Deloitte.
德勤

China
Technical

HKFRS Financial Reporting Update

HKICPA issues new standards on consolidation, joint ventures and disclosures

24 June 2011

On **Friday, 5 August 2011, Deloitte** will host a public seminar at Kowloon Shangri-La Hotel in Hong Kong. At the seminar, we will explain to you the key requirements of these new or revised standards and discuss various related practical issues.

Please **click here** for registration. (event code: 050811_FRU)

Introduction

On 24 June 2011, the Hong Kong Institute of Certified Public Accountants (the HKICPA) issued:

- HKFRS 10 *Consolidated Financial Statements*;
- HKFRS 11 *Joint Arrangements*;
- HKFRS 12 *Disclosure of Interests in Other Entities*;
- Revisions to HKAS 27 *Separate Financial Statements*; and
- Revisions to HKAS 28 *Investments in Associates and Joint Ventures*.

These five new or revised standards are the same as the new or revised International Financial Reporting Standards issued by the International Accounting Standards Board in May 2011.

These new or revised standards are mandatorily effective for annual periods beginning on or after 1 January 2013. Early application is permitted so long as all of the five new or revised standards are applied early.

Scope of the new or revised standards

The table below gives a summary of the scope of the new or revised standards:

Standard	Scope
HKFRS 10	• Whether or not an investor controls an investee and hence consolidates the investee as a subsidiary • How to apply the control principle in a number of situations (e.g. when de facto control arises) • How to prepare consolidated financial statements
HKFRS 11	• How a joint arrangement should be classified (i.e. a joint venture or a joint operation) • HKFRS 11 requires the use of the equity method of accounting for interests in joint ventures – proportionate consolidation is no longer allowed
HKFRS 12	• Disclosure requirements applicable to entities that have interests in subsidiaries, joint arrangements, associates or unconsolidated structured entities
HKAS 27	• How to prepare separate financial statements of an investor and what disclosures should be made in the separate financial statements
HKAS 28	• How to apply the equity method of accounting to interests in associates and joint ventures

Overview of HKFRS 10

HKFRS 10 replaces part of HKAS 27 *Consolidated and Separate Financial Statements* that deals with consolidated financial statements and captures issues relating to HK (SIC)-Int 12 *Consolidation – Special Purpose Entities*. HK (SIC)-Int 12 has been withdrawn upon the issuance of HKFRS 10.

Headline changes brought about by HKFRS 10 are explained below:

- Under HKFRS 10, there is only one single basis for consolidation for all entities, and that basis is control. This change removes the perceived inconsistency between the previous version of HKAS 27 and HK (SIC)-Int 12 – the former used control concept whilst the latter placed greater emphasis on risks and rewards.

- A more robust definition of control has been developed in HKFRS 10 in order to address unintentional weaknesses of the definition of control set out in the previous version of HKAS 27. The definition of control in HKFRS 10 includes three elements: (a) power over an investee, (b) exposure, or rights, to variable returns from its involvement with the investee; and (c) ability to use its power over the investee to affect the amount of the investor's returns.

- HKFRS 10 requires an investor to focus on activities that significantly affect the returns of an investee ("relevant activities") in assessing whether it has control over the investee (not merely financial and operating policies as set out in the previous version of HKAS 27).

- HKFRS 10 replaces the term 'benefits' with the term 'returns" so as to clarify that an investor's returns could have the potential to be positive, negative or both.

- HKFRS 10 makes it clear that there must be a linkage between 'power' and 'returns from the investee'.

- HKFRS 10 requires that, in assessing control, only substantive rights (i.e. rights that their holder has the practical ability to exercise) are considered. For a right to be substantive, the right needs to be currently exercisable by the time when decisions about the relevant activities need to be made. With regards to what is meant by 'currently exercisable', HKFRS 10 has a more 'relaxed' view as compared with the previous version of HKAS 27 (particularly in the context of potential voting rights).

• HKFRS 10 adds several pages of application guidance to assist in assessing whether an investor controls an investee in complex scenarios, including:

- application guidance on when an investor that has less than 50 per cent of the voting rights of an investee has control over the investee for reasons other than contractual arrangements and potential voting rights (commonly referred to as "defacto control").

- application guidance on whether a decision maker is acting as a principal or an agent for another party. A decision maker that has decision-making authority over the relevant activities of an investee does not have control over the investee when it is merely an agent acting on behalf of its principal.

- application guidance on when a particular set of assets and liabilities of an investee (i.e. a portion of an investee) can be deemed as a separate entity for the purposes of determining whether that portion is a subsidiary of the investor. HKFRS 10 states that a portion of an investee is treated as a separate entity for consolidation purposes when that portion is economically 'ring-fenced' from the rest of the investee.

HKFRS 10 does not contain “bright lines” as to when an investor should or should not consolidate an investee. Overall, the application of HKFRS 10 requires significant judgement on a number of aspects.

HKFRS 10 requires investors to reassess whether or not they have control over their investees on transition to HKFRS 10. In general, HKFRS 10 requires retrospective application, with certain limited transitional provisions.

Regarding the requirements for the preparation of consolidated financial statements, most of the requirements have been moved unchanged from the previous version of HKAS 27 to HKFRS 10.

For more detailed requirements of HKFRS 10, please **click here** to read Deloitte's publication – *IFRS in Focus: IASB issues new standard on consolidation* issued in May 2011.

Overview of HKFRS 11

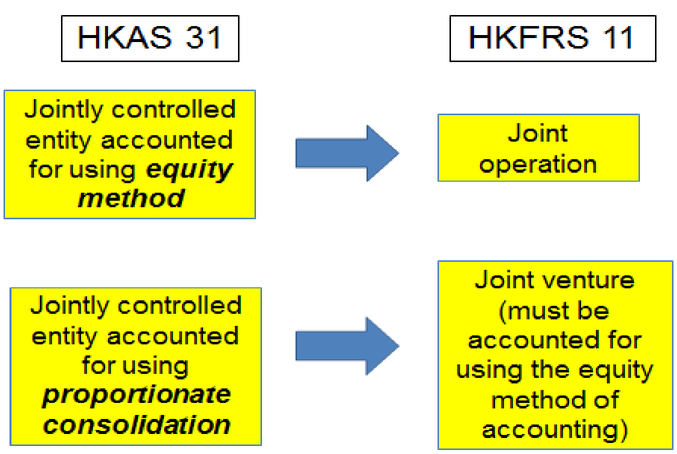
HKFRS 11 replaces HKAS 31 *Interests in Joint Ventures* and HK (SIC)-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*.

HKFRS 11 deals with how a joint arrangement of which two or more parties have joint control should be classified. There are two types of joint arrangements under HKFRS 11: joint operations and joint ventures. These two types of joint arrangements are distinguished by parties' rights and obligations under the arrangements.

Type of joint arrangement	Features	Accounting under HKFRS 11
Joint venture	Joint venturers have rights to the *net assets* of the arrangement	Equity method of accounting - proportionate consolidation is not allowed
Joint operation	Joint operators have rights to the *assets and obligations for the liabilities* of the arrangement	Each joint operator recognises its share of the assets, liabilities, revenues and expenses

Under HKFRS 11, the existence of a separate vehicle is no longer a sufficient condition for a joint arrangement to be classified as a joint venture whereas, under HKAS 31, the establishment of a separate legal vehicle is the key factor in determining the existence of a jointly controlled entity.

Therefore, upon application of HKFRS 11, the following changes may happen:



In general, HKFRS 11 requires retrospective application.

For more detailed requirements of HKFRS 11, please **click here** to read Deloitte's publication – *IFRS in Focus: IASB issues new standard on joint arrangements* issued in May 2011.

Overview of HKFRS 12

HKFRS 12 is a disclosure standard and is applicable to entities that have interests in subsidiaries, joint arrangements, associates or unconsolidated structured entities.

HKFRS 12 establishes disclosure objectives and specifies minimum disclosures that entities must provide to meet those objectives. The objective of HKFRS 12 is that entities should disclose information that helps users of financial statements evaluate the nature of and risks associated with its interests in other entities and the effects of those interests on financial statements.

The disclosure requirements set out in HKFRS 12 are more extensive than those in the current standards. Significant effort may be required to collect the necessary information.

For more detailed requirements of HKFRS 12, please **click here** to read Deloitte's publication – *IFRS in Focus: IASB issues new standard on disclosure of interests in other entities* issued in May 2011.

You can read and subscribe to *IFRS in Focus* newsletter which covers new and revised Standards and Interpretations, Exposure Drafts and discussion documents, including summaries of the documents and consideration of the principal amendments/ proposals. For details, please visit: **http://www.iasplus.com/iasplus/iasplus.htm**.

35/F One Pacific Place
88 Queensway
Hong Kong SAR