the measurement to fair value less costs to sell or fair value adjustments on the disposal of the assets (or disposal group) should be presented as a single amount on the face of the income statement. Detailed disclosure of revenue, expenses, pre-tax profit or loss, and related income taxes is required either in the notes or on the face of the income statement in a section distinct from continuing operations.

HKFRS 5 prohibits the retroactive classification as a discontinued operation, when the discontinued criteria are met after the balance sheet date.

Adjustments made in the current period to amounts disclosed as discontinued operations in prior periods must be separately disclosed.

If an entity ceases to classify a component as held for sale, the results of that component previously presented in discontinued operations must be reclassified and included in income from continuing operations for all periods presented.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKFRS 5	SSAP 33 *Discontinuing operations*
Specific Deloitte publications	IFRS 5 e-learning module

Illustrative disclosures

Note: For illustrative disclosures for the presentation of held for sale and discontinued items in the balance sheet and income statements see HKAS 1 *Presentation of Financial Statements*.

	Discontinued operation
HKFRS 5.30 **HKFRS 5.41**	On 14 May 2005, the Group entered into a sale agreement to dispose of Subsix Limited, which carried out all of the Group's toy manufacturing activities. The disposal was effected in order to generate cash flow for the expansion of the Group's other businesses. The disposal was completed on 30 November 2005, on which date control of Subsix Limited passed to the acquirer.
	The profit for the year from the discontinued operation is analysed as follows:

	Year ended 31/12/05 HKD'000	Year ended 31/12/04 HKD'000
Profit of toy manufacturing operation for the year	2,183	4,171
Gain on disposal of toy manufacturing operation	8,493	-
	10,676	4,171

HKFRS 5.33(b) **HKFRS 5.34**	The results of the toy manufacturing operation for the period from 1 January 2005 to 30 November 2005 are as follows:

	Period ended 30/11/05	Year ended 31/12/04
	HKD'000	HKD'000
Revenue	159,438	141,203
Cost of sales	(97,431)	(79,923)
Distribution costs	(19,447)	(16,458)
Administrative expenses	(38,067)	(39,432)
Finance costs	(493)	(830)
Profit before tax	4,000	4,560
Income tax expense	(1,817)	(389)
Profit for the year	2,183	4,171

HKFRS 5.33(c) **HKFRS 5.34**	During the year, Subsix Limited contributed HKD4.8 million (2004: HKD4.25 million) to the Group's net operating cash flows, paid HKD1.37 million (2004: HKD 2.89 million) in respect of investing activities and paid HKD 0.9 million (2004: HKD 3.71 million) in respect of financing activities. The carrying amounts of the assets and liabilities of Subsix Limited at the date of disposal are disclosed in note 39.
HKFRS 5.41	**Non-current assets held for sale** On 20 December 2005, the directors resolved to dispose of one of the Group's production lines for electronic goods. Negotiations with several interested parties have subsequently taken place. The assets and liabilities attributable to the production line, which are expected to be sold within twelve months, have been classified as a disposal group held for sale and are presented separately in the balance sheet. The operations are included in the Group's electronic goods activities for segment reporting purposes (see note 6).
	The proceeds of disposal are expected to exceed the net carrying amount of the relevant assets and liabilities and, accordingly, no impairment loss has been recognised on the classification of these operations as held for sale.

HKFRS 5.38	The major classes of assets and liabilities comprising the disposal group classified as held for sale are as follows:	
		Year ended 31/12/05 HKD'000
	Goodwill	22
	Property, plant and equipment	1,698
	Inventories	202
	Total assets classified as held for sale	1,922
	Trade and other payables, and total for liabilities associated with assets classified as held for sale	(247)
	Net assets of disposal group	1,675

Compliance with IFRSs

There are no significant differences between HKFRS 5 and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Future Developments

There are no significant developments currently in progress.

HKAS 17 Leases (issued December 2004)

Objective

To prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.

Entities Most Likely to be Affected by Changes

Entities with leasehold land classified as property, plant and equipment. Minor impact on other lessees/lessors.

HKAS 17 Requirements at a Glance

Classification	Finance lease (if transfers substantially all risks and rewards), otherwise operating lease.
Four scenarios/ accounting treatments	Finance lease: Lessor – Recognise receivable and finance income. Lessee – Recognise leased asset, related liability, depreciation and interest / reduction in liability. Operating lease: Lessor – Retain leased asset. Recognise income on straight-line basis. Lessee – Recognise payments on straight- line basis.
Lease of land and buildings	Split into land and buildings elements unless no reliable allocation or interest is classified as investment property under HKAS 40 *Investment Property* and fair value model is used.
Sale and leaseback	Depends on classification of lease as finance or operating.

Key Changes under HKAS 17

- Defines 'inception date' as the date when the lease is signed and classified for accounting purposes and 'commencement date' as the date when the lease is recognised.
- Prohibits the recognition of initial direct costs as an expense when incurred. Finance lessors should add the initial direct costs to the initial measurement of the lease receivable. This will impact the calculation of the interest rate implicit in the lease and therefore reduce the amount of income recognised over the lease term. Manufacturer/dealer lessors should exclude the initial direct costs from the lease receivable and charge them to the income statement when the selling profit is recognised. Operating lessors should add the initial direct costs to the carrying value of the leased asset and recognise them as an expense over the lease term.
- Clarifies that a lease of both land and buildings should be assessed separately. The minimum lease payments must split into two elements, a lease of land and a lease of buildings, in proportion to their relative fair values. The land element would normally be classified as an operating lease unless title passes to the lessee at the end of the lease term. The buildings element would be classified as an operating or finance lease by applying the classification criteria in HKAS 17. Separate measurement of the land and buildings elements is not required when:
  - the lease payment can not be allocated reliably between the land and the buildings in which case the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases; or
  - the lessee's interest in both the land and the buildings is classified as an investment property in accordance with HKAS 40 and the fair value model is adopted.

Implications of Changes

Under HKAS 17, **leasehold interests in land** (which will be the case for most land in Hong Kong and the PRC) will be classified as operating leases, and hence not shown as property plant and equipment, unless the leasehold interest meets the criteria to be, and is, classified as an investment property under HKAS 40 and the fair value model is adopted. Therefore, if the leasehold interest in land is not classified as investment property, reclassification of leasehold land from property, plant and equipment to prepaid lease payments is required upon transition to HKAS 17. However, there is an **exemption** if the lease payments for a lease of land and buildings cannot be allocated reliably between the land and building elements (and it is clear that both elements are not operating leases). In such circumstances, the entire lease is classified as a finance lease and should be accounted for as usual under HKAS 40, if it is investment property, or under HKAS 16 *Property, Plant and Equipment*. Under SSAP 17 *Property, plant and equipment*, leasehold interests in land are generally classified as property, plant and equipment. In Hong Kong, land and buildings are frequently leased together instead of acquired separately. In such situations, practical problems may arise when determining the relative fair values of the two components. Professional help will probably need to be sought to value the two components at inception.

An entity will need to keep two separate records for the land and the buildings elements for a **lease of both land and buildings** in order to assess and account for the two elements separately. In many cases, it may be difficult to allocate lease payments between the land and buildings elements reliably. Obtaining the necessary **split of the lease payments** between land and buildings may entail approaching the lessor, or using an appropriately qualified property valuer. This process may take some time so it is advisable to finalise the treatment in advance of the year-end.

Initial direct costs can no longer be expensed when occurred, meaning the expense will be recognised in income over the lease term, rather than in the current year.

If there is a significant period of time between the **commencement of the lease** (i.e. the date when an entity is entitled to use the leased assets) and the **inception of the lease** for assets under leases, then an adjustment may need to be made in the financial statements to ensure the assets, liabilities, income or expenses resulting from the lease, are recognised on commencement date.

Summary of HKAS 17

A lease is classified as a finance lease if it transfers substantially all risks and rewards incidental to ownership. Examples:

- Lease covers substantially all of the asset's life.
- Present value of lease payments is substantially equal to the asset's fair value.

All other leases are classified as operating leases.

A lease of both land and buildings should be split into the land and building elements. The land element is generally an operating lease. The building element may be an operating or finance lease based on the criteria in HKAS 17. Separate measurement of the land and buildings elements is not required if the lessee's interest in both land and buildings is classified as an investment property under HKAS 40 *Investment Property* and the fair value model is adopted.

Finance leases – lessee's accounting

- Recognise an asset and a liability at the lower of the present value of the minimum lease payments (discounted using the interest rate implicit in the lease) and the fair value of the asset.
- The depreciation policy should be the same as that for owned assets.
- The finance lease payment is apportioned between interest and a reduction in the liability.

Finance leases – lessor's accounting

- Recognise a receivable at an amount equal to the net investment in the lease.
- Recognise finance income based on a pattern reflecting a constant periodic rate of return on the lessor's net investment.
- Initial direct costs must be spread over the lease term (immediate expensing is prohibited).

Operating leases – lessee's accounting

- Recognise lease payments as an expense in the income statement on a straight-line basis over the lease term, unless another systematic basis is more representative of the pattern of the user's benefit.
- Incentives for the agreement of a new or renewed operating lease should be recognised as a reduction in the rental expense over the lease term.

Operating leases – lessor's accounting

- Assets under operating leases should be presented in the lessor's balance sheet according to the nature of the asset.
- Lease income should be recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the pattern in which use benefit derived from the asset is diminished.
- Incentives for the agreement of a new or renewed operating lease should be recognised as a reduction in the rental income over the lease term.
- Initial direct costs must be spread over the lease term (immediate expensing is prohibited).

Manufacturer/dealer lessors should include selling profit or loss in the same period as they would for an outright sale. If artificially low rates of interest are charged, selling profit should be restricted to that which would apply if a commercial rate of interest were charged.

The accounting treatment for sale and leaseback transactions depends on whether they are essentially finance or operating leases.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (IFRIC) – Int 4 *Determining whether an Arrangement Contains a Lease* HK (SIC) – Int 15 *Operating Leases – Incentives* HK (SIC) - Int 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (previously Interpretation 14) HK – Int 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*
Existing pronouncements replaced by HKAS 17	SSAP 14 *Leases* Interpretation 14 *Evaluating the substance of transactions involving the legal form of a lease*
Specific Deloitte Publications	IAS 17 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 17 and IAS 17 *Leases*.

Future Developments

There is currently an IASB research project on leasing that may result in a fundamental change in accounting for leases. The primary objective of the project is to ensure that the recognition of assets and liabilities arising under leases is consistent with the definitions in the Framework.

IFRIC plans to issue guidance that a sale should not be recognised in a sale and leaseback containing a repurchase agreement (including an option), if the seller retains significant risks or rewards under the repurchase agreement. A Draft Interpretation is expected in the future.

HKAS 32 Financial Instruments: Disclosure and Presentation (issued May 2004)

Objective

To enhance users' understanding of the significance of on-balance sheet and off-balance sheet financial instruments to an entity's financial position, performance, and cash flows.

Entities Most Likely to be Affected by Changes

All entities.

HKAS 32 Requirements at a Glance

Classification (e.g. compound instruments)	Classify a financial instrument issued by an entity as a liability or as equity based on the substance at the time of issuance.
Treasury shares	Treasury shares are equity instruments reacquired and held by the issuing entity itself or by its subsidiaries. Treasury shares are deducted from equity and resales of treasury shares are equity transactions.
Offset rules	Offset a financial asset and financial liability only when legally enforcable right and intention to net settle.
Disclosure	Comply with a broad range of disclosures about financial instruments, including giving fair value information.

Key Changes under HKAS 32

- HKAS 32 requires the issuer of a financial instrument to classify the instrument, or its component parts, on initial recognition as liability or equity. If an instrument has both liability and equity components, the instrument needs to be split and the two components accounted for separately The classification of liabilities and equity instruments was not previously dealt with in Hong Kong accounting literature. Due to the previous lack of guidance, practice has varied widely.
- This is the first comprehensive Accounting Standard in Hong Kong which covers the disclosure and presentation of financial instruments. SSAP 24 *Accounting for investments in securities* dealt only with investments in debt and equity securities, whereas HKAS 32 deals with all financial instruments, so includes payables, receivables, derivatives, cash/bank deposits, convertible bonds and preference shares. HKAS 32 replaces the limited guidance which existed in a number of old Standards including the following:
  - SSAP 1 *Presentation of financial statements*, which dealt with offsetting (the offsetting criteria is stricter in some areas under HKAS 32)
  - SSAP 14 *Leases* (HKAS 32 adds new disclosure requirements, in addition to those in HKAS 17 *Leases*)
  - SSAP 24 (the disclosure requirements are much more comprehensive under HKAS 32)

Implications of Changes

Some financial instruments previously classified as equity instruments or compound financial instruments may instead be **reclassified as debt** under HKAS 32 (e.g. types of preference shares), reducing net assets and impacting future profitability as distributions will be expensed.

Instruments such as **convertible bonds** often contain both an equity and a liability component. An exercise will need to be carried out to determine the appropriate split, and to restate the amounts in both the balance sheet and income statement accordingly.

SSAP 24 included some disclosure requirements in relation to investments in securities, but didn't address any of the wider issues dealt with in HKAS 32. All entities, not only financial institutions, will be impacted by the significant new **disclosure requirements,** which will be both costly and time consuming to prepare. In addition the disclosure may require entities to give information about sensitive issues.

Judgement will need to be exercised when determining the **level of detail** of the disclosures that should be provided, e.g. with regards to aggregation.

HKAS 32 specifies that a financial asset and a financial liability should be offset if an entity has a legally enforceable right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. Whilst HKAS 32 does not require the financial asset and financial liability to be with the same counterparty, as under SSAP 1, HKAS 32 requires the legal right to be currently enforceable. Rights which are enforceable only on the occurrence of some future event, such as default of the counterparty, do not meet the conditions for offset under HKAS 32. Furthermore, unlike the offsetting requirements under SSAP 1 which allows net presentation if the debit balance matures no later than the credit balance provided other conditions are met, HKAS 32 only allows offset if the financial asset and financial liability are settled simultaneously. Given that the offsetting requirements are different between SSAP 1 and HKAS 32, entitles should re-assess the balance sheet presentation as at the date of transition to ensure compliance with the new offsetting requirements.

Summary of HKAS 32

Scope

HKAS 32 applies to the presentation and disclosure of information for all types of financial instruments except for the following:

- Interests in subsidiaries, associates, and joint ventures that are covered by other Standards. It does however apply to all derivatives on interests in such investments.
- Employers' rights and obligations under employee benefit plans.
- Certain items covered by share-based payments.
- Rights and obligations arising under insurance contracts. However, it applies to a financial instrument that takes the form of an insurance (or reinsurance) contract but that principally involves the transfer of financial risks. Also, it applies to derivatives that are embedded in insurance contracts.
- Contracts for contingent consideration in a business combination.

HKAS 32 applies to those contracts to buy or sell a non-financial item (such as a commodity) that can be settled net in cash or another financial instrument, except for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.

Key definitions

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- cash;
- an equity instrument of another entity;
- a contractual right:
  - to receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

A financial liability is any liability that is:

- a contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Classification as liability or equity

A financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. The entity must make the decision at the time the instrument is initially recognised and the classification is not subsequently changed.

A financial instrument is an equity instrument if the instrument includes no contractual obligation to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer. If the instrument will or may be settled in the issuer's own equity instruments, it is either:

- a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Illustration - Preference shares

If an entity issues preference (preferred) shares that pay a fixed rate of dividend and that have a mandatory redemption feature at a future date, the substance is that they are a contractual obligation to deliver cash and, therefore, should be recognised as a liability. In contrast, preference shares that do not have a fixed maturity and the issuer does not have a contractual obligation to make any payment are equity.

Compound financial instruments

Some financial instruments (sometimes called compound instruments) have both a liability and an equity component from the issuer's perspective. In that case, HKAS 32 requires that the component parts be accounted for and presented separately according to their substance based on the definitions of liability and equity. The split is made at issuance and is not revised for subsequent changes in market interest rates, share prices or other events that change the likelihood that the conversion option will be exercised.

Illustration – Convertible bonds

A convertible bond contains two components. One is a financial liability, namely the issuer's contractual obligation to pay cash, and the other is an equity instrument, namely the holder's option to convert into common shares.

When the initial carrying amount of a compound financial instrument is required to be allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component.

Interest, dividends, gains, and losses relating to an instrument classified as a liability should be reported in the income statement (e.g. dividend payments on preferred shares classified as liabilities are treated as expenses). Distributions (e.g. dividends) to holders of a financial instrument classified as equity should be charged directly against equity.

Treasury shares

The cost of an entity's own equity instruments that it has reacquired ('treasury shares') is deducted from equity. A gain or loss is not recognised on the purchase, sale, issue, or cancellation of treasury shares. Treasury shares may be acquired and held by the entity or by other members of the consolidated group. Any consideration paid or received is recognised directly in equity.

Offsetting

A financial asset and a financial liability should be offset and the net amount reported when, and only when, an entity has a legally enforceable right to set off the amounts; and intends either to net settle, or to realise the asset and settle the liability simultaneously.

Disclosures

Disclosure requirements include:

- Risk management and hedging policies.
- Hedge accounting policies and practices, and gains and losses from hedges.
- Terms and conditions of, and accounting policies for, all financial instruments.
- Information about exposure to interest rate risk.
- Information about exposure to credit risk.
- Fair values of all financial assets and financial liabilities (except those for which a reliable measure of fair value is not available) and the methods and significant assumptions used
- Information about derecognition, reclassifications, collateral, impairment, defaults and breaches.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (IFRIC) – Int 2 *Members' Shares in Co-operative Entities and Similar Instruments*
Existing pronouncements replaced by HKAS 32	SSAP 24 *Accounting for investments in securities*
Specific Deloitte publications	• iGAAP 2005 Financial Instruments: IAS 32 and IAS 39 Explained • IAS 32/39 (Part I) e-learning module

Compliance with IFRSs

There are no other significant differences between HKAS 32 and IAS 32 *Financial Instruments: Disclosure and Presentation*.

Future Developments

The IASB has issued an Exposure Draft, ED 7 *Financial Instruments: Disclosures*, (which will lead to a new standard, IFRS 7) that would add certain new disclosures about financial instruments to those currently required by IAS 32, would replace the disclosures now required by IAS 30 *Disclosures in the Financial Statements of Banks and Similar Institutions*, and would put all financial instrument disclosures together in a new Standard. IAS 32 would then deal only with financial instrument presentation matters.

HKAS 36 Impairment of Assets (issued August 2004)

Objective

To ensure that assets are carried at no more than their recoverable amount and to prescribe how recoverable amount is calculated.

Entities Most Likely to be Affected by Changes

The changes in HKAS 36 result from the issuance of HKFRS 3 *Business Combinations* and hence mainly relate to the aspects of impairment testing that are relevant to accounting for business combinations.

Changes will affect most entities, especially those with goodwill, intangible assets with indefinite useful lives and intangible assets that are not yet available for use.

HKAS 36 Requirements at a Glance

Scope	Applies to all assets, unless covered by a specific HKFRS.
Measurement	Recognise impairment when carrying amount exceeds recoverable amount (higher of value in use and fair value less costs to sell). Reversals allowed in certain instances (excluding goodwill).
Impairment test	Test for impairment if an impairment is indicated. Test goodwill and intangibles with indefinite lives, or not ready for use, annually.
Cash- generating units (CGUs)	If it is not possible to determine an asset's recoverable amount, determine recoverable amount of asset's CGU. Perform impairment test for goodwill on the smallest group of CGUs to which goodwill can be allocated.

Key Changes under HKAS 36

- Extends the frequency for performing impairment tests for certain assets by requiring the measurement of the recoverable amount of the following assets annually, irrespective of whether there is any indication that they may be impaired:
  - Intangible assets with an indefinite useful life
  - Intangible assets not yet available for use
  - Goodwill acquired in a business combination
- Gives more guidance (see points below) leading to stricter requirements for impairment testing

- Clarifies that the following elements should be reflected in the calculation of an asset's value in use:
  - An estimate of the future cash flows the entity expects to derive from the assets
  - Expectations about possible variations in the amount or timing of those future cash flows
  - The time value of money, represented by the current market risk-free rate of interest
  - The compensation for bearing the uncertainty inherent in the asset
  - The factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the assets
- Clarifies that the cash flow projections used to measure the value in use of an asset should exclude any estimated cash inflows or outflows expected to arise from:
  - future restructuring to which the entity is not yet committed; or
  - improving or enhancing the asset's performance.
- Provides additional guidance on using present value techniques in measuring an asset's value in use.
- Clarifies that goodwill should, from the acquisition date, be allocated to cash generating units before testing for impairment.
- Permits the performance of an impairment test for goodwill and intangible assets with indefinite useful lives, or those not yet available for use, at any time during an annual reporting period provided the test is performed at the same time every year and allows different cash-generating units (group of units) to be tested for impairment at different times.
- Prohibits the reversal of impairment losses for goodwill.
- Introduces significant new disclosure requirements.

Implications of Changes

Most entities will be impacted by the more prescriptive impairment tests. The **stricter requirements** and more detailed guidance within HKAS 36 mean that an entity may need to implement a more rigorous impairment testing regime for all assets and this will tend to lead to impairment losses occurring more frequently. For example, the additional guidance may lead to cash generating units (CGUs) being assessed at a lower level in the business than in previous years. All entities will need to review their current impairment testing methods to ensure they comply with HKAS 36. Significant changes may be required to apply the new requirements

The requirement to perform **annual impairment tests** for goodwill and certain other intangible assets, in addition to the requirement to test when there are indications of impairment, will be very significant for many entities as it will be time consuming and will probably lead to impairment losses being recorded more frequently. Also, where goodwill has been allocated to a cash generating unit, that cash generating unit must be tested annually for impairment. Many entities will find the identification and monitoring of CGUs a time consuming and complex requirement.

Entities will need to put some thought into determining the **timing of the annual impairment** tests to ensure information and other necessary resources are available. For example, if budgets for future periods only become available towards the end of the current reporting period, the impairment testing would have to be done in between when the budgets become available and the end of the reporting period. The timing is also very important because once the date is set the impairment test should be carried out at that same date every year.

Reversals of impairment losses are no longer permitted for goodwill. Therefore, not only should an entity expect impairment losses to arise more frequently, when they do they will be permanent. Overall entities should expect the changes in HKAS 36 to have a significant impact, in particular with respect to goodwill. The removal of amortisation and the new impairment testing requirements may result in increased volatility in the income statement.

Entities will also need to deal with **significantly expanded disclosure requirements** in particular in relation to recoverable amount and impairment, including information about key assumptions and in some cases sensitivity analysis.

Summary of HKAS 36

Scope

HKAS 36 applies to all assets except the following:

- Inventories (see HKAS 2 *Inventories*)
- Assets arising from construction contracts (see HKAS 11 *Construction Contracts*)
- Deferred tax assets (see HKAS 12 *Income Taxes*)
- Assets arising from employee benefits (see HKAS 19 *Employee Benefits*)
- Financial assets (see HKAS 39 *Financial Instruments: Recognition and Measurement*)
- Investment property measured at fair value (see HKAS 40 *Investment Property*)
- Biological assets related to agricultural activity measured at fair value less estimated point-of-sale costs (see HKAS 41 *Agriculture*)
- Insurance contract assets (see HKFRS 4 *Insurance Contracts*)
- Assets held for sale (see HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*)

Identifying an asset that may be impaired

At each balance sheet date, assets should be reviewed to look for any indication they might be impaired. If an impairment is indicated for an asset, recoverable amount should be calculated.

Goodwill, other intangibles with indefinite useful lives and intangible assets not yet available for use will no longer be depreciated but must be tested for impairment at least annually.

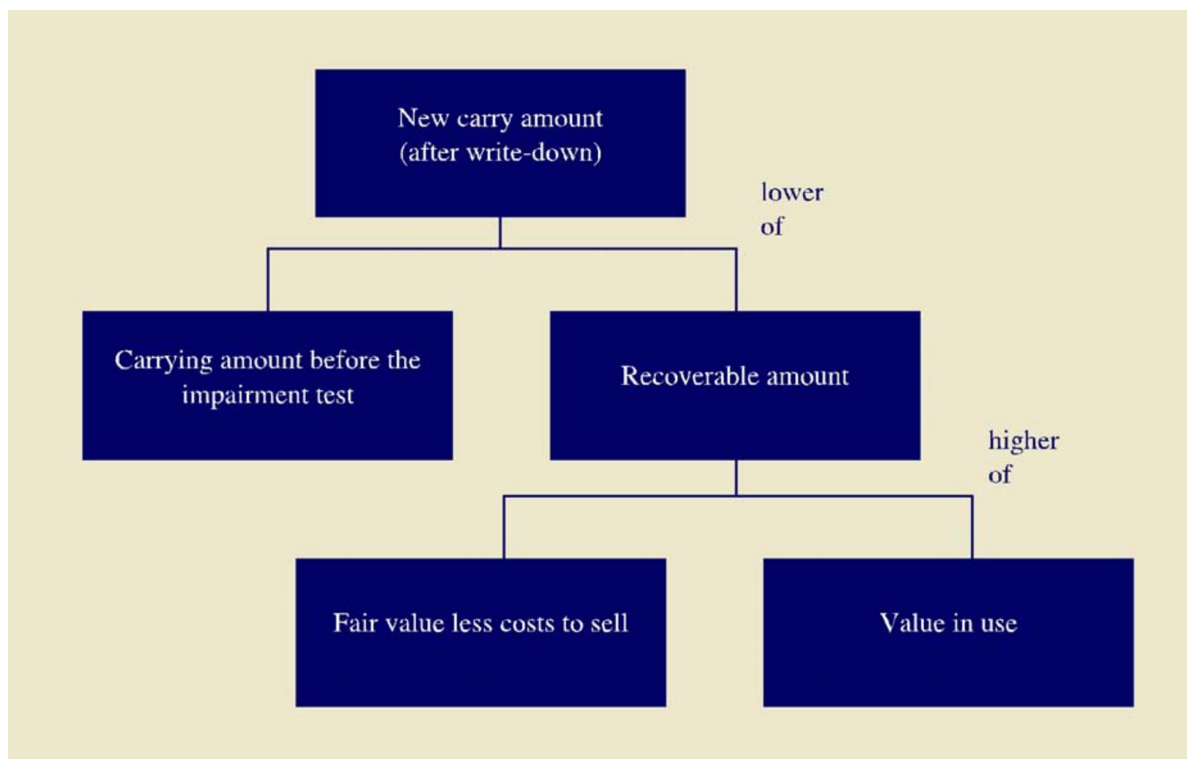
Recoverable amount

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset, and from its disposal at the end of its useful life. The discount rate to be used is the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset. The discount rate should not reflect risks for which the future cash flows have been adjusted and should equal the rate of

return that investors would require if they were to choose an investment that would generate cash flows equivalent to those expected from the asset.

If it is not possible to determine the recoverable amount for the individual asset, then recoverable amount should be determined for the asset's cash-generating unit. The impairment test for goodwill should be performed at the smallest group of cash-generating units to which goodwill can be allocated on a reasonable and consistent basis. Each unit or group of units to which the goodwill is allocated should be the smallest group of assets generating independent cash flows which represents the lowest level at which goodwill is monitored internally and should not be larger than a segment based on HKAS 14 *Segment Reporting*.



Recognition of impairment loss

An impairment loss must be recognised when the carrying amount of an asset exceeds its recoverable amount. The impairment loss is recognised through the income statement for assets carried at cost and treated as a decrease in the revaluation surplus for assets carried at revalued amount.

The reversal of impairment losses recognised in prior years is allowed in certain instances (always prohibited for goodwill).

Disclosures include impairment losses by class of assets and by segment (if applying HKAS 14) and any reversal of impairment losses

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 36	SSAP 31 *Impairment of assets*
Specific Deloitte publications	IAS 36 e-learning module

Illustrative disclosures for goodwill

	Goodwill	
		HKD'000
HKFRS 3.74	***Cost***	
HKFRS 3.75	At 1 January 2004	8,840
	Exchange differences	(216)
	At 1 January 2005	8,624
	Elimination of amortisation accumulated prior to the adoption of IFRS 3	(6,086)
	Arising on acquisition of a subsidiary	2,043
	Eliminated on disposal of a subsidiary	(1,673)
	Reclassified as held for sale	(22)
	At 31 December 2005	2,886
	Amortisation	
	At 1 January 2004	6,026
	Exchange differences	(187)
	Amortisation for the year	247
	At 1 January 2005	6,086
	Elimination of amortisation accumulated prior to the adoption of IFRS 3	(6,086)
	At 31 December 2005	-
	Impairment	
	Impairment loss recognised in the year ended 31 December 2005 and balance at 31 December 2005	463
	Carrying amount	
	At 31 December 2005	2,423
	At 31 December 2004	2,538

HKAS 36.134(a)

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. Before recognition of impairment losses, the carrying amount of goodwill had been allocated as follows:

	31/12/05	31/12/04
	HKD'000	HKD'000
Electronic goods:		
Subfive Limited (single CGU)	2,043	-
Subthree Limited (single CGU)	-	22
Construction (comprised of several CGUs):		
residential property construction activities	843	843
Toy operations		
Subsix Limited (single CGU)		1,673
	2,886	2,538

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

HKAS 36.134(b) to(d)

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows for the following five years based on an estimated growth rate of 3%. This rate does not exceed the average long-term growth rate for the relevant markets.

HKAS 36.130(g)

The rate used to discount the forecast cash flows from Subfive Limited is 8.9 per cent, and from the Group's residential property construction activities is 11.2 per cent.

HKAS 36.130(a),(b)

HKAS 36.130(d)

At 31 December 2005, before impairment testing, goodwill of HKD 0.843 million was allocated to the residential property construction CGU within the construction business segment. Due to increased competition in the market, the Group has revised its cash flow forecasts for this CGU. The residential property CGU has therefore been reduced to its recoverable amount through recognition of an impairment loss against goodwill of HKD 0.463 million.

Compliance with IFRSs

There are no significant differences between HKAS36 and IAS 36 *Impairment of Assets*.

Future Developments

There is an IASB research project on measurement which will seek to resolve issues concerning the appropriate measurement objectives for items recognised in the financial statements. The project will focus initially on impairment.

HKAS 38 Intangible Assets (issued August 2004)

Objective

To prescribe the accounting treatment for recognising, measuring, and disclosing all intangible assets that are not dealt with specifically in another HKFRS.

Entities Most Likely to be Affected by Changes

The changes in HKAS 38 result from the issuance of HKFRS 3 *Business Combinations* and hence mainly relate to the aspects of impairment testing that are relevant to accounting for business combinations

Entities with significant intangible assets other than goodwill, especially those intangibles acquired in a business combination or that have no foreseeable limit to the period over which they will generate net cash inflows.

HKAS 38 Requirements at a Glance

Recognition	If it is probable that future economic benefits will flow to the entity and the cost of the asset can be measured reliably. Additional criteria for internally generated assets and those acquired in a business combination.
Subsequent measurement	Intangible assets with indefinite useful lives are not amortised, but must be tested for impairment at each reporting date. An intangible asset with a finite useful life is amortised over that life.
Revaluation model	Permitted if asset has a market price in an active market.

Key Changes under HKAS 38

- Adds guidance on 'identifiability' such that an asset meets the 'identifiability' criterion when it is separable or arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- Requires that intangible assets acquired in a business combination must be recognised as assets separately from goodwill if they meet the definition of an asset, are either separable or arise from contractual or other legal rights, and their fair value can be measured reliably.
- Removes the rebuttable presumption that the useful life of an intangible asset is always finite and cannot exceed twenty years from the date the asset is available for use. It now requires an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

- Clarifies that the useful life of an intangible asset arising from contractual or other legal rights should not exceed the period of those rights, but may be shorter and if the rights are conveyed for a limited term that can be renewed, the useful life should include the renewal period only if there is evidence to support renewal by the entity without significant cost.
- Does not allow the amortisation of an intangible asset with an indefinite useful life. However, the useful life of such an asset should be reviewed each reporting period and if the useful life changes from indefinite to finite, this should be accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates, and Errors.*
- Removes the requirement to perform an impairment test at each year end on an intangible asset that is being amortised over more than twenty years. Therefore, an impairment test of such an asset will need to be performed only when there is an indication that the asset may be impaired.
- Requires disclosure of the carrying amount of an intangible asset having an indefinite useful life and the reasons supporting the indefinite useful life assessment.

Implications of Changes

The new requirements for recognising intangibles that are acquired in a business combination will lead to **more intangibles being recognised** on the balance sheet and a lower value being assigned to goodwill.

Entities will need to **review their current amortisation policies** and the useful lives assigned to intangible assets under the new requirements in HKAS 38, particularly those for intangibles that may be classified as having indefinite lives under the new Standard.

If an entity has assets with indefinite lives, it will not amortise those assets. This will lead to an overall reduction to amortisation in the income statement. However, an entity must perform **annual impairment tests** for such assets, and also for intangibles not yet available for use, regardless of whether there are any indications of impairment. The additional tests will be time consuming and will probably lead to impairment losses being recorded more frequently and hence give greater volatility in the accounts.

Summary of HKAS 38

Initial recognition

An entity is required to recognise an intangible asset, whether purchased or self-created, if:

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

HKAS 38 has additional recognition criteria for internally generated intangible assets.

All research costs are recognised as an expense when incurred. Development costs are capitalised only after the technical and commercial feasibility of the resulting product or service has been established.

Intangible assets, including in-process research and development, acquired in a business combination should be recognised separately from goodwill if they arise from contractual or legal rights or are separable from the

business (i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability).

Internally-generated goodwill, brands, mastheads, publishing titles, customer lists, start-up costs, training costs, advertising costs, and relocation costs should not be recognised as intangible assets.

Measurement subsequent to acquisition

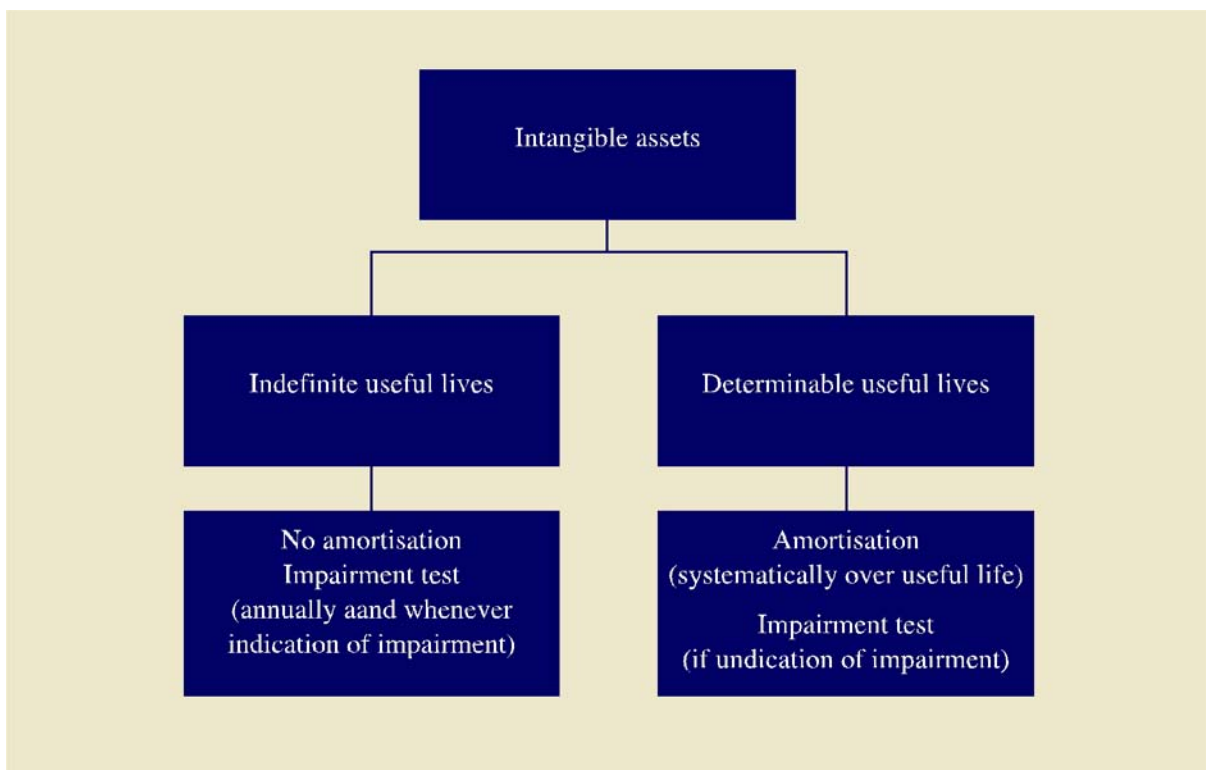
If an intangible item does not meet both the definition and the recognition criteria for an intangible asset, expenditure on the item is recognised as an expense when it is incurred, unless the item is acquired as part of a purchase business combination, in which case the cost should form part of the amount attributed to goodwill at the date of acquisition.

For the purpose of accounting subsequent to initial acquisition, an entity assesses when the useful life of the intangible is indefinite or finite:

- Indefinite life: No foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. ‘Indefinite’ does not mean ‘infinite’.
- Finite life: A limited period of benefit to the entity.

Intangible assets with indefinite useful lives are not amortised, but must be tested for impairment at each reporting date. If the recoverable amount is lower than the carrying amount, an impairment loss is recognised. The assessment must also consider whether the intangible continues to have an indefinite life.

Generally, the cost (residual value is normally zero) of an intangible asset with a finite useful life is amortised over that life. If the intangible asset has a quoted market price in an active market a revaluation model is permitted to be used as the accounting policy choice. Under the revaluation model, the asset is carried at revalued amount, which is fair value at revaluation date less subsequent depreciation.



Normally, subsequent expenditure on an intangible asset after its purchase or completion is recognised as an expense, as only in rare cases will the asset recognition criteria be met.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) - Int 32 *Intangible Assets – Web Site Costs*
Existing pronouncements replaced by HKAS 38	SSAP 29 *Intangible assets*
Specific Deloitte Publications	IAS 38 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 38 and IAS 38 *Intangible Assets*.

Future Developments

There are no significant developments currently in progress.

HKAS 39 Financial Instruments: Recognition and Measurement (issued May 2004)

Objective

To establish principles for recognising, derecognising, and measuring financial assets and financial liabilities and some contracts to buy and sell non-financial items.

Entities Most Likely to be Affected by Changes

All entities, in particular financial institutions and entities with extensive hedging positions.

HKAS 39 Requirements at a Glance

Initial measurement	Recognise all financial assets and financial liabilities (including derivatives) on balance sheet at fair value
Subsequent measurement of financial assets	Loans and receivables - amortised cost Held-to-maturity - amortised cost Designated as "at fair value through profit and loss" - fair value with changes to profit and loss Available-for-sale - fair value with changes to equity All assets assessed for impairment
Subsequent recognition of financial liabilities	Designated as "at fair value through profit and loss" - fair value with changes to profit and loss Others - amortised cost
Derecognition	Financial assets - when contractual rights to cash flows expire or when transferred and transfer qualifies for derecognition Financial liabilities - when extinguished
Hedging	Strict and detailed criteria Fair value hedge (changes in fair value of hedging instrument and hedged item taken to profit and loss) Cash flow hedge (changes in fair value of hedging instrument taken to equity and reversed to profit and loss in the same periods that the hedged item affects profit and loss) Hedge of a net investment (as cash flow hedge)

Key Changes under HKAS 39

- This is the first comprehensive Accounting Standard in Hong Kong which covers the recognition and measurement of financial instruments. SSAP 24 *Investments in securities* dealt only with investments in debt and equity securities, whereas HKAS 39 deals with all financial instruments, so includes payables, receivables, derivatives, cash/bank deposits, convertible bonds and preference shares. It replaces the limited guidance that existed in a number of old Standards including the following:

  - SSAP 11 *Foreign currency translation*, which contained some guidance on hedge accounting (the guidance under HKAS 39 is significantly more comprehensive and meeting the criteria for hedge accounting is considerably more difficult)
  - SSAP 14 *Leases* (HKAS 39 gives additional guidance on the derecognition and impairment of lease receivables/payables and addresses derivatives embedded in leases)
  - SSAP 24 (the classification and measurement of financial assets under HKAS 39 is relatively similar to the alternative treatment of investments in securities under SSAP 24. However, HKAS 39 applies to all financial assets, not just investments in securities. HKAS 39 also has a fourth category, namely loans and receivables. In general, HKAS 39 imposes more rigid rules for the classification of assets as held-to-maturity than are specified in SSAP 24. It also imposes a 'penalty' if securities classified as held-to-maturity are, in fact, sold before maturity.)

- The old Standards above set out requirements in respect of several categories of financial instruments, but they do not provide a comprehensive framework. There are a number of additional areas of accounting addressed in HKAS 39 that have not been previously addressed in Hong Kong accounting literature and where current practice varies widely. These include:

  - Financial liabilities
  - Derecognition of financial assets and financial liabilities
  - Derivatives and other financial assets held for trading
  - Embedded derivatives
  - Impairment of financial assets
  - Hedging

Implications of Changes

Most entities will find that implementing HKAS 39 will result in **fundamental changes,** in particular in areas that in the past have not been the subject of specific guidance, such as the accounting treatments for derivatives entered into for hedging purposes, embedded derivatives and the derecognition requirements.

HKAS 39 is a very complex and comprehensive Standard. The Standard has the potential to **affect all entities**, not only financial institutions. A comprehensive exercise must be undertaken to determine the **impact** of financial instruments on the financial statements. The new requirements may lead to certain financial instruments (especially derivatives and embedded derivatives) being recognised for the first time. The **cost and effort** of identifying and measuring financial instruments such as embedded derivatives, even for non-financial institutions, can be significant.

It is important that HKAS 39 is understood in order to avoid **unexpected** accounting results from **embedded derivatives** contained within new contracts signed on behalf of the company and the potential impact of non-financial item contracts (e.g. commodity contracts), which may fall within the scope of HKAS 39.

Entities will also need to spend time **categorising** the financial instruments. The new categories may lead to financial instruments currently recognised being measured differently (e.g. amortised cost vs. fair value). The introduction of the category "at fair value through profit and loss" also introduces a new choice to be considered. HKAS 39 requires all financial instruments to be initially recognised at fair value. Therefore, **transactions that don't take place on an arm's length basis** may potentially result in fair value adjustments being taken to the income statement on initial recognition. HKAS 39 has stringent rules for classifying financial assets in the amortised cost categories. For example, financial assets classified as loans and receivables cannot be quoted in active markets and the held-to-maturity category is subject to tainting rules, whereby an entity cannot classify any financial assets as held-to-maturity for three financial years if it sells or reclassifies more than an insignificant amount of its held-to-maturity investments before maturity.

The need to recognise all derivatives, and some other financial instruments, on a **fair value basis** will introduce volatility into the financial statements. Entities need to consider their use of financial instruments and ensure they understand the level of volatility they may bring to the financial statements.

The specific requirements for **derecognition** can change outcomes, e.g. factoring transactions, securitisations and in-substance defeasances.

Entities will need to review their **impairment** policies to ensure they comply with the requirements under HKAS 39. Impairment assessments for financial assets classified as held-to-maturity investments, loans and receivables or available-for-sale debt instruments are based on the present value of estimated future cash flows discounted using the original effective interest rate. Many entities will not have used such discounting in the past.

Under existing Hong Kong requirements, **investment securities** are held at cost less impairment. Under HKAS 39, they will be classified as available for sale and held at fair value with movements in fair value recognised in equity. In addition, HKAS 39 has **stringent impairment rules** for investments in equity instruments. Any impairment loss from a significant or prolonged decline in fair value below cost should be recorded in income. However, any subsequent reversal of those impairment losses cannot be taken through profit and loss and should be treated as a revaluation with the change to equity.

The specific requirements for **hedge accounting** may result in conditions not being met for some derivatives previously accounted for as hedges. In addition, if a company wishes to apply hedge accounting to transactions in the future, all requirements of the Standard must be implemented prior to the transaction becoming effective. To qualify for hedge accounting, the entity should expect the hedge to be **highly effective** at the inception of the hedge. In addition, hedge effectiveness tests will need to be assessed on an ongoing basis.

An entity will need to review its hedging **policies and procedures** to see whether its existing hedging strategies meet the requirements of HKAS 39 and give the optimal outcomes.

Entities will need to ensure their current **systems** can cope with the extensive new requirements. Additional capital expenditure and software upgrades may be required in advance. The documentation and monitoring requirements for hedge accounting are onerous and usually require system modification. Entities may therefore decide to accept the **additional volatility** in their profits instead of pursuing hedge accounting.

Summary of HKAS 39

Scope

HKAS 39 deals with the initial recognition and measurement of financial assets and liabilities, measurement subsequent to initial recognition, impairment, derecognition, and hedge accounting.

HKAS 39 applies to all types of financial instruments except for the following:

- Interests in subsidiaries, associates, and joint ventures that are covered by other Standards. It does however apply to all derivatives on such interests.
- Employers' rights and obligations under employee benefit plans.
- Contracts for contingent consideration in a business combination.
- Contracts requiring payment based on climatic, geological, or other physical variables which are inside the scope of HKFRS 4 *Insurance Contracts*, except derivatives embedded in such contracts.
- Rights and obligations under insurance contracts, although HKAS 39 does apply to financial instruments that take the form of an insurance (or reinsurance) contract but that principally involve the transfer of financial risks, and derivatives embedded in insurance contracts.
- Financial instruments that meet the definition of own equity under HKAS 32 *Financial Instruments: Disclosure and Presentation*
- Certain loans commitments and financial guarantee contracts.
- Contracts for contingent consideration in a business combination.

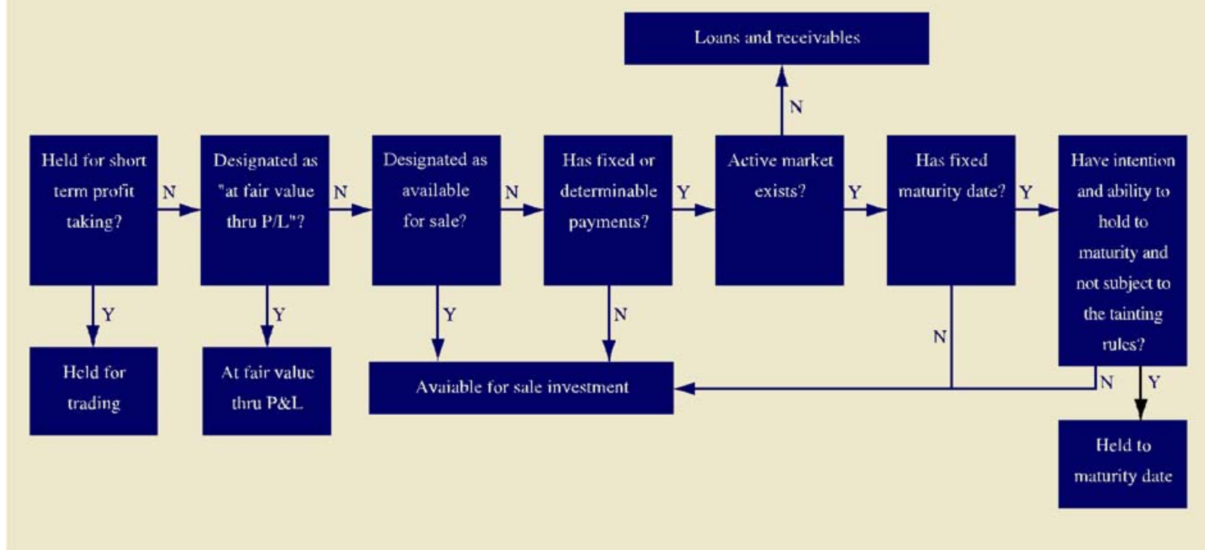
HKAS 39 applies to lease receivables with respect to the derecognition and impairment provisions, lease payables with respect to the derecognition provisions and derivatives embedded in leases.

HKAS 39 applies to contracts to buy or sell non-financial items if they can be settled net in cash or another financial instrument.

Classification of financial assets and liabilities

HKAS 39 classifies financial assets into four categories:

- Loans and receivables
- Held-to-maturity (HTM) investments, such as debt securities and mandatory redeemable preferred shares that the entity intends and is able to hold to maturity. If an entity sells any HTM investments other than in exceptional circumstances, all of its other HTM investments must be reclassified as available-for-sale and the entity is prohibited from classifying any financial assets as HTM for the current and next two financial reporting years.
- Financial assets measured at fair value through profit and loss, which includes those held for trading (short-term profit taking) and any other financial asset that the entity chooses to designate (the “fair value option”). Derivative assets are always in this category unless they are designated as hedging instruments.
- Available-for-sale investments (AFS) are non-derivative financial assets that are designated as AFS or financial assets that do not fall into one of the other three categories. This includes all investments in equity instruments that are not measured at fair value through profit and loss.



HKAS 39 classifies financial liabilities into two categories:

- Financial liabilities at fair value through profit or loss.
- Other financial liabilities measured at amortised cost using the effective interest method.

Derivatives/embedded derivatives

A derivative is a financial instrument:

- whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index;
- that requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and
- that is settled at a future date.

Examples of Derivatives

Forwards: Contracts to purchase or sell a specific quantity of a financial instrument, a commodity, or a foreign currency at a specified price determined at the outset, with delivery or settlement at a specified future date. Settlement is at maturity by actual delivery of the item specified in the contract, or by a net cash settlement.

Interest Rate Swaps: Contracts to exchange cash flows as of a specified date or a series of specified dates based on a notional amount and fixed and floating rates.

Futures: Contracts similar to forwards but with the following differences: Futures are generic exchange-traded, whereas forwards are individually tailored. Futures are generally settled through an offsetting (reversing) trade, whereas forwards are generally settled by delivery of the underlying item or cash settlement.

Options: Contracts that give the purchaser the right, but not the obligation, to buy (call option) or sell (put option) a specified quantity of a particular financial instrument, commodity, or foreign currency, at a specified price (strike price), during or at a specified period of time. The purchaser of the option pays the seller (writer) of the option a fee (premium) to compensate the seller for the risk of payments under the option.

Caps and Floors: These are contracts sometimes referred to as interest rate options. An interest rate cap will compensate the purchaser of the cap if interest rates rise above a predetermined rate (strike rate) while an interest rate floor will compensate the purchaser if rates fall below a predetermined rate.

Examples of Embedded Derivatives

Contracts that are denominated in currencies other than the functional currency of the reporting entity

Options to renew borrowing based on a pre-determined fixed rate

Contingent rentals

Rise and fall clauses in contracts

Supply contracts based on movements in market prices of other commodities

Equity conversion rights

HKAS 39 requires an embedded derivative to be separated from its host contract and accounted for as a derivative when:

- the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

Recognition and measurement

A financial asset or a financial liability must be recognised when, and only when, the entity becomes a party to the contractual provisions of the instrument. On initial recognition, financial assets and liabilities should be measured at fair value (including transaction costs, for assets and liabilities not measured at fair value through profit or loss).

Subsequent to initial recognition financial assets and liabilities (including derivatives) should be measured at fair value (with changes in fair value taken to equity for AFS assets and to profit or loss for other financial instruments), with the following exceptions:

- Loans and receivables, held-to-maturity investments, and financial liabilities, other than those classified as "fair value through profit and loss", should be measured at amortised cost using the effective interest method (The effective interest rate is the rate that exactly discounts estimated future cash payments / receipts through the expected life of the financial instrument to the net carrying amount of the financial asset / liability).
- Investments in equity instruments with no reliable fair value measurement (and derivatives indexed to such equity instruments) should be measured at cost.
- Financial assets and liabilities that are designated as a hedged item or hedging instrument are subject to measurement under the hedge accounting requirements of HKAS 39.
- Financial assets and financial liabilities that are accounted for using the continuing-involvement method are subject to specific measurement requirements.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Impairment

An entity should assess, at each balance sheet date, whether there is any objective evidence of impairment of a financial asset or group of assets.

For financial assets classified as loans and receivables, held to maturity and AFS debt instruments, an impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate.

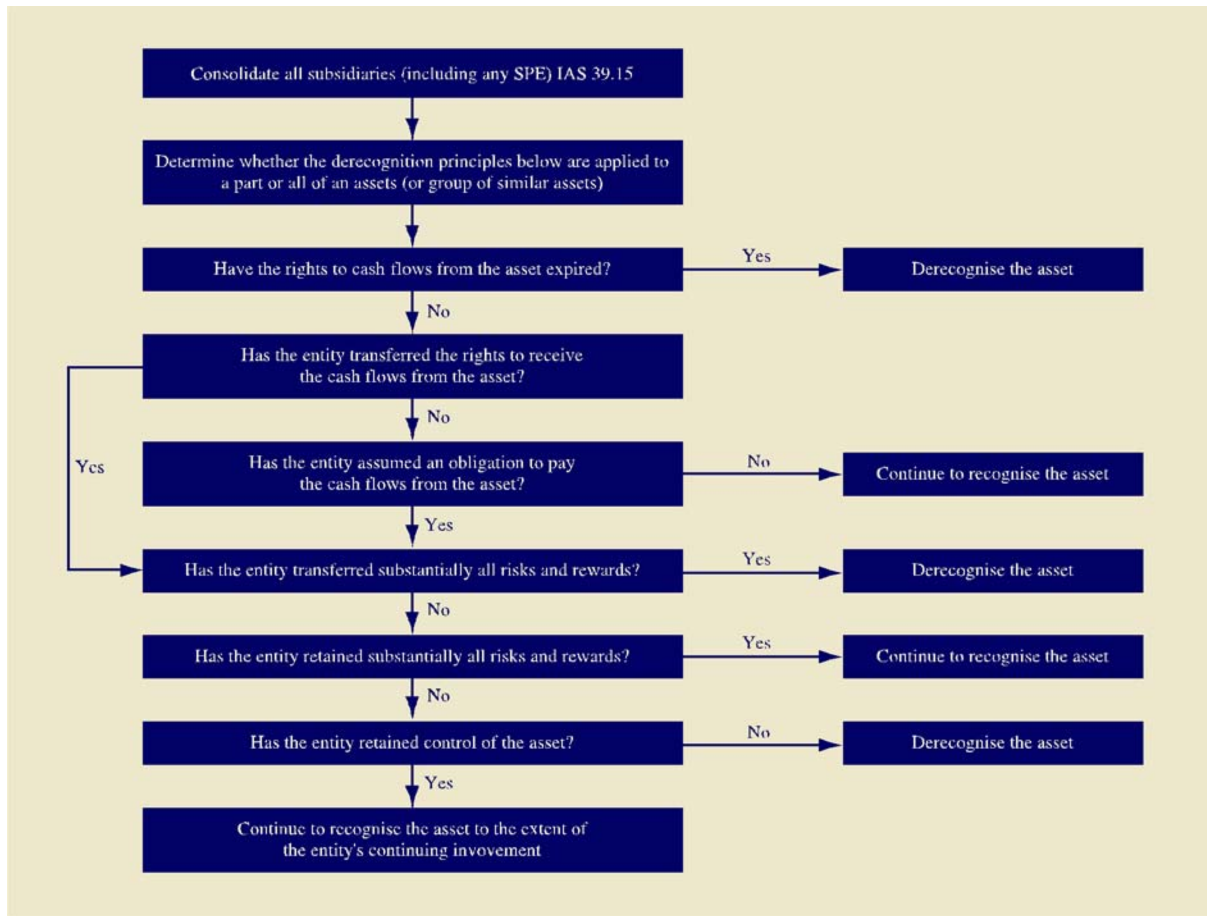
Reversal of impairment losses relating to a financial asset carried at amortised cost or a debt instrument carried as available-for-sale due to an event occurring after the impairment was originally recognised is reversed through profit and loss. Impairments relating to investments in available-for-sale equity instruments are not reversed.

Derecognition of financial assets

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or when the financial asset is transferred and the transfer qualifies for derecognition. If transferred, then an entity determines whether or not substantially all of the risks and rewards of ownership of the asset have been transferred. An asset is derecognised if substantially all the risks and rewards have been transferred. An asset is not derecognised if substantially all the risks and rewards have been retained.

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then derecognition is appropriate only if the entity does not control the asset. If the entity has retained control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in it.

These various derecognition steps are summarised below in a decision tree below



Derecognition of financial liabilities

A financial liability should be derecognised when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged, cancelled, or expired.

Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Hedge accounting

Hedge accounting is optional under HKAS 39. Entities whose hedging activities are not substantial may opt not to practice hedge accounting due to the amount of work, time and resources that will be required.

HKAS 39 permits hedge accounting under certain circumstances provided that

- the hedging relationship is formally designated and documented and expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated, and effectiveness can be reliably measured, and

- at the inception of a hedge and, at a minimum, at each reporting date, the changes in the fair value or cash flows of the hedged item attributable to the hedged risk must be expected to be highly effective in offsetting the changes in the fair value or cash flows of the hedging instrument on a prospective basis, and on a retrospective basis where actual results are within a range of 80% to 125%.
- HKAS 39 provides for three types of hedges:
- Fair value hedge - If an entity hedges a change in fair value of a recognised asset or liability or firm commitment, the change in fair values of both the hedging instrument and the hedged item are recognised in profit or loss when they occur.
- Cash flow hedge - If an entity hedges changes in the future cash flows relating to a recognised asset or liability or a probable forecast transaction, then the change in fair value of the hedging instrument is recognised directly in equity until such time as those future cash flows occur.
- Hedge of a net investment in a foreign operation - Accounting is similar to a cash flow hedge.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

HKAS 39 requires discontinuance of hedge accounting prospectively if:

- the hedging instrument expires or is sold, terminated, or exercised;
- the hedge no longer meets the hedge accounting criteria (e.g. it is no longer effective);
- for cash flow hedges the forecast transaction is no longer expected to occur; or
- the entity revokes the hedge designation.

Amendment to HKAS 39 - Transition and initial recognition of financial assets and financial liabilities

An amendment was issued to HKAS 39 that gives entities a choice when they first adopt HKAS 39 of applying the "day one gain and loss" recognition requirements either

- retrospectively (as previously required by HKAS 39);
- prospectively to transactions entered into after 25 October 2002; or
- prospectively to transactions entered into after 1 January 2004.

"Day one gains and losses" arise when the transaction price differs from a calculated fair value (e.g. through using a valuation model)

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 39	SSAP 24 *Accounting for investments in securities*
Specific Deloitte publications	• iGAAP 2005 Financial Instruments: IAS 32 and IAS 39 Explained. • IAS 32/39 (Part I to III) e-learning modules

Compliance with IFRSs

There are no significant differences between HKAS 39 and IAS 39 *Financial Instruments*: *Measurement and Recognition.*

Future Developments

In April 2005, the IASB adopted amendments to IAS 39 concerning cash flow hedge accounting of forecast intragroup transactions. This is expected to be adopted in Hong Kong soon. The amendment clarifies that forecast intragroup transactions cannot be considered hedged items, but also provides guidance that in the consolidated accounts, a highly probable forecasted external transaction designated in the functional currency of the entity entering into the transaction can be designated as the hedged item if it gives rise to an exposure with an effect on consolidated profit or loss.

The IASB has proposed limited amendments to IAS 39 in two Exposure Drafts:

- The Fair Value Option
  - Proposes to limit the option in IAS 39 to permit an entity to designate only specified financial assets and financial liabilities, on initial recognition, as ones to be measured at fair value, with value changes through profit and loss.
- Financial Guarantee Contracts and Credit Insurance.
  - Proposes to include financial guarantee contracts and credit insurance within the scope of IAS 39 and requires the issuer of a financial guarantee contract to measure the contract initially at fair value. It also addresses the subsequent measurement of those guarantees.

IFRIC has issued Draft Interpretation D15 on embedded derivatives which proposes the following requirements:

- The assessment of whether an embedded derivative must be separated from the host contract is made only when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract, in which case it is required.
- A first-time adopter of IFRSs should make its assessment on the basis of the conditions that existed when the entity first became a party to the derivatives contract, rather than those prevailing when the entity adopts IFRSs for the first time.

HKAS 40 Investment Property (issued December 2004)

Objective

To prescribe the accounting treatment for investment property and the related disclosures.

Entities Most Likely to be Affected by Changes

Entities with investment properties

HKAS 40 Requirements at a Glance

Scope	Land or buildings held to earn rentals and/or for capital appreciation (excludes owner–occuped property and property under construction or held for sale).
Measurement	Cost or fair value model. Change methods only if gives more appropriate presentation. Chosen model applied to all investment property.
Property held by lessee under operating lease	Can qualify if lessee uses fair value model.

Key Changes of HKAS 40

- Introduces a fair value model that requires all changes in fair value of an investment property to be recognised in the income statement. Under SSAP 13 *Accounting for investment properties*, such fair value changes were taken directly to an investment property revaluation reserve on a portfolio basis to the extent that the reserve remained in surplus.
- Introduces an option to use a cost model for accounting for investment property (other than investment property held under an operating lease). If chosen, it must be applied to all investment property. The selection between the alternatives is made on the first-time adoption of HKAS 40. Under SSAP 13, only unlisted companies with investment properties where the estimated aggregated open market value was less than HK$50 million or was less than 15% of the carrying amount of the total assets of the company could carry investment properties at cost (no depreciation was required) less impairment loss.
- Removes the SSAP 13 requirement to depreciate property carried at fair value and held under leasehold interest with a remaining lease term of 20 years or less.
- Removes the 15% benchmark for determining the significance of the portion of property held for own use or leased to group companies.
- Requires an entity to treat an investment property which is leased to other group companies as investment property in an entity's individual financial statements

- Allows a lessee to classify an interest in land and buildings held under an operating lease as an investment property in accordance with HKAS 40 provided that it meets the criteria for investment property and the fair value model is adopted for that property.
- Clarifies the classification of investment properties. It is noted that when an entity provides ancillary services to the occupants of a property it holds, the entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is added to indicate that if an entity owns and manages a hotel, services provided to guests are regarded as significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property. This is discussed further in HK – Int 2 *The Appropriate Accounting Policies for Hotel Properties.*

Implication of Changes

Entities that have previously accounted for investment properties at open market value with changes in value taken to a revaluation reserve under SSAP 13 will have to change their accounting policy. An entity will need to choose whether to use the **cost basis** and depreciate the asset, or use the **fair value basis** and record all changes in fair value in the income statement. The fair value method will undoubtedly lead to increased volatility in the income statement.

Under HKAS 17 *Leases*, **leasehold interests in land** (which will be the case for most land in Hong Kong and the PRC) will be classified as operating leases, and hence not shown as property plant and equipment, unless the leasehold interest meets the criteria to be, and is, classified as an investment property under HKAS 40 and the fair value model is adopted. Therefore, if the leasehold interest in land is not classified as investment property, reclassification of leasehold land from property, plant and equipment to prepaid lease payments is required upon transition to HKAS 17. However, there is an **exemption** if the lease payments for a lease of land and buildings cannot be allocated reliably between the land and building elements (and it is clear that both elements are not operating leases). In such circumstances, the entire lease is classified as a finance lease and should be accounted for as usual under HKAS 40, if it is investment property, or under HKAS 16 *Property, Plant and Equipment*. Under SSAP 17 *Property, plant and equipment*, leasehold interests in land are generally classified as property, plant and equipment. In Hong Kong, land and buildings are frequently leased together instead of acquired separately. In such situations, practical problems may arise when determining the relative fair values of the two components. Professional help will probably need to be sought to value the two components at inception.

Summary of HKAS 40

Scope

Investment property is property (land or a building – or part of a building – or both) held (whether by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both.

HKAS 40 does not apply to owner-occupied property or property that is being constructed or developed for future use as investment property, or property held for sale in the ordinary course of business.

Measurement

HKAS 40 permits an entity to choose either the fair value model or the cost model. The chosen measurement model must be applied to all of the entity's investment property.

- Fair value model: Investment property is measured at fair value, and changes in fair value are recognised in the income statement.
- Cost model: Investment property is measured at depreciated cost less any accumulated impairment losses. The fair value of the investment property must still be disclosed.

If an entity uses the fair value model but, when a particular property is acquired, there is clear evidence that the entity will not be able to determine its fair value on a continuing basis, the cost model is used for that property and it must continue to be used until disposal of the property.

A change from one model to the other is permitted if it will result in a more appropriate presentation (this is highly unlikely for a change from the fair value to the cost model).

A property interest held by a lessee under an operating lease can qualify as investment property provided that the lessee uses the fair value model of HKAS 40 and the relevant criteria are met. In this case, the lessee accounts for the lease as if it were a finance lease.

Disclosures

Disclosures include:

- Method of determining fair value.
- Extent of use of an independent valuer in determining fair value.
- Criteria used to classify (or not classify) property as investment property.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK- Int 2 *The Appropriate Policies for Hotel Property*
Existing pronouncements replaced by HKAS 40	SSAP 13 *Accounting for investment properties*
Specific Deloitte publications	IAS 40 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 40 and IAS 40 *Investment Property*.

Future Developments

There are no significant developments currently in progress.

HK – Int 2 The Appropriate Accounting Policies for Hotel Properties

Summary

HK - Int 2 was developed due to concerns expressed about the appropriate accounting treatment for owner-operated hotel properties. In particular, an industry practice had developed which was a hybrid of the treatments in SSAP 13 *Accounting for investment properties* and SSAP 17 *Property, plant and equipment.* In many cases such properties were being held at revalued amounts, but not being depreciated.

HK - Int 2 requires a hotel property to be accounted for and classified under either HKAS 16 *Property, Plant and Equipment* (or SSAP 17) or under HKAS 40 *Investment Property* (or SSAP 13) depending on the circumstances relevant to the specific property. Accordingly an owner operated hotel property should be accounted for as property, plant and equipment under HKAS 16.

Impact on Entities

For entities holding owner-operated properties at revalued amounts without previous charging depreciation, management will need to restate the financial statements to reflect the impact of depreciating the company's hotel properties.

HK – Int 3 Revenue – Pre-completion Contracts for the Sale of Development Properties

Summary

HK – Int 3 was developed due to diverse practice by property developers with regard to accounting for pre-construction contracts for the sale of development properties. In particular, HK-Int 3 arose due to concerns as to whether such pre-completion contracts would satisfy the definition of construction contracts and, if not, whether the stage of completion method would be acceptable under HKFRSs.

HK - Int 3 concludes that pre-completion contracts for the sale of development properties do not meet the definition of construction contracts set out in HKAS 11 *Construction Contracts* (or SSAP 23 *Construction contracts*) if the contracts in question are not specifically negotiated for the construction of the properties. As a result the stage of completion method shall not be used to recognise revenue arising from such contracts.

Property developers need to apply HKAS 18 *Revenue* (or SSAP 18 *Revenue)* in recognising revenue arising from pre-completion contracts for the sale of development properties that do not fall within the scope of HKAS 11. Therefore, revenue is recognised only when the conditions in paragraph 14 of HKAS 18 for the sale of goods are met.

Impact on Entities

If a property developer currently uses the stage of completion method to recognise revenue on pre-completion contracts for the sale of development properties that are not specifically negotiated for the construction of the properties, then the developer will need to change its revenue recognition accounting policy. Applying the criteria for the sale of goods in HKAS 18 is likely to result in revenue being recognised later and often fully recognised within one accounting period. This Interpretation must be applied to all contracts entered into on or after 1 January 2005. Retrospective application of this Interpretation to pre-completion contracts for sale before 1 January 2005 is permitted but not required. If prospective application is followed then, for pre-completion contracts entered into before 1 January 2005, the developer shall account for those contracts using its former accounting policy.

HK – Int 4 Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases

Summary

HK – Int 4 was issued due to concern, in the light of the current land policy of the Government of the Hong Kong Special Administrative Region (the HKSAR Government), as to how the length of the lease term of a Hong Kong land lease should be determined for the purpose of applying the requirements under HKAS 16 *Property, Plant and Equipment* and HKAS 17 *Leases*, as appropriate. The renewal of such leases is at the sole discretion of the HKSAR government.

HK - Int 4 concludes that the lease term of a Hong Kong land lease for the purpose of applying the requirements under HKAS 16 and HKAS 17 shall be determined by reference to the legal form and status of the lease. Renewal of a lease is assumed only when the lessee has a renewal option and it is reasonably certain at the inception of the lease that the lessee will exercise the option. Options for extending the lease term that are not at the discretion of the lessee shall not be taken into account.

Impact on Entities

Lessees cannot assume that the lease term of a Hong Kong land lease will be extended for a further 50 years, or any other period, while the HKSAR Government retains the sole discretion as to whether to renew. Any general intention expressed by the Government to renew certain types of property leases is not sufficient for a lessee to include such extensions in the determination of the lease term for amortisation (depreciation) under HKAS 16/17.

This Interpretation may lead to such properties accounted for as finance leases being depreciated over much shorter periods (due to the fact the lease term normally provides an indication of the useful life of the property interest), which may lead to a significantly greater expense to the income statement. For properties under operating leases, the lease term in consideration would not include the period after the renewal.

HKFRSs having a moderate impact

The Standards and Interpretations within this section are:

- HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards
- HKFRS 4 Insurance Contracts
- HKFRS 6 Exploration for and Evaluation of Mineral Resources
- HKAS 1 Presentation of Financial Statements
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 16 Property, Plant and Equipment
- HKAS 19 Employee Benefits
- HKAS 21 The Effects of Changes in Foreign Exchange Rates
- HKAS 23 Borrowing Costs
- HKAS 24 Related Party Disclosures
- HKAS 27 Consolidated and Separate Financial Statements
- HKAS 28 Investments in Associates
- HKAS 29 Financial Reporting in Hyperinflationary Economies
- HKAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions
- HKAS 31 Interests in Joint Ventures
- HKAS 33 Earnings Per Share
- HK (IFRIC) – Int 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities
- HK (IFRIC) – Int 4 Determining whether an Arrangement contains a Lease
- HK – Int 1 The Appropriate Accounting Policies for Infrastructure Facilities

This section provides an overview of the HKFRSs that are expected to have a moderate impact on Hong Kong entities, in general. However, the impact of any particular Standard or Interpretation on an entity will vary widely depending on that entity's own unique set of circumstance and outcomes. For example, under HKAS 16, the carrying amounts of assets that will require dismantling, removing or restoring will need to be increased to include those future costs. At first glance, this appears to be a less significant change than, for example, the expensing of all share-based payments under HKFRS 2 *Share-based Payment*. However, it may have a significant effect on the depreciation expense of a mining entity with obligations to incur considerable restoration expenses for its mining sites.

Also, within this section, there are a number of Standards (for example HKAS 1, HKAS 8 and HKAS 24) that have been excluded from the "major impact" section of this publication, as they don't involve such extensive changes to existing recognition and measurement. They do, however, introduce considerable new disclosure requirements. They will make the preparation of the financial statements more time consuming and may require entities to disclose more sensitive information.

In addition, this section contains HKFRSs that will not have an impact on the majority of entities. For example, HKFRS 1 has complex requirements, but is only applicable to first-time adopters of HKFRSs, and HKAS 30 introduces extensive new disclosure requirements, but they only apply to financial institutions. Other entities should note, however, that due to the release of the International Exposure Draft ED 7, expected to be released as IFRS 7 in mid 2005, the HKAS 30 disclosures may become applicable to all entities at a later date.

HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards (issued October 2003)

Objective

To prescribe the procedures when an entity adopts HKFRSs for the first time as the basis for preparing its general-purpose financial statements.

Entities Most Likely to be Affected by Changes

Entities adopting HKFRSs for the first time.

Key Changes under HKFRS 1

- This is the first Accounting Standard on first-time adoption in Hong Kong.

Implications of Changes

As only a first-time adopter of HKFRS should apply HKFRS 1, the new Standard will not be applicable to many entities in Hong Kong.

Summary of HKFRS 1

Scope

HKFRS 1 sets out the procedures that an entity must follow when it adopts HKFRS for the first time as the basis for preparing its general purpose financial statements. Only a first time adopter of HKFRS should apply HKFRS 1. To help users to identify a first time adopter, different circumstances are discussed in the Standard.

A first-time adopter is an entity that, for the first time, makes an explicit and unreserved statement that its general purpose financial statements comply with HKFRSs. An entity is a first-time adopter if, in the preceding year, it prepared HKFRS financial statements for internal management use, as long as those financial statements were not given to owners or external parties such as investors or creditors. If a set of HKFRS financial statements was, for any reason, given to an external party in the preceding year, then the entity will already be considered to be using HKFRSs so HKFRS 1 does not apply.

Adjustments on first-time adoption

At the time of first-time adoption of HKFRSs, adjustments are required to move from the previous GAAP to HKFRSs, these include:

- derecognition of some existing assets and liabilities if they do not qualify for recognition under HKFRS but have satisfied the recognition criteria of previous GAAP;
- recognition of some new assets and liabilities if they are required to be recognised by HKFRS even if they were never recognised under previous GAAP; and
- reclassification of balance sheet items from the previous GAAP classifications to the appropriate HKFRS classification.

Measurement principle

The general measurement principle is to apply HKFRSs in measuring all recognised assets and liabilities. However there are several significant exceptions noted below.

Overview for an entity that adopts HKFRSs for the first time in its annual financial statements for the year ended 31 December 2005

Accounting policies

Select accounting policies based on HKFRSs in force at 31 December 2005.

HKFRS reporting periods

Prepare at least 2005 and 2004 financial statements and restate retrospectively the opening balance sheet (beginning of the first period for which full comparative financial statements are presented) by applying the HKFRSs in force at 31 December 2005.

- Since HKAS 1 *Presentation of Financial Statements* requires at least one year of comparative prior period financial information to be presented, the opening balance sheet will be 1 January 2004, if not earlier.
- If a 31 December 2005 adopter reports selected financial data (but not full financial statements) on an HKFRS basis for periods prior to 2004, in addition to full financial statements for 2004 and 2005, that does not change the fact that its opening HKFRS balance sheet is as of 1 January 2004.

Adjustments required to move from previous GAAP to HKFRSs at the time of first-time adoption should be recognised directly in retained earnings or another appropriate category of equity at the date of transition to HKFRSs unless it qualifies as one of the optional or mandatory exceptions below.

Exceptions to the measurement principle

Optional exceptions - There are ten optional exceptions to the general restatement and measurement principles. Exceptions in the following areas are individually optional, not mandatory:

- Business combinations that occurred before the opening balance sheet date
- Fair value or revaluation as deemed cost for property, plant, and equipment, intangible assets, and investment property
- Actuarial gains and losses under SSAP 34 *Employee benefits*
- Accumulated translation reserves
- Assets and liabilities of subsidiaries which have a transition date later than the parent
- Designation of previously recognised financial instruments under HKAS 39 *Financial Instruments: Recognition and Measurement*
- Retrospective application of HKFRS 2 *Share-based Payment*
- Insurance contracts
- Changes in existing decommissioning, restoration and similar liabilities

Mandatory exceptions **-** There are also four exceptions to the general restatement and measurement principles set out above that are mandatory, not optional. These are in the following areas:

- HKAS 39 – Derecognition of financial assets and financial liabilities
- HKAS 39 – Hedge accounting
- Accounting estimates
- Assets classified as held for sale and discontinued operations

HKFRS 1 also requires significant disclosure, including disclosures that explain how the transition from previous GAAP to HKFRSs affected the entity's reported financial position, financial performance, and cash flows.

HKFRS 1 also gives guidance for situations when a parent or investor becomes a first-time adopter earlier than or later than its subsidiary, associate, or joint venture investee.

Effective date	First HKFRS financial statements for a period beginning on or after 1 January 2004.
Related Interpretations	None
Existing pronouncements replaced by HKFRS 1	N/A
Specific Deloitte publications	• Guide to IFRS 1 *First-time Adoption of International Financial Reporting Standards* • IFRS 1 e-learning module

Compliance with IFRSs

There are no significant differences between HKFRS 1 and IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Future Developments

There are no significant developments currently in progress.

HKFRS 4 Insurance Contracts (issued August 2004)

Objective

To prescribe the financial reporting for insurance contracts. This is an interim Standard, which will be replaced when the IASB completes the second phase of its project on insurance contracts.

To improve disclosures for insurance contracts and make modest improvements to recognition and measurement practices

Entities Most Likely to be Affected by Changes

Entities involved in insurance

All entities that issue insurance contracts and/or hold reinsurance contracts.

Key Changes under HKFRS 4

- This is the first Accounting Standard on insurance contracts in Hong Kong. The main change to current practice is via the introduction of significant new disclosure requirements.
- Prohibits provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions).

Implications of Changes

Much of HKFRS 4 will not be applicable to companies outside of the insurance and banking industries, unless individual transactions that they enter into fall within the scope of the Standard. However, HKFRS 4 applies to insurance contracts, rather than entities involved in insurance so all **entities** will need to ensure than they do not have any contracts that fall within the scope of the new Standard.

In practice, HKFRS 4 is unlikely to have a significant impact on the accounting treatment for insurance contracts. The main impact from HKFRS 4 will be the **significant new disclosure requirements** that will be time-consuming to prepare. Phase II of the insurance project, however, may result in significant changes to current accounting practice (see Future Developments).

Summary of HKFRS 4

Scope

HKFRS 4 applies to virtually all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. It does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*. Furthermore, it does not address accounting by policyholders.

An insurance contract is defined as a "contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder."

Accounting policies

HKFRS 4 exempts an insurer temporarily, until completion of Phase II of the Insurance Project (see Future Developments below), from some requirements of other HKFRSs, including the requirement to consider the Framework in selecting accounting policies for insurance contracts. However, HKFRS 4:

- prohibits provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions);
- requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets; and
- requires an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and prohibits offsetting insurance liabilities against related reinsurance assets.

Changing accounting policies

An insurer is permitted to change its accounting policies for insurance contracts only if, as a result, its financial statements present information that is more relevant and are no less reliable, or more reliable and no less relevant. In particular, an insurer cannot introduce any of the following practices, although it may continue using accounting policies that involve them:

- Measuring insurance liabilities on an undiscounted basis.
- Measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current market-based fees for similar services.
- Using non-uniform accounting policies for the insurance liabilities of subsidiaries.

Remeasuring insurance liabilities

The introduction of an accounting policy that involves remeasuring designated insurance liabilities consistently in each period to reflect current market interest rates is permitted (and, if the insurer so elects, other current estimates and assumptions). Without this permission, an insurer would have been required to apply the change in accounting policies consistently to all similar liabilities.

Other issues

An insurer is not required to change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it should not introduce additional prudence.

There is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts.

An insurer is allowed to reclassify some or all financial assets as 'at fair value through profit or loss when it changes its accounting policies for insurance liabilities.

The HKFRS:

- Clarifies that an insurer need not account for an embedded derivative separately at fair value if the embedded derivative meets the definition of an insurance contract.
- Requires an insurer to unbundle (that is, to account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet.
- Clarifies the applicability of the practice sometimes known as 'shadow accounting'.
- Permits an expanded presentation for insurance contracts acquired in a business combination or portfolio transfer.
- Addresses limited aspects of discretionary participation features contained in insurance contracts or financial instruments.

The HKFRS also requires significant disclosures.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKFRS 4	None

Compliance with IFRSs

There are no significant differences between HKFRS 4 and IFRS 4 *Insurance Contracts*.

Future Developments

The insurance contracts project is a comprehensive project addressing all issues on accounting for insurance contracts. The IASB split the project into two phases, so that some components could be put in place by 2005 without delaying the rest of the project.

Phase I involved the issuance of an interim Standard to provide guidance on how existing IFRSs should be applied to insurance contracts. Phase I was completed with the issuance of IFRS 4 (identical to HKFRS 4 described above)

Phase II is taking a fresh look at accounting for insurance contracts. The only restrictions on Phase II are the IASB's Framework and the general principles established in the IASB's existing Standards. The next step in the Phase II project will be for the IASB to publish a discussion paper.

HKFRS 6 Exploration for and Evaluation of Mineral Resources (issued February 2005)

Objective

To specify the financial reporting for the exploration for and evaluation of mineral resources. This is an interim Standard, which will be replaced when the IASB completes the second phase of its project.

Entities Most Likely to be Affected by Changes

Entities incurring expenses in connection with the search for mineral resources (including minerals, oil, natural gas and similar non-regenerative resources).

Key Changes under HKFRS 6

- This is the first Accounting Standard on the exploration for and evaluation of mineral resources in Hong Kong**.** The main change to current practice are via the introduction of significant new disclosure requirements. Entities are unlikely to need to revise their accounting policies for the changes introduced by HKFRS 6.
- Provides different recognition requirements from those in HKAS 36 *Impairment of Assets* for impairment of exploration and evaluation assets, but measures the impairment in accordance with HKAS 36 once it has been identified.

Implications of Changes

HKFRS 6 will not be applicable to many companies outside the **extractive industries**, unless individual transactions that they enter into fall within the scope of the Standard.

HKFRS 6 introduces significant **new disclosure requirements** for entities within its scope. Therefore, preparation of the financial statements will be more time consuming and entities may need to disclose more sensitive information.

HKFRS 6 makes modest improvements to recognition and measurement practices, in particular with respect to testing exploration and evaluation assets for **impairment**. Entities will need to ensure their current accounting policies are appropriate, given the new guidance.

Summary of HKFRS 6

Scope

HKFRS 6 applies to exploration and evaluation expenditures, i.e. to expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources. Affected activities include the search

for mineral resources, as well as the determination of the technical feasibility and commercial viability of extracting those resources.

HKFRS 6 does not apply to expenditures incurred:

- before the exploration for and evaluation of mineral resources, e.g. expenditures incurred before the entity has obtained the legal rights to explore a specific area and
- after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

Accounting policies

HKFRS 6 permits entities to continue to use their existing accounting policies provided that they result in information that is relevant to the economic decision-making needs of users and reliable.

Measurement

On initial recognition, exploration and evaluation assets are required to be measured at cost. After recognition, entities can apply either the cost or the revaluation model. Where the revaluation model is selected, the rules of HKAS 16 *Property, Plant and Equipment* are applied to exploration and evaluation assets classified as tangible assets and the rules of HKAS 38 *Intangible Assets* are applied to those classified as intangible assets.

Impairment

HKFRS 6 modifies the rules of HKAS 36 *Impairment of Assets* as regards to the circumstances in which such assets are required to be assessed for impairment. A detailed impairment test is required in two circumstances:

- when the technical feasibility and commercial viability of extracting a mineral resource become demonstrable, at which point the asset falls outside the scope of HKFRS 6 and is reclassified in the financial statements, and
- when facts and circumstances suggest that the asset's carrying amount may exceed its recoverable amount

When such circumstances occur the entity is required to assess the affected assets for impairment in accordance with HKAS 36, subject to special requirements with respect to the level at which impairment is assessed.

Disclosure

HKFRS 6 requires disclosure of information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources, including

- its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets, and
- the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

HKFRS 6 is effective for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity adopts HKFRS 6 before 1 January 2006, transitional relief is available for some comparative disclosures.

Effective date	Annual periods beginning on or after 1 January 2006
Related Interpretations	None
Existing pronouncements replaced by HKFRS 6	None

Compliance with IFRSs

There are no significant differences between HKFRS 6 and IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

Future Developments

Exposure Draft to IFRS 1

In May 2005, the IASB issued an Exposure Draft to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that clarifies that an entity that adopts IFRSs before 1 January 2006 and chooses to adopt IFRS 6 before 1 January 2006 need not apply the requirements of IFRS 6 to comparative information presented in its first IFRS financial statements. The Exposure Draft was issued as the previous wording in IFRS 1 didn't reflect the intent of the IASB.

Future IFRS on extractive industries

IFRS 6 is the first step in the IASB's project to achieve the convergence of varying accounting treatments around the world for extractive activities. The IASB decided it was not feasible to complete a comprehensive project addressing accounting for extractive industries in time for the many entities that will adopt IFRSs in 2005. However, it decided it was necessary to provide guidance on the treatment of exploration and evaluation costs for entities applying IFRSs in 2005 and consequently it developed IFRS 6 as an interim measure. Longer term, a comprehensive Standard on the extractive industries is expected to be developed.

There is a current research project on accounting for extractive activities. The primary focus of the research project is on the financial reporting issues associated with reserves/resources – in particular whether and how to define, recognise, measure and disclose reserves/resources. As part of the research project, the project team will also complete a review of other issues that exist in accounting for extractive activities.

At the conclusion of the research project, a discussion paper incorporating the IASB's preliminary views on the financial reporting of reserves/resources will be published for public comment. At this stage the discussion paper is expected to be issued in 2006.

HKAS 1 Presentation of Financial Statements (issued March 2004)

Objective

To set out the overall framework for presenting general-purpose financial statements, including guidelines for their structure and minimum content.

Entities Most Likely to be Affected by Changes

All entities.

Key Changes under HKAS 1

- Introduces additional guidance on the notion of 'true and fair view' and re-emphasises the message that an override of HKFRS requirements is extremely rare.
- Adds a new definition of materiality.
- Requires a current/non-current presentation of assets unless a liquidity presentation is more relevant.
- Requires a financial liability that is due within 12 months after the balance sheet date, or for which the entity does not have an unconditional right to defer its settlement for at least 12 months after the balance sheet date, to be classified as a current liability. This classification is required even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date but before the financial statements are authorised for issue.
- Adds new disclosures on significant judgements made by management, key assumptions about the future and other sources of measurement uncertainty, and the principal place of business.
- Introduces the following presentation requirements for the balance sheet:
  - Present minority interests on the face of the balance sheet within equity.
  - Show the issued capital and reserves attributable to equity holders of the parent.
  - Present the following new line items on the face of the balance sheet:
    - investment properties,
    - biological assets,
    - liabilities and assets for current tax, deferred tax liabilities and deferred tax assets,
    - financial liabilities other than trade and other payables and provisions,
    - the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with HKFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, and
    - liabilities included in disposal groups classified as held for sale in accordance with HKFRS 5.
- Introduces the following presentation requirements for the income statements
  - Prohibits the presentation of extraordinary items.

- Eliminates the requirement to present ‘results of operating activities’ and ‘profit or loss from ordinary activities’.
- Requires a single amount to be presented on the face of the income statement which comprises the total of the post-tax profit or loss of discontinued operations and the post tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- Requires allocation of the profit or loss, on the face of the income statement, between ‘profit or loss attributable to minority interest’ and ‘profit or loss attributable to equity holders of the parent’. The allocated amounts shall not be presented as income and expense in the income statement.

- Requires separate presentation of minority interests in the statement of changes in equity.
- Eliminates the detailed rules for offsetting assets and liabilities and states only that assets and liabilities shall not be offset unless required or permitted by a Standard or an Interpretation.
- Eliminates the provision allowing companies not to disclose comparative information for the reconciliation of movements in fixed assets.

Implications of Changes

All entities will be impacted by the changes to the **format** of the financial statements and the increased disclosure. Preparation of the financial statements will be more time consuming. The **new disclosure requirements**, in particular the significant judgements and assumptions, will need to be considered carefully to ensure that they are reasonable and will withstand public scrutiny. Entities may find that they need to **significantly redraft** their financial statements due to the interaction of the new requirements within HKAS 1 and HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (see HKFRS 5 for more detail).

Additional liabilities may be required to be classified as short-term. This may have a significant impact on **financial statement ratios**, and consequently on debt covenants. Entities may need to review their current **financing arrangements** to ensure that timetables for renegotiation and compliance with loan covenants and conditions ensure that borrowings can remain classified as non-current if necessary.

Summary of HKAS 1

HKAS 1 outlines the fundamental principles underlying the preparation of financial statements, including the going concern assumption, consistency in presentation and classification, the accrual basis of accounting and materiality.

Preparation of financial statements

A complete set of financial statements should include a balance sheet, income statement, statement of changes in equity, cash flow statement, a summary of significant accounting policies and other explanatory notes. The statement of changes in equity must show either:

- all changes in equity; or
- changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders.

Financial statements must be prepared at least annually. If the date of the year end changes, and financial statements are presented for a period longer or shorter than one year, disclosure is required.

Assets and liabilities, and income and expenses, may not be offset unless offsetting is permitted or required by another HKFRS.

The current/non-current distinction for assets and liabilities is normally required. In general post-balance sheet events are not considered in classifying items as current or non-current.

Comparative prior-period information must be presented for amounts shown in the financial statements and notes.

Minimum requirements

HKAS 1 specifies minimum line items to be presented on the face of the balance sheet, income statement, and statement of changes in equity, and includes guidance for identifying additional line items. It also specifies minimum note disclosures. These must include information about the following:

- Accounting policies followed.
- The judgements that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.
- The key assumptions concerning the future, and other key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) - Int 29 *Service Concession Arrangements* (previously Interpretation 16)
Existing pronouncements replaced by HKAS 1	SSAP 1 *Presentation of financial statements* Interpretation 8 *Presentation of financial statements – Current assets: classification of restricted and appropriated cash balances* Interpretation 16 *Service concession arrangements*
Specific Deloitte publications	IAS 1 e-learning module

Illustrative financial statement structure

HKAS 1.8(b) **HKAS 1.46(b),(c)**	Consolidated income statement for the year ended 31 December 2005			
HKAS 1.104 **HKAS 1.46(d),(e)**		Notes	Year ended 31/12/05 HKD'000	Year ended 31/12/04 HKD'000 (restated)
	Continuing operations			
HKAS 1.81 (a)	Revenue	5	1,064,660	728,250
HKAS 1.88	Cost of sales		(697,027)	(552,343)
HKAS 1.83	Gross profit		367,633	175,907
HKAS 1.88	Other operating income		9,892	6,745
HKAS 1.88	Distribution costs		(96,298)	(45,609)
HKAS 1.88	Administrative expenses		(131,485)	(69,545)
HKAS 1.88	Other operating expenses		(23,400)	(17,724)
HKAS 1.83	Operating profit		126,342	49,774
HKAS 1.81(c)	Share of profit of associates		12,763	983
HKAS 1.83	Investment revenues	7	3,501	717
HKAS 1.83	Other gains and losses		(563)	(44)
HKAS 1.81(b)	Finance costs	8	(36,187)	(32,165)
HKAS 1.83	Profit before tax		105,856	19,265
HKAS 1.81(d)	Income tax expense	9	(16,166)	(3,810)
HKAS 1.83	Profit for the year from continuing operations		89,690	15,455
	Discontinued operation			
HKAS 1.81(e)	Profit for the year from discontinued operation	10	10,676	4,171
HKAS 1.81(f)	**Profit for the year**	12	100,366	19,626
	Attributable to:			
HKAS 1.82(b)	Equity holders of the parent		99,757	19,529
HKAS 1.82(a)	Minority interest		609	97
			100,366	19,626
	Earnings per share	14		
	From continuing and discontinued operations:			
HKAS 33.66	Basic		66.1 cents	13.0 cents
HKAS 33.66	Diluted		51.4 cents	12.9 cents
	From continuing operations:			
HKAS 33.66	Basic		59.0 cents	10.2 cents
HKAS 33.66	Diluted		46.0 cents	10.1 cents
	Note: The format outlined above aggregates expenses according to their function.			

Reference	Consolidated balance sheet as at 31 December 2005			
HKAS 1.8(a) HKAS 1.46(b), (c)				
HKAS 1.04		Notes	31/12/05	31/12/04
HKAS 1.46(d), (e)			HKD'000	HKD'000
				(restated)
	Assets			
HKAS 1.51	***Non-current assets***			
HKAS 1.68(a)	Property, plant and equipment	15	657,905	566,842
HKAS 1.68(b)	Investment property	16	12,000	11,409
HKAS 1.69	Goodwill	17	2,423	2,538
HKAS 1.68(c)	Other intangible assets	18	26,985	21,294
HKAS 1.69	Negative goodwill		-	(2,465)
HKAS 1.68(e)	Investments in associates	20	45,060	12,274
HKAS 1.69	Available-for-sale investments	22	23,543	25,602
HKAS 1.69	Finance lease receivables	22	114,937	104,489
HKAS 1.68(n)	Deferred tax assets	35	5,006	3,291
HKAS 1.69	Derivative financial instruments	34	2,602	1,307
			890,461	746,581
HKAS 1.51	***Current assets***			
HKAS 1.68(g)	Inventories	24	117,693	108,698
HKAS 1.69	Finance lease receivables	23	54,713	49,674
HKAS 1.68(h)	Trade and other receivables	25	127,916	123,656
HKAS 1.69	Investments held for trading	22	37,243	29,730
HKAS 1.69	Derivative financial instruments	34	2,436	4,817
HKAS 1.68(i)	Cash and cash equivalents		11,609	1,175
HKAS1.68A(a)	Assets classified as held for sale	11	1,922	-
			353,532	317,750
	Total assets		1,243,993	1,064,331

	Consolidated balance sheet at 31 December 2005 – continued			
		Notes	31/12/05 HKD'000	31/12/04 HKD'000 (restated)
	Equity and liabilities			
HKAS 1.68(p)	***Capital and reserves***			
HKAS 1.69	Share capital	27	121,650	120,000
HKAS 1.69	Capital reserves	28	41,331	33,300
HKAS 1.69	Revaluation reserves	29	95,248	34,591
HKAS 1.69	Hedging and translation reserves	30	(11,70(	508
HKAS 1.69	Retained earnings	31	252,268	155,086
HKAS 1.68(o)	Equity attributable to equity holders of the parent		498,797	343,485
HKAS 1.51	Minority interest		3,185	2,576
	Total equity		501,982	346,061
HKAS 1.51	***Non-current liabilities***			
HKAS 1.69	Bank loans	32	356,353	448,753
HKAS 1.69	Convertible loan notes	33	24,327	-
HKAS 1.69	Retirement benefit obligation	46	33,928	38,474
HKAS 1.68(n)	Deferred tax liabilities	35	15,447	5,772
HKAS 1.69	Obligations under finance leases	36	923	1,244
HKAS 1.69	Liability for share-based payments	45	6,528	3,516
HKAS 1.68(k)	Provisions	38	2,118	-
			439,624	497,759
HKAS 1.51	***Current liabilities***			
HKAS 1.68(j)	Trade and other payables	37	141,429	84,412
HKAS 1.68(m)	Current tax liabilities		8,229	1,986
HKAS 1.69	Obligations under finance leases	36	1,470	1,483
HKAS 1.69	Bank overdrafts and loans	32	144,307	128,686
HKAS 1.68(k)	Provisions	38	6,432	2,065
HKAS 1.69	Derivative financial instruments	34	273	1,879
	assets classified as held for sale	11	247	-
			302,387	220,511
	Total liabilities		742,011	718,270
	Total equity and liabilities		1,243,993	1,064,331

HKAS 1.8(c)(ii) **HKAS1.46(b),(c)**	Consolidated statement of recognised income and expense for the year ended 31 December 2005		
HKAS 1.46(d),(e)		Year ended 31/12/05 HKD'000	Year ended 31/12/04 HKD'000
HKAS 1.96(b)	Gain/(loss) on revaluation of property	64,709	(4,369)
HKAS 1.96(b)	(Deferred tax liability arising) reversal of deferred tax liability on revaluation of land and buildings	(3,692)	320
HKAS 1.96(b)	Gains on cash flow hedges taken to equity	1,723	550
HKAS 1.96(b)	Gains on available-for-sale investments taken to equity	251	201
HKAS 1.96(b)	Exchange differences on translation of foreign operations	(12,718)	2,706
HKAS 1.96(b)	Net income recognised directly in equity	50,273	(592)
	Transfers:		
HKAS 32.59(b)	Transfer to profit or loss from equity on cash flow hedges	(995)	(895)
HKAS 32.59(c)	Transfer to initial carrying amount of non-financial hedged item on cash flow hedges	(218)	-
HKAS 32.94(h)	Transfer to profit or loss from equity on sale of available-for-sale investments	(611)	-
HKAS 1.96(a)	Profit for the year	100,366	19,626
HKAS 1.96(c)	Total recognised income and expense for the year	148,815	18,139
HKAS 1.96(c)	Attributable to:		
	Equity holders of the parent	148,206	18,042
	Minority interest	609	97
		148,815	18,139
HKAS 1.96(d)	Effects of changes in accounting policy:		
	Attributable to equity holders of the parent - increase in retained earnings at the beginning of the year	2,465	90
	Attributable to minority interest	-	-
		2,465	90

Note: HKAS 1 requires that the financial statements should include a statement showing either all changes in equity, or changes in equity other than those arising from capital transactions with owners and distributions to owners. The above illustrates an approach which presents those changes in equity that represent income and expense in a separate component of the financial statements. If this method of presentation is adopted, a reconciliation of the opening and closing balances of share capital, reserves and retained earnings is required to be provided in the explanatory notes. An alternative method of presenting changes in equity is illustrated on the next page.

The consequential amendments to HKAS 1 following the adoption of the amendments to HKAS 19 *Employee Benefits*, require that the title of this statement be changed to the statement of recognised income and expense. These amendments have been adopted in advance of their effective date for the purpose of this illustration.

HKAS 1.8(c)(i) HKAS 1.46(b),(c)	## Consolidated statement of changes in equity for the year ended 31 December 2005

Reference		Share capital HKD'000	Capital reserves HKD'000	Revaluation reserves HKD'000	Hedging and translation reserves HKD'000	Retained earnings HKD'000	Attributable to equity holders of the parent HKD'000	Minority Interest HKD'000	Total HKD'000
HKAS 1.97(b),(c) HKAS 1.46(d),(e)									
	Balance at 1 January 2004	120,000	32,098	38,439	(1,853)	143,507	332,191	2,479	334,670
HKAS 1.96(d)	Effect of changes in accounting policy					90	90	-	90
	As restated	120,000	32,098	38,439	(1,853)	143,597	332,281	2,479	334,760
HKAS 1.96(b)	Loss on revaluation of property	-	-	(4,369)	-	-	(4,369)	-	(4,369)
HKAS 1.96(b)	Reversal of deferred tax liability on revaluation of land and buildings	-	-	320	-	-	320	-	320
HKAS 1.96(b)	Gains on cash flow hedges	-	-	-	550	-	550	-	550
HKAS 1.96(b)	Gains on available-for sale investments	-	-	201	-	-	201	-	201
HKAS 1.96(b)	Exchange differences arising on translation of foreign operations	-	-	-	2,706	-	2,706	-	2,706
HKAS 1.96(b)	Net income recognised directly in equity	-	-	(3,848)	3,256	-	(592)	-	(592)
HKAS 32.59(b)	Transfer to profit or loss on cash flow hedges	-	-	-	(895)	-	(895)	-	(895)
HKAS 1.96(a)	Profit for the year	-	-	-	-	19,529	19,529	97	19,626
HKAS 1.96(c)	Total recognised income and expense for the year	-	-	(3,848)	2,361	19,529	18,042	97	18,139
HKAS 1.97(a)	Recognition of share-based payments	-	1,202	-	-	-	1,202	-	1,202
HKAS 1.97(a)	Dividends	-	-	-	-	(8,040)	(8,040)	-	(8,040)
	Balance at 1 January 2005	120,000	33,300	34,591	508	155,086	343,485	2,576	346,061
HKAS 1.96(d)	Effect of changes in accounting policy	-	-	-	-	2,465	2,465	-	2,465
	As restated	120,000	33,300	34,591	508	157,551	345,950	2,576	348,526
HKAS 1.96(b)	Gain on revaluation of property	-	-	64,709	-	-	64,709	-	64,709
HKAS 1.96(b)	Deferred tax liability arising on revaluation of land and buildings	-	-	(3,692)	-	-	(3,692)	-	(3,692)
HKAS 1.96(b)	Gains on cash flow hedges	-	-	-	1,723	-	1,723	-	1,723
HKAS 1.96(b)	Gains on available-for-sale investments	-	-	251	-	-	251	-	251
HKAS 1.96(b)	Exchange differences arising on translation of foreign operations	-	-	-	(12,718)	-	(12,718)	-	(12,718)
HKAS 1.96(b)	Net income recognised directly in equity	-	-	61,268	(10,995)	-	50,273	-	50,273
	Transfers:								
HKAS 32.59(b)	Transfer to profit or loss on cash flow hedges	-	-	-	(995)	-	(995)	-	(995)
HKAS 32.59(c)	Transfer to initial carrying amount of non-financial hedged item on cash flow hedges	-	-	-	(218)	-	(218)	-	(218)
HKAS 32.94(h)	Transfer to profit or loss on sale of available-for-sale investments	-	-	(611)	-	-	(611)	-	(611)
HKAS 1.96(a)	Profit for the year	-	-	-	-	99,757	99,757	609	100,366
HKAS 1.96(c)	Total recognised income and expense for the year	-	-	60,657	(12,208)	99,757	148,206	609	148,815
HKAS 1.97(a)	Recognition of equity component of convertible loan notes	-	995	-	-	-	995	-	995
HKAS 1.97(a)	Deferred tax liability on recognition of equity component of convertible loan notes	-	(174)	-	-	-	(174)	-	(174)
HKAS 1.97(a)	Recognition of share-based payments	-	2,860	-	-	-	2,860	-	2,860
HKAS 1.97(a)	Dividends	-	-	-	-	(5,040)	(5,040)	-	(5,040)
HKAS 1.97(a)	Issue of share capital	1,650	4,350	-	-	-	6,000	-	6,000
	Balance at 31 December 2005	121,650	41,331	95,248	(11,700)	252,268	498,797	3,185	501,982

Note: See previous page for alternative method of presenting changes in equity.

The above layout combines reserves of a similar nature for ease of presentation. However, HKAS 1 requires a reconciliation of the opening and closing position on each reserve separately. Therefore, if such a combined presentation is adopted for the purposes of the statement of changes in equity, further details should be presented in the notes to the financial statements.

Illustrative critical accounting judgements and key sources of estimation uncertainty

	Note: The following are examples of the types of disclosures that might be required in this area. The matters disclosed will be dictated by the circumstances of the individual entity, and by the significance of judgements and estimates made to the results and financial position.
HKAS 1.113	**Critical judgements in applying the entity's accounting policies** In the process of applying the entity's accounting policies, which are described in note W, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements (apart from those involving estimations, which are dealt with below). Revenue recognition Note X describes the expenditure required in the year for rectification work to be carried out on goods supplied to one of the Group's major customers. These goods were delivered to the customer in the months of January to July 2005, and shortly thereafter the defects were identified by the customer. Following negotiations, a schedule of works was agreed, which will involve expenditure by the Group until 2007. In the light of the problems identified, management was required to consider whether it was appropriate to recognise the revenue from these transactions of HKD102 million in the current period, in line with the Group's general policy of recognising revenue when goods are delivered, or whether it was more appropriate to defer recognition until the rectification work was complete. In making its judgement, management considered the detailed criteria for the recognition of revenue from the sale of goods, set out in HKAS 18 Revenue and, in particular, whether the Group had transferred to the buyer the significant risks and rewards of ownership of the goods. Following the detailed quantification of the Group's liability in respect of rectification work, and the agreed limitation on the customer's ability to require further work or to require replacement of the goods, the directors are satisfied that the significant risks and rewards have been transferred and that recognition of the revenue in the current year is appropriate, in conjunction with recognition of an appropriate provision for the rectification costs. Capitalisation of borrowing costs As described in note Y, it is the Group's policy to capitalise borrowing costs directly attributable to the acquisition, construction or production of qualifying assets. Capitalisation of the borrowing costs relating to construction of the Group's premises in A Land was suspended in 2004, while the development was delayed as management reconsidered its detailed plans. Capitalisation of borrowing costs recommenced in 2005 – following the finalisation of revised plans, and resumption of the activities necessary to prepare the asset for its intended use. Although construction of the premises was not restarted until May 2005, borrowing costs have been capitalised from February 2005, at which time the technical and administrative work associated with the project recommenced.

HKAS 1.116 HKAS 1.120	**Key sources of estimation uncertainty** The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below. Recoverability of internally-generated intangible asset During the year, management reconsidered the recoverability of its internally-generated intangible asset arising from the Group's e-business development, which is included in its balance sheet at 31 December 2005 at HKD3.24 million. The project continues to progress in a very satisfactory manner, and customer reaction has reconfirmed management's previous estimates of anticipated revenues from the project. However, increased competitor activity has caused management to reconsider its assumptions regarding future market shares and anticipated margins on these products. Detailed sensitivity analysis has been carried out and management is confident that the carrying amount of the asset will be recovered in full, even if returns are reduced. This situation will be closely monitored, and adjustments made in future periods, if future market activity indicates that such adjustments are appropriate. Impairment of goodwill Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value. The carrying amount of goodwill at the balance sheet date was HKD2.423 million after an impairment loss of HKD0.463 million was recognised during 2005. Details of the impairment loss calculation are provided in note Z.

Compliance with IFRSs

HKAS 1 uses the terms "true and fair view" and "give a true and fair view", to agree with the terminology used in the Companies Ordinance, instead of the terms "fair presentation" and "present fairly", which are used in IAS 1 *Presentation of Financial Statements*. The difference in terminology has no significance in respect of measurement or disclosure in the financial statements.

There are no other significant differences between HKAS 1 and IAS 1.

Future Developments

These is a current IASB agenda project addressing broadly the issues related to the display and presentation in the financial statements of all recognised changes in assets and liabilities from transactions or other events, except those related to transactions with owners acting as owners (sometimes called comprehensive income). Therefore, the project is considering items that presently are reported in the income statement, cash flow statement, and statement of changes in equity. The key issues addressed in this project include:

- Whether performance should be reported in a single statement of comprehensive income, with subtotals for "income from continuing operations" and "net profit or loss", or in multiple statements.
- Whether business activities should be separated from financing and what other subtotals should be presented (e.g. continuing operations).
- Whether comparative data for prior periods should be required, and if so for how many periods.
- Whether recycling between "net profit or loss" and "comprehensive income" should be permitted
- Whether initial measurement of items should be separated from their remeasurement.
- Whether the direct method should be required in the cash flow statement.

A discussion paper should be released in late 2005.

HKAS 7 Cash Flow Statements (issued December 2004)

Objective

To require the presentation of information about historical changes in an entity's cash and cash equivalents by means of a cash flow statement, which classifies cash flows during the period according to operating, investing, and financing activities.

Entities Most Likely to be Affected by Changes

Entities with revenue of less than HK$20 million per annum, charities and non-profit making entities whose financial statements are prepared on a cash basis.

Key Changes under HKAS 7

- Removes the exemption from preparing a cash flow statement for entities with revenue of less than HK$20 million per annum, charities and non-profit making entities whose financial statements are prepared on a cash basis.
- If a venturer chooses to change to accounting for its interests in jointly controlled entities using the proportionate consolidation method this will need to be reflected in the cash flow statement (see HKAS 31 *Interests in Joint Ventures).*

Implications of Changes

Cash flow statements will need to be presented by **all entities**.

Summary of HKAS 7

The cash flow statement must analyse changes in cash and cash equivalents during a period. Cash equivalents include investments that are short term (less than 3 months from the date of acquisition), readily convertible to a known amount of cash, and subject to an insignificant risk of changes in value. Generally such investments exclude equity investments.

Cash flows from operating, investing, and financing activities must be separately reported. Cash flows from operating activities are reported using either the direct (recommended) or indirect methods. Cash flows arising from taxes on income are classified as operating unless they can be specifically identified with financing or investing activities.

The exchange rate used for the translation of transactions denominated in a foreign currency and the cash flows of a foreign subsidiary should be the rate in effect at the date of the cash flows.

Aggregate cash flows relating to acquisitions and disposals of subsidiaries and other business units should be presented separately and classified as investing activities, with specified additional disclosures.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 7	SSAP 15 *Cash flow statements*
Specific Deloitte publications	IAS 7 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 7 and IAS 7 *Cash Flow Statements*.

Future Developments

These is a current IASB agenda project addressing broadly the issues related to the display and presentation in the financial statements of all recognised changes in assets and liabilities from transactions or other events except those related to transactions with owners acting as owners (sometimes called comprehensive income). Therefore, the project is considering items that presently are reported in the income statement, cash flow statement, and statement of changes in equity (see discussion for HKAS 1 *Presentation of Financial Statements*, for more detail).

A discussion paper should be released in late 2005.

HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (issued March 2004)

Objective

To prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in estimates, and errors.

Entities Most Likely to be Affected by Changes

All entities.

Key Changes under HKAS 8

- Includes the guidance on the selection of accounting policies and items to be presented in the income statement previously included in SSAP 1 *Presentation of financial statements*.
- Updates the hierarchy governing the selection of accounting policies.
- Replaces the concept of 'fundamental error' with that of 'material error'. In order for an error to be corrected retrospectively, the error previously had to be "fundamental" to the financial statements. This threshold has been lowered to require the retrospective correction of all "material" errors.
- Defines "material" as it relates to omissions or misstatements and describes how to apply the concept of materiality.
- Includes a definition of 'impracticable' and guidance on its interpretation.
- Introduces new disclosure requirements dealing with the effect of the adoption of a new Standard issued but not yet effective.
- Requires more detailed disclosure of the amounts of adjustments resulting from changes in accounting policies or corrections of prior period errors.
- Includes a definition of a change in accounting estimate and clarifies how to record changes in estimates.

Implications of Changes

All entities will be impacted by the changes to the format of the financial statements and the increased disclosure. The new **disclosure requirements** will make the preparation of the financial statements more time consuming. For example, the required disclosure regarding Standards that have been issued, but which are not yet effective, will require an entity to consider the future impact of new Standards and estimate what their effect will be on financial position.

Under HKAS 8, a change in accounting policy or correction of a prior period error is applied/corrected retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change/error. The detailed specification of the meaning of the term **impracticable** used in HKAS 8 sets out a much stricter interpretation of that term than the previous interpretation in SSAP 2 of

requiring undue cost and effort or using the cost benefit approach. Therefore, only in rare cases will an entity not be able to apply the new accounting policy or correct a prior period error retrospectively.

Also we will expect to see more errors being **corrected retrospectively** due to the lowering of the threshold from "fundamental" to "material". This means additional work will be required as the comparative amounts and/or the opening retained earnings of the prior period will have to be adjusted and significant disclosure must be given concerning the nature of the errors and their impact.

Summary of HKAS 8

Selection and application of accounting policies

HKAS 8 prescribes a hierarchy for choosing accounting policies as follows

1. HKICPA Standards and Interpretations dealing with the issue, taking into account any relevant implementation guidance.
2. In the absence of a Standard dealing specifically with the issue, look to the requirements and guidance in HKICPA Standards and Interpretations dealing with similar and related issues and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.
3. Management may also consider the most recent pronouncements of other Standard-setting bodies that use a similar conceptual framework to develop accounting Standards, other accounting literature, and accepted industry practices.

Changes in accounting policies

Accounting policies must be consistently applied to similar transactions. A change in accounting policy is only made if it is required by a Standard or Interpretation or the change results in more relevant and reliable information. If a change in accounting policy is required by a Standard or Interpretation, that pronouncement's transitional provisions are followed. If none are specified, or if the change is voluntary, the new accounting policy is applied retrospectively by restating prior periods. If restatement is impracticable, the cumulative effect of the change is included in profit or loss. If the cumulative effect cannot be determined, the new policy is applied prospectively.

Changes in accounting estimates (e.g., a change in the useful life of an asset) are accounted for in the current year, or future years, or both (no restatement). All material errors should be corrected by restating comparative prior period amounts and, if the error occurred before the earliest period presented, by restating the opening balance sheet.

Disclosures are required about accounting changes, changes in estimates, and error corrections.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 8	SSAP 2 *Net profit or loss for the period, fundamental errors and changes in accounting policies.*
Specific Deloitte publications	IAS 8 e-learning module

Illustrative disclosures for a new Standard or Interpretation that has been issued, but is not yet effective.

(Note: The following examples are for illustrative purposes only and do not represent all potential impact of these new HKFRSs.)

Illustration 1 - The Group has considered the new HKFRSs issued but not yet effective, but does not expect a material effect on how the results of operations and financial position are prepared and presented.

HKAS 8.30(a)	At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective: HKFRS 6 *Exploration for and Evaluation of Mineral Resources* HK (IFRIC) – Int 4 *Determining whether an Arrangement contains a Lease* HK (IFRIC) – Int 5 *Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
HKAS 8.30(b)	The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group.

Illustration 2 - The Group has considered the new HKFRSs and has identified one or more HKFRSs that may have a material effect on how the results of operations and financial positions are prepared and presented.

HKAS 8.30(a)	In April 2004, the HKICPA issued HKFRS 2 *Share-based Payment*, which requires an expense to be recognised where the Group buys goods or obtains services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions"). The principal impact of HKFRS 2 on the Group is in relation to the expensing of directors' and employees' share options of the Company. Currently, the Group does not expense the share options issued by the Company. The Group intends to take advantage of the transitional provisions set out in HKFRS 2. In relation to share options granted on or before 7 November 2002 and share options granted after 7 November 2002 and vested before 1 January 2005, the Group does not intend to recognise and expense those share options. However, in relation to share options granted after 7 November 2004 and vested on or after 1 January 2005, such share options shall be accounted for retrospectively in accordance with HKFRS 2. Accordingly, the Group estimates that the adoption of HKFRS 2 in the annual period beginning on 1 January 2005 would result in a decrease in the net profit for the year ended 31 December 2004 of HKD [X], a decrease in retained earnings of HKD [X] as at 31 December 2004 and an increase in capital reserves of HKD [X] as at 31 December 2004. In relation to other new HKFRSs, the Group does not expect that their issuance will have a material effect on how the results of operations and financial position of the Group are prepared and presented.

Compliance with IFRSs

There are no significant differences between HKAS 8 and IAS 8 *Accounting Policies: Changes in Accounting Estimates and Errors.*

Future Developments

There are no significant developments currently in progress.

HKAS 16 Property, Plant & Equipment (issued March 2004)

Objective

To prescribe the principles for the initial recognition and subsequent accounting for property, plant, and equipment

Entities Most Likely to be Affected by Changes

Most entities.

Key Changes under HKAS 16

- Removes the scope exclusion for charitable, government subvented and not-for-profit organisations whose long term financial objective is other than to achieve operating profits.
- Requires the use of HKAS 40 *Investment Property* (rather than HKAS 16) to account for existing investment properties under re-development for continued use as investment properties. SSAP 13 *Accounting for investment properties*, which was replaced by HKAS 40, stated that investment properties should be completed properties.
- Adopts a single recognition principle for both initial costs and subsequent costs such that an asset shall be recognised when it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. There are different recognition principles for initial cost and subsequent costs in SSAP 17 *Property, plant and equipment.*
- Includes dismantlement, removal and restoration costs in the cost of an asset. SSAP 17 requires that only the cost incurred as a consequence of installing the item should be included in the cost of an asset.
- Requires the measurement of exchanges of non-monetary assets at fair value unless the exchange transaction lacks commercial substance. In SSAP 17, an exchange of assets is measured at fair value unless the exchanged assets are similar.
- Allows a revaluation model only when the fair values of the items to be revalued are reliably measurable.
- Requires the amount initially recognised in respect of an item of property plant and equipment (PP&E) to be allocated to its significant parts and each such part to be depreciated separately. In such circumstances, the depreciation charge must be determined separately for each significant part of an item of PP&E ("component depreciation"). Such a requirement is not clearly set out in SSAP 17.
- Defines residual value as "an estimated amount an entity would currently receive for the asset if the asset were already of the age and in the condition expected at the end of its useful life" and states clearly that the effects of inflation should not be included in measuring the residual value. If the residual value is greater than the carrying amount, no further depreciation should be recognised.
- Requires a review of the residual value and the useful life of an asset, as well as the depreciation method applied to an asset, at least at each financial period end. Under the current SSAP 17, a review of the useful life and depreciation method is only required "periodically".
- Requires an asset to be depreciated as soon as it is available for use and continued depreciation until it is derecognised (unless the usage method of depreciation is used), even if during that period the item is idle (other than an item of PP&E which is accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*). Under SSAP 17, an item retired from its active use and held for disposal should no longer be depreciated.

- Introduces criteria for derecognition such that an item of PP&E is derecognised on the date the criteria for the sale of goods in HKAS 18 *Revenue* are met.
- Requires derecognition of the carrying amount of each part of an item of PP&E which has been replaced and the cost of the replacement included in the carrying amount of the item of PP&E.
- Includes a requirement that the gain or loss arising from a disposal of an item of PP&E is recognised in profit or loss (but not classified as revenue).
- Removes the guidance on transfers between different categories of PP&E in SSAP 17. Such guidance is now included in HKAS 40.

Implications of Changes

Most entities will be impacted due to the addition information that needs to be gathered and the need to ensure **systems** can cope with the new requirements.

The criteria for capitalising **subsequent expenditure** on assets appears less stringent than previously under SSAP 17, which may lead to a greater level of costs being capitalised in the future. Costs which in the past would have been expensed (e.g. replacement cost) may be able to be added to the carrying values of assets already in use provided that the carrying amounts of the portion of the asset replaced is derecognised.

Systems will need to be reviewed to ensure they can track the information necessary for **componentisation** of assets. The derecognition requirements may lead to expenses being recognised where components have not been adequately tracked and separately depreciated at the time of initial recognition, e.g. if too little depreciation has been charged because a component has not been allocated an appropriate useful life.

The carrying amounts of assets that will require **dismantling, removing or restoring** will need to be increased to include these future costs. This will have an impact on the company's depreciation expense. For example, where a site is required to be restored (for instance leased premises), this expected cost must be capitalised and depreciated.

Residual values, useful lives and depreciation methods must be reassessed annually which will require significant judgement and effort. Also changes may be required to systems and there may be a significant impact on the depreciation expense going forward. This will particularly be the case where the residual values are liable to fluctuate from period to period, e.g. land and buildings.

Under HKAS 17 *Leases*, **leasehold interests in land** (which will be the case for most land in Hong Kong and the PRC) will be classified as operating leases, and hence not shown as property plant and equipment, unless the leasehold interest meets the criteria to be, and is, classified as an investment property under HKAS 40 and the fair value model is adopted. Therefore, if the leasehold interest in land is not classified as investment property, reclassification of leasehold land from property, plant and equipment to prepaid lease payments is required upon transition to HKAS 17. However, there is an **exemption** if the lease payments for a lease of land and buildings cannot be allocated reliably between the land and building elements (and it is clear that both elements are not operating leases). In such circumstances, the entire lease is classified as a finance lease and should be accounted for as usual under HKAS 40, if it is investment property, or under HKAS 16. Under SSAP 17, leasehold interests in land are generally classified as property, plant and equipment. In Hong Kong, land and buildings are frequently leased together instead of acquired separately. In such situations, practical problems may arise when determining the relative fare values of the two components. Professional help will probably need to be sought to value the two components at inception.

Summary of HKAS 16

Recognition

An item of property, plant, and equipment should be recognised as an asset when it is probable that the future economic benefits associated with the asset will flow to the entity and the cost of the asset can be measured reliably.

On initial recognition assets are measured at cost, which includes all costs necessary to bring the asset to working condition for its intended use. This would include not only its original purchase price but also costs of site preparation, delivery and handling, installation, related professional fees for architects and engineers, and the estimated cost of dismantling and removing the asset and restoring the site. If payment is deferred, interest must be recognised. In accounting subsequent to acquisition, HKAS 16 allows a choice of accounting model:

- Cost model: The asset is carried at cost less accumulated depreciation and impairment.
- Revaluation model: The asset is carried at revalued amount, which is fair value at revaluation date less subsequent depreciation.

Revaluation model

Under the revaluation model, revaluations must be done regularly. All items of a given class must be revalued (for instance, all buildings). Revaluation increases are credited to equity. Revaluation decreases are charged first against the revaluation surplus in equity, and any excess against profit and loss. When the revalued asset is disposed of, the revaluation surplus in equity remains in equity and is not recycled through profit and loss.

Depreciation

Components of an asset with differing patterns of benefits must be depreciated separately. Depreciation is charged systematically over the asset's useful life. The depreciation method must reflect the pattern of benefit consumption. The residual value must be reviewed at least annually. If operation of an item of property, plant, and equipment (for example, an aircraft) requires regular major inspections, when each major inspection is performed, its cost is recognised in the carrying amount of the asset as a replacement if the recognition criteria are satisfied.

Other areas

Impairment of property, plant, and equipment must be assessed under IAS 36.

All exchanges of property, plant, and equipment should be measured at fair value, including exchanges of similar items, unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable.

Disclosures include accounting policies depreciation methods and lives acquisitions, disposals, impairments, and reversals amounts and details of revaluations and commitments.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (IFRIC) – Int 1 *Changes In Existing Decommissioning, Restoration And Similar Liabilities* HK – Int 1 *The Appropriate Policies for Infrastructure Facilities* HK – Int 2 *The Appropriate Policies for Hotel Property* HK – Int 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*
Existing pronouncements replaced by HKAS 16	SSAP 17 *Property, plant & equipment* Interpretation 1 *Costs of modifying existing software* Interpretation 5 *Property, plant and equipment – Componentisation for the impairment or loss of items*
Specific Deloitte publications	IAS 16 e-learning module

Compliance with IFRSs

HKAS 16 retains a transitional arrangement, previously included in SSAP 17, to relieve certain entities which carried their property, plant and equipment at revalued amounts before 30 September 1995 from making regular revaluations. This does not appear in IAS 16 *Property, Plant and Equipment*.

There are no other significant differences between HKAS 16 and IAS 16 *Property, Plant and Equipment*.

Future Developments

There is a future IASB agenda project which would seek to converge the various approaches in different jurisdictions to accounting for revaluations of assets. It would be a limited-scope project to ensure that whenever and wherever revaluations are permitted they are measured and reported consistently and in a comparable fashion.

HKAS 19 Employee Benefits (issued December 2004)

Objective

To prescribe the accounting and disclosure for employee benefits

Entities Most Likely to be Affected by Changes

Entities with defined benefit plans

Key Changes under HKAS 19

- The following changes all come from an amendment to HKAS 19:
  - Provides an additional option to recognise actuarial gains and losses in full in the statement of recognised income and expense.
  - Requires significant additional disclosures.
  - Specifies how group entities should account for defined benefit plans in their separate and individual financial statements.
  - Clarifies the accounting treatment for a contractual agreement under a multi-employer plan that determines how a surplus is distributed or a deficit funded.

Implication of Changes

Entities will need to deal with expanded **disclosure requirements** from the amendment to HKAS 19 which will be time consuming to prepare.

Entities will need to decide whether to continue to use their current method of **recognising actuarial gains and losses** in the income statement or whether to change to recognise actuarial gains and losses in full in the statement of recognised income and expense. If an entity chooses to change its method, this is likely to lower the employee benefits expense in the income statement and, where the entity has previously used the 10% corridor method of deferring actuarial gains and losses, will remove the need for complex calculations.

Participating entities in **group schemes** will need to review their existing accounting treatment to ensure they are in compliance with the new requirements introduced by the amendments to HKAS 19.

Summary of HKAS 19

Scope

HKAS 19 applies to accounting for employee benefits, except those to which HKFRS 2 *Share-based Payment* applies. Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees and include short-term benefits (wages, annual leave, sick leave, annual profit-sharing, bonuses, and non-monetary benefits); post-employment benefits (pensions post-employment life insurance and medical benefits); other long-term employee benefits (long-service leave, disability, deferred compensation, and long-term profit-sharing and bonuses) and termination benefits.

The underlying principle of HKAS 19 is that the cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable.

Post-employment benefits

Post-employment benefit plans (such as pensions and health care) are categorised as either defined contribution plans or defined benefit plans. Under defined contribution plans, expenses are recognised in the period the contribution is payable.

Defined benefit plans (DBP) – Balance sheet

Under defined benefit plans, a liability is recognised in the balance sheet equal to the net of:

- the present value of the defined benefit obligation (the present value of expected future payments required to settle the obligation resulting from employee service in the current and prior periods);
- deferred actuarial gains and losses and deferred past service cost; and
- the fair value of any plan assets at the balance sheet date (plan assets include assets held by a long-term employee benefit fund and qualifying insurance policies)

The present value of the defined benefit obligation should be determined using the Projected Unit Credit Method. The discount rate should be determined by reference to market yields at the balance sheet date on high quality corporate bonds.

DBP – Actuarial gains and losses

If the accumulated unrecognised actuarial gains and losses exceed 10% of the greater of the defined benefit obligation or the fair value of plan assets, the excess divided by the expected average remaining working lives of the participating employees must be recognised immediately. Actuarial gains and losses that do not breach the 10% limits need not be recognised, however an entity can choose to do so.

DBP – Asset ceiling

If the calculation of the balance sheet amount as set out above results in an asset, there are requirements in HKAS 19 which may limit the amount recognised.

DBP – Income statement

The charge to income recognised in a period in respect of a defined benefit plan will be made up of the following components:

- current service cost (the actuarial estimate of benefits earned by employee service in the period);
- interest cost (the increase in the present value of the obligation as a result of moving one period closer to settlement);
- expected return on plan assets;
- actuarial gains and losses, to the extent recognised;
- past service cost, to the extent recognised; and
- the effect of any plan curtailments or settlements

Other employee benefits

Short-term employee benefits (payable within 12 months) should be recognised as an expense in the period in which the employee renders the service. Profit-sharing and bonus payments are to be recognised only when the entity has a constructive obligation to pay them and the costs can be reliably estimated.

Long-term employee benefits should be recognised and measured the same way as post-employment benefits under a defined benefit plan. However, unlike defined benefit plans, the deferral of actuarial gains or losses and past service costs is prohibited.

Termination benefits should be recognised when the entity is demonstrably committed to the termination of one or more employees before the normal retirement date or to provide termination benefits from an offer made to encourage voluntary redundancy.

Amendment to HKAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures

An amendment was issued to HKAS 19 to allow an additional option of recognising actuarial gains and losses in full in the period in which they occur, outside profit or loss, in a statement of recognised income and expense. However, entities don't need to change their approach and they can continue to recognise actuarial gains and losses in profit or loss either in the period they occur or spread over the service lives of the employees.

The amendment requires significant new disclosures to be given, such as the sensitivity of defined benefit plans to changes in medical cost trend rates; five- year histories of the plan liabilities, plan assets, the surplus or deficit and experience adjustments, trends in the plan; contributions expected to be paid to the plan during the following financial year and all the terms of the plan used in the determination of the defined benefit obligation.

The amendment specifies how group entities should account for defined benefit group plans in their separate or individual financial statements. It also clarifies the accounting treatment for a contractual agreement under a multi-employer plan that determines how a surplus is distributed (or a deficit funded).

Effective date	Annual periods beginning on or after 1 January 2005. The amendment is effective for annual periods beginning on or after 1 January 2006 (but may be adopted early)
Related Interpretations	None
Existing pronouncements replaced by HKAS 19	SSAP 34 *Employee benefits*
Specific Deloitte publications	IAS 19 e-learning module

Illustrative disclosures for defined benefit plans

Note: The following disclosures include the disclosures required by the amendment to HKAS 19.

HKAS 19(r2004). 120A(b)	**Defined benefit plan** The Group operates a funded defined benefit plan for qualifying employees of its subsidiaries in C Land, and previously for the employees of Subsix Limited. Under the plan, the employees are entitled to retirement benefits varying between 40 and 65 per cent of final salary on attainment of a retirement age of 60. No other post-retirement benefits are provided. The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out at 31 December 2005 by Mr. F.G. Ho, Fellow of the Institute of Actuaries. The present value of the defined benefit obligation, and the related current service cost and past service cost, were measured using the projected unit credit method.
HKAS 19(r2004). 120A(n)	The principal assumptions used for the purpose of the actuarial valuations were as follows:

	Valuation at	
	31/12/05	31/12/04
Discount rate	7%	7%
Expected return on plan assets	9%	8%
Expected rate of salary increases	5%	5%
Future pension increases	4%	4%

HKAS 19(r2004). 120A(f)

The amount recognised in the balance sheet in respect of the Group's defined benefit retirement benefit plan is as follows:

	31/12/05	31/12/04
	HKD'000	HKD'000
Present value of funded obligations	180,512	177,395
Fair value of plan assets	(125,093)	(118,828)
	55,419	58,567
Unrecognised actuarial losses	(17,310)	(15,372)
Unrecognised past service cost	(4,181)	(4,721)
Net liability recognised in the balance sheet	33,928	38,474

HKAS 19(r2004). 120A(g)

Amounts recognised in profit or loss in respect of the defined benefit plan are as follows:

	Year ended 31/12/05	Year Ended 31/12/04
	HKD'000	HKD'000
Current service cost	17,561	12,297
Interest on obligation	9,021	7,057
Expected return on plan assets	(10,443)	(9,503)
Actuarial losses recognised in the year	-	1,309
Past service cost	540	1,888
	16,679	13,048

HKAS 19(r2004). 120A(g)	The charge for the year is included in the employee benefits expense in the income statement. [Where analysis of expenditure in the income statement is by nature] OR Of the charge for the year, HKD12.832 million (2004:HK10.035 million) is included in cost of sales in the income statement and HKD3.847 million (2004: HKD3.013 million) is included in administrative expenses. [Where analysis of expenditure in the income statement is by function]
HKAS 19(r2004). 120A(m)	The actual return on plan assets was HKD10.32 million (2004: HKD9.7 million).
HKAS 19(r2004). 120A(c)	Changes in the present value of the defined benefit obligation are as follows:

	Year ended 31/12/05	Year ended 31/12/04
	HKD'000	HKD'000
Opening defined benefit obligation	177,395	169,541
Service cost	17,561	12,297
Interest cost	9,021	7,057
Actuarial losses	2,238	2,512
Obligation transferred on disposal of subsidiary	(4,932)	-
Obligation acquired on acquisition of a subsidiary	2,436	-
Exchange differences	138	(721)
Benefits paid	(23,345)	(13,291)
Closing defined benefit obligation	180,512	177,395

HKAS 19(r2004). 120A(e)	Changes in the fair value of plan assets are as follows:

	Year ended 31/12/05 HKD'000	Year Ended 31/12/04 HKD'000
Opening fair value of plan assets	118,828	108,095
Expected return	10,443	9,503
Actuarial gains	300	995
Contributions by employer	18,429	14,440
Exchange difference	438	(914)
Benefits paid	(23,345)	(13,291)
Closing fair value of plan assets	125,093	118,828

HKAS 19(r2004). 120A(j)	The fair value of plan assets at the balance sheet date is analysed as follows:

	31/12/05 HKD'000	31/12/04 HKD'000
Equity instruments	3,182	4,629
Debt instruments	34,096	38,735
Property	29,717	18,226
Other assets	58,098	57,238
	125,093	118,828

HKAS 19 (r2004).120A(k)	The plan assets do not include any of the Group's own financial instruments, nor any property occupied by, or other assets used by, the Group.
HKAS 19 (r2004).120A(I)	The expected rates of return on individual categories of plan assets are determined by reference to relevant indices published by the A Stock Exchange. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the plan's investment portfolio.

HKAS 19(r2004). 120A(p)	The history of the plan for the current and prior period is as follows:

	31/12/05 HKD'000	31/12/04 HKD'000
Present value of defined benefit obligation	180,512	177,395
Fair value of plan assets	(125,093)	(118,828)
Deficit	55,419	58,567
Experience adjustments on plan liabilities	1,862	784
Experience adjustments on plan assets	300	684

In accordance with the transitional provisions for the amendments to HKAS 19 *Employee Benefits* in December 2004, the disclosures above are determined prospectively from the 2004 reporting period.

HKAS 19(r2004). 120A(q)	The Group expects to contribute approximately HKD16 million to its defined benefit plan in 2006.

Compliance with IFRSs

There are no significant differences between HKAS 19 and IAS 19 *Employee Benefits*.

Future Developments

There are no significant developments currently in progress.

HKAS 21 The Effects of Changes in Foreign Exchange Rates (issued March 2004)

Objective

To prescribe the accounting treatment for an entity's foreign currency transactions and foreign operations.

Entities Most Likely to be Affected by Changes

Minor impact for all entities with foreign currency transactions or foreign operations.

Key Changes under HKAS 21

- Excludes from its scope foreign currency derivatives that are within the scope of HKAS 39 *Financial Instruments: Measurement and Recognition* and moves the hedging guidance to HKAS 39. The use of a foreign currency liability to hedge the net investment in a foreign entity is now under HKAS 39.
- Replaces the notion of "reporting currency" with "functional currency". Each entity should determine its own functional currency and each entity should have only one functional currency. Selection of the functional currency is not a free choice but is based on the underlying facts and circumstances, i.e. the primary economic environment in which the entity operates.
- There is no longer a distinction between integral foreign operations and foreign entities as the results and financial position of each individual entity included in the reporting entity shall be measured in its functional currency. The presumption is that entities which were previously categorised as integral foreign operations should have the same functional currency as the reporting entity.
- A change in functional currency is accounted for prospectively.
- A reporting entity can present its financial statements in any currency (or currencies). If the presentation currency is not the same as the functional currency, an entity translates its results and financial position from its functional currency into its presentation currency (or currencies).
- There are special rules for translating into a presentation currency the results and financial position of an entity whose functional currency is hyperinflationary.
- Requires goodwill and fair value adjustments arising on the acquisition of a foreign entity to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate. The old treatment as non-monetary items which are reported using the exchange rate at the date of the transaction is eliminated.
- Clarifies that when a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss is also recognised in equity.
- States that on the disposal of a foreign operation, the cumulative amount of exchange differences deferred in a separate component of equity relating to that foreign operation is recognised in profit or loss when the gain or loss on disposal is recognised.

Implications of Changes

There will be a minor impact for **all entities with foreign currency transactions or foreign operations**. HKAS 21 is more comprehensive than SSAP 11 *Foreign currency translation*, however the main change is a change in terminology, rather than in the overall approach.

Determining the correct functional currency is particularly significant for entities that regularly transact in numerous different currencies. To determine the **functional currency**, entities that are impacted by a number of different economic environments and currencies will need to apply judgement when applying the strict factors in HKAS 21. In a few cases applying HKAS 21 may lead to a change in functional currency, leading to significant adjustments to the financial statements.

If a Hong Kong entity has a foreign operation which records transactions in a currency other than its functional currency, there will be significant adjustments to make in order to **restate the financial statements** in the true functional currency for consolidation purposes. In the PRC, financial and accounting reports must be prepared in Renminbi (RMB). Therefore most entities record their transactions in RMB for ease of accounting, even if their transactions are mainly denominated in other currencies. For example, many trading companies in the PRC record their transactions in RMB, even though their functional currency would be determined to be US dollars under HKAS 21.

Each entity must determine its own functional currency. There is no such thing as a group functional currency and there may be a number of different functional currencies within a group. Entities cannot choose to have the same functional currency as their parent's for ease of reporting. However, the **group** financial statements can be presented in any currency.

Entities are no longer required to use the temporal method to **translate foreign operations**. Where any material foreign subsidiaries were previously classified as integral foreign operations, corrections may be required to either reclassify these subsidiaries as foreign entities, or change their functional currencies. In general most integral foreign operations will have the same functional currency as the parent, so limited amendments will be required.

Although the functional currency is fixed, and all transactions must first be recorded in this currency, entities can decide to present their financial statements in any currency they choose (**presentation currency**). This may benefit entities which would prefer to report in other currencies, e.g. wholly owned subsidiaries of foreign entities. In practice the free choice may be restricted by legislation.

An entity will not be able to avoid restatement under HKAS 29, *Financial Reporting in **Hyperinflationary Economies*** by, for example adopting a stable currency.

Goodwill and fair value adjustments arising on acquisitions must be translated at the closing rate at the year end. Where entities treated them as non-monetary items reported using the exchange rate at the date of the transaction, adjustments will be required, with a consequential impact on foreign currency translation reserves.

Summary of HKAS 21

Foreign currency transactions

First, an entity determines its functional currency (the currency of the primary economic environment in which the entity operates). Selection of the functional currency is not a free choice but is based on the underlying facts and circumstances.

The primary factors to consider are the currency that influences sales prices, the currency of the country whose competitive forces and regulations determine sales prices and the currency that influences labour and other costs of sales. The secondary factors are the currency in which the entity funds its activities and the currency in which receipts from operating activities are retained. There are additional secondary factors to consider for foreign operations.

All foreign currency items should be translated into the functional currency:

- At the date of transaction - using the transaction-date exchange rate for initial recognition and measurement.
- At subsequent balance sheet dates:
  - using the closing rate for monetary items;
  - using the transaction-date exchange rates for non-monetary items carried at historical cost; and
  - using the valuation-date exchange rates for non-monetary items that are carried at fair value.

Exchange differences arising on the settlement of monetary items and on the translation of monetary items at a rate which is different than when they were initially recognised are included in net profit or loss. One exception is when exchange differences arise on monetary items that form part of the reporting entity's net investment in a foreign operation. They are recognised in the consolidated financial statements that include the foreign operation in a separate component of equity and they will be recognised in profit or loss on disposal of the net investment.

Translation from functional currency to presentation currency

The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency (the currency in which the financial statements are presented) using the following procedures:

- assets and liabilities for each balance sheet presented (including comparatives) are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement presented (including comparatives) are translated at exchange rates at the dates of the transactions; and
- all resulting exchange differences are recognised as a separate component of equity.

Goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity are required to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.

There are special rules for translating into a presentation currency the results and financial position of an entity whose functional currency is hyperinflationary. If the functional currency is a currency of a hyperinflationary economy and the presentation currency is not, all prior year amounts are in the presentation currency, therefore, restatement is not required. If both the functional and presentation currencies are hyperinflationary, all amounts are translated at the closing rate of the most recent balance sheet date.

Disposal of a foreign operation

When a foreign operation is disposed of, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation are recognised in profit or loss when the gain or loss on disposal is recognised.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 21	SSAP 11 *Foreign currency translation*
Specific Deloitte publications	IAS 21 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 21 and IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Future Developments

There are no significant developments currently in progress.

HKAS 23 Borrowing Costs (issued December 2004)

Objective

To prescribe the accounting treatment for borrowing costs.

Entities Most Likely to be Affected by Changes

Entities which have "qualifying" assets.

Key Changes under HKAS 23

- Introduces a benchmark treatment that allows all borrowing costs to be expensed immediately, but continues to permit the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as an alternative treatment.

Implications of Changes

Entities can choose between:

- capitalising certain borrowing costs; and
- expensing all borrowing costs.

Under SSAP 19 *Borrowing costs* there was no choice and borrowing costs were required to capitalised where they related to qualifying assets. Therefore, only entities that have qualifying assets and that on adoption of HKAS 23 change their accounting policy so that they expense borrowing costs will be affected. The impact on the financial statements of changing to the **benchmark treatment** will be the immediate recognition of certain borrowing costs that were previously recognised over time as the qualifying asset was depreciated or impaired.

Summary of HKAS 23

Borrowing costs include interest, amortisation of discounts or premiums on borrowings, and amortisation of ancillary costs incurred in the arrangement of borrowings.

Two accounting models are allowed:

- ***Expense model***: Expense all borrowing costs when incurred.
- ***Capitalisation model***: Capitalise borrowing costs which are directly attributable to the acquisition or construction of a qualifying asset, but only when it is probable that these costs will result in future economic benefits to the entity, and the costs can be measured reliably. All other borrowing costs, those that do not satisfy the conditions for capitalisation, are to be expensed when incurred.

A qualifying asset is one that requires a substantial period of time to make it ready for its intended use or sale. Examples include manufacturing plants, investment properties, and some inventories.

If funds are borrowed generally and used for the purpose of obtaining the qualifying asset, HKAS 23 requires a capitalisation rate (weighted average of borrowing costs applicable to the general outstanding borrowings during the period) to be applied to expenditure incurred during the period, to determine the amount of borrowing costs eligible for capitalisation.

Disclosure includes the accounting policy adopted for borrowing costs.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 23	SSAP 19 *Borrowing costs*
Specific Deloitte publications	IAS 23 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 23 and IAS 23 *Borrowing Costs*.

Future Developments

There are no significant developments currently in progress.

HKAS 24 Related Party Disclosures (issued December 2004)

Objective

To ensure that the financial statements draw attention to the possibility that the financial position and results of operations may have been affected by the existence of related parties.

Entities Most Likely to be Affected by Changes

All entities with related parties (note - the new definition of a related parties is much broader).

Key Changes under HKAS 24

- Eliminates the following:
  - Exemption from specific disclosures granted by statute.
  - The exemption for a wholly-owned subsidiary from disclosing related party transactions.
- Requires the disclosure of related party relationships between parents and subsidiaries regardless of whether there have been any transactions between the related parties.
- Requires the disclosure of the compensation of key management personnel in aggregate by nature of compensation.
- Expands the definition of related parties to cover parties with joint control over the entity (i.e. the venturer), joint ventures in which the entity is a venturer (i.e. the joint venture) and post-employment benefit plans for the benefit of employees of an entity, or of an entity that is a related party to that entity.
- Clarifies the definition of close members of the family of an individual.
- Removes the requirement to disclose pricing of transactions and related disclosures between related parties, but requires disclosure of the following:
  - The amounts of transactions and outstanding balances with related parties, whether the balances are secured, and the nature of consideration to be provided in settlement. Disclosure of proportions of transactions and outstanding balances will no longer be sufficient.
  - Details of any guarantees given or received
  - Allowances for doubtful debts on amounts due from related parties
  - The settlement of liabilities on behalf of the entity or by the entity on behalf of a related party
  - The expense recognised during the period in respect of bad or doubtful debts due from related parties.
  - Classification of amounts payable to, and receivable from, related parties into different categories of related parties.
  - The name of the entity's parent and, if different, the ultimate controlling party. If neither produces financial statements available for public use, the name of the next most senior parent that does so is required.

Implications of Changes

Nearly all entities with related parties will be impacted by the **altered and increased disclosure requirements**. The new disclosure requirements will make the preparation of the financial statements more time consuming.

All entities must revisit their **list of related parties** to ensure all parties which are considered to be related under HKAS 24 have been identified. This process may require significant time and judgement.

Wholly-owned subsidiaries will need to provide related party disclosures for the first time making their financial statements more onerous.

Entities will no longer be able to rely on specific **exemptions from disclosure granted by statute**, for example certain loan agreements between the company and members of key management will no longer be exempt from disclosure using section 161B(5) of the Hong Kong Companies Ordinance.

HKAS 24 doesn't have an exemption for **state-controlled entities** from disclosure of transactions with other state-controlled entities. Due to the high proportion of state-owned entities in the PRC, this is currently a very big issue. At the moment no action has been taken by the HKICPA to respond to this and its impact is difficult to predict.

Some entities will find the changes will require them to disclose **sensitive** information, for example more disclosures are required in relation to transactions, events and balances with **specified directors and executives.**

Summary of HKAS 24

Definition

A party is related to an entity if

(a) directly, or indirectly through one or more intermediaries, the party:

   i. controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
   ii. has significant influence over the entity; or
   iii. has joint control over the entity;

(b) the party is an associate of the entity;

(c) the party is a joint venture in which the entity is a venturer;

(d) the party is a member of the key management personnel of the entity or its parent (Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity);

(e) the party is a close member of the family of any individual referred to in (a) or (d) (Close members of family are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

A related party transaction is a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged

Disclosure

Specified disclosures are required for:

- Relationships involving control, even when there have been no transactions between the entities.
- Related party transactions, made separately for different categories of related party.
- Compensation of key management, including nature of compensation.
- Examples of related party transactions that must be disclosed:
- Purchases or sales of goods.
- Purchases or sales of assets.
- Rendering or receiving of services.
- Leases.
- Transfers of research and development.
- Transfers under licence agreements.
- Transfers under finance arrangements (including loans and equity contributions).
- Provision of guarantees or collateral.
- Settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 24	SSAP 20 *Related party disclosures*
Specific Deloitte publications	IAS 24 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 24 and IAS 24 *Related Party Disclosures*.

Future Developments

There are no significant developments currently in progress.

HKAS 27 Consolidated and Separate Financial Statements (issued April 2004)

Objective

To prescribe the requirements for preparing and presenting consolidated financial statements for a group of entities under the control of a parent.

To prescribe how to account for investments in subsidiaries, jointly controlled entities, and associates in separate financial statements.

Entities Most Likely to be Affected by Changes

Entities with subsidiaries

Entities with jointly controlled entities and associates which produce separate financial statements.

Key Changes under HKAS 27

- The Standard now applies to the accounting for investments in jointly controlled entities and associates in the separate financial statements.
- Clarifies that a subsidiary should not be excluded from consolidation simply because the entity is a venture capital organisation, mutual fund, unit trust or similar entity.
- Removes the requirement for a parent to exclude from consolidation an entity that is operating under severe long-term restrictions that significantly impair its ability to transfer funds to the parent. This condition may, however, evidence a loss of control by the parent over the entity.
- Removes the requirement for a parent to exclude from consolidation an entity under temporary control. A parent should account for such investments in subsidiaries as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*
- Revises the criteria to exempt a parent from presenting consolidated financial statements as follows:
  - the parent itself is a wholly-owned or partially-owned subsidiary (with permission from owners other than its parent);
  - the parent's debt or equity instruments are not publicly traded;
  - the parent is not in the process of a public filing for issue of such instruments; and
  - the ultimate or intermediate parent produces HKFRS or IFRS consolidated financial statements.
- Transfers the specific guidance on the consolidation of special purpose entities to HK (SIC) -Int 12 *Consolidation - Special Purpose Entities.*
- Requires consideration of the existence and effect of potential voting rights that are currently exercisable or convertible when assessing whether an entity has the power to govern the financial and operating policies of another entity. This requirement was previously included in Interpretation 18 *Consolidation and equity method – Potential voting rights and allocation of ownership interests.*

- Removes the exemption where it is “not practicable to use uniform accounting policies” for reporting like transactions and other events in similar circumstances.
- Requires the presentation of minority interests in the consolidated balance sheet within equity, separately from the parent shareholders’ equity.
- Prescribes the accounting treatment for investment in subsidiaries, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements. It requires these investments, which are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 to be accounted for at cost or in accordance with HKAS 39 *Financial Instruments: Measurement and Recognition*. Investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) should be accounted for in accordance with HKFRS 5.

Implications of Changes

The enforcement of the requirement to use **uniform accounting policies** may require certain entities, which have taken the practicability exemption in the past, to produce additional information which may demand significant cost or effort.

If there are any subsidiaries that are reporting under **severe long term restrictions** that have not been consolidated**,** but where control has not been lost, adjustments will be required to the financial statements to consolidate them.

If there are any subsidiaries that are not consolidated due to being under **temporary control**, adjustments will be required to the financial statements to consolidate them, unless they are **held for sale** in accordance with HKFRS 5. In the latter case adjustments will be required for the new IFRS 5 measurement requirements (see discussion for HKFRS 5).

Under the new requirements certain partially-owned subsidiaries may be **exempt from preparing consolidated financial statements**, if specific criteria are met. SSAP 32 *Consolidated financial statements and accounting for investments in subsidiaries* only has an exemption for wholly-owned subsidiaries. HKAS 27 also introduces stricter criteria for wholly-owned subsidiaries to be exempt from producing consolidating financial statements, so that such entities currently using the SSAP 32 exemption will need to ensure they are still eligible.

Under HKAS 27, in order for a parent to be exempt from presenting consolidated financial statements an ultimate or intermediate parent must produce **HKFRS or IFRS consolidated financial statements** (e.g. US GAAP consolidated financial statement would not qualify). Under SSAP 32, a wholly-owned parent was exempt regardless of the GAAP used to prepare the ultimate or intermediate parent’s consolidated financial statements (e.g. US GAAP, UK GAAP etc. could be used etc).

Summary of HKAS 27

Control

A subsidiary is an entity controlled by another entity, known as the parent. Control is the power to govern the operating and financial policies. Control is presumed to exist when the parent acquires more than half of the voting rights of an entity. Even when more than one half of the voting rights are not acquired, control may be evidenced by power:

- over more than one half of the voting rights by virtue of an agreement with other investors; or
- to govern the financial and operating policies of the other entity 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.

Consolidated financial statements

Consolidated financial statements are financial statements of a group (parent and subsidiaries) presented as those of a single economic entity. They must include all subsidiaries.

A parent is required to present consolidated financial statements in which it consolidates its investments in subsidiaries, except in one circumstance (see Key Changes under HKAS 27).

The financial statements of the parent and its subsidiaries used in preparing the consolidated financial statements should all be prepared as of the same reporting date, unless impracticable and the reporting dates of subsidiaries can never be more than three months different from the group reporting date.

In preparing consolidated financial statements intragroup balances, transactions, income, and expenses should be eliminated in full and they must be prepared using uniform accounting policies. Intragroup losses may indicate that an impairment loss on the related asset should be recognised.

Minority interest

Minority interest is reported in equity in the balance sheet and is not deducted in measuring the group's profit or loss. However, group profit or loss is allocated between the minority interest and the parent's shareholders on the face of the income statement. 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.

Separate financial statements

Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees (e.g. those financial statements prepared in addition to consolidated financial statements or in addition to financial statements where an entity is equity accounted for/ or proportionate consolidated).

The financial statements of an entity that does not have a subsidiary, associate or venturer's interest in a jointly controlled entity are not separate financial statements.

In the parent's/investor's separate financial statements, investments in subsidiaries, associates, and jointly controlled entities should be accounted for either at cost, or in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) - Int 12 *Consolidation – Special Purpose Entities*
Existing pronouncements replaced by HKAS 27	SSAP 32 *Consolidated financial statements and accounting for investments in subsidiaries* Interpretation 18 *Consolidation and equity method – Potential voting rights and allocation of ownership interests.*
Specific Deloitte publications	IAS 27 e-learning module

Compliance with IFRSs

HKAS 27 contains additional paragraphs (21A, 21B and 42A) to reflect the requirements of the Hong Kong Companies Ordinance, i.e. a company incorporated under the Hong Kong Companies Ordinance does not consolidate a subsidiary failing to meet the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance. This additional requirement is not consistent with IAS 27 *Consolidated and Separate Financial Statements*. The HKICPA requires disclosures of what the effect would have been if these entities were consolidated.

The Companies Ordinance will be amended to bring the definition of a subsidiary in line with IFRSs, removing the difference between HKAS 27 and IAS 27.

There are no other significant differences between HKAS 27 and IAS 27.

Future Developments

There is a current IASB agenda project which addresses both the basis on which a parent entity should consolidate its investments in subsidiaries, and the procedures for consolidation. It will provide more rigorous guidance around the concept of "control", which is the basis for consolidation under IAS 27.

There are no specific requirements in IFRSs that address accounting for investments by venture capital organisations, mutual funds, unit trusts, and similar entities that hold investments in a fiduciary capacity. As a result, depending on whether an entity has control, joint control, or significant influence over an investee, IAS 27, 28 or 31 are applied as usual. IFRIC is considering whether the resulting presentations are the most appropriate and other related issues.

HKAS 28 Investments in Associates (issued April 2004)

Objective

To prescribe the investor's accounting for investments in associates.

Entities Most Likely to be Affected by Changes

Entities with associates.

Key Changes under HKAS 28

- Excludes from the scope of the Standard any investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds, when those investments are classified as held for trading or designated as at fair value through profit or loss and accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.
- Requires consideration of the existence and effect of potential voting rights that are currently exercisable or convertible when assessing whether an entity has the power to participate in the financial and operating policies decisions of the investee. This requirement was previously included in Interpretation 18 *Consolidation and equity method – Potential voting rights and allocation of ownership interests.*
- Requires that in the financial statements of the investor (that are not separate financial statements), an investment in an associate must be accounted for using the equity method, irrespective of whether the investor also has investments in subsidiaries and prepares consolidated financial statements, unless:
  - the investor is a parent and is exempt from preparing consolidated financial statements under the exemption available in HKAS 27 *Consolidated and Separate Financial Statements*; or
  - if it were a parent, would be exempt in the same circumstances as set out in HKAS 27; or
  - the investment is classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- Requires that in the separate financial statements, investments in associates should be accounted for at cost or in accordance with HKAS 39. However, if the investments are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5, the investments should be accounted for by applying HKFRS 5.
- Requires that when the financial statements of an associate used in applying the equity method are prepared as of a reporting date that is different from that of the investor, the difference must be no greater than three months. Adjustments must be made for the effects of significant transaction or events that occur between that date and the date of the investor's financial statements. Also, the difference in reporting dates should be consistent from period to period.
- Eliminates the exemption from applying the equity method when an associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor. This condition may, however, evidence a lack of significant influence over the entity.
- Removes the exemption where it is "not practicable to use uniform accounting policies" for reporting like transactions and other events in similar circumstances.

Implications of Changes

Any venture capital organisations, mutual funds, unit trusts and similar entities which meet the **scope exclusion** will need to make adjustments to recognise their investments in associates at fair value.

The enforcement of the requirement to use **uniform accounting policies** may require certain entities, which have taken the practicability exemption in the past, to produce additional information which may demand significant cost or effort.

If there are any associates that are reporting under **severe long term restrictions** and have not been equity accounted for, but where significant influence has not been lost, adjustments will be required to the financial statements for restatement using the equity method.

If there are any associates that are not equity accounted as they are under **temporary control**, adjustments will be required to the financial statements to equity account for them, unless they are considered to be **held for sale** in accordance with HKFRS 5. In the later case adjustments will be required for the new HKFRS 5 measurement requirements (see discussion for HKFRS 5).

The difference between the **reporting date** of an associate and that of the group should be no more than three months. If there are associates with reporting dates outside the three month threshold, new reporting arrangements will be required and conversion adjustments must be made to align the reporting dates of the associates with the group. Depending on the investor's relationship with the specific associate, the investor may request that audited financial statements be prepared at an appropriate date.

Summary of HKAS 28

Scope

HKAS 28 applies to all investments in which an investor has significant influence, unless the investor is a venture capital firm, mutual fund, or unit trust, in which case HKAS 39 *Financial Instruments: Recognition and Measurement* must be followed in certain circumstances.

Significant influence

An investor must use the equity method for all investments in associates. An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions but not control them. There is a rebuttable presumption that significant influence exists if the investor holds, directly and indirectly, more than 20% of the investee.

The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

- Representation on the board of directors or equivalent governing body of the investee
- Participation in the policy-making process
- Material transactions between the investor and the investee
- Interchange of managerial personnel
- Provision of essential technical information

HKAS 28 gives some exceptional circumstances when the equity method is not required, which are similar to the exemptions explained for HKAS 27 *Consolidated and Separate Financial Statements*.

Equity method

Under the equity method, the investment is initially recorded at cost. It is subsequently adjusted by the investor's share of the investee's post acquisition change in net assets. The investor's income statement reflects its share of the investee's post-acquisition profit or loss. Distributions received from the investee reduce the carrying amount of the investment.

If an associate is accounted for using the equity method, unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions should be eliminated to the extent of the investor's interest in the associate. However, unrealised losses should not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred. The associate's accounting policies must be the same as those of the investor and the difference between the reporting date of the associate and that of the investor cannot be longer than three months.

If an investor's share of losses of an associate equals or exceeds its "interest in the associate", the investor discontinues recognising its share of further losses. The "interest in an associate" is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate.

Individual financial statements

Equity accounting is required in the individual financial statements of the investor even if consolidated financial statements are not required, for example, because the investor has no subsidiaries. However, the investor does not apply the equity method when presenting separate financial statements that are prepared in accordance with HKAS 27. Instead, the investor accounts for the investment either at cost or as investments under HKAS 39.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 28	SSAP 10 *Accounting for investments in associates* Interpretation 18 *Consolidation and equity method – Potential voting rights and allocation of ownership interests.*
Specific Deloitte publications	IAS 28 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 28 and IAS 28 *Investment in Associates*.

Future Developments

There are no significant developments currently in progress.

HKAS 29 Financial Reporting in Hyperinflationary Economies (issued March 2004)

Objective

To prescribe specific Standards for entities reporting in the currency of a hyperinflationary economy, so that the financial information provided is meaningful.

Entities Most Likely to be Affected by Changes

Entities with overseas operations in countries considered to be experiencing hyperinflation.

Key Changes under HKAS 29

- This is the first accounting Standard on reporting in hyperinflationary economies in Hong Kong**.**

Implications of Changes

Although not directly applicable for Hong Kong operations, this Standard will impact Hong Kong reporting entities with **overseas operations** in countries considered to be experiencing hyperinflation. If any entities are identified, the process of restating their financial statements is complex and time consuming and may require the entities to access historical records evidencing the purchase of assets (which can prove difficult).

The following countries may be hyperinflationary. This list does not intend to be exhaustive:

Angola

Belarus

Democratic Republic of Congo

Dominican Republic

Equatorial Guinea

Turkey

Uzbekistan

Zimbabwe

In practice, the number of countries falling within the scope of HKAS 29 will be very few. Whether or not a country is to be considered as **experiencing hyperinflation** for the purposes of HKAS 29 will be determined by a consensus of the accounting profession rather than by each entity individually.

Summary of HKAS 29

Background

The premise underlying HKAS 29 is that, since money rapidly loses its purchasing power in a hyperinflationary economy, to report an entity's operating results and financial position in the currency of that economy without restatement would be meaningless to a user of the accounts. Comparative information would have no value, and even the profits of a single financial period would be distorted. For example, the cost at which inventory is acquired and the price at which it is sold do not only reflect a normal trading profit margin, but also include a price change which is beyond the control of the entity.

Restatement of financial statements

HKAS 29 requires the financial statements of an entity that reports in the currency of a hyperinflationary economy to be stated in terms of the measuring unit current at the balance sheet date. Comparative figures for prior period(s) should be restated into the same current measuring unit.

The application of a general price index is required for such restatement. Items such as monetary items that are already stated at the measuring unit at the balance sheet date are not restated. Other items are restated based on the change in the general price index between the date those items were acquired or incurred and the balance sheet date.

The gain or loss on the net monetary position should be included in net income and separately disclosed.

Characteristics of the environment

HKAS 29 does not establish an absolute inflation rate at which hyperinflation is deemed to exist, but allows judgement as to when restatement of financial statements becomes necessary. Characteristics of the economic environment of a country which may indicate the existence of hyperinflation include the following:

- The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.
- The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.
- Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.
- The cumulative inflation rate over three years approaches, or exceeds, 100%.

HKAS 29 describes characteristics that may indicate that an economy is hyperinflationary. However, it concludes that it is a matter of judgement when restatement of financial statements becomes necessary.

Cessation of hyperinflation

When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements in accordance with HKAS 29, it should treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 29	None
Specific Deloitte publications	IAS 29 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 29 and IAS 29 *Financial Reporting in Hyperinflationary Economies.*

Future Developments

There are no significant developments currently in progress.

HKAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions (issued December 2004)

Objective

To prescribe appropriate presentation and disclosure Standards for banks and similar financial institutions, as a supplement to the requirements of other HKFRSs.

Entities Most Likely to be Affected by Changes

Banks and similar financial institutions.

If entities are regulated by Hong Kong's banking legislation, this will generally indicate that they fall within the scope of this Standard.

Key Changes under HKAS 30

- This is the first accounting Standard on disclosures for banks and other financial institutions in Hong Kong.

Implications of Changes

HKAS 30 will introduce more **comprehensive disclosures** for entities engaged in the business of taking and investing deposits. The intention is to provide users with appropriate information to assist them in evaluating the financial position and performance of banks and to enable them to obtain a better understanding of the special characteristics of the operations of banks.

Previously requirements in Hong Kong have been established by the Hong Kong Monetary Authority and other regulatory bodies.

Summary of HKAS 30

HKAS 30 applies to banks and similar financial institutions (hereafter called 'banks') and supplements the requirements of other Standards.

A bank is required to group income and expenses by nature in the income statement and should report the following specific amounts in the income statement or notes:

- interest income
- interest expense

- dividend income
- fee and commission income
- fee and commission expense
- net gains/losses from securities dealing
- net gains/losses from investment securities
- net gains/losses from foreign currency dealing
- other operating income
- loan losses
- general administrative expenses
- other operating expenses.

HKAS 30 sets out specific line items to be included in a bank's balance sheet and requires a bank to group assets and liabilities by nature and list them in liquidity sequence.

Guidelines are provided for the limited circumstances in which income and expense items or asset and liability items may be offset.

A bank must disclose the fair values of each class of its financial assets and financial liabilities as required by HKAS 32 *Financial Instruments: Disclosure and Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement*.

Disclosure is required of the following:

- specific contingencies and commitments (including off-balance sheet items) requiring disclosure
- the maturities of assets and liabilities
- concentrations of assets, liabilities and off-balance sheet items
- losses on loans and advances
- general banking risks
- assets pledged as security.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 30	None

Compliance with IFRSs

There are no significant differences between HKAS 30 and IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

Future Developments

There is a current project to improve and enhance the disclosures in IAS 30. An Exposure Draft (E7) was released proposing to add certain new disclosures about financial instruments to those currently required by IAS 32 *Financial Instruments: Disclosure and Presentation*, replace the disclosures now required by IAS 30 and put all of the financial instrument disclosures together in a new Standard, expected to be released in June 2005. As part of these future changes several of the disclosures outlined above will become applicable to entities other than financial institutions. The new Standard will be effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged.

HKAS 31 Interests in Joint Ventures (issued December 2004)

Objective

To prescribe the accounting treatment required for interests in joint ventures, regardless of the structure or legal form of the joint venture activities.

Entities Most Likely to be Affected by Changes

Entities with jointly controlled entities.

Key Changes under HKAS 31

- Allows a venturer to recognise its interest in a jointly controlled entity using either proportionate consolidation or the equity method.
- Excludes from the scope of the Standard any interests in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds when those investments are classified as held for trading or designated as at fair value through profit or loss and accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.
- Clarifies the definition of "joint control" such that this exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).
- Requires that in the group financial statements of the investor, an investment in a jointly controlled entity must be accounted for using proportionate consolidation or the equity method, irrespective of whether the investor also has investments in subsidiaries and prepares consolidated financial statements, unless:
  - the investor is a parent and is exempt from preparing consolidated financial statements under the exemption available in HKAS 27 *Consolidated and Separate Financial Statements*;
  - if it were a parent, would be exempt in the same circumstances as set out in HKAS 27; or
  - the investment is classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- Requires an investor to account for its interests in jointly controlled entities that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5, to account for those interests in accordance with HKFRS 5, rather than using the proportionate consolidation or equity methods.
- In the venturer's separate financial statements, interests in jointly controlled entities are accounted for at cost or in accordance with HKAS 39. However, those interests that are classified as held for sale (or included in a disposal group that is classified as held for sale) should be accounted for in accordance with HKFRS 5.

Implications of Changes

Venture capital organisations, mutual funds, unit trusts and similar entities which meet the **scope exclusion** will need to make adjustments to recognise their investments in jointly controlled entities at fair value.

Investments in joint ventures may have to be re-evaluated to identify whether "joint control" still exists under the **revised definition**.

Entities will need to decide whether to continue to use the equity method to account for jointly controlled entities, or use **proportionate consolidation**. If it is considered that the proportionate consolidation method of accounting provides more relevant information than the equity method, a change to this new method should be considered. If an entity changes to proportionate consolidation, this will significantly affect the way that the jointly controlled entities are presented in the financial statements. An entity using proportionate consolidation will also need to decide whether it combines its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items, line by line, in the consolidated financial statements or whether it includes separate line items for them.

If a venturer chooses to change its accounting policy and account for jointly controlled entities using proportionate consolidation, rather than using the equity method, the presentation of its **cash flow statement** will also change. This is because the venturer must show the proportionate share of the jointly controlled entity's cash flows on a line-by-line basis.

If there are any jointly controlled entities that are reporting under **severe long term restrictions** that have not previously been accounted for using the equity method**,** but where joint control has not been lost, adjustments will be required to the financial statements.

If there are any jointly controlled entities that are not equity accounted for as they are under **temporary control**, adjustments will be required to the financial statements to equity account for/proportionately consolidate them, unless they are considered to be **held for sale** in accordance with HKFRS 5. In the later case adjustments will be required for the new HKFRS measurement requirements (see discussion for HKFRS 5).

Summary of HKAS 31

Scope

HKAS 31 applies to all investments in which an investor has joint control unless the investor is a venture capital firm, mutual fund, or unit trust, in which case HKAS 39 *Financial Instruments: Recognition and Measurement*, must be followed. Joint control is the contractually agreed sharing of control over an economic activity such that no individual contracting party has control.

The key characteristic of a joint venture is a contractual arrangement to share control. Joint ventures may be classified as jointly controlled operations, jointly controlled assets, or jointly controlled entities. There are different recognition principles for each type of joint venture.

Jointly controlled operations

Jointly controlled operations involve the use of assets and other resources of the venturers rather than the establishment of a separate entity. Each venturer uses its own assets, incurs its own expenses and liabilities, and raises its own finance.

A venturer recognises the assets it controls, and expenses and liabilities it incurs, and its share of income earned, in both its separate and consolidated financial statements.

Jointly controlled assets:

Jointly controlled assets involve the joint control, and often the joint ownership, of assets dedicated to the joint venture. Each venturer may take a share of the output from the assets and each bears a share of the expenses incurred

A venturer recognises its share of the joint assets, any liabilities that it has incurred directly and its share of any liabilities incurred jointly with the other venturers, income from the sale or use of its share of the output of the joint venture, its share of expenses incurred by the joint venture and expenses incurred directly in respect of its interest in the joint venture.

Jointly controlled entities

A jointly controlled entity is a corporation, partnership, or other entity in which two or more venturers have an interest, under a contractual arrangement that establishes joint control over the entity.

Two accounting policy choices are permitted:

- Proportionate consolidation. Under this method the venturer's balance sheet includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. Its income statement includes its share of the income and expenses of the jointly controlled entity. An entity may either
  - combine its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items, line by line, in the consolidated financial statements; or
  - include separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in the consolidated financial statements
- Equity method. As described in HKAS 28 *Investments in Associates*.

HKAS 31 gives some exceptional circumstances when proportionate consolidation and the equity method are not required, which are similar to the exemption in HKAS 27 *Consolidated and Separate Financial Statements.*

If a venturer contributes or sells an asset to a jointly controlled entity it should recognise only the proportion of the gain attributable to the other venturers. The venturer should recognise the full amount of any loss incurred when it is indicative of a permanent decline in value.

When a venturer purchases assets from a jointly controlled entity, it should not recognise its share of the gain until it resells the asset to an independent party. Losses should be recognised if they are indicative of a permanent decline in value.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) – Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* (previously Interpretation 6)
Existing pronouncements replaced by HKAS 31	SSAP 21 *Accounting for interests in joint ventures* Interpretation 6 *Jointly controlled entities – Non- monetary contributions by venturers*
Specific Deloitte publications	IAS 31 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 31 and IAS 31 *Interests in Joint Ventures*.

Future Developments

There is a current IASB project which is considering removing the ability to choose between two methods of accounting for jointly controlled entities.

There is also a longer term research project on the accounting for interests in joint venture arrangements.

HKAS 33 Earnings per Share (issued March 2004)

Objective

To prescribe the principles for determining and presenting earnings per share (EPS) amounts in order to improve performance comparisons between different entities in the same period and between different accounting periods for the same entity.

The focus of HKAS 33 is on the denominator of the EPS calculation.

Entities Most Likely to be Affected by Changes

Entities whose securities are publicly traded or that are issuing securities to the public.

Entities that voluntarily present EPS information.

Key Changes under HKAS 33

- Provides additional guidance and illustrative examples on selected complex matters, such as the effects of contingently issuable shares, potential ordinary shares of subsidiaries, joint ventures or associates, participating equity instruments, written put options, purchased put and call options and mandatorily convertible instruments.
- Requires disclosure of the basic and diluted EPS amounts for profit or loss from continuing operations and those for discontinued operations.
- Prohibits the disclosure of earnings per share amounts based on separate unconsolidated results within the consolidated financial statements.

Implications of Changes

Although the approach to determining the EPS amounts has not been changed, the **additional guidance** in HKAS 33 may lead to changes in the figures due to the previous lack of guidance in SSAP 5 *Earnings per share.* Entities will need to reassess their calculations to ensure compliance with the new guidance.

Where entities have **discontinued operations**, they will need to calculate additional basic and diluted EPS amounts for profit or loss from continuing operations and those for the discontinued operations.

Summary of HKAS 33

Scope

HKAS 33 applies to entities whose securities are publicly traded or that are in the process of issuing securities to the public. Other entities that choose to present EPS information must also comply with HKAS 33.

Requirement to present EPS

An entity must present, on the face of the income statement, basic and diluted earnings per share for:

- profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity; and
- profit or loss attributable to the ordinary equity holders of the parent entity.

Basic and diluted EPS must be presented, on the face of the income statement:

- for each class of ordinary shares,
- with equal prominence, and
- for all periods presented.

Basic and diluted EPS must be presented even if the amounts are negative (that is, a loss per share).

In consolidated financial statements, EPS reflects earnings attributable to the parent's shareholders.

If an entity reports a discontinued operation, basic and diluted amounts per share must be disclosed for the discontinued operation either on the face of the income statement or in the notes.

Basic EPS calculation:

- Earnings numerator: Profit or loss attributable to ordinary equity holders of the parent entity (after deduction of all expenses, including tax and preference dividends).
- Denominator: Weighted average number of shares outstanding during the period.

Diluted EPS calculation:

- Earnings numerator: Net profit for the period attributable to ordinary shares is increased by the after-tax amount of dividends and interest recognised in the period in respect of the dilutive potential ordinary shares (e.g. options, warrants, convertible securities, and contingent insurance agreements) and adjusted for any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.
- Denominator: Should be adjusted for the number of shares that would be issued on the conversion of all of the dilutive potential ordinary shares into ordinary shares.
- Anti-dilutive potential ordinary shares are excluded from the calculation.

Dilution is a reduction in EPS or an increase in loss per share on the assumption that convertible instruments are converted, that options or warrants are exercised or that ordinary shares are issued, when specified conditions are met.

Antidilution in an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 33	SSAP 5 *Earnings per share* Interpretation 10 *Earnings per share - Financial instruments and other contracts that may be settled in shares*
Specific Deloitte publications	IAS 33 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 33 and IAS 33 *Earnings per Share*.

Future Developments

There are no significant developments currently in progress.

HK (IFRIC) – Int 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities (effective 1 September 2004)

Summary

HK (IFRIC) – Int 1 contains guidance on accounting for changes in decommissioning, restoration and similar liabilities that have previously been recognised both as part of the cost of an item of property, plant and equipment and as a provision (liability). An example would be a liability that was recognised by the operator of a nuclear power plant for costs that it expects to incur in the future when the plant is shut down (decommissioned).

The Interpretation deals with three kinds of change in an existing liability for such costs. The two main kinds of change are those that arise from:

- the revision of estimated outflows of resources embodying economic benefits (e.g. the estimated costs of decommissioning a nuclear power plant may vary significantly both in timing and amount); and
- revisions to the current market-based discount rate.

Where entities account for their property, plant and equipment using the cost model, changes are required to be capitalised as part of the cost of the item and depreciated prospectively over the remaining life of the item to which they relate.

Where entities account for their property, plant and equipment using the fair value model, a change in the liability does not affect the valuation of the item for accounting purposes. Instead, it alters the revaluation surplus or deficit on the item, which is the difference between its valuation and what would be its carrying amount under the cost model. Any cumulative deficit is taken to profit or loss, but any cumulative surplus is credited to equity.

The third kind of change dealt with by the Interpretation is an increase in the liability that reflects the passage of time, also referred to as the unwinding of the discount. This is recognised in profit or loss as a finance cost as it occurs.

Impact on Entities

Entities will need to identify what decommissioning, restoration and similar liabilities exist in relation to property, plant and equipment. The requirements for capitalisation of these liabilities are quite complex and judgement must be applied, for example, when a long time-frame is involved.

HK (IFRIC) – Int 4 Determining whether an Arrangement contains a Lease (effective 1 January 2006)

Summary

In recent years arrangements have developed that do not take the legal form of a lease but which convey rights to use assets in return for a payment or series of payments (e.g. outsourcing arrangements).

HK (IFRIC) – Int 4 specifies that an arrangement that meets the following criteria is, or contains, a lease that should be accounted for in accordance with HKAS 17 *Leases*:

- The fulfilment of the arrangement depends upon a specific asset (either explicitly or implicitly identified in the arrangement).
- The arrangement conveys a right to control the use of the underlying asset. HK (IFRIC) – Int 4 provides further guidance to identify when this situation exists.

Impact on Entities

Entities with arrangements that do not take the legal form of a lease, but which convey rights to use assets in return for payments, will need to consider the new guidance and apply judgement to determine whether such arrangements are, or contain, leases.

HK – Int 1 The Appropriate Accounting Policies for Infrastructure Facilities (effective 1 October 2004)

Summary

This Interpretation applies to the allocation of cost of infrastructure facilities, regardless of whether the related asset is classified as property plant and equipment, an intangible asset or operating lease prepayments. It concludes that the sinking fund method is not an appropriate method of depreciating or amortising such infrastructure assets.

Impact on Entities

This Interpretation mainly impacts infrastructure projects such as toll roads and tunnels where the government allows a company to build and operate the asset for a number of years before handing it back to the government. In addition, Draft Interpretations have recently been issued by the IFRIC which focus specifically on the accounting model to be followed with respect to service concession. Entities with service concession arrangements will also need to also consider the future impact of these Interpretations on their financial reporting.

HKFRSs having a minor impact

The Standards and Interpretations within this section are:

- HKAS 2 Inventories
- HKAS 10 Events After the Balance Sheet Date
- HKAS 11 Construction Contracts
- HKAS 12 Income Taxes
- HKAS 14 Segment Reporting
- HKAS 18 Revenue
- HKAS 20 Accounting for Government Grants and Disclosure of Government Assistance
- HKAS 26 Accounting and Reporting by Retirement Benefit Plans
- HKAS 34 Interim Financial Reporting
- HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- HKAS 41 Agriculture
- HK (IFRIC) – Int 2 Members' Shares in Co-Operative Entities and Similar Instruments
- HK (IFRIC) – Int 3 Emission Rights
- HK (IFRIC) – Int 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- HK (SIC) – Int 10 Government Assistance - No Specific Relation to Operating Activities
- HK (SIC) – Int 12 Consolidation - Special Purpose Entities
- HK (SIC) – Int 13 Jointly Controlled Entities - Non-Monetary Contributions by Venturers
- HK (SIC) – Int 15 Operating leases - Incentives
- HK (SIC) – Int 21 Income Taxes - Recovery of Revalued Non-Depreciable Assets
- HK (SIC) – Int 25 Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders
- HK (SIC) – Int 27 Evaluating the Substance of Transactions in the Legal Form of a Lease
- HK (SIC) – Int 29 Disclosure – Service Concession Arrangements
- HK (SIC) – Int 31 Revenue – Barter Transactions Involving Advertising Services
- HK (SIC) – Int 32 Intangible Assets – Website Costs

This section gives an overview of the Standards and Interpretations that are only expected to have a minor impact on Hong Kong entities, in general, as no significant changes have been made to the previous SSAPs and Interpretations on converting them into HKASs and HK (SIC) – Ints.

HKAS 34 is one of the Standards included in the minor impact section as there are no significant changes introduced by it alone. However, as interim statements must be drawn up on the basis of the accounting policies that will be applied in the next annual accounts, the interim financial statements will be the first set of financial statements to reflect all the changes from the other accounting Standards.

HKAS 2 Inventories (issued March 2004)

Objective

To prescribe the accounting treatment for inventories, including cost determination and expense recognition.

Entities Most Likely to be Affected by Changes

Commodity brokers and traders and producers of agricultural, forest products and mineral and mineral products.

Key Changes under HKAS 2

- Clarifies the scope such that some types of inventories are outside its scope while certain inventories are exempted only from the measurement requirements.
- New exemption for the following items:
  - Agricultural and forest products after harvest, and minerals/mineral products provided the inventories are measured at net realisable value in accordance with well-established practices in those industries
  - Commodity broker-traders, provided the inventories are measured at fair value less costs to sell.
- Clarifies that when inventories are purchased with deferred settlement terms, the difference between the purchase price for normal credit terms and the amount paid shall be recognised as an interest expense over the period of financing.
- Eliminates the reference to the matching principle and limits the circumstances resulting in a reversal of a write-down of inventories recognised in a prior period.
- Eliminates the requirement to disclose the amount of inventories carried at net realisable value.
- Introduces new disclosure requirements for inventories carried at fair value less cost to sell and the amount of any write-down of inventories recognised as an expense in the period.

Implications of Changes

Commodity brokers and traders may measure inventories at fair value less costs to sell even though these amounts may be higher than original cost.

Producers of agricultural, forest products and minerals and mineral products may measure inventories at net realisable value even if this amount is greater than cost.

Summary of HKAS 2

Scope

HKAS 2 excludes the following inventories from its scope:

- Work in process arising under construction contracts (see HKAS 11 *Construction Contracts*)
- Financial instruments (see HKAS 32/HKAS 39 *Financial Instruments*)
- Biological assets related to agricultural activity and agricultural produce at the point of harvest (see HKAS 41 *Agriculture*)

Also HKAS 2 does not apply to the measurement of inventories held by the following types of entities (although they are still within the scope of the Standard):

- Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that inventories are measured at net realisable value (above or below cost) in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.
- Commodity brokers and dealers who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Measurement

Inventories are required to be stated at the lower of cost and net realisable value. Cost includes purchase cost, conversion cost (materials, labour, and overhead), and other costs to bring inventory to its present location and condition. Cost does not include abnormal waste, storage costs, administrative overheads unrelated to production, selling costs, foreign exchange differences and interest cost when inventories are purchased with deferred settlement terms.

For inventory items that are not interchangeable, specific costs are attributed to the specific individual items of inventory. For interchangeable items, cost is determined on either a FIFO or weighted average basis. LIFO is not permitted. The same cost formula should be used for all inventories with similar characteristics as to their nature and use to the entity. For groups of inventories that have different characteristics, different cost formulas may be justified.

When inventories are sold, the carrying amount should be recognised as an expense in the period in which the related revenue is recognised.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 2	SSAP 22 *Inventories*
Specific Deloitte publications	IAS 2 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 2 and IAS 2 *Inventories*.

Future Developments

There are no significant developments currently in progress.

HKAS 10 Events After the Balance Sheet Date (issued March 2004)

Objective

To prescribe when an entity should adjust its financial statements for events after the balance sheet date.

To prescribe the disclosures about the date when the financial statements were authorised for issue and about events after the balance sheet date.

Key Changes under HKAS 10

- There are no significant changes.

Summary of HKAS 10

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue.

Adjusting event

An adjusting event is an event after the balance sheet date that provides further evidence of conditions that existed at the balance sheet date (e.g. the resolution of a court case after the balance sheet date), including an event that indicates that the going concern assumption in relation to the whole, or part, of the entity is not appropriate. An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the balance sheet date.

Non–adjusting event

A non-adjusting event is an event after the balance sheet date that is indicative of a condition that arose after the balance sheet date (e.g., a decline in market prices after the year end, which does not change the valuation of investments at the balance sheet date). An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the balance sheet date. Non-adjusting 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.

Dividends proposed or declared on equity instruments after the balance sheet date should not be recognised as a liability at the balance sheet date. Disclosure is required.

An entity should not prepare its financial statements on a going concern basis if events after the balance sheet date indicate that the going concern assumption is not appropriate.

An entity must disclose the date its financial statements are authorised for issue.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 10	SSAP 9 *Events after the balance sheet date*
Specific Deloitte publications	IAS 10 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 10 and IAS 10 *Events After the Balance Sheet Date*.

Future Developments

There are no significant developments currently in progress.

HKAS 11 Construction Contracts (issued October 2004)

Objective

To prescribe the accounting treatment for revenue and costs associated with construction contracts in the financial statements of the contractor.

Key Changes under HKAS 11
• There are no significant changes.

Summary of HKAS 11

Contract revenue should comprise the amount agreed in the initial contract together with variations in contract work, claims, and incentive payments to the extent that it is probable that they will result in revenues and can be measured reliably.

Contract costs should comprise costs that relate directly to the specific contract and costs that are attributable to general contract activity and that can be reasonably allocated to the contract, together with such other costs as are directly attributable to the customer under the terms of the contract.

Where the outcome of a construction contract can be estimated reliably, revenue and costs should be recognised by reference to the stage of completion of contract activity (the percentage of completion method of accounting).

If the outcome cannot be estimated reliably, no profit should be recognised. Instead, contract revenue should be recognised only to the extent that contract costs incurred are expected to be recovered and contract costs should be expensed as incurred.

If it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised immediately.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK - Int 3 *Revenue – Pre-completion Contracts for the Sale of Development Properties*
Existing pronouncements replaced by HKAS 11	SSAP 23 *Construction contracts*
Specific Deloitte publications	IAS 11 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 11 and IAS 11 *Construction Contracts*.

Future Developments

The IFRIC is working to provide guidance for combining and segmenting contracts, including the impact that contract options and additions may have on combining and/or segmenting. HKAS 11 requires that, in some cases, the guidance should be applied separately to the separately identifiable components of a single contract and that, in other cases, it should be applied to a group of contracts taken together. A Draft Interpretation is expected to be released shortly.

HKAS 12 Income Taxes (issued November 2004)

Objective

To prescribe the accounting treatment for income taxes.

To establish the principles and provide guidance in accounting for the current and future income tax consequences related to:

- the future recovery (settlement) of the carrying amounts of assets (liabilities) in an entity's balance sheet, and
- current period transactions recognised in the income statement or directly through equity.

Key Changes under HKAS 12

- There are no significant changes.

Summary of HKAS 12

Current tax liabilities and assets should be recognised for current and prior period taxes, measured at the rates applicable for the period.

A temporary difference is a difference between the carrying amount of an asset or liability and its tax base.

Recognition of deferred tax liabilities

A taxable temporary difference is a temporary difference that will result in taxable amounts in the future when the carrying amount of the asset is recovered or the liability is settled. Deferred tax liabilities must be recognised for the future tax consequences of all taxable temporary differences with three exceptions:

- liabilities arising from the initial recognition of goodwill;
- liabilities arising from the initial recognition of an asset/liability other than in a business combination which, at the time of the transaction, does not affect either the accounting or the taxable profit; and
- liabilities arising from the undistributed profits of investments where the entity is able to control the timing of the reversal of the difference and it is probable that the reversal will not occur in the foreseeable future.

Recognition of deferred tax assets

A deductible temporary difference is a temporary difference that will result in amounts that are tax deductible in the future when the carrying amount of the asset is recovered or the liability is settled. A deferred tax asset must be recognised for deductible temporary differences, unused tax losses, and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be

utilised. There is one exception which is when the deferred tax asset arises from the initial recognition of an asset/liability, other than in a business combination, which at the time of the transaction, does not affect the accounting or the taxable profit.

Measurement

Deferred tax liabilities (assets) should be measured at the tax rates expected to apply when the liability is settled or asset is realised, based on tax rates/laws that have been enacted or substantively enacted by the balance sheet date.

Discounting of deferred tax assets and liabilities is prohibited.

Deferred taxes must be presented as non-current items in the balance sheet.

HKAS 12 specifies detailed disclosure requirements for income taxes.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) - Int 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* (previously Interpretation 20) HK (SIC) – Int 25 *Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders* (previously Interpretation 21)
Existing pronouncements replaced by HKAS 12	SSAP 12 *Income taxes* Interpretation 20 *Income taxes – Recovery of revalued non-depreciable assets* Interpretation 21 *Income taxes – Changes in the tax status of an enterprise or its shareholders*
Specific Deloitte publications	• Accounting for Income Taxes – A Guide to SSAP 12 (Revised) • IAS 12 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 12 and IAS 12 *Income Taxes*.

Future Developments

IAS 12 is likely to be revised in the future as part of the IASB/FASB project to eliminate a variety of differences between IFRSs and US GAAP. Currently both IFRSs and US GAAP are based on the balance sheet liability approach, where an entity recognises deferred tax assets and liabilities for temporary differences and for operating loss and tax credit carryforwards. However, differences arise as both Standards have a number of differing exceptions to the basic principles. The convergence project, therefore, is not reconsidering the underlying approach, but rather looking to eliminate exceptions to the basic principle.

HKAS 14 Segment Reporting (issued November 2004)

Objective

To establish principles for reporting financial information by line of business and by geographical area.

Key Changes under HKAS 14

- There are no significant changes. However, HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* does expand the disclosure requirements for discontinued operations (see HKFRS 5 for more details).

Summary of HKAS 14

HKAS 14 applies to entities whose equity or debt securities are publicly traded and to entities in the process of issuing securities to the public. Also, any entity voluntarily providing segment information must comply with the requirements of HKAS 14.

An entity must look to its organisational structure and internal reporting system for the purpose of identifying its business segments and geographical segments. If internal segments are not geographical or product/service-based, then an entity should look to the next lower level of internal segmentation to identify reportable segments.

HKAS 14 provides guidance on which segments are reportable (generally they are those that are above specified 10% thresholds). One basis of segmentation is identified as primary and the other as secondary. HKAS 14 sets out disclosure requirements for primary and secondary segments, with considerably less disclosure for the secondary segments.

Segment information should be based on the same accounting policies as the consolidated group or entity.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 14	SSAP 26 *Segment reporting*
Specific Deloitte publications	IAS 14 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 14 and IAS 14 *Segment Reporting*.

Future Developments

IAS 14 is being looked at as part of the IASB/FASB project to eliminate a variety of differences between IFRSs and US GAAP. Therefore, minor changes to IAS 14 may be made in the future.

HKAS 18 Revenue (issued November 2004)

Objective

To prescribe the accounting treatment for revenue arising from certain types of transactions and events.

Key Changes under HKAS 18

- There are no significant changes

Summary of HKAS 18

Revenue is the gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary activities of an entity (such as the sale of goods, sale of services, interest, royalties, and dividends).

Revenue should be measured at the fair value of the consideration received/receivable. An exchange for goods or services of a similar nature and value is not regarded as a transaction that generates revenue. However, an exchange for dissimilar items is regarded as generating revenue.

Recognition of revenue

- From sale of goods: When significant risks and rewards have been transferred to the buyer, the seller has lost effective control and the amount can be reliably measured.
- From sale of services: Percentage of completion method.
- For interest, royalties, and dividends: Recognised when it is probable that economic benefits will flow to the entity:
  - Interest – on a time proportion basis, taking into account the effective yield on the asset.
  - Royalties – on an accrual basis in accordance with the substance of the agreement
  - Dividends – when the shareholder's right to receive the payment is established.

Disclosure requirements include revenue recognition accounting policies.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) – Int 31 *Revenue – Barter Transactions Involving Advertising Services* (previously Interpretation 17) HK – Int 3 *Revenue – Pre-completion Contracts for the Sale of Development Properties*
Existing pronouncements replaced by HKAS 18	SSAP 18 *Revenue* Interpretation 17 *Revenue – Barter transactions involving advertising services*
Specific Deloitte publications	IAS 18 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 18 and IAS 18 *Revenue*.

Future Developments

There is currently an active IASB project addressing the general principles for determining when revenue should be recognised in the financial statements.

The IFRIC is working to produce specific guidance on how service concession arrangements should be accounted for. It has recently issued three Draft Interpretations in this area.

HKAS 20 Accounting for Government Grants and Disclosure of Government Assistance (issued December 2004)

Objective

To prescribe the accounting for, and disclosure of, government grants and other forms of government assistance.

Key Changes under HKAS 20

- There are no significant changes.

Summary of HKAS 20

Accounting treatment

Government grants are recognised only when there is reasonable assurance that the entity will comply with the conditions attached to the grants, and the grants will be received. Non-monetary grants are usually recognised at fair value, though recognition at nominal value is permitted.

The grant is recognised as income over the period necessary to match it with the related costs for which it is intended to compensate, on a systematic basis. It should not be credited directly to equity. A grant receivable as compensation for costs already incurred or for immediate financial support, with no future related costs, should be recognised as income in the period in which it is receivable.

Income-related grants may either be presented as a credit in the income statement or a deduction in reporting the related expense. Asset-related grants may be presented as either deferred income in the balance sheet, or deducted in arriving at the carrying amount of the asset.

Repayment

Repayment of a government grant is accounted for as a change in accounting estimate. Where the original grant related to income, the repayment should be applied first against any related unamortised deferred credit, and any excess should be dealt with as an expense. Where the original grant related to an asset, the repayment should be treated as increasing the carrying amount of the asset or reducing the deferred income balance. The cumulative depreciation which would have been charged had the grant not been received should be charged as an expense.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (SIC) - Int 10 Government Assistance – No Specific Relation to Operating Activities
Existing pronouncements replaced by HKAS 20	SSAP 35 *Accounting for government grants and disclosure of government assistance*

Compliance with IFRSs

There are no significant differences between HKAS 20 and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.*

Future Developments

IAS 20 will be amended to reflect the requirements for government grants contained in IAS 41 *Agriculture*. The basic principles of IAS 20 will be revised as follows:

- An unconditional grant will be recognised as income when the grant becomes receivable.
- A conditional grant will be recognised as income when the conditions attaching to the government grant are met.

IAS 20 is likely to be replaced in the future, however the IASB doesn't consider this to be a priority project at the current time. The revision is likely to take place when the revenue recognition project has been completed.

HKAS 26 Accounting and Reporting by Retirement Benefit Plans (issued August 2004)

Objective

To specify the measurement and disclosure principles for the financial reports of retirement benefit plans.

Key Changes under HKAS 26

- There are no significant changes.

Summary of HKAS 26

Definitions

A retirement benefit plan is an arrangement by which an entity provides benefits to employees on or after termination of service. Under a defined contribution plan benefits to employees are based on the amount of funds contributed to the plan by the employer plus earnings thereon. Under a defined benefit plan, employees receive benefits based on a formula usually linked to employee earnings.

Defined contribution plans

The report of a defined contribution plan should contain a statement of net assets available for benefits and a description of the funding policy.

Defined benefit plans

The report of a defined benefit plan should contain either:

- a statement that shows the net assets available for benefits, the actuarial present value of promised retirement benefits (distinguishing between vested and non-vested benefits) and the resulting excess or deficit; or
- a statement of net assets available for benefits, including either a note disclosing the actuarial present value of promised retirement benefits (distinguishing between vested and non-vested benefits) or a reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared at the date of the report of a defined benefit plan, the most recent valuation should be used as a base. The actuarial present value of promised retirement benefits should be based on the benefits promised under the terms of the plan on service rendered to date, using either current or projected salary levels.

The report should explain the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits.

Retirement benefit plan investments should be carried at fair value. For marketable securities, fair value means market value.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 26	Industry Accounting Guideline 2 (IAG 2) *Financial Statements of Retirement Schemes*
Specific Deloitte publications	IAS 26 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 26 and IAS 26 *Accounting and Reporting by Retirement Benefit Plans*. However, HKAS 26 includes an appendix that sets out additional guidance on preparing financial statements of Mandatory Provident Fund Schemes and Occupational Retirement Schemes Ordinance Schemes.

Future Developments

There are no significant developments currently in progress.

HKAS 34 Interim Financial Reporting (issued October 2004)

Objective

To prescribe the minimum content of an interim financial report (IFR) and the recognition and measurement principles for an IFR.

Entities Most Likely to be Affected by Changes

Entities producing interim financial statements.

Key Changes under HKAS 34

- There are no significant changes from HKAS 34 alone, however, as interim statements must be drawn up on the basis of the accounting policies that will be applied in the next annual accounts, the interim financial statements will be the first set of financial statements to reflect all the changes from the other accounting Standards.

Implication of Changes

Entities will need to start preparing interim financial statements using the new Standards in the year the new Standards are first adopted. For example, if an entity chooses not to adopt the new Standards early, the 2005 interims will be the first financial statements to be prepared using the **new accounting policies** from the Standards effective for accounting periods beginning on or after 1 January 2005.

Summary of HKAS 34

Scope

An interim financial report (IFR) is a financial report that contains either a complete or condensed set of financial statements for a period shorter than an entity's full financial year.

HKAS 34 only specifies the content of an IFR that is described as conforming to HKFRSs. It does not mandate:

- which entities should publish an IFR,
- how frequently, or
- how soon after the end of an interim period.

Such matters will be decided by national governments, securities regulators, stock exchanges, and accountancy bodies.

Stock exchange requirements - In Hong Kong the requirement to report interim financial information is generally restricted to entities listed either on the Main Board or the GEM of the SEHK. Main Board listed entities are required to prepare half-yearly interim reports, and GEM listed entities are required to report quarterly.

Minimum components

The minimum components specified for an IFR are:

- a condensed balance sheet,
- a condensed income statement,
- a condensed statement of changes in equity,
- a condensed cash flow statement and
- selected explanatory notes.

If a complete set of financial statements is published in the IFR, those financial statements should be in full compliance with HKFRSs.

If the financial statements are condensed, they should include, at a minimum, each of the headings and sub-totals included in the most recent annual financial statements and the explanatory notes required by HKAS 34. Additional line-items should be included if their omission would make the interim financial information misleading.

Periods to be covered by the IFR

- Balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year.
- Income statements for the current interim period and cumulatively for the current financial year to date, with comparative income statements for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.
- Statement showing changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.
- Cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

The notes in an IFR should provide an explanation of events and transactions significant to understanding the changes since the last annual financial statements.

Accounting policies

The accounting policies should be the same as those used in the last annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. If a decision is made to change a policy mid-year, the change is implemented retrospectively, and previously reported interim data is restated.

Important measurement points

- Measurements for interim reporting purposes should be made on a year-to-date basis, so that the frequency of the entity's reporting does not affect the measurement of its annual results.
- Revenue and costs should be recognised when they occur, not anticipated or deferred.
- Materiality should be assessed in relation to the interim period financial data, not forecasted annual data.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 34	SSAP 25 *Interim financial reporting*
Specific Deloitte publications	IAS 34 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 34 and IAS 34 *Interim Financial Reporting*.

Future Developments

There are no significant developments currently in progress.

HKAS 37 Provisions, Contingent Liabilities and Contingent Assets (issued November 2004)

Objective

To prescribe appropriate recognition criteria and measurement bases for provisions, contingent liabilities, and contingent assets and to ensure that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

Key Changes under HKAS 37

- There are no significant changes.

Summary of HKAS 37

HKAS 37 aims to ensure that only genuine obligations are dealt with in the financial statements. Planned future expenditure, even when authorised by the board of directors or equivalent governing body, is excluded from recognition, as are accruals for self-insured losses, general uncertainties, and other events that have not yet taken place.

Provisions

A provision is a liability of uncertain timing or amount and is recognised only when a past event has created a legal or constructive obligation, an outflow of resources is probable, and the amount of the obligation can be estimated reliably. The amount recognised as a provision is the best estimate of the settlement amount at the balance sheet date.

HKAS 37 requires a review of provisions at each balance sheet date to adjust for changes in estimate. Provisions must only be utilised for their original purposes. Examples of provisions may include onerous contracts, restructuring provisions, warranties, refunds, and site restoration. Comprehensive disclosures, including descriptions and amounts, are required for each class of provision.

Contingent liabilities

A contingent liability arises when:

- there is a possible obligation to be confirmed by a future event that is outside the control of the entity; or
- a present obligation may, but probably will not, require an outflow of resources; or
- a sufficiently reliable estimate of the amount of a present obligation cannot be made (this is rare).

Contingent liabilities require disclosure only (no recognition). If the possibility of outflow is remote, then no disclosure is required.

Contingent assets

Contingent assets arise when the inflow of economic benefits is probable, but not virtually certain, and occurrence depends on an event outside the control of the entity.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	HK (IFRIC) – Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
Existing pronouncements replaced by HKAS 37	SSAP 28 *Provisions, contingent liabilities and contingent assets*
Specific Deloitte publications	IAS 37 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 37 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

Future Developments

IAS 37 is likely to be revised in the future as part of the IASB/FASB project to eliminate a variety of differences between IFRSs and US GAAP. An Exposure Draft is expected to be released containing proposed changes such as:

- Amendments to the definitions of contingent assets, contingent liabilities and of a constructive obligation
- Additional recognition guidance for onerous contracts
- Withdrawal of the existing guidance on provisions for restructuring costs
- Amendments to the requirements relating to termination benefits
- Amendments to some of the measurement requirements in IAS 37

HKAS 41 Agriculture (issued December 2004)

Objective

To prescribe the accounting treatment for agricultural activity (the management of the biological transformation of biological assets into agricultural produce)

Key Changes under HKAS 41

- There are no significant changes.

Summary of HKAS 41

Biological assets

Biological assets (living animals and plants) should be measured on initial recognition and at subsequent reporting dates at fair value less estimated point-of-sale costs, unless fair value cannot be reliably measured. The gain on initial recognition of biological assets at fair value, and changes in fair value of biological assets during a period, are reported in net profit or loss.

HKAS 41 presumes that fair value can be reliably measured for most biological assets. However, that presumption can be rebutted for a biological asset that, at the time it is initially recognised in the financial statements, does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are determined to be clearly inappropriate or unworkable. In such a case, the asset is measured at cost less accumulated depreciation and impairment losses.

Agricultural produce

Agricultural produce (the harvested product from biological assets) should be measured at fair value less estimated point-of-sale costs at the point of harvest.

Harvested produce is a marketable commodity so there is no 'measurement reliability' exception. A gain on initial recognition of agricultural produce at fair value should be included in net profit or loss for the period in which it arises.

Fair value measurement

A quoted market price in an active market generally represents the best measure of fair value of a biological asset or agricultural produce. If an active market does not exist, HKAS 41 provides guidance for choosing another measurement basis.

Fair value measurement stops at harvest. After harvest, HKAS 2 *Inventories*, will apply.

Effective date	Annual periods beginning on or after 1 January 2005
Related Interpretations	None
Existing pronouncements replaced by HKAS 41	SSAP 36 *Agriculture*
Specific Deloitte publications	IAS 41 e-learning module

Compliance with IFRSs

There are no significant differences between HKAS 41 and IAS 41 *Agriculture*.

Future Developments

There are no significant developments currently in progress.

HK (IFRIC) – Int 2 Members' Shares in Co-Operative Entities and Similar Instruments (effective 1 January 2005)

Summary

Members' shares in co-operative entities have some characteristics of equity. They also give the holder the right to request redemption for cash, although that right may be subject to certain limitations. HK (IFRIC) – Int 2 gives guidance on how those redemption terms should be evaluated in determining whether the shares should be classified as financial liabilities or as equity. Shares for which the member has the right to request redemption are normally liabilities, but, they are equity if:

- the entity has an unconditional right to refuse redemption, or
- local law, regulation, or the entity's governing charter imposes prohibitions on redemption. However, the mere existence of law, regulation, or charter provisions that would prohibit redemption only if conditions (such as liquidity constraints) are met, or are not met, does not result in members' shares being equity.

Impact on Entities

Provides additional guidance for co-operative societies and similar entities when classifying shares.

HK (IFRIC) – Int 3 Emission Rights (effective 1 March 2005)

Summary

The Interpretation focuses on the accounting to be adopted by participants in a 'cap and trade' emission rights scheme, although some of its requirements might be relevant to similar schemes. Typically in cap and trade schemes, a government (or government agency) issues rights (allowances) to participating entities to emit a specified level of emissions. Participants in the scheme are able to buy and sell allowances. Participants are required to deliver allowances equal to their actual emissions.

The Interpretation specifies the following:

- Rights (allowances) are intangible assets that should be recognised in the financial statements in accordance with HKAS 38 *Intangible Assets*.
- When allowances are issued to a participant by the government for less than their fair value, the difference between the amount paid (if any) and their fair value is a government grant that is accounted for in accordance HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.
- As a participant produces emissions, it recognises a provision for its obligation to deliver allowances in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Impact on Entities

HK (IFRIC) – Int 3 is expected to be withdrawn following the withdrawal of IFRIC 3 *Emission Rights*, the related International Interpretation.

HK (IFRIC) – Int 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Funds (effective 1 January 2006)

Summary

Some entities have obligations to decommission assets or to perform environmental restoration or rehabilitation. Some entities contribute to a fund established to reimburse such costs when they are incurred. HK (IFRIC) - Int 5 addresses how a contributor should account for its interest in a fund and any obligation to make additional contributions

If an entity recognises a decommissioning obligation under HKFRSs and contributes to a fund to segregate assets to pay for the obligation, it should determine whether decommissioning funds should be consolidated, proportionately consolidated or accounted for under the equity method by applying the appropriate Standards. When a fund is not consolidated, proportionately consolidated, or accounted for under the equity method, and that fund does not relieve the contributor of its obligation to pay decommissioning costs, the contributor should recognise:

- its obligation to pay decommissioning costs as a liability, and
- its rights to receive reimbursement from the fund as a reimbursement under HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

A right to reimbursement should be measured at the lower of (i) the amount of the decommissioning obligation recognised and (ii) the contributor's share of the fair value of the net assets of the fund. Changes in the carrying amount of this right (other than contributions to and payments from the funds) should be recognised in profit or loss.

Impact on Entities

Entities which have obligations to decommission assets or to perform environmental restoration or rehabilitation and that contribute to a fund established to reimburse such costs when they are incurred will need to reassess their accounting treatment under the new guidance.

HK (SIC) - Int 10 Government Assistance – No Specific Relation to Operating Activities

Summary

Under HK (SIC) – Int 10, government assistance to entities that is aimed at encouragement or long-term support of business activities either in certain regions or industry sectors meets the definition of government grants in HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. Such grants should therefore not be credited directly to shareholders' interests.

Impact on Entities

This guidance used to be incorporated into SSAP 35 *Accounting for government grants and disclosure of government assistance* and hence doesn't propose any significant changes

HK (SIC) – Int 12 Consolidation – Special Purpose Entities

Summary

HK (SIC) - Int 12 addresses when a special purpose entity should be consolidated by a reporting entity under the consolidation principles in HKAS 27 *Consolidated and Separate Financial Statements*. Under HK (SIC) - Int 12, an entity must consolidate a special purpose entity ("SPE") when, in substance, the entity controls the SPE. In addition to the situations described in HKAS 27, any of the following circumstances, for example, may indicate a relationship in which an entity controls an SPE:

- The activities of the SPE are being conducted on behalf of the entity according to its specific business needs.
- The entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an "autopilot" mechanism, has delegated these decision making powers.
- By having a right to the majority of the SPE's benefits, the entity is exposed to the SPE's business risks.
- The entity retains the majority of the residual or ownership risks related to the SPE.

Examples of SPEs include entities set up to effect a lease, a securitisation of financial assets, or research and development activities.

Impact on Entities

HK (SIC) – Int 12 supercedes guidance in SSAP 32 *Consolidated financial statements and accounting for investments in subsidiaries* and also includes equity compensation plans in the scope of the Interpretation, resulting in the consolidation of certain equity compensation plans, (such as trust companies) that were previously held off-balance sheet. These plans will be accounted for in accordance with HKFRS 2 *Share-based Payments*.

HK (SIC) – Int 13 Jointly Controlled Entities - Non-Monetary Contributions by Venturers

Summary

HK (SIC) - Int 13 indicates that recognition of gains or losses on contributions of non-monetary assets to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity is appropriate unless:

- the significant risks and rewards related to the non-monetary asset are not transferred to the jointly controlled entity;
- the gain or loss cannot be measured reliably; or
- similar assets are contributed by the other venturers.

Non-monetary assets contributed by venturers are similar when they have a similar nature, a similar use in the same line of business and a similar fair value. A gain should also be recognised if, in addition to the equity interest in the jointly controlled entity, the venturer receives consideration in the form of either cash or other assets which are dissimilar to the non-monetary assets contributed.

Impact on Entities

HK (SIC) – Int 13 supercedes Interpretation 6 *Jointly controlled entities - Non-monetary contributions by venturers* and proposes no significant changes

HK (SIC) – Int 15 Operating Leases – Incentives

Summary

HK (SIC) – Int 15 clarifies the recognition of incentives related to operating leases by both the lessee and lessor. The Interpretation indicates that lease incentives (such as rent-free periods) should be considered an integral part of the consideration for the use of the leased asset. They should be recognised by both the lessor and the lessee over the lease term, with each party using a single amortisation method applied to the net consideration.

Impact on Entities

HK (SIC) – Int 15 supercedes guidance in SSAP 14 *Leases* and proposes no significant changes

HK (SIC) – Int 21 Income Taxes - Recovery of Revalued Non-Depreciable Assets

Summary

HK (SIC) – Int 21 deals with cases where a non-depreciable asset (freehold land) is carried at a revalued amount under HKAS 16 *Property, Plant and Equipment*. No part of the carrying amount of such an asset is considered to be recovered through its use. Therefore, the deferred tax liability or asset that arises from revaluation must be measured based on the tax consequences that would follow from the sale of the asset rather than through use.

Impact on Entities

HK (SIC) – Int 21 supercedes Interpretation 20 *Income taxes - Recovery of revalued non-depreciable assets* and proposes no significant changes

HK (SIC) – Int 25 Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders

Summary

A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in the pre-tax amounts recognised directly in equity. Therefore, HK (SIC) - Int 25 concludes that the current and deferred tax consequences of the change in tax status should be included in net profit or loss for the period. However, where a transaction or event does result in a direct credit or charge to equity, for example the revaluation of property, plant or equipment, the related tax consequence would still be recognised directly in equity.

Impact on Entities

HK (SIC) – Int 25 supercedes Interpretation 21 *Income taxes - Changes in the tax status of an enterprise or its shareholders* and proposes no significant changes

HK (SIC) – Int 27 Evaluating the Substance of Transactions in the Legal Form of a Lease

Summary

HK (SIC) - Int 27 includes a list of indicators that individually demonstrate that an arrangement may not, in substance, involve a lease under IAS 17 *Leases*.

If an arrangement does not meet the definition of a lease, HK (SIC) - Int 27 addresses whether a separate investment account and lease payment obligation (that might exist) represent assets and liabilities of the entity; how the entity should account for other obligations resulting from the arrangement and how the entity should account for a fee it might receive from an investor.

A series of transactions that involve the legal form of a lease are linked and therefore should be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole.

Impact on Entities

HK (SIC) – Int 27, supercedes Interpretation 14 *Evaluating the substance of transactions in the legal form of a lease* and proposes no significant changes

HK (SIC) - Int 29 Disclosure - Service Concession Arrangements

Summary

HK (SIC) - Int 29 prescribes the information that should be disclosed in the notes to the financial statements of a concession operator and a concession provider when the two parties are joined by a service concession arrangement. A service concession arrangement exists when an entity (the concession operator) agrees with another entity (the concession provider) to provide services that give the public access to major economic and social facilities.

Examples of service concession arrangements involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. Examples of arrangements that are not service concession arrangements include an entity outsourcing the operation of its internal services (for instance, employee cafeteria, building maintenance, and accounting or information technology functions).

Impact on Entities

HK (SIC) – Int 29 supercedes Interpretation 16, *Disclosure - Service concession arrangements* and proposes no significant changes

HK (SIC) – Int 31 Revenue - Barter Transactions Involving Advertising Services

Summary

Under HKAS 18, revenue cannot be recognised if the amount of revenue is not reliably measurable. Under HK (SIC) - Int 31, revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction by reference only to non-barter transactions that:

- involve advertising similar to the advertising in the barter transaction;
- occur frequently;
- represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;
- involve cash and/or another form of consideration (such as marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
- do not involve the same counterparty as in the barter transaction.

Impact on Entities

HK (SIC) – Int 31 supercedes Interpretation 17 *Revenue - Barter transactions involving advertising services* and proposes no significant changes

HK (SIC) – Int 32 Intangible Assets - Website Costs

Summary

HKAS 32 concludes that a website developed by an entity using internal expenditure, whether for internal or external access, is an internally generated intangible asset that is subject to the requirements of HKAS 38, *Intangible Assets*.

HKAS 32 identifies the following stages of website development:

- Planning
- Application and infrastructure development
- Content development
- Operating

SIC 32 addresses the appropriate accounting treatment for internal expenditure on each of those stages of development and operation:

Impact on Entities

HK (SIC) – Int 32 supercedes Interpretation 19 *Intangible assets - Website costs* and proposes no significant changes

Appendix 1 – List of Hong Kong Financial Reporting Standards and Exposure Drafts

List of new Hong Kong Financial Reporting Standards

The following HKFRSs have been issued and are effective for financial periods commencing 1 January 2005 unless otherwise indicated:

HKFRS No.	Title	IFRS No.	Supersedes	Changes Effective
HKFRS 1[Δ]	First-time Adoption of Hong Kong Financial Reporting Standards	IFRS 1	-	N/A[Δ]
HKFRS 2	Share-based Payment	IFRS 2	-	Transitional Provisions
HKFRS 3	Business Combinations	IFRS 3	SSAP 30 Interpretation 12 Interpretation 13 Interpretation 15	Transitional Provisions (mainly prospective)
HKFRS 4	Insurance Contracts	IFRS 4	-	Transitional Provisions (mainly retrospective)
HKFRS 5	Non-current Assets Held for Sale and Discontinued Operations	IFRS 5	SSAP 33	Transitional Provisions (mainly prospective)
HKFRS 6[@]	Exploration for and Evaluation of Mineral Resources	IFRS 6	-	Transitional Provisions (mainly retrospective)

Notes:

Δ HKFRS 1 must be used if a company's first set of HKFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is allowed.

@ HKFRS 6 is effective for financial periods beginning on or after 1 January 2006 with earlier adoption encouraged.

List of New Hong Kong Accounting Standards

All revised HKASs are effective for financial periods commencing 1 January 2005 unless otherwise indicated.

HKAS No.	Title	IAS No.	Supersedes	Changes Effective
HKAS 1	Presentation of Financial Statements	IAS 1	SSAP 1 Interpretation 8	Retrospective
HKAS 2	Inventories	IAS 2	SSAP 22	Retrospective
HKAS 7	Cash Flow Statements	IAS 7	SSAP 15	Retrospective
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8	SSAP 2	Retrospective
HKAS 10	Events After the Balance Sheet Date	IAS 10	SSAP 9	Retrospective
HKAS 11[#]	Construction Contracts	IAS 11	SSAP 23	No significant changes
HKAS 12[#]	Income Taxes	IAS 12	SSAP 12	No significant changes
HKAS 14[#]	Segment Reporting	IAS 14	SSAP 26	No significant changes
HKAS 16	Property, Plant and Equipment	IAS 16	SSAP 17 Interpretation 1 Interpretation 5	Retrospective
HKAS 17	Leases	IAS 17	SSAP 14	Prospective (retrospective encouraged)
HKAS 18[#]	Revenue	IAS 18	SSAP 18	No significant changes
HKAS 19[#]	Employee Benefits	IAS 19	SSAP 34	No significant changes
HKAS 19 Amendment[+]	Actuarial Gains and Losses, Group Plans and Disclosures	Amendment to IAS 19	SSAP 34	Mainly retrospective

HKAS No.	Title	IAS No.	Supersedes	Changes Effective
HKAS 20#	Accounting for Government Grants and Disclosure of Government Assistance	IAS 20	SSAP 35	No significant changes
HKAS 21	The Effects of Changes in Foreign Exchange Rates	IAS 21	SSAP 11	Transition Provisions
HKAS 23	Borrowing Costs	IAS 23	SSAP 19	Transition Provisions
HKAS 24	Related Party Disclosures	IAS 24	SSAP 20	Retrospective
HKAS 26	Accounting and Reporting by Retirement Benefit Plans	IAS 26	-	Retrospective
HKAS 27	Consolidated and Separate Financial Statements	IAS 27	SSAP 32 Interpretation 18	Retrospective
HKAS 28	Investments in Associates	IAS 28	SSAP 10 Interpretation 18	Retrospective
HKAS 29	Financial Reporting in Hyperinflationary Economies	IAS 29	-	Retrospective
HKAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions	IAS 30	-	Retrospective
HKAS 31	Interests in Joint Ventures	IAS 31	SSAP 21	Retrospective
HKAS 32	Financial Instruments: Disclosure and Presentation	IAS 32	SSAP 24	Retrospective
HKAS 33	Earnings Per Share	IAS 33	SSAP 5 Interpretation 10	Retrospective
HKAS 34#	Interim Financial Reporting	IAS 34	SSAP 25	No significant changes
HKAS 36	Impairment of Assets	IAS 36	SSAP 31	Transitional Provisions
HKAS 37#	Provisions, Contingent Liabilities and Contingent Assets	IAS 37	SSAP 28	No significant changes
HKAS 38	Intangible Assets	IAS 38	SSAP 29	Transitional Provisions
HKAS 39	Financial Instruments: Recognition and Measurement	IAS 39	SSAP 24	Transitional Provisions
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial	IAS 39	SSAP 24	Transitional Provisions

HKAS No.	Title	IAS No.	Supersedes	Changes Effective
	Liabilities			
HKAS 40	Investment Property	IAS 40	SSAP 13	Transitional Provisions
HKAS 41[#]	Agriculture	IAS 41	SSAP 36	No significant changes

Notes:

For the purpose of achieving full convergence of SSAPs with IASs, these HKASs (with numbers corresponding to the equivalent IASs) replace the previous SSAPs with effect from 1 January 2005. Other than the changes in the names and the consequential amendments arising from other newly issued HKASs and HKFRSs, no significant changes have been made to the previous SSAPs on converting them into HKASs.

+The amendment to HKAS 19 is effective from 1 January 2006, however early adoption is encouraged.

List of New HK (IFRIC) - Interpretations

The following new HK (IFRIC) -Ints have been issued:

HK (IFRIC) -Int No.	Title	IFRIC Interpretation No.	Effective for periods beginning	Changes Effective
1	Changes in Existing Decommissioning, Restoration and Similar Liabilities	1	1 September 2004	Retrospective
2	Members' Shares in Co-Operative Entities and Similar Instruments	2	1 January 2005	Retrospective
3	Emission Rights	3	Expected to be withdrawn	N/A
4	Determining whether an Arrangement contains a Lease	4	1 January 2006	Transitional Provisions
5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	5	1 January 2006	Retrospective

List of HK (SIC) - Interpretations

The following HK (SIC)-Ints have been issued/revised:

HK (SIC) - Int No.	Title	SIC Interpretation No.	Supersedes	Changes Effective
10	Government Assistance - No Specific Relation to Operating Activities	10	SSAP 35	Retrospective
12	Consolidation - Special Purpose Entities	12	SSAP 32	Retrospective
13	Jointly Controlled Entities - Non-Monetary Contributions by Venturers	13	SSAP 21	Transitional Provisions
15	Operating Leases – Incentives	15	SSAP 14	Retrospective
21	Income Taxes - Recovery of Revalued Non-Depreciable Assets	21	Interpretation 20	Retrospective
25+	Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders	25	Interpretation 21	No significant changes
27+	Evaluating the Substance of Transactions in the Legal Form of a Lease	27	Interpretation 14	No significant changes
29+	Disclosure – Service Concession Arrangements	29	Interpretation 16	No significant changes
31+	Revenue – Barter Transactions Involving Advertising Services	31	Interpretation 17	No significant changes
32+	Intangible Assets – Website Costs	32	Interpretation 19	No significant changes

Notes:

\+ For the purpose of achieving full convergence of Interpretations with SIC Interpretations, these HK (SIC)-Int (with numbers corresponding to the equivalent SIC Interpretations) replace the previous Interpretations with effect from 1 January 2005. Other than the changes in the names and the consequential amendments arising from other newly issued HKASs and HKFRSs, no significant changes have been made to the previous Interpretations on converting them into HK (SIC)-Int.

\- SIC-7 *Introduction of the Euro* will not be adopted in Hong Kong.

List of HK – Interpretation*s*

HK - Int No.	Title	SIC Interpretation No.	Effective for periods beginning	Changes Effective
1	The Appropriate Policies for Infrastructure Facilities	-	1 October 2004	Retrospective
2	The Appropriate Policies for Hotel Properties	-	1 January 2005	Retrospective
3	Revenue – Pre-completion Contracts for the Sale of Development Properties	-	1 January 2005	Prospective
4	Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases	-	24th May 2005	Retrospective

List of Exposure Drafts and Draft Interpretations

The following Exposure Drafts, IASB Exposure Drafts and IFRIC Interpretations have been issued for comments in Hong Kong:

Exposure drafts	Title
Hong Kong Exposure Drafts	Proposed Accounting Guideline on Merger Accounting SME Financial Reporting Framework and Financial Reporting Standard
IASB Exposure Drafts	Proposed Amendments to IFRS 6 Exploration for and Evaluation of Mineral Resources and IFRS 1 First-time Adoption of International Financial Reporting Standards ED 7 Financial Instruments: Disclosures Cash Flow Hedge Accounting for Forecast Intragroup Transactions (adopted in April 2005 under IFRS, but still pending adoption in Hong Kong) Financial Guarantee Contracts and Credit Insurance Proposed Limited Amendment to IFRS 3 Business Combinations: Combinations by Contract Alone or Involving Mutual Entities Proposed Limited Amendment to IAS 39 Financial Instruments: Recognition and Measurement on the Fair Value Option

IFRIC Draft interpretation No.	Title
D5	Applying IAS 29 Financial Reporting in Hyperinflationary Economies for the First Time
D6	Multi-employer Plans
D9	Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions
D10	Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment
D11	Changes in Contributions to Employee Share Purchase Plans (ESPPs)
D12	Service Concession Arrangements - Determining the Accounting Model
D13	Service Concession Arrangements - the Financial Asset Model
D14	Service Concession Arrangements - the Intangible Asset Model
D15	Reassessment of Embedded Derivatives
D16	Scope of IFRS 2
D17	IFRS 2 – Group and Treasury Share Transactions

IAS Plus

Deloitte's www.iasplus.com website provides comprehensive information about international financial reporting in general and the IASB activities in particular. Unique features include:

- Daily news about financial reporting globally.
- Summaries of all Standards, Interpretations, and proposals.
- Many IFRS-related publications available for download.
- Model IFRS financial statements.
- An electronic library of several hundred IFRS resources.
- All Deloitte Touche Tohmatsu comment letters to the IASB.
- Links to several hundred international accounting websites.
- E-learning modules for each Standard.
- Updates on developments in national accounting standards.

Deloitte IFRS resources

In addition to this publication, Deloitte Touche Tohmatsu has a range of tools and publications to assist companies in implementing and reporting under IFRSs. A few of these are shown below.

Deloitte's IFRS e-Learning Modules	E-Learning IFRS training material, one module for each IAS and IFRS and the Framework, with self-tests. Available without charge on www.iasplus.com
IAS Plus Newsletter	A quarterly newsletter on recent developments in IFRSs and accounting updates for individual countries. To subscribe, visit www.iasplus.com.

Publications - Electronic versions of the following publications, and others, are available at www.iasplus.com/dttpubs/pubs.htm.

IFRSs: Model Financial Statements and Disclosure Checklist 2005	Illustrates the presentation and disclosure requirements of IFRSs.
iGAAP 2005 Financial Instruments: IAS 32 and IAS 39 Explained	Guidance on how to apply both of these complex Standards, including illustrative examples and interpretations.
IFRS in your Pocket	IFRS in your Pocket Published in English, Chinese, French, Spanish, Polish, Danish and other languages. This pocket-sized guide includes summaries of all IASB Standards and Interpretations, updates on agenda projects and other IASB-related information.
First-time Adoption: A Guide to IFRS 1	Application guidance for the "stable platform" Standards effective in 2005.
Share-based Payment: A Guide to IFRS 2	Guidance on applying IFRS 2 to many common share-based payment transactions.
Business Combinations: A Guide to IFRS 3	Supplements the IASB's own guidance for applying this Standard

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