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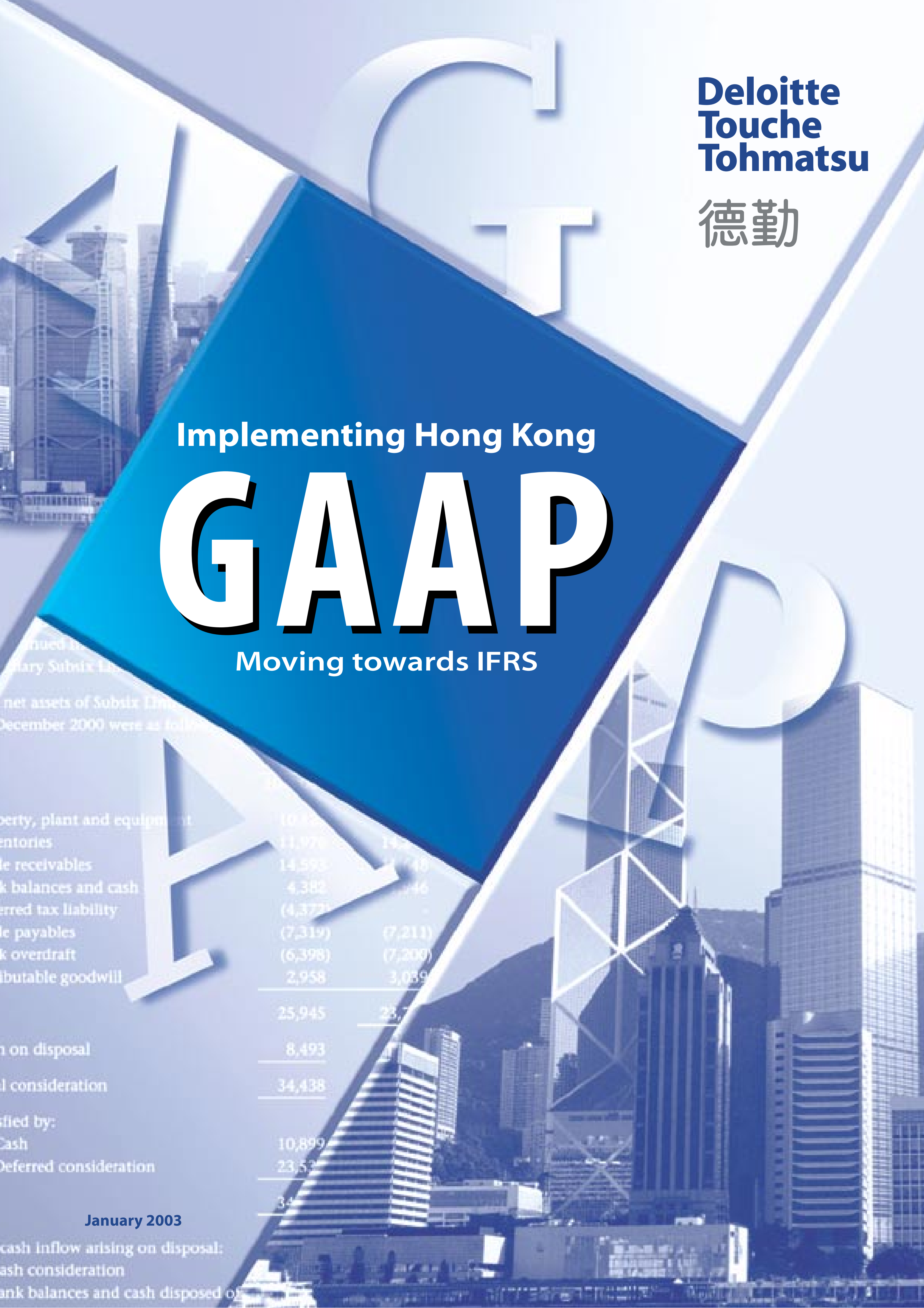

Implementing Hong Kong

GAAP

Moving towards IFRS

January 2003

OUR MISSION: TO HELP OUR CLIENTS AND OUR PEOPLE EXCEL

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PUBLICATIONS

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

Hong Kong GAAP: A Practical Guide to Generally Accepted Accounting Practice	2nd Edition. Written by Stephen Taylor and Norma Hall, Deloitte Touche Tohmatsu, Hong Kong. Published by Sweet & Maxwell Asia.
Hong Kong GAAP: A Guide for the Preparation of Interim Reports	Guidance on the requirements for interim reports for listed enterprises, including model interim report and disclosure checklist. Published by Deloitte Touche Tohmatsu.
Hong Kong GAAP - Update	Regular newsletter on accounting developments in Hong Kong. Published by Deloitte Touche Tohmatsu.

The following Hong Kong GAAP Updates were issued during 2002

No.	Title	Date of Issue
13	SSAP 33 Discontinuing Operations	8 March 2002
14	SSAP 34 Employee Benefits	26 March 2002
15	Cash Flow Statements and Statements of Changes in Equity	10 April 2002
16	A New Era of Accounting Standards Setting in Hong Kong	
	- Exposure Draft: Proposed Improvements to International Standards	26 June 2002
17	Five New Interpretations	5 August 2002
18	Proposed SSAPs on Financial Instruments	3 September 2002
19	Exposure Drafts on Business Combinations, Intangibles and Impairment	19 December 2002

If you would like to receive copies of our regular Updates, whether by post or email, please email your name and contact details to the Technical Administrator at **technical@deloitte.com.hk**.

Deloitte Touche Tohmatsu publications intended to assist users in understanding International Financial Reporting Standards (IFRS) are listed on the inside back cover of this publication.

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INTRODUCTION

Although 2002 has not been as exhausting for Hong Kong standard-setting as 2001, there have nevertheless been a number of significant Standards and Interpretations issued which will demand the attention of preparers and auditors of financial statements in the coming reporting seasons. There are five new or revised Standards effective from 1 January 2002, listed below, and one more (SSAP 35 dealing with government grants) effective from 1 July 2002.

SSAP 1 (Revised)	*Presentation of Financial Statements*	SSAP 33	*Discontinuing Operations*
SSAP 11 (Revised)	*Foreign Currency Translation*	SSAP 34	*Employee Benefits*
SSAP 15 (Revised)	*Cash Flow Statements*		

A number of these Standards (SSAPs 1, 15 and 33 in particular) will result in significant changes in disclosure in primary financial statements and, therefore, will require substantial redrafting of financial statements. In addition, SSAP 34 introduces a comprehensive framework for accounting for employee benefits and may result in the remeasurement of a reporting enterprise's obligations, particularly where it has defined benefit retirement benefit arrangements. In our Hong Kong GAAP Update, we have summarised the principal implications of these new Standards - focussing on practical implementation issues. We have also provided brief summaries of Interpretations that are effective for the first time in 2002.

Two Standards are already in issue that will be effective in later reporting periods. The more significant of these (SSAP 12 (Revised) *Income Taxes*) is effective from 1 January 2003 and will impact a large number of reporting enterprises. It introduces a fundamental change in the model used for accounting for deferred tax, as well as explicit accounting rules for current tax for the first time. We have included a brief summary of the Standard on page 27. In addition, given the significance of the Standard, we will shortly be issuing another Hong Kong GAAP Guide dedicated to the subject of Income Taxes.

We have also previewed SSAP 36 *Agriculture*, which is effective from 1 January 2004. Prior to that effective date, this Standard represents best practice for enterprises engaged in agricultural activity (including some enterprises operating in the bio-technology sector) and the Standard encourages early adoption.

Over recent years, the Hong Kong Society of Accountants (HKSA) has achieved tremendous progress towards its objective of convergence with International Financial Reporting Standards (IFRS). Our brief comparison of SSAPs and IFRS at Appendix II to this publication highlights the few remaining differences. The progress made has been such that, with effect from 2002, the HKSA now seeks to issue Hong Kong Exposure Drafts contemporaneously with the equivalent Exposure Drafts issued by the International Accounting Standards Board (IASB), with the intention that the Hong Kong SSAPs will have the same effective date as the equivalent IFRS. As a result, it is key that Hong Kong enterprises monitor carefully the progress of IASB projects, so that they can anticipate the likely effect on Hong Kong GAAP. For example, the current Exposure Draft on Share-based Payment has a proposed effective date of 7 November 2002 (see page 46). Therefore, Hong Kong enterprises currently considering share option arrangements need to appreciate the potential impact of that proposed Standard.

As an indication of the future Standards anticipated, both in the short term and the medium term, we have included summaries of all current Hong Kong Exposure Drafts, and we have also identified the most significant of the IASB projects and provided a summary of the likely implications for Hong Kong reporting enterprises. We would encourage readers to track these developments carefully - the projects can be monitored on our IAS Plus website (www.iasplus.com).

We trust that readers will find this publication of practical assistance in understanding the implications for their financial statements of recent and anticipated developments in Accounting Standards.

Deloitte Touche Tohmatsu
Hong Kong
January 2003

ABBREVIATIONS

The following abbreviations have been used throughout this publication:

FASC	Financial Accounting Standards Committee of the HKSA
GAAP	Generally Accepted Accounting Practice
HKSA	Hong Kong Society of Accountants
IAS	International Accounting Standard(s)
IASB	International Accounting Standards Board of the IASC
IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standard(s)
INT	Interpretation issued by the UIISC
SSAP	Statement of Standard Accounting Practice issued by the HKSA
UIISC	Urgent Issues and Interpretations Sub-Committee of the FASC

SSAP 1 (REVISED) PRESENTATION OF FINANCIAL STATEMENTS

Impact

The requirement for a Statement of Recognised Gains and Losses (SRGL) has been replaced by a requirement for a statement of changes in equity, with three alternative presentations illustrated.

Action required

Reporting enterprises will need to select the format of presentation most suitable for their circumstances.

Those who favour the SRGL approach see this statement as presenting some measure of ‘total’ performance in the period. However, this measure of performance is compromised where gains and losses are ‘recycled’ through the income statement (e.g. fair value gains on investment properties).

The comprehensive statement of changes in equity is favoured by those who believe that the statement should enable a user of the financial statements to understand exactly how the net assets of the enterprise have been increased/decreased during the reporting period. Because all movements are disclosed separately, the effects of reserves transfers and recycling are understood at a glance.

The summary equity reconciliation is intended to be some sort of ‘middle ground’ - showing all movements in total equity, but relegating the analysis by individual category of equity to the notes, so that the clarity of the primary financial statement is maintained.

All three alternatives are illustrated in the following pages to enable readers to understand the differences in presentation.

Commentary

We believe that the comprehensive format of presentation of the statement of changes in equity is the most informative for users of the financial statements. Our experience with the SRGL over the past few years is that it is not understood clearly, even by relatively sophisticated users of financial information, and we believe that enterprises should move to the more comprehensive presentation. The objective of reporting ‘total performance’ (the perceived advantage of the SRGL) is the subject of a current IASB project, and we expect that a more appropriate format for a comprehensive statement of performance will emerge from that project.

Additional Points

Under the revisions to SSAP 1, the option of not presenting a statement of changes in equity where there are no recognised gains and losses other than the result for the year has been removed. In these circumstances, we suggest that the reporting enterprise should present a comprehensive statement of changes in equity as a primary statement, since the presentation of a SRGL (which would include only the net profit/loss for the year) will be meaningless.

Requirements of the Standard

> *An enterprise should present, as a separate component of its financial statements, a statement showing:*
>
> *(a) the net profit or loss for the period;*
>
> *(b) each item of income and expense, gain or loss which, as required by other Standards, is recognised directly in equity, and the total of these items; and*
>
> *(c) the cumulative effect of changes in accounting policy and the correction of fundamental errors dealt with in accordance with SSAP 2, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.*
>
> *In addition, an enterprise should present, either within this statement or in the notes:*
>
> *(d) capital transactions with owners and distributions to owners;*
>
> *(e) the balance of accumulated profit or loss at the beginning of the period and at the balance sheet date, and the movements for the period; and*
>
> *(f) a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and the end of the period, separately disclosing each movement. [SSAP 1.94]*
>
> *The requirements in paragraph 94 may be met in a number of ways. One alternative is to follow a columnar format which reconciles between the opening and closing balances of each element within shareholders' equity, including items (a) to (f). Another alternative is to present a separate component of the financial statements which presents only items (a) to (c). Under this approach, the items described in (d) to (f) are shown in the notes to the financial statements. ... Whichever approach is adopted, paragraph 94 requires a sub-total of the items in (b) to enable users to derive the total gains and losses arising from the enterprise's activities during the period. [SSAP 1.99]*

Compliance with IFRS

The requirement to present a statement of changes in equity is derived from IFRS. The Hong Kong Standard is generally consistent with the equivalent IFRS (IAS 1). However, the third option of presenting a summary equity reconciliation as illustrated in SSAP 1 (Revised) is not referred to in the equivalent IFRS. Nevertheless, the HKSA has concluded that, by presenting the detailed equity reconciliation in the notes, the requirements of IFRS are met.

Illustrative Statements of Changes in Equity

Alternative 1 - Comprehensive Statement of Changes in Equity

	Share capital	Share premium	Revaluation reserve	Translation reserve	Accumulated profits	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Balance at 1 January 2001	120,000	32,098	33,208	(2,368)	143,777	326,715
Revaluation decrease on investment properties	-	-	(4,049)	-	-	(4,049)
Exchange differences arising on translation of overseas operations	-	-	-	2,706	-	2,706
Net gains/(losses) not recognised in the income statement	-	-	(4,049)	2,706	-	(1,343)
Net profit for the year	-	-	-	-	23,756	23,756
Dividends	-	-	-	-	(8,040)	(8,040)
Balance at 1 January 2002	120,000	32,098	29,159	338	159,493	341,088
Revaluation increase on investment properties	-	-	62,984	-	-	62,984
Exchange differences arising on translation of overseas operations	-	-	-	(13,446)	-	(13,446)
Net gains/(losses) not recognised in the income statement	-	-	62,984	(13,446)	-	49,538
Released on disposal of investment properties	-	-	(17,903)	-	-	(17,903)
Net profit for the year	-	-	-	-	105,457	105,457
Dividends	-	-	-	-	(5,040)	(5,040)
Balance at 31 December 2002	120,000	32,098	74,240	(13,108)	259,910	473,140

Note : The above layout provides a reconciliation of the opening and closing position on each reserve separately. Therefore, no further details are required to be presented in the notes to the financial statements.

Alternative 2 - Summary Statement of Changes in Equity

	Year ended 31/12/02	Year ended 31/12/01
	HK$'000	HK$'000
Opening balance - total equity	341,088	326,715
Revaluation increase/(decrease) on investment properties	62,984	(4,049)
Exchange differences arising on translation of overseas operations	(13,446)	2,706
Net gains/(losses) not recognised in the income statement	49,538	(1,343)
Net profit for the year	105,457	23,756
Less : Revaluation reserve transferred to income on disposal of investment properties	(17,903)	-
	87,554	23,756
Dividends	(5,040)	(8,040)
Closing balance - total equity	473,140	341,088

Note : The above presentation summarises the equity movements in the period. However, in order to meet the requirements of SSAP 1, a detailed analysis of the movements on each individual reserve is required to be presented in the notes to the financial statements.

Alternative 3 - Statement of Recognised Gains and Losses

	Year ended 31/12/02	Year ended 31/12/01
	HK$'000	HK$'000
Revaluation increase/(decrease) on investment properties	62,984	(4,049)
Exchange differences arising on translation of overseas operations	(13,446)	2,706
Net gains/(losses) not recognised in the income statement	49,538	(1,343)
Net profit for the year	105,457	23,756
Total recognised gains and losses	154,995	22,413

Note : The above illustrates an approach which presents those changes in equity that represent gains and losses in a separate component of the financial statements. If this method of presentation is adopted, other movements in capital and reserves, and a reconciliation of the opening and closing balances of share capital, reserves and accumulated profits are required to be provided in the notes to the financial statements.

SSAP 11 (REVISED) FOREIGN CURRENCY TRANSLATION

Impact

The revisions to SSAP 11 involve only one basic principle. Where the net investment method of translation is used, the choice of translating the income statements of "foreign enterprises" at the closing rate for the period has been eliminated. The results of such enterprises are now required to be translated at an average rate for the period.

The revisions to SSAP 11 do not affect the method of accounting for foreign enterprises where the trade of the foreign enterprise is more dependent on the economic circumstances of the investing company's reporting currency than on its own reporting currency. In such circumstances, the temporal method of translation should continue to be used.

Action required

Where enterprises have used the closing rate to translate the results of foreign enterprises in previous years, it will be necessary to consider whether any prior period adjustment is required. This will arise if there is a material misstatement between retained profits and exchange reserves.

Comparatives for the income statement will also need to be restated if translation at average rate has a material effect. In addition, the enterprise's accounting policy will need to be revised and the current year's results calculated on the revised basis.

Commentary

Our observations of 2002 reporting to date have indicated that restatements on the basis of the change in exchange rate used for translation are not common. This is not surprising, given the relative stability of major trading currencies over the past few years. In general, the resulting differences on retranslation would appear not to be material.

Requirements of the Standard

> *The profit and loss account of a foreign enterprise accounted for under the net investment method should be translated at an average rate for the period. Where an average rate is used, the difference between the profit and loss account translated at an average rate and at the closing rate should be recorded as a movement on reserves. The average rate used should be calculated by the method considered most appropriate for the circumstances of the foreign enterprise; the use of a weighting procedure will in most cases be desirable. [SSAP 11.30]*

Compliance with IFRS

In respect of this particular topic, the change has brought SSAP 11 into line with the equivalent IFRS (IAS 21 *The Effects of Changes in Foreign Exchange Rates*). However, there remain a number of differences between SSAP 11 and IAS 21 (see Appendix II) which will not be eliminated until the HKSA issues a new Standard based on IAS 21. This project is likely to be progressed upon the completion of the IASB's Improvements Project (see page 35).

SSAP 15 (REVISED) CASH FLOW STATEMENTS

Impact

SSAP 15 has been revised in order to bring the format of cash flow statements produced under Hong Kong GAAP into line with IFRS.

The format of the cash flow statement has been revised to eliminate the headings 'returns on investments and servicing of finance' and 'taxation'. The definitions of cash and cash equivalents have also been revised, which may lead to reclassifications.

In addition, the option to translate the cash flows of foreign operations at the closing rate has been eliminated.

Action required

All enterprises will be required to redraft their cash flow statements using the revised format. Comparative amounts should be redrafted in a consistent manner.

Where the revised Standard allows alternatives for the presentation of particular categories of cash flows (e.g. interest and dividends received and paid), the enterprise will need to determine which presentation is most appropriate in its circumstances.

One of the most important matters for consideration will be the assets and liabilities previously reported as components of cash and cash equivalents. Each component will need to be looked at separately, and its classification re-assessed.

Commentary

Although not highlighted as one of the significant changes brought about by the revisions to SSAP 15, we believe that the new Standard requires a change in the indirect method of presentation of operating cash flows. Under the previous version of the Standard, where the indirect method of presentation was adopted, the enterprise was required to present a reconciliation between profit before taxation and the net cash flow from operating activities in a note to the financial statements.

In the revised Standard, the illustration of the indirect method presents these adjustments on the face of the cash flow statement. This is also by far the most common presentation used by enterprises applying the equivalent IFRS. Therefore, from the implementation of SSAP 15 (Revised), we believe that the 'reconciliation' from profit to operating cash flows should be presented on the face of the cash flow statement (see Appendix A to SSAP 15 (Revised) for illustration).

A related matter arises in relation to the starting point for this reconciliation. The Standard refers to 'net profit or loss' which means profit or loss before taxation. However, the items disclosed between operating profit and net profit or loss are generally non-operating cash flows (share of result of associates, interest paid etc.). Where this is the case, rather than using the net profit or loss as the starting point for the reconciliation and immediately adjusting for all of the items between net profit and loss and operating profit, we suggest that using the operating profit as the starting point for the reconciliation provides a clearer presentation for the user of the financial statements.

Key features

The following summary does not deal with all of the requirements of the revised Standard, but focusses on the key impacts of SSAP 15 (Revised).

Cash and cash equivalents

Under the revised Standard, **cash** comprises cash on hand and demand deposits. Unlike the previous version of SSAP 15, the revised Standard does not restrict the definition to deposits with banks and financial institutions. Therefore, deposits placed with other corporate entities to which the reporting enterprise has immediate access may meet the definition of cash under the revised Standard.

Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. The following points are noteworthy:

- the Standard explains that cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. Thus, in order to determine the appropriate classification, it is necessary to look at the purpose for holding an investment;
- in order to qualify as short-term and highly liquid, the investment will *normally* have a maturity of three months or less from the date of acquisition. Thus, the requirement for a three-month maturity is not part of the definition, but will nevertheless be a presumption except in very exceptional circumstances; and
- the definition does not refer to the inclusion of bank borrowings repayable within 3 months of advance. However, the Standard acknowledges that bank overdrafts repayable on demand and forming an integral part of an enterprise's cash management should be included as a component of cash and cash equivalents. The Standard does not allow for other short-term loans (e.g. credit import loans and trust receipt loans) to be classified as cash and cash equivalents, since they are considered to be financing in nature.

Interest and dividends

The classification of interest and dividends, previously dealt with under a separate heading ‘returns on investments and servicing of finance’, will be changed on implementation of SSAP 15 (Revised).

The requirements of the revised Standard are as follows:

- the cash flows arising from interest and dividends paid and received should each be disclosed separately; and
- the cash flows should be classified in a consistent manner from period to period as either operating, investing or financing activities.

SSAP 15 (Revised) therefore permits each enterprise to choose how it wishes to classify its interest and dividends. It suggests that dividends paid should be reported in either financing or operating activities. The argument in favour of financing activities is that the dividends are a cost of obtaining financial resources. The argument in favour of classification within operating activities is that it will assist users to determine the ability of the enterprise to pay dividends out of operating cash flows.

Interest paid, and interest and dividends received, should generally be classified as operating cash flows by a financial institution. For other enterprises, the Standard suggests that the cash flows might similarly be classified as operating because the items are included in arriving at net profit or loss in the income statement. However, interest paid could be classified as a financing cash flow, and interest and dividends received could be classified as investing cash flows, because the former is a cost of obtaining financial resources and the latter two are returns on investments.

Taxes

Under SSAP 15 (Revised), unless they can be specifically identified with financing or investing activities, cash flows in respect of taxes should be classified as operating cash flows. Cash flows in respect of taxes are required to be separately disclosed.

Clearly, transactions of all types may have tax consequences. Identifying whether each amount of income or expense included in the tax computation derives from operating, investing or financing activities might be a reasonably easy task. However, identifying the *cash flows* is not always so easy. The Standard points out that, because it is often impracticable to identify cash flows in respect of investing and financing activities and the fact that such cash flows often arise in a different period from the cash flows of the underlying transaction, taxes paid should generally be classified as cash flows from operating activities.

Foreign currency cash flows

The revised Standard has modified the rules in respect of the translation of the cash flows of an overseas subsidiary, and requires that they should be included in the group cash flow statement translated at the exchange rates ruling on the dates of the cash flows. The use of a weighted average rate for the period will generally be acceptable. Unlike the previous version of the Standard, SSAP 15 (Revised) does not permit the cash flows of an overseas subsidiary to be translated using the rate of exchange ruling on the balance sheet date.

Compliance with IFRS

SSAP 15 (Revised) retains certain of the exemptions previously available from the requirement to present a cash flow statement. Therefore, a cash flow statement is required to be prepared by all reporting enterprises other than:

- entities with revenue of less than HK$20 million per annum (provided that they are not listed on a recognised stock exchange or registered dealers under the Securities Ordinance); and
- charities and non-profit-making entities whose financial statements are prepared on a cash basis.

The equivalent IFRS (IAS 7) contains no such exemptions. Except for this difference, compliance with SSAP 15 (Revised) will ensure compliance with IAS 7 in all material respects.

SSAP 33 DISCONTINUING OPERATIONS

Impact

The introduction of SSAP 33 will result in public disclosure of information at an earlier stage in the process of discontinuance. Whereas SSAP 2 only required disclosure once the discontinuance was completed, SSAP 33 requires that financial statement amounts related to the discontinuing operation be segregated from the point at which either a binding sale agreement is entered into or a detailed plan for the discontinuance is announced.

SSAP 33 provides expanded guidance on the application of the definition of discontinuing operations, and specifies and illustrates disclosure requirements at various stages of discontinuance. The volume of detailed disclosure in respect of each discontinuing operation has also been expanded.

Action required

The implementation of SSAP 33 will require reporting enterprises to re-examine their disclosures in respect of discontinuing operations in two respects:

- to identify operations that would not have met the definition of 'discontinued' under SSAP 2 and therefore were not previously disclosed, but which do meet the definition of 'discontinuing' under SSAP 33 and therefore require separate disclosure from the date of adoption of that Standard; and
- the disclosure requirements of SSAP 33 are more onerous than those previously specified by SSAP 2. Therefore, reporting enterprises will need to ensure that they have identified the additional disclosures required.

Commentary

Enterprises will also need to consider the extent to which they wish to separately identify the results of discontinuing operations on the face of the income statement. Under the Standard, the minimum requirement is that the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to a discontinuing operation should be disclosed on the face of the income statement. In addition, the Standard *encourages* the disclosure of the amounts of turnover, other revenue and expenses attributable to discontinuing operations in each period on the face of the income statement. The enterprise will need to determine the appropriate level of disclosure on the face of the income statement - based on the most effective means of conveying the information to users of the financial statements. A detailed analysis on the face of the income statement does give the information greater prominence, but it may undermine the true and fair view by obscuring other important information. Appendix I to the Standard provides helpful illustrative disclosures.

Key features

The following summary does not deal with all of the requirements of the new Standard, but focusses on the key impacts of SSAP 33.

Definition

SSAP 33 defines a **discontinuing operation** as a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

  (i) disposing of substantially in its entirety, such as by selling the component in a single transaction, by de-merger or spin-off of ownership of the component to the enterprise's shareholders; or

  (ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

  (iii) terminating through abandonment;

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

SSAP 33 does not specify any detailed size criteria for determining what is a "major line of business". It is clear that the sale, termination or abandonment of a reportable business segment or geographical segment, as defined in SSAP 26 *Segment Reporting*, would normally satisfy criterion (b) in the definition above. However, a significant, separately identifiable part of a segment might also satisfy that criterion.

Disclosure

The initial disclosure event

The first prompt to begin disclosure under SSAP 33 is the occurrence of an "initial disclosure event", i.e. the earlier of the following two occurrences:

- the enterprise entering into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
- the enterprise's board of directors or similar governing body both approving and announcing a detailed, formal plan for the discontinuance.

Thus, there has been a significant shift from the requirements of SSAP 2. Previously, the identification and disclosure of discontinued operations was only required when the discontinuance was completed. Under SSAP 33, once the enterprise is committed to the discontinuance, whether or not any disposals of assets or settlements of liabilities have occurred, the elements of the financial statements attributable to the discontinuing operation are required to be segregated.

Other disclosures

In the period when an enterprise disposes of individual assets or settles individual liabilities attributable to a discontinuing operation (which may be in the period of the initial disclosure event or in a later period), disclosure is required of:

- the amount of the pre-tax gain or loss; and
- the income tax expense relating to the gain or loss.

The disclosure of the amount of the pre-tax gain or loss from the sale or settlement of assets and liabilities is the only disclosure in SSAP 33 that is required to be presented on the face of the income statement.

Subsequent reporting periods

Where the discontinuance is not completed within a single reporting period, subsequent to the period of initial disclosure the enterprise is required to include in its financial statements a description of any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled and the events causing those changes.

Interim reports

SSAP 33 requires disclosure in the notes to an interim financial report of any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation, and any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled.

Presentation

The disclosures required in respect of discontinuing operations should be made separately for each discontinuing operation.

SSAP 33 allows a choice of presentation for the required numerical disclosures. They can be presented either on the face of the financial statements or in the notes thereto, except that the disclosure of any pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities is required to be shown on the face of the income statement. However, the Standard encourages presentation of the elements of income and expense and the elements of the cash flows on the face of the relevant statements.

Appendix I to the Standard illustrates the presentation of the required disclosures on the face of the income statement using a columnar format, where additional columns are provided to segregate the elements of income and expense relating to discontinuing operations and continuing operations with a total column.

SSAP 33 explicitly disallows the presentation of a discontinuing operation as an extraordinary item. This means that the results of a discontinuing operation are included in the results of ordinary activities of the enterprise. The Standard explains that the two examples of extraordinary items cited in SSAP 2 (closure of operations due to expropriation of assets and natural disasters) do not fall within the scope of discontinuing operations, as defined by SSAP 33, as such events are not within the control of the management of the enterprise.

Compliance with IFRS

SSAP 33 is consistent with the equivalent IFRS, IAS 35, in all material respects. Therefore, compliance with SSAP 33 will ensure compliance with relevant IFRS requirements.

SSAP 34 EMPLOYEE BENEFITS

Impact

The major impact of SSAP 34 will be on those entities that have defined benefit retirement benefits schemes, where the detailed rules introduced may represent a significant change from current practice. For other enterprises, the Standard should only codify what is currently accepted as best practice.

For defined contribution retirement benefits schemes (including Mandatory Provident Fund Schemes), SSAP 34 is not expected to bring about any real change to existing practice.

SSAP 34 also contains detailed disclosure requirements for equity compensation benefits (e.g. share options granted to employees). Although these requirements are applicable to all reporting enterprises, they will apply most commonly to listed enterprises. The Stock Exchange of Hong Kong Limited has already introduced comprehensive disclosure requirements in respect of share options from 2001 year ends and, therefore, the principal impact of SSAP 34 in this regard will be to bring certain of these disclosures within the body of the financial statements and, therefore, within the scope of the audit report.

Action required

Enterprises with defined benefit retirement benefits schemes will need to ensure that appropriate valuations have been carried out to enable them to comply with the requirements of SSAP 34. In particular, the valuations must be timely and must adopt appropriate valuation methods (see page 20).

Where the enterprise has a significant transitional liability (see page 21), the directors will need to select between the available alternatives of immediate recognition as a prior period adjustment and recognition as an expense over a period of up to 5 years.

For SSAP 34 disclosures in relation to share options, listed enterprises in particular will need to consider the most appropriate presentation given the interaction of the SSAP 34 requirements and those of the Listing Rules/GEM Rules.

Commentary

Within the Hong Kong environment, one issue to which reporting enterprises should pay particular attention is the area of long service payments under the Employment Ordinance. Previously, reporting enterprises assessed whether or not a provision was required in respect of long service payments at each reporting date using the criteria set out in SSAP 28 *Provisions, Contingent Liabilities and Contingent Assets.* As a consequential amendment on the implementation of SSAP 34, employee benefits have now been excluded from the scope of SSAP 28.

For many reporting enterprises, it may be possible to conclude that the obligation in respect of long service payments is not material. However, the directors will need to ensure that appropriate actuarial assumptions have been used in arriving at that conclusion.

Key features

The following summary does not deal with all of the requirements of the new Standard, but focusses on the key impacts of SSAP 34.

General principles

SSAP 34 addresses:

- short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave, paid sick leave, profit-sharing and bonuses (payable within 12 months of the year end), and non-monetary benefits for current employees;
- post-employment benefits (e.g. pensions, other retirement benefits, post-employment life insurance and post-employment medical care);
- other long-term employee benefits (e.g. long service payments under the Employment Ordinance, long-service leave);
- termination benefits; and
- equity compensation benefits.

For most of these categories, SSAP 34 merely codifies existing best practice.

For short-term benefits, the general principle is that enterprises should recognise an expense as employees render service that increases their entitlement to benefits. Explicit rules are stated for the first time in respect of compensated absences (e.g. annual leave) and profit-sharing/bonus plans.

For defined contribution retirement benefits schemes (e.g. Mandatory Provident Fund Schemes), the cost of contributions should be recognised as they are earned by the employee.

As regards termination benefits (e.g. lump sum payments or enhanced post-employment benefits payable as a result of termination of employment), SSAP 34 requires that an enterprise should only recognise such costs when it is demonstrably committed to making the payments. The criteria established are consistent with SSAP 28 *Provisions, Contingent Liabilities and Contingent Assets.*

Those aspects of the Standard requiring more detailed consideration are discussed in the following sections.

Defined benefit retirement benefits schemes

The amount at which an enterprise's liability for a defined benefit scheme should be recognised in the balance sheet can be summarised as follows.

Balance sheet recognition of defined benefit liability

The defined benefit liability recognised in the balance sheet is the net total of:

- the present value of the defined benefit obligation at the balance sheet date (i.e. the present value of expected future payments required to settle the obligation resulting from employee service in the current and prior periods);
- plus actuarial gains, less actuarial losses, not recognised in the income statement;
- less any past service cost not yet recognised in the income statement;
- less the fair value at the balance sheet date of plan assets out of which the obligations are to be settled directly.

SSAP 34 requires that the present value of the defined benefit obligation should be determined using the Projected Unit Credit Method. Valuations are not specifically required to be carried out annually, but should be carried out with sufficient regularity such that the amounts recognised in the financial statements do not differ materially from those that would be determined at the balance sheet date. The assumptions used for the purposes of such valuations should be unbiased and mutually compatible. The rate used to discount estimated cash flows should be determined by reference to market yields at the balance sheet date on high quality corporate bonds.

On an ongoing basis, actuarial gains and losses arise which, in the long term, may offset one another. SSAP 34 does not require that the enterprise should recognise all such gains and losses immediately. If the accumulated unrecognised actuarial gains and losses exceed 10% of the greater of the defined benefit obligation and the fair value of plan assets, a portion of that net gain or loss (the excess divided by the expected average remaining working lives of the participating employees) should be recognised immediately as income or expense. Actuarial gains and losses that do not breach the 10% limits described above (the 'corridor') need not be recognised - although the enterprise may choose to do so.

Over the life of the scheme, changes in benefits under the scheme will result in increases or decreases in the enterprise's obligation. 'Past service cost' is the term used to describe the change in the obligation for employee service in prior periods arising as a result of changes to scheme arrangements in the current period. Past service cost should be recognised immediately to the extent that it relates to former employees or to active employees already vested. Otherwise, it should be amortised on a straight-line basis over the average period until the amended benefits become vested.

If the calculation of the balance sheet amount as set out above results in an asset, the amount recognised should be restricted to the real future economic benefit that it represents for the enterprise.

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

Income statement charge for defined benefit scheme

The charge to the income statement is the net total of:

- 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);
- the expected return on plan assets and on any reimbursement rights;
- actuarial gains and losses, to the extent recognised;
- past service cost, to the extent recognised; and
- the effect of any plan curtailments or settlements.

Transitional liability

When SSAP 34 is first implemented, enterprises are required to determine their 'transitional' liability - the present value of their post-employment obligation at the date of adoption minus the fair value, at the date of adoption, of plan assets minus any past service cost to be recognised in later periods. If the transitional liability exceeds the liability that would have been calculated under the enterprise's previous accounting policy, the directors choose either:

- to recognise that increase immediately as a prior period adjustment; or
- to amortise the increase on a straight-line basis over up to five years from the date of adoption.

Long service payments under the Employment Ordinance

The rules set out above in respect of retirement benefits schemes apply equally to arrangements whereby employers provide other long-term employee benefits, including long service payments under the Employment Ordinance. An employee is entitled to a long service payment calculated in accordance with specified formulae where, upon the termination of his employment or upon his retirement, the employee fulfills certain conditions and the termination meets the required circumstances.

In practice, for many enterprises, the probability of making any significant payments for long service is low, because:

- the amount payable is reduced by any payment under a retirement scheme;
- the enterprise is not required to make long service payments if employees resign voluntarily or are dismissed for good reason; and
- Hong Kong's labour force is highly mobile and a significant proportion will never become entitled to any payment under the Employment Ordinance.

In the past, when reporting enterprises have used the recognition criteria under SSAP 28 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether or not a provision was required, the basis of estimation was the amount that would be required to be paid to the employees of the enterprise in respect of their services up to the reporting date i.e. "If all of the enterprise's employees were terminated at the balance sheet date, what would be the required payout?". Under SSAP 34, the basis of estimation is different. The estimate of the enterprise's liability should reflect the present value of the amounts expected to be paid to its employees when they leave the enterprise's employment. Where such a valuation shows a material liability, it should be recognised in full - there is no 'corridor' approach or amortisation of the past service cost over the service life of the employee.

Equity compensation benefits

Equity compensation benefits are employee benefits under which either (a) employees are entitled to receive equity financial instruments issued by the enterprise (or its parent), or (b) the amount of the enterprise's obligation to employees depends on the future price of equity financial instruments issued by the enterprise. Equity compensation benefits include benefits in such forms as shares, share options and other equity instruments issued to employees at less than the fair value at which those instruments would be issued to a third party; and cash payments, the amount of which will depend on the future market price of the reporting enterprise's shares.

The disclosures required by SSAP 34 in respect of equity compensation plans are set out below. The Standard does not deal with recognition or measurement issues. These are being dealt with under the current project on share-based payment (see page 46).

Disclosures for equity compensation plans

Enterprises are required to disclose:

- the nature and terms (including any vesting provisions);
- the accounting policy followed;
- the amounts recognised in the financial statements;
- the number and terms of the enterprise's own equity financial instruments that are held by equity compensation plans (and, in the case of share options, by employees) at the beginning and end of the period. The extent to which employees' entitlements to those instruments are vested at the beginning and end of the period should be specified;
- the number and terms of equity financial instruments issued by the enterprise to equity compensation plans or to employees (or of the enterprise's own equity financial instruments distributed by equity compensation plans to employees) during the period and the fair value of any consideration received from the equity compensation plans or the employees;
- the number, exercise dates and exercise prices of share options exercised under equity compensation plans during the period;
- the number of share options held by equity compensation plans, or held by employees under such plans, that lapsed during the period;
- the amount, and principal terms, of any loans or guarantees granted by the reporting enterprise to, or on behalf of, equity compensation plans;
- the fair value, at the beginning and end of the period, of the enterprise's own equity financial instruments (other than share options) held by equity compensation plans; and
- the fair value, at the date of issue, of the enterprise's own equity financial instruments (other than share options) issued by the enterprise to equity compensation plans or to employees, or by equity

Compliance with IFRS

SSAP 34 is consistent with the equivalent IFRS, IAS 19, in all material respects. Therefore, compliance with SSAP 34 will ensure compliance with relevant IFRS requirements.

SSAP 35 ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE (effective 1 July 2002)

Impact

Although government grants are not very prevalent in Hong Kong, SSAP 35 will impact enterprises operating in Mainland China and overseas, where government incentives are more common. It applies to all government grants and other forms of government assistance. However, it does not cover government assistance that is provided in the form of benefits in determining taxable income.

SSAP 35 is clear that it requires all government grants to be reflected in income - either immediately or over the lives of the assets to which they relate. However, SSAP 35 still allows a large number of choices, and therefore it is unlikely to “standardise” practice.

Action required

Enterprises will need to understand the various alternatives available under SSAP 35 and determine which are more appropriate to their circumstances.

Under the transitional provisions, enterprises can elect whether to apply the Standard retrospectively, or to apply the measurement requirements only to grants or portions of grants becoming receivable or repayable after 1 July 2002. Enterprises will therefore need to consider and select between these alternatives.

In particular, enterprises should also consider the requirement to provide details of forms of government assistance other than government grants from which the enterprise has directly benefited.

Commentary

SSAP 35 has been implemented in Hong Kong as part of the HKSA’s drive for harmonisation with IFRS. However, the equivalent IFRS, IAS 20, is an old Standard, and the availability of alternative treatments is not in line with recent trends in IFRS. One alternative in particular, the netting of grants received against related assets in the balance sheet, appears to us to go against the general prohibition on offsetting balance sheet amounts, and we would encourage enterprises to select the more informative ‘gross presentation’ approach.

Key features

The following summary does not deal with all of the requirements of the new Standard, but focusses on the key impacts of SSAP 35.

Definition

Government grants are defined as assistance by government (local, national, international) in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise.

They exclude those forms of government assistance which cannot reasonably have a value placed on them (e.g. free technical marketing advice, the provision of guarantees) and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise (e.g. trade sales to government or government agencies). Although SSAP 35 does not specify any accounting rules for these other types of government assistance, it does require disclosure of the nature, extent and duration of the assistance where that is necessary in order that the financial statements are not misleading.

Recognition

A government grant is recognised only when there is reasonable assurance that (a) the enterprise will comply with any conditions attached to the grant, and (b) the grant will be received.

Grants should be recognised as income over the period necessary to match them with the related costs for which they are intended to compensate, on a systematic basis, and should not be credited directly to equity. Grants in recognition of specific expenses are recognised as income in the same period as the relevant expense. Grants related to depreciable assets are usually recognised in income as depreciation of the asset is charged.

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.

Measurement

Non-monetary grants, such as grants of land or other resources, are usually accounted for by recognising both the grant and the asset at fair value. However the alternative of recording both the asset and the grant at a nominal amount is also permitted by SSAP 35.

Presentation

A grant relating to an asset may be presented in the balance sheet either:

- as deferred income (recognised as income over the useful life of the asset); or
- by deducting the grant from the asset's carrying amount (recognised as income by way of reduced depreciation charge).

Irrespective of the balance sheet presentation, SSAP 35 does recommend that the cash flows in respect of purchases of assets and receipts of related grants should be presented separately in the cash flow statement.

A grant relating to income may be reported separately as 'other income', or deducted from the related expense.

Repayment

If a grant becomes repayable, it should be treated as a change in 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 that would have been charged had the grant not been received should be charged as an expense.

Disclosure

The following disclosures are required:

(a) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the enterprise has directly benefited; and

(c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognsied.

Compliance with IFRS

SSAP 35 is consistent with the equivalent IFRS, IAS 20, in all material respects. Therefore, compliance with SSAP 35 will ensure compliance with relevant IFRS requirements.

INTERPRETATIONS EFFECTIVE IN 2002

INT 14 Evaluating the Substance of Transactions involving the Legal Form of a Lease

Effective Date : 30 June 2002 Interprets: SSAP 14

The Interpretation addresses a number of issues that may arise when an arrangement between an enterprise and an investor involves the legal form of a lease. It addresses how to determine whether a series of transactions is linked and should be accounted for as one transaction, and whether an arrangement meets the definition of a lease under SSAP 14. The Interpretation concludes that the accounting should reflect the substance of the arrangement.

If an arrangement does not meet the definition of a lease, the Interpretation continues by addressing whether any separate investment accounts and lease payment obligations that exist represent assets and liabilities of the enterprise; how the enterprise should account for other obligations resulting from the arrangement; and how the enterprise should account for any fee it receives from an investor.

INT 15 Business Combinations - "Date of Exchange" and Fair Value of Equity Instruments

Effective Date : Acquisitions given initial accounting recognition on or after 30 June 2002 Interprets: SSAP 30

The Interpretation addresses when the "date of exchange" occurs where shares are issued as purchase consideration in an acquisition. This is important because SSAP 30 requires the purchase consideration in an acquisition to be measured at its fair value at the date of exchange.

When an acquisition is achieved in one exchange transaction, the "date of exchange" is the date when the acquirer obtains control over the net assets and operations of the acquiree. When the acquisition is achieved in stages (e.g. successive share purchases), the fair value of the equity instruments issued as purchase consideration at each stage should be determined at the date that each individual investment is recognised in the financial statements of the acquirer.

The Interpretation also concludes that the published price at the date of exchange provides the best evidence of the instrument's fair value and should be used to measure the purchase consideration, except in the rare circumstances when it can be demonstrated that the published price is not a reliable indicator.

INT 16 Disclosure - Service Concession Arrangements

Effective Date : 30 June 2002 Interprets: SSAP 1

The Interpretation addresses what information should be disclosed in the notes to the financial statements of a Concession Operator and a Concession Provider (as defined) when the two parties are joined by a service concession arrangement. A service concession arrangement exists when an enterprise (the Concession Operator) agrees with another enterprise (the Concession Provider) to provide services that give the public access to major economic and social facilities. Examples of service concession arrangements include water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. The Interpretation requires that all of the significant aspects of such arrangements should be disclosed – including future commitments and repricing dates.

INT 17 Revenue - Barter Transactions involving Advertising Services

Effective Date : 30 June 2002 Interprets: SSAP 18

The Interpretation addresses whether a seller can reliably measure revenue at the fair value of advertising services received or provided in a barter transaction. It concludes that revenue from a barter transaction involving advertising can only be measured reliably by reference to the seller's own non-barter transactions that:

- involve advertising similar to the advertising in the barter transaction;
- occur frequently, and represent a predominant number of transactions and amount when compared to all transactions to provide similar advertising;
- involve cash and/or another form of consideration and that has a reliably measurable fair value; and
- do not involve the same counterparty as in the barter transaction.

INT 18 Consolidation and Equity Method - Potential Voting Rights and Allocation of Ownership Interests

Effective Date : Annual financial periods beginning or after 1 July 2002 Interprets: SSAPs 10/32

An enterprise may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments of another enterprise (potential voting rights). The Interpretation addresses whether the existence and effect of potential voting rights should be considered when assessing whether the first enterprise controls or exercises significant influence over the second enterprise as described in SSAP 32 and SSAP 10 respectively. The Interpretation concludes that the existence and effect of potential voting rights that are presently (i.e. currently) exercisable or presently convertible should be considered.

The Interpretation also concludes that the proportion allocated to the parent and minority interests in preparing consolidated financial statements, and the proportion allocated to an investor that accounts for its investment in an associate using the equity method, should be determined based solely on present ownership interests.

INT 19 Intangible Assets - Web Site Costs

Effective Date : 15 October 2002 Interprets: SSAP 29

The Interpretation addresses whether a web site developed by an enterprise from internal expenditure for internal or external access is an internally-generated intangible asset that is subject to the requirements of SSAP 29 *Intangible Assets*. The Interpretation identifies five stages of web site development and addresses the appropriate accounting treatment for each of those five stages.

Web site development costs should be recognised as an intangible asset if and only if, in addition to complying with the general requirements described in SSAP 29 paragraph 19 for recognition and initial measurement, the enterprise can demonstrate how its web site will generate probable future economic benefits under SSAP 29 paragraph 45(d). Development costs incurred on a web site designed solely or primarily for promoting and advertising the enterprise's own products and services should be recognised as an expense when incurred.

SSAP 12 (REVISED) INCOME TAXES (effective 1 January 2003)

Impact

SSAP 12 (Revised) introduces a comprehensive framework for accounting for both current and deferred tax.

While the introduction of recognition and measurement rules for current tax assets and liabilities merely codifies exciting accounting practice, the revised requirements for deferred tax are fundamentally different from those set out in the previous version of the Standard and may result in significant prior period adjustments. Key differences of principle are:

- a focus on 'temporary differences' rather than 'timing differences';
- full provision for deferred taxation is required, subject to very limited exceptions, in contrast to the partial provision approach followed under the previous Standard;
- deferred tax assets, including those arising from tax losses, will be recognised when it is probable that taxable profits against which the deferred tax assets can be utilised will be available;
- deferred tax must be provided in full when an asset is revalued;
- deferred tax must be provided in full when fair value adjustments are made in business combinations; and
- discounting of deferred tax assets and liabilities is explicitly prohibited.

The revised Standard has also expanded the disclosure requirements for taxation. In particular, a detailed reconciliation is required to be presented between the accounting profit multiplied by the applicable tax rate and the actual tax charge.

Commentary

The key to a successful implementation of SSAP 12 (Revised) is to gain a proper understanding of the Standard. There are important differences of principle between the revised Standard and its predecessor. The introduction of the balance sheet approach, under which the carrying amounts of assets and liabilities in the balance sheet are compared with their tax bases, requires a fresh look at previous estimates of deferred tax assets and liabilities. The requirement for full provisioning means that the most common justifications for non-recognition in the past (that reversing timing differences would be replaced by similar originating differences, or that there was no intention to dispose of an asset) will no longer be available. In addition, it is necessary to look at the liability to tax in respect of the profits generated from the use of an asset as well as the liability to tax on the ultimate disposal of the asset.

With a view to assisting preparers of financial statements in obtaining a complete understanding of SSAP 12 (Revised), we will shortly be issuing a comprehensive guide to that Standard. If you wish to obtain a copy of the guide, please register your interest by emailing your contact details to the Technical Administrator at **technical@deloitte.com.hk**.

Key features

The following summary does not deal with all of the requirements of the revised Standard, but focusses on the key aspects of SSAP 12 (Revised).

Definitions

Temporary difference: A difference between the carrying amount of an asset or liability and its tax base.

Taxable temporary difference: 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.

Deductible temporary difference: 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.

Recognition of deferred tax liabilities

The general principle established in SSAP 12 (Revised) is that deferred tax liabilities should be recognised for all taxable temporary differences. There are three exceptions to the requirement for full provision:

- liabilities arising from goodwill for which amortisation is not deductible for tax purposes;
- 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 undistributed profits from investments where the enterprise is able to control the timing of the reversal of the difference and the reversal is not foreseen.

Recognition of deferred tax assets

A deferred tax asset should be recognised for deductible temporary differences to the extent that it is probable that sufficient taxable profit will be available against which the deductible temporary differences can be utilised, unless the deferred tax asset arises from:

- negative goodwill which is treated as deferred income under SSAP 30 *Business Combinations*; or
- 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.

Deferred tax assets for deductible temporary differences arising from investments in subsidiaries, associates, branches and joint ventures should be recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and that taxable profit will be available against which the temporary difference will be utilised.

A deferred tax asset should be recognised for an unused tax loss carryforward or unused tax credit if, and only if, it is considered probable that there will be sufficient future taxable profit against which the loss or credit carryforward can be utilised.

The carrying amount of deferred tax assets should be reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction should be subsequently reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Measurement of deferred tax assets and liabilities

Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled (liability method), and should not be discounted.

Where a non-depreciable asset is carried at a revalued amount under SSAP 17, Property, Plant and Equipment, no part of such an asset is considered to be recovered through its use. Therefore, the deferred tax liability or asset that arises from revaluation should be measured based on the tax consequence that would follow from the sale of the asset rather than through use. ***[INT 20]***

Recognition of tax expense or income

Current and deferred tax should be recognised as income or expense and included in net profit or loss for the period, except that:

- if the tax relates to items that are credited or charged directly to equity, the tax should also be charged or credited directly to equity; and
- if the tax arises from a business combination that is an acquisition, it should be recognised as an identifiable asset or liability at the date of acquisition in accordance with SSAP 30 *Business Combinations*.

A change in the tax status of an enterprise or its shareholders does not give rise to increases or decreases in the pre-tax amounts recognised directly in equity. Therefore, the current and deferred tax consequences of such a change in status should be included in net profit or loss for the period, unless those consequences relate to transactions and events that result in a direct credit or charge to the recognised amount of equity. ***[INT 21]***

Presentation and disclosure

The following principles should be applied in the presentation of tax assets and liabilities:

- tax assets and liabilities should be presented separately from other assets and liabilities in the balance sheet;
- current tax assets and liabilities should be distinguished from deferred tax assets and liabilities; and
- when the enterprise distinguishes between current and non-current assets and liabilities in its financial statements, deferred tax assets (liabilities) should not be treated as current assets (liabilities).

Offsetting of current tax assets and current tax liabilities, and deferred tax assets and deferred tax liabilities, is subject to stringent conditions.

The major components of tax expense/income and deferred tax assets/liabilities are required to be disclosed. In addition, a reconciliation is required between the tax income/expense and the product of accounting profit multiplied by the tax rate.

Compliance with IFRS

SSAP 12 (Revised) is consistent with the equivalent IFRS, IAS 12, in all material respects. Therefore, compliance with SSAP 12 (Revised) will ensure compliance with relevant IFRS requirements.

SSAP 36 AGRICULTURE (effective 1 January 2004)

Impact

SSAP 36 is the first Accounting Standard in Hong Kong dealing with the accounting treatment, financial statement presentation and disclosure for agricultural activity.

The Standard introduces a fair value model, which is a major shift away from the historical cost model widely applied in the initial recognition of assets. Under SSAP 36, all biological assets are measured at the balance sheet date at fair value. Further, all agricultural produce at the point of harvest is measured at fair value. This fair value model has been introduced with the objective of providing more relevant information about the performance and future prospects of the reporting enterprise. Some agricultural activity, such as the raising of livestock and the growing of timber, may take several years to give rise to produce for sale. Under the historical cost model, a sales transaction is usually required before the recognition of income is triggered. However, in the context of agricultural activity, the event giving rise to income is the progress of development of the biological assets, e.g. growth, procreation, harvest. The fair value model is intended to capture this income generation as it occurs.

The language of the Standard is complex - particularly the definitions provided for what are commonly-used terms. However, the principles established are relatively straightforward, and result in the introduction of a comprehensive fair value model for agricultural activity.

Commentary

Although agricultural activity is not very common in Hong Kong, the new Standard may have significant implications for the following enterprises:

- enterprises with subsidiaries carrying out agricultural activity in the People's Republic of China (PRC) or overseas; and
- PRC enterprises carrying out agricultural activity which plan to list on the Main Board or the GEM Market of the Stock Exchange of Hong Kong Limited.

As can be seen from the definitions on the next page, agricultural activity is not restricted to traditional farming operations, but will also apply to some enterprises operating in the bio-technology sector.

SSAP 36 is effective for accounting periods beginning on or after 1 January 2004. Because there was no previous Hong Kong Standard on this topic, and the equivalent IFRS, IAS 41, is effective from 1 January 2003, SSAP 36 represents best practice in this area from its date of issue.

Key features

The following summary does not deal with all of the requirements of the new Standard, but focusses on the key impacts of SSAP 36.

Definitions

Agricultural activity refers to the management by an enterprise of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets. A biological asset is a living animal or plant.

Agricultural produce is the harvested product of the enterprise's biological assets.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

Biological transformation comprises the processes of growth, degeneration, production and procreation that cause qualitative or quantitative changes in a biological asset.

Measurement

Biological assets 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.

SSAP 36 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 circumstances, the asset is measured at cost less accumulated depreciation and impairment losses. But the enterprise must still measure all of its other biological assets at fair value. If circumstances change, and fair value becomes reliably measurable, a switch to fair value less point-of-sale costs is required.

Agricultural produce should be measured at fair value less estimated point-of-sale costs at the point of harvest. Because harvested produce is a marketable commodity, there is no 'measurement reliability' exception for produce.

The following guidance is provided on the measurement of fair value:

- a quoted market price in an active market for a biological asset or agricultural produce is the most reliable basis for determining the fair value of that asset. If an active market does not exist, SSAP 36 provides guidance for choosing another measurement basis. First choice would be a market-determined price such as the most recent market price for that type of asset, or market prices for similar or related assets;
- if reliable market-based prices are not available, the present value of expected net cash flows from the asset should be used, discounted at a current market-determined pre-tax rate;
- in limited circumstances, cost is an indicator of fair value, where little biological transformation has taken place or the impact of biological transformation on price is not expected to be material; and
- the fair value of a biological asset is based on current market prices and is not adjusted to reflect the actual price in a binding sale contract that provides for delivery at a future date.

Recognition of gains and losses

The gain on 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.

A gain on recognition of agricultural produce at fair value should be included in net profit or loss for the period in which it arises.

All costs related to biological assets that are measured at fair value are recognised as expenses when incurred, other than costs to purchase biological assets.

Other issues

Fair value measurement stops at harvest. SSAP 22 *Inventories* applies after harvest.

Agricultural land is accounted for under SSAP 17 *Property, Plant and Equipment* and SSAP 13 *Accounting for Investment Properties*. However, biological assets that are physically attached to land are measured as biological assets separate from the land.

Intangible assets relating to agricultural activity (e.g. milk quotas) are accounted for under SSAP 29 *Intangible Assets*.

Unconditional government grants received in respect of biological assets measured at fair value are reported as income when the grant becomes receivable.

Presentation and disclosure

SSAP 36 requires an enterprise to:

- present the carrying amount of its biological assets separately on the face of its balance sheet;
- disclose (either in the notes to the financial statements or on the face of income statement) the aggregate gain or loss arising during the current period on initial recognition of biological assets or agricultural produce and from the change in fair value less estimated point-of-sale costs of biological assets;
- present a detailed reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the accounting period;
- describe each group of biological assets and the nature of the enterprise's agricultural activities; and
- disclose the basis for fair values incorporated in the financial statements or, where fair value cannot be measured reliably, an explanation and the accounting treatment adopted.

Compliance with IFRS

SSAP 36 in consistent with the equivalent IFRS, IAS 41, in all material respects. Therefore, compliance with SSAP 36 will ensure compliance with relevant IFRS requirements.

CURRENT HONG KONG EXPOSURE DRAFTS

There are currently a number of signficant Exposure Drafts in issue proposing new or revised Hong Kong Standards.

Exposure Draft	Timetable
Proposed new Standard on *Financial Reporting in Hyperinflationary Economies*	Deadline for comments: 30 January 2003 Final Standard expected in 2nd quarter of 2003
Proposed Improvements to IFRS	Comment deadline expired on 31 August 2002 Final Standard expected in 1st quarter of 2003
Proposed new Standards based on IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*	Comment deadline expired on 30 September 2002 Final Standard expected in 2nd half of 2003
Proposed new Standard on *First-time Application of Hong Kong SSAPs*	Comment deadline expired on 15 October 2002 Final Standard expected in 2nd quarter of 2003
Proposed revised *Framework for the Preparation and Presentation of Financial Statements*	Comment deadline expired on 15 November 2002 Revised Framework expected in 1st quarter of 2003
Proposed new Standard on *Share-based Payment*	Deadline for comments (HK): 15 February 2003 Final Standard expected in 2nd half of 2003
Proposed new Standard on *Business Combinations*, and proposed amendments to SSAP 31 *Impairment of Assets* and SSAP 29 *Intangible Assets.*	Deadline for comments (HK): 15 March 2003 Final Standard expected in 2nd half of 2003

The first Exposure Draft listed above (Hyperinflationary Economies) is based on IAS 29 of the same title. The proposed revised Framework has been circulated with a view to bringing the Hong Kong Framework into line with the equivalent Framework issued by the IASB.

The remaining Exposure Drafts are IASB Exposure Drafts that have been published by the HKSA with the objective of soliciting comments from interested parties in Hong Kong to be included in the Society's submissions to the IASB. As part of its policy of convergence, the HKSA now issues these Exposure Drafts at the same time as they are issued for comment by the IASB, so that the Hong Kong Standard can be finalised and effective for the same period as the IFRS.

In the following pages we have highlighted the most significant proposals included in the Exposure Drafts.

FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

Background

This Exposure Draft, based on IAS 29 of the same title, is designed to establish specific standards for enterprises reporting in the currency of a hyperinflationary economy, so that the financial information reported is meaningful. In practice, the number of countries falling within the scope of the new Standard will be very few. Whether or not a country is to be considered as experiencing hyperinflation for the purposes of the Standard will be determined by a consensus of the accounting profession rather than by each enterprise individually. Although not directly applicable for Hong Kong operations, this Standard will impact Hong Kong reporting enterprises with overseas operations in those countries considered to be experiencing hyperinflation.

Since this Standard will implement a well-established IFRS, we anticipate that it will have a relatively easy passage through the HKSA standard-setting process. Therefore, we would expect the finalisation of a Standard in the second quarter of 2003, with a likely effective date of 1 January 2004.

Key features

The basic principle established in the proposed SSAP is that the financial statements of an enterprise that reports in the currency of a hyperinflationary economy should 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.

Restatements are made by applying a general price index. Items such as monetary items that are already expressed in 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 dates those items were acquired or incurred and the balance sheet date. A gain or loss on the net monetary position is included in net income, and disclosed separately.

The proposed Standard does not establish an absolute rate at which hyperinflation is deemed to arise. Characteristics of the economic environment of a country which indicate the existence of hyperinflation include:

- 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; and
- the cumulative inflation rate over three years approaches, or exceeds, 100%.

When an economy ceases to be hyperinflationary and an enterprise discontinues the preparation and presentation of financial statements in accordance with the proposed Standard, 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.

Transition

The proposed Standard contains no specific transitional provisions. Therefore, SSAP 2's general principle of retrospective application should be followed. Comparative amounts will be required to be restated, if materially affected by the change.

PROPOSED IMPROVEMENTS TO IFRS

Background

The objective of the IASB Improvements Project is to improve the clarity and consistency of the requirements of existing Standards issued by the IASB's predecessor, the IASC Board. The issues addressed are those that have been identified by various sources as narrow issues of substance whose resolution could improve the quality of the IASC Standard and/or increase convergence of national and international standards. Also included are issues for which an IASC Standard allows explicit or implicit alternative treatments. A summary of the IASB's proposals is included on Deloitte Touche Tohmatsu's IAS Plus website (www.iasplus.com).

The IASB Exposure Draft proposes the withdrawal of IAS 15 *Information Reflecting the Effects of Changing Prices* and the amendment of another 13 Standards.

The IASB has indicated that it expects to issue the revised Standards in the first quarter of 2003. Amendments to Hong Kong SSAPs would follow shortly thereafter, with a likely effective date of 1 January 2004. Certain of the proposals may, however, be delayed if they are impacted by the IASB's convergence project (see page 53).

Key features

The IASB Exposure Draft is primarily intended to eliminate alternatives and standardise financial reporting practice in a number of areas. For many of the topics addressed in the IASB Exposure Draft, there are existing differences between Hong Kong GAAP and IFRS. In particular, because the HKSA has generally eliminated alternatives available under IFRS, not all of the proposed changes will impact Hong Kong. The HKSA does not intend to issue a Hong Kong Exposure Draft highlighting the specific changes proposed for Hong Kong Standards. Based on our review of the IASB Exposure Draft, the following are the principal changes that we anticipate for Hong Kong Standards.

SSAP	Anticipated Amendments
SSAP 1 *Presentation of Financial Statements*	Refinancing after the balance sheet date will not be taken into account in classifying liabilities as current/non-current. If, at the balance sheet date, a lender has an absolute right to demand repayment immediately, the liability will be classified as a current liability, even if, after the balance sheet date, the lender agrees not to demand payment. If a borrowing agreement includes a covenant that has the effect that a liability becomes repayable on demand if certain conditions relating to the borrower's financial position are breached, and those conditions are breached, the liability will be classified as current, even if corrected after the balance sheet date.
SSAP 2 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*	Removal of the distinction between fundamental and other errors. All material errors will be corrected by retrospective prior period adjustment. Elimination of the concept of an extraordinary item.
SSAP 5 *Earnings Per Share*	Basic and diluted EPS to be shown on the face of the income statement for both profit or loss from continuing operations and net profit or loss. Additional guidance on more complex matters.

SSAP	Anticipated Amendments
SSAP 10 *Accounting for Investments in Associates*	If an investor does not prepare consolidated financial statements because it does not have any subsidiaries, it should use the equity method to account for investments in associates. The definition of investment in an associate will be expanded to include certain loans and long-term advances. This affects the base to be reduced when an associate incurs losses.
SSAP 14 *Leases*	Leases of land and buildings to be split into separate components. A lease of land is generally classified as an operating lease. However, if the lease payments for land and buildings cannot be allocated reliably, the entire lease can be classified as a finance lease, unless it is clear that both land and buildings are operating leases.
SSAP 17 *Property, Plant and Equipment*	Exchanges of similar assets to be at fair value with gain/loss recognised.
SSAP 22 *Inventories*	Additional disclosure required in respect of the amount of any write-down of inventories to net realisable value.
SSAP 32 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*	IFRS/Hong Kong SSAPs currently exempt wholly-owned subsidiaries from the requirement to prepare consolidated financial statements. The exemption would be tightened. More conditions would be established in order to avail of the exemption. For non-wholly owned subsidiaries, exemption from preparing consolidated financial statements will be allowed under IFRS if approval is obtained from the minority shareholders. The Hong Kong SSAP does not currently permit this exemption. Exemption from consolidation due to severe long-term restrictions will no longer be available.

Transition

The revised IFRS arising from the Improvements Project are expected to be effective for periods beginning on or after 1 January 2004 (subject to delays arising from the IASB's convergence project as referred to on the previous page), with the option of early adoption. We expect that the revised Hong Kong SSAPs will have the same effective date. Generally, retrospective application will be required.

There has been no suggestion that the revised Standards should be considered a 'package', and that early adoption for one will require early adoption of all. We agree with this position, since the changes in the individual Standards are largely unrelated.

FINANCIAL INSTRUMENTS : DISCLOSURE AND PRESENTATION
FINANCIAL INSTRUMENTS : RECOGNITION AND MEASUREMENT

Background

Early in 2002, the HKSA issued Exposure Drafts based on the current versions of IAS 32 and IAS 39. In July 2002, the IASB issued an Exposure Draft on proposed improvements to those Standards, which was also issued by the HKSA. It is therefore intended that the Standards to be introduced in Hong Kong will be the IFRS as amended for the outcome of the current IASB consultation. Our discussion below therefore assumes that the IASB proposals are implemented as drafted.

The IASB has indicated that it aims to issue the revised IAS 32 and IAS 39 in the second half of 2003. We anticipate that the Hong Kong Standards will be finalised shortly after the revised IFRS, with a likely implementation date of 1 January 2004. The new Standards would replace SSAP 24 *Accounting for Investments in Securities* and the portions of SSAP 11 *Foreign Currency Translation* dealing with hedging.

The transitional issues raised by the implementation of IAS 32 and IAS 39 are complex (see page 43).

Key features of IAS 32 *Financial Instruments: Disclosure and Presentation*

IAS 32 deals principally with three matters:

- liability vs. equity classification;
- offsetting of financial assets and liabilities; and
- disclosure.

Liability vs equity

The fundamental principle of IAS 32 is that an instrument should be classified as either a liability or equity instrument according to its substance. The classification is established at the time the instrument is initially recognised. The classification is not subsequently changed based on changed circumstances. The key distinguishing feature is that a financial liability involves a contractual obligation either to deliver cash or another financial asset, or to issue another financial instrument under terms that are potentially unfavourable. An instrument that does not give rise to such a contractual obligation is an equity instrument.

Examples

While most preference shares are equity instruments, those that have a mandatory redemption feature at a future date obligate the issuer to pay cash (and, usually, to pay a fixed rate of return in the interim). Mandatorily redeemable preference shares are a contractual obligation that should be recognised as a liability. Similarly, if the holder of these shares has a put option that, if exercised, would require the reporting enterprise to redeem the shares for cash, it is a liability. In contrast, normal preference shares do not have a fixed maturity, and the issuer does not have a contractual obligation to make any payment. Therefore, they are equity. Even if they have a call option (issuer can redeem for cash), the substance is equity since the enterprise does not have a present obligation to pay cash.

Interest, dividends, gains, and losses relating to an instrument classified as a liability should be charged or credited in arriving at net profit or loss for the period. This means that dividend payments on preference shares classified as liabilities are treated as expenses. On the other hand, distributions to holders of a financial instrument classified as equity should be charged directly against equity, not against earnings.

Compound financial instruments

Some financial instruments - sometimes called compound instruments - have both a liability and an equity element. IAS 32 requires that the component parts of a compound instrument be split, with each part accounted for and presented separately according to its substance. To illustrate, 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. This split is made at the time the instrument is issued and is not subsequently revised as a result of a change in interest rates, share price, or other event that changes the likelihood that the conversion option will be exercised.

Offsetting of financial assets and financial liabilities

IAS 32 also prescribes rules for the offsetting of financial assets and financial liabilities. It specifies that a financial asset and a financial liability should be offset and the net amount reported when, and only when, an enterprise:

- 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.

In Hong Kong, SSAP 1 currently has more stringent conditions for offsetting. The HKSA proposes to leave the SSAP 1 conditions in place until the Hong Kong equivalent of IAS 32 is adopted.

Disclosures

Reporting enterprises are required to disclose their financial risk management objectives and policies, including hedging policies.

In addition, for each class of financial asset, financial liability, and equity, both recognised and unrecognised, IAS 32 specifies disclosure requirements for:

- the extent and nature of the financial instruments, including significant terms and conditions;
- accounting policies and methods adopted;
- specified information about exposure to interest rate risk;
- specified information about exposure to credit risk; and
- specified information about the fair value of financial instruments, or a statement that it is not practicable to provide such information.

Key features of IAS 39 *Financial Instruments: Recognition and Measurement*

The main issues addressed by IAS 39 are:

- balance sheet recognition of financial instruments;
- initial measurement of financial instruments;
- subsequent measurement of financial assets;
- subsequent measurement of financial liabilities;
- derecognition;
- impairment and collectibility; and
- hedge accounting.

Balance sheet recognition of financial instruments

IAS 39 requires that all financial assets and all financial liabilities should be recognised on the balance sheet. That includes all derivatives. Purchases and sales of each broad category of financial assets must be accounted for consistently using either trade date or settlement date accounting. If settlement date accounting is used, certain value changes between trade and settlement dates must be recognised.

In a Hong Kong context, the principal impact of these rules will be the recognition on-balance sheet of derivatives for the first time.

Initial measurement of financial instruments

Financial assets and financial liabilities are measured initially at cost, which is the fair value of whatever was paid or received to acquire or incur them. Acquisition cost includes transaction costs such as commissions, fees, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include premiums or discounts, financing costs, or allocations of internal administrative or holding costs.

Subsequent measurement - financial assets

The following table summarises the classification and measurement scheme for financial assets under IAS 39.

Category of Financial Asset	Description	Measurement Basis
Originated loans and receivables	Loans and receivables created by an enterprise by providing money, goods or services directly to the debtor.	Amortised cost, subject to impairment recognition.
Held-to-maturity investments	Fixed maturity investments that the enterprise intends and is able to hold to maturity.	Amortised cost, subject to impairment recognition.
Available for sale financial assets - normal case	Includes: ■ fixed maturity investments that the enterprise either does not intend or is not able to hold to maturity; ■ equity investments with a quoted market price; and ■ equity investments with no quoted market price but able to estimate fair value.	Fair value. Enterprise has a one-time, enterprise-wide choice of reporting changes in fair value (a) in net profit or loss, or (b) in equity until the asset is sold or otherwise disposed of, at which time the cumulative gain or loss is reported in net profit or loss.
Available for sale financial assets - unusual	Equity investments with no quoted market price and the enterprise is not able to estimate fair value.	Cost, subject to impairment recognition.
Financial assets held for trading	Financial assets acquired for the purpose of generating a profit from short term fluctuations in price. This includes all derivative assets and liabilities.	Fair value, changes in fair value in net profit or loss.

The proposed changes to IAS 39 would impact the subsequent measurement rules for financial assets described above as follows:

- enterprises could choose to classify any individual financial asset as held for trading and therefore measure it at fair value with valuation movements dealt with in income;
- enterprises could also choose to classify any originated loan as available-for-sale; and
- the option to report fair value changes for available-for-sale financial assets in income would be removed. Therefore, all movements on available-for-sale financial assets would be reported in equity until they were disposed of or determined to be impaired, at which time they would be reported in income.

The IAS 39 rules for measurement of financial assets will impact those Hong Kong enterprises that have previously designated investments as 'investment securities' under SSAP 24's benchmark treatment, and therefore carried them at cost. The new Standard will require that such investments are measured at fair value, where such fair value can be reliably measured.

Subsequent measurement - financial liabilities

After acquisition, most financial liabilities are measured at original recorded amount less principal repayments and amortisation of discounts and premiums. Only derivatives with a negative market value and liabilities held for trading (such as an obligation for securities borrowed in a short sale, which have to be returned in the future) are required to be remeasured to fair value.

Under the proposed changes to IAS 39, the enterprise could choose to classify any individual financial liability as held for trading and therefore measure it at fair value with valuation movements dealt with in income.

Derecognition (removal) of financial assets and liabilities

IAS 39 establishes conditions for determining when control over a financial asset or liability has been transferred to another party and, therefore, the instrument should be removed from the balance sheet (derecognised).

For financial assets, derecognition is normally appropriate if:

- the transferee has the right to sell or pledge the asset; and
- the transferor does not have the right to reacquire the transferred asset. However, such a right does not prevent derecognition if either the asset is readily obtainable in the market or the reacquisition price is fair value at the time of reacquisition.

Under the proposed amendments to IAS 39, derecognition will not be permitted to the extent that the transferor has continuing involvement with the transferred asset, which could result from call and put options, forwards, guarantees and subordinations. The transferor is also considered to have continuing involvement when (a) it could be required to reacquire control of the transferred asset, or (b) the transferor provides a guarantee of the performance of the transferred asset.

With respect to derecognition of liabilities, the creditor must legally release the debtor from primary responsibility for the liability either judicially or contractually, to enable the debtor to derecognise the liability.

If part of a financial asset or liability is sold or extinguished, the carrying amount is split based on relative fair values. If fair values are not determinable, IAS 39 prescribes a cost recovery approach to profit recognition.

Impairment of financial assets

If it is probable that the holder of a financial asset that is carried at amortised cost (loans, receivables and held-to-maturity investments) will not be able to collect all of the principal and interest amounts due according to the original contractual terms, IAS 39 requires that an impairment or bad debt loss be recognised. The impairment calculation compares the carrying amount of the financial asset with the discounted present value of the currently estimated amounts and timings of payments. Thus, impairment is recognised if any interest or principal payments are reduced, forgiven or delayed. The financial instrument's original effective interest rate is the rate to be used for discounting. Any impairment loss is charged to net profit or loss for the period.

Once impairment has been recognised, if the fair value of the financial asset increases in a subsequent period such that the impairment loss is reduced or eliminated, a reversal of the impairment loss is recognised, up to what the amortised-cost carrying amount would have been at the time of reversal.

Impairment is also an issue for a financial asset carried at fair value if the fair value change is reported directly in equity. IAS 39 requires that impairment be assessed for these financial assets as well and, if impaired, any loss previously reported in equity is charged against net profit or loss.

Under the proposed amendments to IAS 39, no reversal will be allowed for impairments of investments in debt or equity securities that are classified as available-for-sale.

Hedge accounting

Hedge accounting means designating a derivative financial instrument as an offset in net profit or loss, in whole or in part, to the change in fair value or cash flows of a hedged item. A non-derivative financial instrument may also be a designated hedging instrument, but only with respect to hedges of foreign currency risks. The designation must be in writing, up front (no retrospective designations), and be consistent with an established risk management strategy. In essence, under IAS 39, hedge accounting is not mandatory. If an enterprise does not want to use hedge accounting, it simply does not designate a hedging relationship.

Hedge accounting is permitted under IAS 39 in certain circumstances, provided that the hedging relationship is:

- clearly defined: what risk is being hedged and what is the expected relationship between that risk and the hedging instrument;
- measurable: what technique will be used to assess hedge effectiveness; and
- actually effective: if, despite strategies and expectations, the hedge was not effective, or was only partially effective, the ineffective portion is not eligible for hedge accounting.

IAS 39 recognises three types of hedge. They are:

- Fair value hedge: a hedge of the exposure to changes in the fair value of an asset or liability that is already recognised in the balance sheet (such as a hedge of exposure to changes in the fair value of fixed rate debt as a result of changes in interest rates). The gain or loss from the change in fair value of the hedging instrument is recognised immediately in net profit or loss. At the same time, the carrying amount of the hedged item is adjusted for the corresponding gain or loss since the inception of the hedge, which also is recognised immediately in net profit or loss.

- Cash flow hedge: a hedge of the exposure to variability in cash flows relating to (a) a recognised asset or liability (such as all or some future interest payments on variable rate debt), (b) an unrecognised firm commitment (such as a non-cancellable fixed price purchase order), or (c) a forecasted transaction (such as an anticipated purchase or sale). To the extent that the hedge is effective, the portion of the gain or loss on the hedging instrument is recognised initially directly in equity. Subsequently, that amount is included in net profit or loss in the same period or periods during which the hedged item affects net profit or loss (for example, when cost of sales, depreciation, or amortisation are recognised). For hedges of forecasted transactions, the gain or loss on the hedging instrument will adjust the carrying amount recorded for the acquired asset or liability at the date of acquisition.
- Hedge of a net investment in a foreign entity. These are accounted for as cash flow hedges.

Under the proposed amendments to IAS 39:

- hedges of firm commitments will be fair value hedges, not cash flow hedges; and
- if a derivative is used to hedge a forecasted transaction (for instance, an asset purchase in a foreign currency), under the old IAS 39 the gain or loss on the derivative is deferred in equity. When the asset is acquired, the gain or loss becomes an adjustment of the cost of the asset, resulting in depreciation of the net amount. This is known as "basis adjustment". Under the revised IAS 39, the gain or loss deferred in equity will remain in equity after the asset is acquired and will have to be tracked and amortised separately but at the same time as the asset is amortised.

Disclosure and presentation of financial instruments - additional IAS 39 requirements

IAS 39 supplements the IAS 32 disclosure requirements with some new disclosures, of which the most significant are as follows:

- methods and assumptions used in estimating fair values;
- the accounting policy for changes in fair value of available-for-sale financial assets;
- a description of the enterprise's financial risk management objectives and policies;
- for each category of hedge: a description of the hedge; which financial instruments are designated as hedging instruments; and the nature of the risks being hedged;
- significant items of income and expense and gains and losses resulting from financial assets and financial liabilities, and whether they are included in net profit or loss or as a separate component of equity and, if in equity, a reconciliation of movements in and out of equity;
- details of securitisations and repurchase agreements; and
- the nature and amount of any impairment loss recognised or reversed.

Transition

The HKSA's Exposure Drafts based on IAS 32 and IAS 39 do not propose to change any of the transitional rules of the IFRS.

For the Standard based on IAS 32, therefore, the Exposure Draft indicates that the Standard will be applied retrospectively, requiring the reclassification of all instruments in issue at the effective date. This may prove to be a difficult exercise in practice, particularly for compound instruments.

As regards disclosure, the proposed Standard does allow that, when comparative information for prior periods is not available, it need not be presented in the first period in which the Standard is adopted.

IAS 39 establishes a general principle of prospective application from the date of issuance of that Standard. If the same transitional rules are adopted in Hong Kong, the following specific rules will apply:

- recognition, derecognition, measurement, and hedge accounting policies followed in earlier accounting periods will not be reversed and, therefore, there will be no restatement of earlier financial statements;
- where hedge accounting has been followed previously, but the designated hedge does not meet the IAS 39 conditions, hedge accounting is discontinued for open hedges with effect from the date of implementation of the Standard, but accounting in prior years is not changed retrospectively;
- all derivatives to be measured at fair value and brought on-balance sheet at the beginning of the financial year in which the Standard is adopted. The difference between previous carrying amounts (which may have been zero) and the fair value should be recognised as an adjustment to opening retained earnings (unless the derivative is a designated hedging instrument);
- at the beginning of the year in which the Standard is adopted, the rules of the Standard should be used to identify those financial assets and financial liabilities to be carried at fair value and those to be carried at cost. Following remeasurement, any adjustment of the carrying amount is recognised as an adjustment to opening retained earnings;
- the hedge accounting rules of the new Standard should be followed from the beginning of the period in which the Standard is first adopted. Transactions entered into prior to the date of adoption should not be retrospectively designated as hedges; and
- the accounting for securitisations, transfers or other derecognition transactions entered into prior to the effective date should not be retrospectively changed to conform to the requirements of the new Standard.

FIRST-TIME APPLICATION OF HONG KONG SSAPs

Background

In July 2002, the IASB issued ED1 *First-time Application of International Financial Reporting Standards*. The HKSA issued the IASB Exposure Draft for comment in Hong Kong at the same time, with the intention of issuing an equivalent Hong Kong SSAP. Whereas the proposed IFRS deals with the first-time application of IFRS, it is intended that the Hong Kong Standard will have the perspective of first-time application of Hong Kong SSAPs. This will be the first guidance on this topic in Hong Kong.

The IASB has stated its objective of issuing its final Standard on this topic in the 2nd quarter of 2003. We anticipate that the HKSA will aim to finalise the equivalent SSAP shortly thereafter, so that it can be effective from 1 January 2004.

Key features

In the period in which Hong Kong SSAPs are adopted for the first time, the Exposure Draft would allow an enterprise to restate information using either of the following alternative approaches:

- the SIC 8 approach. This approach, based on the IASB's Interpretation *First-Time Application of IASs as the Primary Basis of Accounting*, requires retrospective restatement using the Standards applicable at the dates of transactions, and their subsequent revisions and transitional provisions, if applicable; or
- an 'opening-balance sheet' approach. Under this approach, the enterprise is required to use the Standards current at the end of the reporting period in which it first adopts Hong Kong SSAPs, and apply those Standards retrospectively. Where this approach is adopted, exceptions to the general restatement principles are proposed in respect of business combinations, measurement of fixed assets under the historical cost model, employee benefits, translation reserves and hedging. At least one year of comparative information prepared using those same SSAPs is required.

First-time adopters of Hong Kong SSAPs will be required to disclose how the transition to Hong Kong Standards affected the enterprise's reported financial position, performance and cash flows.

FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Background

In September 2002, the HKSA issued an Exposure Draft of a proposed revised *Framework for the Preparation and Presentation of Financial Statements*.

The objective of the HKSA in revising the Framework is to achieve convergence with the equivalent framework issued by the IASB. The changes made are largely eliminations of insignificant textual differences. They do not anticipate future changes to the IASB Framework that are likely to arise from current IASB Agenda Projects.

The revised Framework is expected to be released early in 2003.

Key features

The principal proposed revisions are:

- to widen the scope of the Framework to cover "general purpose financial statements" rather than solely "true and fair view financial statements";
- to recognise that a wide range of users places reliance on financial statements for making economic decisions;
- to eliminate a number of minor textual differences currently existing between the Hong Kong Framework and the IASB Framework; and
- to include within the purpose of the Framework the fact that the Framework assists the HKSA Council in developing Accounting Standards.

SHARE-BASED PAYMENT

Background

This project seeks to develop a Standard on all aspects of accounting for share-based payments to employees (including employee share options and their repricing), suppliers, creditors and others.

The IASB Exposure Draft was issued in Hong Kong in November 2002, with a 15 February 2003 deadline for comments to the HKSA. The IASB intends to finalise its Standard on this topic in the second half of 2003, with a 1 January 2004 likely implementation date. We anticipate a similar timetable for Hong Kong. However, given the proposed transitional arrangements (see below), the new rules are expected to apply with effect from November 2002.

Key features

The following are the most significant proposals:

- All share-based payment transactions should be recognised in the financial statements, using a fair value measurement basis. An expense should be recognised when the goods or services received are consumed. There are no proposed exemptions from these requirements. The same recognition and measurement standards would apply to both public and non-public companies.
- In principle, transactions in which goods or services are received as consideration for equity instruments of the enterprise should be measured at the fair value of the goods or services received, or the fair value of the enterprise instruments granted, whichever is more readily determinable:
  - for transactions with parties other than employees, there is a rebuttable presumption that the fair value of the goods or services received is more readily determinable;
  - for transactions measured at the fair value of the equity instruments granted (such as transactions with employees), fair value should be estimated at grant date; and
  - for transactions measured at the fair value of the goods or services received, fair value should be estimated at the date of receipt of those goods or services.
- To estimate the fair value of a share option, where an observable market price does not exist, an option pricing model should be used. The Exposure Draft does not specify which particular model should be used. The enterprise should disclose the model used, the inputs to that model, and various other information about how fair value was measured.
- The Exposure Draft contains various proposals on estimating the fair value of employee share options, to allow for differences between employee share options and traded options. For example, the valuation should take into account all types of vesting conditions, including service conditions and performance conditions. In other words, the grant date valuation should be reduced to allow for the possibility of forfeiture because of failure to satisfy vesting conditions.
- Repricing of options (and other changes in terms and conditions) should be accounted for by recognising additional remuneration expense based on the incremental value given on repricing, i.e. additional to expenses recognised in respect of the original option grant.
- The Exposure Draft also contains proposals on accounting for the cancellation of share or option plans, share-based payment transactions settled in cash, and transactions in which either the enterprise or the counterparty may choose whether the enterprise settles in cash or by issuing equity instruments.

- Proposed 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; and
  - the effect of expenses arising from share-based payment transactions on the enterprise's profit or loss.

Transition

The Exposure Draft proposes that an enterprise should apply the requirements of the new Standard to grants of equity instruments (e.g. share options) that were granted after the publication date of the Exposure Draft (7 November 2002) that have not vested at the date of implementation of the Standard. The intention is obviously to prevent a flurry of option grants in the run-up to the effective date of the Standard which would not fall within the scope of the Standard. Assuming that this proposal is followed through, this means that the Standard is already effective. The new requirements will be applicable not only to new arrangements (e.g. share option schemes) entered into after 7 November 2002, but to pre-existing arrangements where the grant date for the options is after 7 November 2002.

Where the adoption of the Standard results in the recognition of a liability, the requirements of the Standard should be applied retrospectively to that liability, except that the enterprise is not required to measure vested share appreciation rights (and similar liabilities) at fair value, but instead should measure them at the amount that would have been paid on settlement of the liability had the counterparty demanded settlement at the date the liability is measured.

BUSINESS COMBINATIONS, IMPAIRMENT AND INTANGIBLE ASSETS

Background

The IASB has an ongoing project on business combinations which is divided into two stages. The current IASB Exposure Drafts, representing the output of Phase I of that project, deal with:

- the definition of a business combination;
- method(s) of accounting for a business combination;
- accounting for goodwill (and negative goodwill) and intangible assets acquired in a business combination;
- the initial measurement of the identifiable net assets acquired in a business combination;
- provisions (liabilities) for terminating or reducing the activities of an acquiree; and
- related changes to IAS 36 *Impairment of Assets (*for Hong Kong, *SSAP 30),* and IAS 38 *Intangible Assets (*for Hong Kong, *SSAP 29)* .

The IASB has stated that it intends to finalise its Standards arising from Phase 1 in the second half of 2003. The equivalent Hong Kong Standards will follow shortly thereafter, with a likely effective date of 1 January 2004.

Key features

The following is a brief summary of the key issues arising from the Exposure Drafts from a Hong Kong perspective.

Method of accounting for business combinations

All business combinations covered by the revised Standard should be accounted for using the purchase method. The use of merger accounting (pooling of interests) will no longer be permitted under IFRS.

In Hong Kong, this change will have no impact, since the use of merger accounting is already prohibited, except in the case of group reconstructions qualifying under SSAP 27 *Accounting for Group Reconstructions*.

Although combinations of entities under common control are excluded from the proposed business combinations Standard, the Exposure Draft does, for the first time, provide a definition of what is meant by that term. It is a business combination in which all of the combining entities are ultimately controlled by the same party or parties before and after the business combination, and that control is not transitory. Because this definition focusses on control, rather than actual shareholdings, the extent of minority interests in each of the combining entities before and after combination is not relevant in determining whether a combination involves entities under common control.

This in contrast to the definition of a qualifying group reconstruction under SSAP 27, which requires that there be no change in the relative rights of shareholders, and that minority interests remain unchanged. If the HKSA adopts the IASB Exposure Draft as currently worded, they will need to reconsider the definition in SSAP 27 so that it is not inconsistent with the new Standard.

Phase II of the IASB project is expected to deal with combinations of entities under common control. Whatever proposals emerge may have implications for current Hong Kong practice as set out in SSAP 27. Since the most common application of that Standard is in relation to group reconstructions prior to listing, any future proposals from the IASB will be of significant interest in Hong Kong.

Goodwill

Under the revised Standard, goodwill will be measured on an ongoing basis at cost less any accumulated impairment losses. Therefore, the amortisation of goodwill will be prohibited.

Instead, goodwill will be subject to impairment testing. Impairment should be assessed at least annually (more often if evidence warrants). However, a detailed calculation of recoverable amount is required only if there is evidence of impairment.

To enable impairment testing of goodwill, at acquisition all goodwill should be allocated to one or more cash-generating units (CGUs) on a reasonable and consistent basis. The CGU should represent the lowest level at which management evaluates the return on investment from assets that include the goodwill. The CGU is never larger than a SSAP 26 segment.

A CGU that includes goodwill is tested for impairment by comparing its carrying amount (including the goodwill) with its recoverable amount:

- if the CGU's carrying amount is less than its recoverable amount, then the goodwill within the CGU is regarded as not impaired;
- if the CGU's carrying amount exceeds recoverable amount, the enterprise must determine whether the excess is due to impairment of goodwill or impairment of other assets;
- impairment of goodwill is the difference between the carrying amount of the goodwill and its 'implied value' (i.e. the difference between the recoverable amount of the entire CGU and the current fair values of the identifiable net assets of the CGU at the date the impairment test is carried out); and
- if the goodwill is impaired, its carrying amount is reduced to its implied value, and a loss is recognised.

Reversals of impairment losses previously recognised in respect of goodwill are prohibited.

Negative goodwill

Any negative goodwill remaining after a reassessment of the identification and measurement of the identifiable net assets acquired should be recognised immediately in the income statement as a gain.

Intangible assets acquired in a business combination

The proposed revisions will introduce more detailed guidance on the recognition of intangible assets in a business combination, including an illustrative list of potential acquired intangibles, and specific reference to in-process research and development expenditure (IPR&D).

The initial measurement of an intangible asset acquired as part of a business combination and recognised separately from goodwill will no longer be limited to an amount that does not create or increase negative goodwill.

Purchased IPR&D acquired as part of a business combination should be recorded as an intangible asset separate from goodwill when it is separable or arises as a result of contractual or legal rights. If the IPR&D is not contractual or separable, the cost should form part of the amount attributed to goodwill. Subsequent expenditure on IPR&D acquired in a business combination and recognised as an asset separately from goodwill should be accounted for in accordance with the requirements of SSAP 29. If the subsequent expenditure is for a project that is in the nature of research, the expenditure would be recognised as an expense when it is incurred. If the project is in the nature of development, the expenditure would be capitalised only if the enterprise can satisfy all of the criteria for deferral in SSAP 29.

Intangible assets - subsequent measurement

Intangible assets with **finite** useful lives will continue to be accounted for in accordance with SSAP 29 after initial recognition - i.e. they will be amortised over their useful lives, and an impairment loss recognised where it is identified.

The existing rebuttable presumption of a 20-year maximum useful life is eliminated.

Impairment testing for all intangible assets with finite lives should be the same, whether they are being amortised over less than 20 years or longer. The current SSAP 29 requirement for an annual impairment calculation for any intangibles being amortised over more than 20 years is eliminated.

An intangible asset with an **indefinite** useful life (whether or not acquired in a business combination) will not be subject to amortisation, but should be tested for impairment at each financial year end (or more frequently if events or changes in circumstances indicate that the asset might be impaired) by comparing the asset's recoverable amount with its carrying amount.

Contingent liabilities

The acquirer is required to recognise the contingent liabilities of the acquiree at fair value at the date of acquisition, if that fair value can be measured reliably. The fair value to be used is the amount that a third party would charge to assume the contingent liability - reflecting all expectations about possible cash flows and not only the single most likely or the expected maximum or minimum cash flow.

If the fair value of a contingency cannot be measured reliably, the acquirer is required to disclose the information about that contingent liability required to be disclosed under SSAP 28 *Provisions, Contingent Liabilities and Contingent Assets*.

Liabilities for terminating or reducing the activities of an acquiree

The acquirer should recognise restructuring-type provisions for terminating or reducing the activities of the acquiree at the time of acquisition only if the acquiree has, as at the date of acquisition, an existing liability for restructuring costs recognised in accordance with SSAP 28 *Provisions, Contingent Liabilities and Contingent Assets*. If the enterprise to be acquired in a business combination is contractually required to make payments to, for example, employees or suppliers in the event of a business combination, such payments are a contingent liability of that enterprise until it becomes probable that a business combination will occur.

Disclosures

A sizeable number of new disclosures are added to existing requirements. Certain current disclosures for post-balance-sheet date business combinations are being eliminated.

The exemptions in SSAP 30 from having to disclose comparative information for movements on goodwill and negative goodwill are removed.

SSAP 25 *Interim Financial Reporting* will be amended to require information about business combinations to be disclosed in interim financial statements.

Some changes are being made to the disclosures in SSAP 29 and SSAP 31, including expanded disclosures regarding shuffling of assets across segments and the change of allocation across CGU's for impairment test purposes.

Transition

Generally, business combinations for which the agreement date is on or after the date the final Standard is issued will be subject to the requirements of that Standard. Given that the IASB has indicated a target date for release of the Standard in the second half of 2003, the new Standard will impact acquisitions occurring after that time.

Amortisation will stop for any goodwill pre-existing at the time the Standards are adopted. Instead, impairment testing will be required. Any negative goodwill pre-existing at the time the Standards are adopted will be credited directly to retained earnings.

An intangible asset acquired in a business combination before the Standards are adopted and that does not meet the recognition criteria in the revised SSAP 29 would be reclassified as goodwill.

The revisions to SSAP 29 would apply to intangible assets recognised at the time the Standards are adopted. Any resulting change in estimated useful life (including a change from a finite life to an indefinite life) would be accounted for prospectively as a change in estimate.

The Exposure Draft for business combinations proposes a delayed effective date for (a) business combinations involving two or more mutual entities, and (b) business combinations in which separate entities are brought together to form a reporting enterprise by contract only without the obtaining of an ownership interest. The Standard would apply only after the IASB has issued supplemental guidance on applying the purchase method to these transactions.

Additional matters for commentators in Hong Kong

In addition to the matters for comment raised by the IASB, the HKSA has identified one item specific to Hong Kong on which they invite comment. This relates to the transitional arrangements for goodwill and negative goodwill.

As permitted by the transitional provisions set out in the current SSAP 30, some enterprises continue to carry goodwill and negative goodwill arising on business combinations before 1 January 2001 in reserves. Because of the HKSA's desire for convergence with IFRS, and for consistency of accounting treatment between enterprises, they propose that all goodwill in reserves should be reinstated on the balance sheet at its carrying amount at the date of adoption of the new Standard. Negative goodwill held in reserves will be transferred to retained earnings.

IASB AGENDA PROJECTS

In addition to the Exposure Drafts discussed in the previous section, the IASB has a number of other projects in progress that are likely to impact on Hong Kong GAAP in the medium term. The following is a brief summary of the major projects on the IASB agenda at 31 December 2002. Readers can monitor the progress of these projects by referring to Deloitte Touche Tohmatsu's IAS Plus website (www.iasplus.com).

Deposit-Taking, Lending and Securities Activities: Disclosure and Presentation

This project is updating the existing requirements (principally IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*) related to disclosing information and presenting financial statements that reflect the specific characteristics of the business activities of banks and other institutions whose business it is to take deposits, grant credit, or provide other financing or investment services.

Expected timetable - Exposure Draft in the 1st quarter of 2003. Standard in 2004.

Performance Reporting

This project addresses the issues related to the presentation in the financial statements of all recognised changes in assets and liabilities except those related to transactions with owners (sometimes called comprehensive income). Thus, it will consider items that currently are reported in the income statement, cash flow statement and statement of changes in equity. Issues addressed in this project include distinguishing revenues and expenses from other sources of comprehensive income or expense, the reporting of holding gains and losses, and distinguishing operating and non-operating items. This is a partnership project with the UK's Accounting Standards Board.

Expected timetable - Exposure Draft in the 1st quarter of 2003. Standard in the 2nd half of 2003.

Business Combinations - Phase II

This project addresses:

- issues relating to the application of the purchase method of accounting for business combinations;
- new basis ('fresh-start') accounting; and
- combinations of entities under common control.

Expected timetable - Exposure Draft in the 1st quarter of 2003. Standard in 2004.

Convergence Topics (short-term strategy)

This project is focusing on topics where one or more partner standard setters and the IASB have standards that are broadly similar but differ in a limited number of areas. The goal is to achieve convergence either by changes in IFRS or changes in the partners' standards.

The principal focus is on reducing differences between IFRS and US GAAP. In October 2002, the Financial Accounting Standards Board (FASB) and the IASB issued a memorandum of understanding, indicating that an Exposure Draft to address identified differences between US GAAP and IFRS is expected to be released in the second half of 2003.

Insurance Contracts - Phase I

This project addresses how existing IFRS should be applied to insurance contracts.

Expected timetable - Exposure Draft in the 1st quarter of 2003. Standard in 2004.

Insurance Contracts - Phase II

This is a continuation of the former IASC project to develop a comprehensive standard on accounting for insurance contracts that is consistent with the conceptual framework definitions of assets and liabilities. This phase of the insurance contracts project is not constrained by existing IFRS.

Timetable not yet established.

Revenue Recognition and Related Aspects of Liabilities

This project addresses three inter-related issues:

- general principles for determining when revenue should be recognised in the financial statements;
- the distinction between liabilities and equity; and
- liability recognition, including guidance on whether an item meets the definition of a liability and, if so, the criteria for recognising liabilities in the financial statements.

Timetable not yet established.

The table below summarises the expected timing of the output from the IASB Agenda Projects listed above.

Project Title	Expected Output					
	2002		2003			2004
	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Half 2	
Deposit-Taking, Lending and Securities Activities: Disclosure and Presentation			ED			IFRS
Performance Reporting			ED		IFRS	
Business Combinations - Phase II			ED			IFRS*
Convergence Topics (short-term strategy)					ED	
Insurance Contracts - Phase I			ED			IFRS*
Insurance Contracts - Phase II	Timetable not yet established					
Revenue Recognition and Related Aspects of Liabilities	Timetable not yet established					

* The IASB aims to have these new or revised IFRS effective for periods beginning on or after 1 January 2005. Other Standards/amendments issued during 2004 and 2005 will not have a mandatory application date before 2005, but early adoption will be permitted.

APPENDIX 1 - LISTING OF CURRENT STANDARDS AND INTERPRETATIONS

The tables below set out the Hong Kong SSAPs and Interpretations in issue at 31 December 2002.

Statements of Standard Accounting Practice	**Effective for financial periods**				
		1 January 2001	**1 January 2002**	**1 January 2003**	**1 January 2004**
SSAP 1 (Revised) Presentation of Financial Statements	Beginning on or after 1 January 1999 Amendments relating to the presentation of changes in equity effective from 1 January 2002				
SSAP 2 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	Beginning on or after 1 January 1999 SSAP 33 replaces the requirements of SSAP 2 as regards disclosure of discontinued operations with effect from 1 January 2002				
SSAP 5 Earnings per Share	Beginning on or after 1 January 1998				
SSAP 9 Events after the Balance Sheet Date		Beginning on or after 1 January 2001			
SSAP 10 Accounting for Investments in Associates	Beginning on or after 1 January 1998				
SSAP 11 (Revised) Foreign Currency Translation	Beginning on or after 1 January 1985 Amendments relating to the translation of the results of foreign enterprises effective from 1 January 2002				
SSAP 12 Accounting for Deferred Tax	Beginning on or after 1 January 1988			SSAP 12 (Revised) *Income Taxes* Effective for periods beginning on or after 1 January 2003	
SSAP 13 Accounting for Investment Properties	Ending on or after 31 October 1994				
SSAP 14 Leases	Beginning on or after 1 July 2000				
SSAP 15 (Revised) Cash Flow Statements	Ending on or after 31 December 1994		SSAP 15 (Revised) Effective for periods beginning on or after 1 January 2002		
SSAP 17 Property, Plant and Equipment	Ending on or after 30 September 1995				
SSAP 18 Revenue	Ending on or after 31 December 1995				
SSAP 19 Borrowing Costs	Beginning on or after 1 April 1996				
SSAP 20 Related Party Disclosures	Beginning on or after 1 October 1997				
SSAP 21 Accounting for Interests in Joint Ventures	Beginning on or after 1 January 1998				
SSAP 22 Inventories	Beginning on or after 1 January 1998				

Statements of Standard Accounting Practice	**Effective for financial periods** (1 January 2001 | 1 January 2002 | 1 January 2003 | 1 January 2004)
SSAP 23 Construction Contracts	Beginning on or after 1 January 1998
SSAP 24 Accounting for Investments in Securities	Beginning on or after 1 January 1999
SSAP 25 Interim Financial Reporting	Beginning on or after 1 January 2000
SSAP 26 Segment Reporting	Beginning on or after 1 January 2001
SSAP 27 Accounting for Group Reconstructions	Transactions entered into on or after 11 November 1999
SSAP 28 Provisions, Contingent Liabilities and Contingent Assets	Beginning on or after 1 January 2001
SSAP 29 Intangible Assets	Beginning on or after 1 January 2001
SSAP 30 Business Combinations	Beginning on or after 1 January 2001
SSAP 31 Impairment of Assets	Beginning on or after 1 January 2001
SSAP 32 Consolidated Financial Statements and Accounting for Investments in Subsidiaries	Beginning on or after 1 January 2001
SSAP 33 Discontinuing Operations	Beginning on or after 1 January 2002
SSAP 34 Employee Benefits	Beginning on or after 1 January 2002
SSAP 35 Accounting for Government Grants and Disclosure of Government Assistance	Beginning on or after 1 July 2002
SSAP 36 Agriculture	Beginning on or after 1 January 2004

Interpretations	Effective date				
		1 January 2001	1 January 2002	1 January 2003	1 January 2004
INT 1 Costs of Modifying Existing Software	1 October 1998				
INT 5 Property, Plant and Equipment - Compensation for the Impairment or Loss of Items	7 September 1999				
INT 8 Presentation of Financial Statements - Current Assets: Classification of Restricted and Appropriated Balancess	18 April 2000				
INT 10 Earnings Per Share - Financial Instruments and other Contracts that may be Settled in Shares	14 December 2000				
INT 12 Business Combinations - Subsequent Adjustment of Fair Values and Goodwill Initially Reported		19 June 2001			
INT 13 Goodwill - Continuing Requirements for Goodwill and Negative Goodwill Previously Eliminated Against/Credited to Reserves		19 June 2001			
INT 14 Evaluating the Substance of Transactions Involving the Legal Form of a Lease			30 June 2002		
INT 15 Business Combinations - "Date of Exchange" and Fair Value of Equity Instruments			Acquisitions given initial accounting recognition on or after 30 June 2002		
INT 16 Disclosure - Service Concession Arrangements			30 June 2002		
INT 17 Revenue - Barter Transactions Involving Advertising Services			30 June 2002		
INT 18 Consolidation and Equity Method - Potential Voting Rights and Allocation of Ownership Interests			Annual financial periods beginning on or after 1 July 2002		
INT 19 Intangible Assets - Web Site Costs			15 October 2002		
INT 20 Income Taxes - Recovery of Revalued Non-Depreciable Assets				Annual financial periods beginning on or after 1 January 2003	
INT 21 Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders				Annual financial periods beginning on or after 1 January 2003	

APPENDIX II - COMPARISON OF HONG KONG SSAPs AND IFRS AT DECEMBER 2002

The following table compares extant International Financial Reporting Standards (IFRS) with Hong Kong SSAPs, taking account of Standards released up to 31 December 2002. Where the SSAPs are not consistent with IFRS, details of current Exposure Drafts and public comments made by the Financial Accounting Standards Committee (FASC) of the HKSA with regard to planned future developments are summarised.

The table below also highlights those situations where differences identified would be eliminated by current projects of the IASB. However, readers should be aware that those IASB projects incorporate other proposals for change that would require further significant amendments to Hong Kong SSAPs if convergence with IFRS is to be maintained. Full details of the proposed changes to IFRS under current IASB projects are provided on our IAS Plus website (www.iasplus.com).

IFRS	Equivalent SSAP	Comment
IAS 1 Presentation of Financial Statements	**SSAP 1 (Revised)** Presentation of Financial Statements	The Standards are consistent, except that: ■ certain detailed disclosures in SSAP 1 (Revised) have been adapted as appropriate to the Hong Kong environment; and ■ the rules for offsetting assets and liabilities differ.
IAS 2 Inventories	**SSAP 22** Inventories	The Standards are consistent in all material respects.
IAS 7 Cash Flow Statements	**SSAP 15 (Revised)** Cash Flow Statements	The Standards are consistent, except that there are no exemptions from the scope of IAS 7 as there are from SSAP 15 (Revised).
IAS 8 Net Profit or Loss for the Period, Fundamental Errors, and Changes in Accounting Policies	**SSAP 2** Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	The Standards are consistent except that IAS 8 allows, as an alternative to the treatment prescribed in SSAP 2, that the amount of the correction of a fundamental accounting error or the cumulative effect of a change in accounting policy may be included in the current period's results. The allowed alternative treatment described in the previous paragraph would be prohibited under proposed amendments to IAS 8 in the IASB's Improvements Project.
IAS 10 Events after the Balance Sheet Date	**SSAP 9** Events after the Balance Sheet Date	The Standards are consistent in all material respects.
IAS 11 Construction Contracts	**SSAP 23** Construction Contracts	The Standards are consistent in all material respects.

IFRS	Equivalent SSAP	Comment
IAS 12 Income Taxes	**SSAP 12 (Revised)** Income Taxes (effective from 1 January 2003)	The Standards are consistent in all material respects. The explanatory guidance and illustrative examples set out in SSAP 12 (Revised) contain material that may not be based on the examples in IAS 12 but based on those in Australian Standard AASB 1020 *Income Taxes*.
IAS 14 Segment Reporting	**SSAP 26** Segment Reporting	The Standards are generally consistent. In drafting SSAP 26, some minor modifications were made to the IFRS to ensure that SSAP 26 is consistent with other Hong Kong Accounting Standards.
IAS 15 Information Reflecting the Effects of Changing Prices	No equivalent Standard	As part of its Improvements Project, the IASB has proposed the withdrawal of IAS 15. Consequently, there are no plans for an equivalent Hong Kong Standard.
IAS 16 Property, Plant and Equipment	**SSAP 17** Property, Plant and Equipment	The Standards are consistent, except that: ■ IAS 16 does not include any of SSAP 17's transitional provisions; ■ SSAP 17 contains guidance on transfers of assets between categories which is not included in IAS 16; and ■ there are no exemptions from the scope of IAS 16 as there are from SSAP 17.
IAS 17 Leases	**SSAP 14** Leases	The Standards are consistent except that SSAP 14 requires that properties held under Hong Kong government leases should generally be accounted for as tangible fixed assets, whereas, under the lease classifications of IAS 17, they would generally be treated as operating leases. The IASB's Improvements Project proposes new guidance on leases of land and buildings. Where lease payments cannot be allocated reliably between the land and buildings elements of a single lease covering both, the entire lease is generally to be classified as a finance lease. This change will address some of the Hong Kong problems in this area (see also IAS 40).

IFRS	Equivalent SSAP	Comment
IAS 18 Revenue	**SSAP 18** Revenue	The Standards are consistent in all material respects.
IAS 19 Employee Benefits	**SSAP 34** Employee Benefits	The Standards are consistent in all material respects.
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	**SSAP 35** Accounting for Government Grants and Disclosure of Government Assistance (effective from 1 July 2002)	The Standards are consistent in all material respects.
IAS 21 The Effects of Changes in Foreign Exchange Rates	**SSAP 11 (Revised)** Foreign Currency Translation	The requirements of the Standards are broadly in line, although IAS 21 is more comprehensive than SSAP 11. Some differences of detail are: ■ the use of a 'contract rate' for translation of a transaction, as required by SSAP 11, is not permitted by IAS 21; ■ IAS 21 allows exchange losses to be added to the carrying amount of an asset in certain restricted circumstances; and ■ the rules for offsetting exchange movements on foreign currency assets hedged by foreign currency borrowings are more restrictive under IAS 21. Under the IASB's Improvements Project, the alternative of capitalising certain exchange differences as referred to above would be eliminated.

IFRS	Equivalent SSAP	Comment
IAS 22 Business Combinations	**SSAP 30** Business Combinations	The requirements of the Standards are materially consistent except that: ■ the definition of 'subsidiary' to be used by Hong Kong incorporated companies is dictated by the Companies Ordinance and may, in certain circumstances, result in the exclusion from consolidation of investees that would be consolidated under IFRS; ■ IAS 22 covers both the purchase (acquisition) and merger (pooling of interests) methods of accounting, whereas SSAP 30 addresses only purchase accounting; and ■ SSAP 30 does not permit IAS 22's benchmark treatment for the allocation of the cost of an acquisition, whereby the minority interest is stated at the minority's share of the pre-acquisition carrying amounts of the assets and liabilities of the subsidiary. Under the IASB's Business Combinations project, the last two of these differences would be eliminated. However, the issue concerning the definition of 'subsidiary' for Hong Kong incorporated companies can only be resolved by a change in Hong Kong law.
IAS 23 Borrowing Costs	**SSAP 19** Borrowing Costs	The treatment specified by SSAP 19 follows closely the allowed alternative accounting treatment permitted under IAS 23. The benchmark treatment under IAS 23, i.e. to expense all borrowing costs in the period in which they are incurred, is not permitted under Hong Kong GAAP.
IAS 24 Related Party Disclosures	**SSAP 20** Related Party Disclosures	The Standards are consistent, except that: ■ parties subject to common joint control or common significant influence are not regarded as related parties under IAS 24, but are specifically included in the SSAP 20 definition;

IFRS	Equivalent SSAP	Comment
		■ IAS 24 requires the disclosure of related party relationships where control exists, irrespective of whether or not there have been transactions between the related parties, whereas SSAP 20 does not require any disclosures in the absence of transactions; and ■ IAS 24 exempts from disclosure transctions between state-controlled enterprises, an exemption which is not reflected in SSAP 20. Proposed amendments to the definition of related party in the IASB Improvements Project will eliminate most of the inconsistencies as regards scope noted above. The Improvements Project also proposes to remove the exemption for state-controlled enterprises. However, the difference as regards disclosure of control in the absence of transactions between the parties is likely to persist.
IAS 26 Accounting and Reporting by Retirement Benefit Plans	No equivalent standard	In Hong Kong, measurement and disclosure principles for the reports of retirement benefit plans are included in Industry Accounting Guideline 2.302 *Financial Statements of Retirement Schemes.*
IAS 27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries	**SSAP 32** Consolidated Financial Statements and Accounting for Investments in Subsidiaries	The Standards are broadly consistent, except that: ■ the definition of subsidiary to be used by Hong Kong incorporated companies is dictated by the Companies Ordinance and may, in certain circumstances, result in the exclusion from consolidation of investees that would be consolidated under IAS 27; ■ IAS 27 allows a parent that is virtually wholly-owned (generally taken to be a 90% holding) not to present consolidated financial statements, provided that the approval of the minority is obtained. SSAP 32 allows no such exception - exemption from the requirement to prepare consolidated financial statements is only available to parents that are themselves wholly-owned subsidiaries;

IFRS	Equivalent SSAP	Comment
		■ the accounting treatments permitted for investments in subsidiaries in a parent's separate financial statements under IAS 27 (cost, equity method or as available-for-sale investments under IAS 39) differ from those permitted under SSAP 32 (cost or in accordance with SSAP 24); and ■ IAS 27 requires that investments in subsidiaries that operate under severe long-term restrictions should be accounted for in accordance with IAS 39, whereas SSAP 32 specifies that they should be accounted for under SSAP 24, which may, in certain circumstances, result in their being accounted for on a cost basis. As noted above in relation to Business Combinations, the difference in respect of the definition of a subsidiary for Hong Kong incorporated companies will not be eliminated until there is a change in the Hong Kong law. Once the HKSA has adopted IAS 39 (see below), it is likely that the differences as regards the measurement of investments in subsidiaries will be eliminated. The IASB's Improvements Project is proposing further changes in the rules as regards exemption from the requirement to present consolidated financial statements, which will need to be considered by the HKSA prior to proposing any change in this regard.
IAS 28 Accounting for Investments in Associates	**SSAP 10** Accounting for Investments in Associates	The Standards are consistent except that: ■ the treatments permitted for accounting for investments in associates in the investor's separate financial statements under IAS 28 (cost, equity method or as available-for-sale investments under IAS 39) differ from those permitted under SSAP 10 (cost or in accordance with SSAP 24); and

IFRS	Equivalent SSAP	Comment
		- IAS 28 requires that investments in associates that operate under severe long-term restrictions should be accounted for in accordance with IAS 39, whereas SSAP 10 specifies that they should be accounted for under SSAP 24, which may, in certain circumstances, result in their being accounted for on a cost basis. As noted above in relation to subsidiaries, once the HKSA has adopted IAS 39 (see below), it is likely that these differences will be eliminated.
IAS 29 Financial Reporting in Hyperinflationary Economies	No equivalent standard	The objective of IAS 29 is to establish specific standards for enterprises reporting in the currency of a hyperinflationary economy, so that the financial information provided is meaningful. In November 2002, the HKSA issued an Exposure Draft based on IAS 29.
IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions	No equivalent standard	The objective of IAS 30 is to prescribe appropriate presentation and disclosure standards for banks and similar financial institutions, which supplement the requirements of other Standards. 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. Equivalent requirements in Hong Kong are established by the Hong Kong Monetary Authority and other regulatory bodies.
IAS 31 Financial Reporting of Interests in Joint Ventures	**SSAP 21** Accounting for Interests in Joint Ventures	The Standards are consistent in all respects, other than in relation to the treatment of jointly controlled entities: - the treatment specified by SSAP 21 for jointly controlled entities (equity accounting) follows closely the allowed alternative treatment permitted under IAS 31. The benchmark treatment under IAS 31, to account for such interests using proportionate consolidation, is not permitted under Hong Kong GAAP; and

IFRS	Equivalent SSAP	Comment
		- for the purposes of the separate financial statements of the venturer, IAS 31 does not indicate a preference for the treatment of jointly controlled entities, whereas SSAP 21 specifies that such interests should be accounted for either using the cost method or in accordance with SSAP 24.
IAS 32 Financial Instruments: Disclosure and Presentation	No equivalent standard	SSAP 24 (see below) includes some disclosure requirements in relation to investments in securities, but does not address any of the wider issues dealt with in IAS 32. In September 2002, the HKSA issued an Exposure Draft based on IAS 32.
IAS 33 Earnings Per Share	**SSAP 5** Earnings Per Share	The Standards are consistent in all material respects.
IAS 34 Interim Financial Reporting	**SSAP 25** Interim Financial Reporting	The Standards are consistent in all material respects.
IAS 35 Discontinuing Operations	**SSAP 33** Discontinuing Operations	The Standards are consistent in all material respects.
IAS 36 Impairment of Assets	**SSAP 31** Impairment of Assets	The Standards are consistent in all material respects.
IAS 37 Provisions, Contingent Liabilities and Contingent Assets	**SSAP 28** Provisions, Contingent Liabilities and Contingent Assets	The Standards are consistent in all material respects.
IAS 38 Intangible Assets	**SSAP 29** Intangible Assets	The Standards are consistent in all material respects.

IFRS	Equivalent SSAP	Comment
IAS 39 Financial Instruments: Recognition and Measurement	**SSAP 24** Accounting for Investments in Securities	The scope of IAS 39 is wider than SSAP 24 – dealing with a broader range of financial instruments, including derivatives. The framework established by IAS 39 is similar to the framework under SSAP 24's alternative treatment. However, the requirements of IAS 39 are much more comprehensive, and compliance with SSAP 24 is unlikely to achieve compliance with IAS 39, except in very simple circumstances. In September 2002, the HKSA issued an Exposure Draft based on IAS 39.
IAS 40 Investment Property	**SSAP 13** Accounting for Investment Properties	There are significant differences between these two Standards. In particular: ■ IAS 40 permits a choice between adopting a cost or a fair value model for investment property whereas, except for some de-minimus exceptions for unlisted enterprises, SSAP 13 does not permit the use of the cost method; ■ where a fair value model is adopted under IAS 40, all movements in fair value are dealt with in the income statement, whereas SSAP 13 generally recognises such movements in equity; ■ under IAS 40's fair value model, investment property is never depreciated, whereas SSAP 13 requires that it be depreciated when the unexpired term of the lease is 20 years or less; and ■ IAS 40 provides guidance on transfers to and from the investment property category, whereas SSAP 13 includes no such guidance. In addition, a significant issue for Hong Kong is that leasehold property will not generally fall within the IFRS definition of investment property (since the lease is likely to be classified as an operating lease).

IFRS	Equivalent SSAP	Comment
		This issue will be addressed to a certain extent by the IASB's Improvements Project which proposes to permit certain 'combined' leases of land and buildings to be classified as finance leases (see IAS 17 above). It is also proposed that the IAS 40 definition of investment property will be amended so that property rights held under an operating lease can qualify as investment property if the other conditions for investment property are met. However, significant divergence as to the reporting of fair value movements remains. The Council of the HKSA has indicated that it will defer the publication of an Exposure Draft based on IAS 40 until the IASB has clarified its proposals on reporting performance.
IAS 41 Agriculture	**SSAP 36** Agriculture (effective from 1 January 2004)	The Standards are consistent in all material respects.
No equivalent Standard	**SSAP 27** Accounting for Group Reconstructions	IAS 22 *Business Combinations* excludes from its scope combinations of enterprises under common control.

Deloitte Touche Tohmatsu publications intended to assist users in understanding International Financial Reporting Standards (IFRS)

International Accounting Standards: A Guide to Preparing Accounts	3rd Edition. Written by Deloitte & Touche, United Kingdom. Published by ABG Professional Information (www.abgweb.com).
International Financial Reporting Standards - A Practical Guide	3rd Edition. Details of IASC structure and IASB agenda projects, summaries of current Standards and Interpretations, model financial statements, and presentation and disclosure checklist.
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