HONG KONG SOCIETY OF ACCOUNTANTS

(Incorporated by the Professional Accountants Ordinance, Cap. 50)

香港會計師公會

16 June 2004

To: HKSA members
All other interested parties

Exposure Draft – Proposed Convergence of Hong Kong Accounting Standards with International Accounting Standards

Comments to be received by 16 September 2004

Issued by the Financial Accounting Standards Committee, Hong Kong Society of Accountants

This Exposure Draft (ED) is the final in a series of EDs designed to achieve full convergence of the existing Statements of Standard Accounting Practice (SSAP) and Interpretations issued by the Hong Kong Society of Accountants (HKSA) with International Accounting Standards (IAS) and SIC Interpretations issued by the International Accounting Standards Board. It is proposed they will take effect for accounting periods beginning on or after 1 January 2005.

The HKSA Financial Accounting Standards Committee (FASC) invites comments from any interested party on the EDs and would like to hear from both those who agree and those who do not. The EDs are identified on page 3 of this Invitation to Comment and may be accessed on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/accounting/exposuredraft/. Comments should be supported by specific reasoning and should preferably be submitted in written form. The proposals contained in this exposure draft may be modified as a result of comments received.

Comments are requested to be received by **16 September 2004** and may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

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Background

1. Pursuant to the HKSA's standards setting due process, the FASC has a mandate to achieve convergence (as far as practicable) with the Standards set by the International Accounting Standards Board (IASB). With this remit, the FASC proposes to recommend that all existing Statements of Standard Accounting Practice (SSAP) that have an equivalent International Accounting Standard (IAS) be replaced by Hong Kong Accounting Standards (HKAS) that are converged with the IASB's Standards with effect for accounting periods beginning on or after 1 January 2005.

2. In April 2004, at the recommendation of the FASC, the HKSA issued a number of HKAS and one HKAS Interpretation that are converged with the IASs and SIC Interpretation issued by the IASB. An explanatory memorandum providing further details about these new HKAS is available for reference on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/accounting/rm/memorandum.pdf. In May 2004, the HKSA also approved, and published, HKAS 32 and HKAS 39 on Financial Instruments – these Standards are also converged with the IASB's Standards on Financial Instruments.

3. The FASC issues this convergence exposure draft (ED) with an aim to achieve full convergence of those SSAPs and Interpretations not previously revised with the IASs and SIC Interpretations issued by the IASB.

4. This ED proposes to:

   - Eliminate, to the greatest extent, all the textual differences, including differences in paragraph numbering and appendix referencing, between SSAPs and IASs;

   - Include a basis for conclusions similar to that contained in the equivalent IASs;

   - Uplift from the SSAP certain Interpretations that had previously been written directly in a SSAP, but for which the IASB is retaining the Interpretation as a separate document and reissue them as a separate interpretation;

   - Allow certain alternative treatments that are currently available under IASs but not under SSAPs;

   - Revise certain of those SSAPs that have not yet been revised consequent to the IASB improvements project where the FASC considers that the changes made by the IASB involved are so significant as to require re-exposure in Hong Kong; and

   - Where appropriate, adopt the remaining IASs or SIC Interpretations where there are currently no equivalent SSAPs or Interpretations in Hong Kong.

5. Given the extent of the changes involved, it is not the intention of this ED to specify in detail all the changes required for the purpose of achieving full convergence of existing SSAPs with the equivalent IASs, in particular those that are not considered to be significant in nature (e.g. changes in paragraph numbering and appendix referencing).

This ED contains the following proposed revised or new HKASs and HKAS Interpretations:

HKAS 7 *Cash Flow Statements*
HKAS 17 *Leases*
HKAS 23 *Borrowing Costs*
HKAS 24 *Related Party Disclosures*
HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*
HKAS 31 *Interests in Joint Ventures*
HKAS 40 *Investment Property*
HKAS-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Ventures*
HKAS-Int 15 *Operating Leases- Incentives*
HKAS-Int 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*

The above documents are available on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/accounting/exposuredraft/.

It is intended that these proposed revised or new HKASs and HKAS Interpretations would become effective for accounting periods beginning on or after 1 January 2005. All recent editorial changes made to the equivalent IASB Standards and Interpretations, not otherwise reflected in the above proposed HKAS and HKAS-Int will be taken into account by the FASC when proposing finalised Standards and Interpretations resulting from this ED.

6. In these HKAS and HKAS Interpretations, the proposed new title, paragraph numbering and appendix referencing of the IAS or SIC Interpretation have been used. Accordingly, they may differ from those found in the existing SSAP or Interpretation. A table of concordance showing how the new HKAS and HKAS Interpretation references, the equivalent IAS and SIC Interpretation references and the previous SSAP and Interpretation references correspond has been posted on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/accounting/dueprocess/concordance.pdf. Proposed HKAS 17, HKAS 24 and HKAS 31 include a table of concordance comparing paragraphs in those proposed HKAS with comparable paragraphs in the equivalent SSAPs.

Summary of Main Changes

1. <u>HKAS 7 *Cash Flow Statements*</u>

The significant change proposed is to remove the exemption from preparing a cash flow statement for:

(a) An entity with revenue of less than HK$20 million per annum; and

(b) A charity or non-profit making entity whose financial statements are prepared on a cash basis.

The HKSA's recently issued Consultation Paper on the Proposed Implementation of a Small and Medium-sized Entity Financial Reporting Framework and Financial

Reporting Standard (available on the HKSA website at: http://www.hksa.org.hk/professionaltechnical/accounting/exposuredraft/SME-GAAP_CP-IIcl.pdf) would be of relevance to those entities with revenue of less than HK$20 million per annum that had previously not presented a cash flow statement.

2. HKAS 17 *Leases* and HKAS-Int 15 *Operating Leases - Incentives*

HKAS 17 *Leases* and HKAS-Int 15 *Operating Leases - Incentives* propose to replace SSAP 14 *Leases.* The main changes proposed are:

- To clarify that when classifying a lease of both land and buildings, the lease shall be split into two elements – a lease of land and a lease of buildings. The land element would normally be classified as an operating lease unless title passes to the lessee at the end of the lease term. The building element would be classified as an operating or finance lease by applying the classification criteria proposed in the Standard. However, this Standard proposes that separate measurement of the land and buildings elements would not be required when:
  - the lease payment between land and building could not be allocated reliably, (in which case, both leases will be classified as finance leases); or
  - the lessee's interest in both land and buildings is classified as an investment property in accordance with HKAS 40 and the fair value model is adopted; and
- To eliminate the choice of how a lessor accounts for initial direct costs incurred in negotiating a lease by requiring that such costs that are incremental and directly attributable to the lease be capitalised and allocated over the lease term. It should be noted, however, that these costs are distinct in nature from general pre-operating costs, which will continue to be expensed as incurred.

3. HKAS 23 *Borrowing Costs*

HKAS 23 *Borrowing Costs* proposes to replace SSAP 19 *Borrowing Costs.* The main change proposed is to allow all borrowing costs be expensed immediately. However, the Standard would also continue to permit the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. This allowed alternative treatment is the same as the treatment currently required under SSAP 19. For this proposed HKAS, the benchmark treatment is interpreted as the recommended treatment unlike other HKAS where the benchmark is typically one of two alternatives.

The FASC is aware of the fact the IASB considered whether to eliminate the choice in IAS 23 *Borrowing Costs* when developing its improvements project. The IASB however decided that this issue is best addressed in the context of a wider project on how to measure an asset on initial recognition. Accordingly, the FASC would consider making further changes to the changes proposed in this Standard should the IASB propose any changes to IAS 23 with effect for accounting periods beginning on or after 1 January 2005.

4. <u>HKAS 24 *Related Party Disclosures*</u>

HKAS 24 *Related Party Disclosures* proposes to replace SSAP 20 *Related Party Disclosures.* The main changes proposed are:

- To clarify that the entity's financial statements should contain the disclosures necessary to draw attention to the possibility that the financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with them. The disclosure of a related party relationship would be required when one party controls the other regardless of whether there have been any transactions between the related parties.

- To expand the definition of related parties to cover post-employment benefit plans for the benefit of employees of an entity or of any entity that is a related party of the entity.

- To require disclosure of the compensation of key management personnel in aggregate by nature of compensation.

- To clarify the definition of close members of the family of an individual by providing a list of examples.

- To remove the exemption from disclosing transactions where specific exemptions are granted by statute.

- To remove the exemption for a wholly owned subsidiary from disclosing related party transactions.

- To require disclosure of the following:

  – The amounts of transactions and outstanding balances with respect to related parties. Disclosure of proportions of transactions and outstanding balances would no longer be sufficient.

  – The expense recognised during the period in respect of bad or doubtful debts due from related parties.

  – Classification of amounts payable to, and receivable from, related parties into different categories of related parties.

  – The name of the entity's parent and, if different, the ultimate controlling party. In addition, if neither of these two parties produces financial statements available for public use, disclosure of the name of the next most senior parent that does so is required.

5. <u>HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*</u>

HKAS 30 is a proposed new accounting standard to converge with IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. Commentators may wish to note that the IASB has a project in progress to develop a new IFRS that would replace IAS 30. In this ED the FASC proposes to adopt the requirements currently found in IAS 30 and, in line with the due process for setting Hong Kong Financial Reporting Standards, would consider issuing a separate invitation to comment on the IASB's proposed replacement of IAS 30 at such time when those proposals are released for public comment.

6. <u>HKAS 31 *Interests in Joint Ventures* and HKAS-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*</u>

HKAS 31 *Interests in Joint Ventures* and HKAS-Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* proposes to replace SSAP 21 *Accounting for Interests in Joint Ventures.* Significant changes proposed are:

- The Standard would not apply to interests in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds, provided that these are designated as either at fair value through profit or loss, or as held for trading, upon initial recognition and are accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.

- To clarify the definition of "joint control".

- To allow a venturer to recognise its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items, line by line, in its financial statements. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its financial statements.

- To make amendments necessary to take account of the extensive changes made to SSAP 32 Consolidated Financial Statements and Accounting for Investments in Subsidiaries and SSAP 10 Accounting for Investments in Associates that were revised as part of the IASB's Improvements project.

The FASC is aware of the fact that the IASB has an active research project on the accounting for joint ventures. In accordance with the HKSA's policy of converging Hong Kong's financial reporting standards with those issued by the IASB, the FASC would consider issuing an Invitation to Comment on an ED issued by the IASB which proposed further changes to IAS 31 *Interests in Joint Ventures* (as revised 2003). With the current timetable of the IASB's research project, however, it is unlikely that any such ED would be issued by the IASB prior to 1 January 2005.

7. HKAS 40 *Investment Property*

HKAS 40 proposes to replace SSAP 13 and would apply to all entities that prepare and present their financial statements in accordance with HKFRS. Significant changes to SSAP 13 proposed are:

- To require that all changes in the fair value of an investment property from one balance sheet date to the next are reported in the income statement. Previously, such changes were taken directly to an investment property revaluation reserve account on a portfolio basis to the extent that the reserve remained in surplus.

- To allow a lessee to classify an interest in land and buildings held under an operating lease as an investment property in accordance with HKAS 40 provided it meets the criteria for investment property and the fair value model is adopted for that property.

- To introduce a cost model for accounting for investment property (other than investment property held under an operating lease) and which, if chosen, would be applied to all investment property and only on the first-time adoption of HKAS 40.

- To remove the current requirement to depreciate property carried at fair value and held under leasehold interest with a remaining lease term of 20 years or less.

- To no longer set a 15% benchmark for determining the significance of the portion of property held for own use or leased to group companies.

- To require that investment property leased to other group companies is treated as investment property in an entity's separate financial statements.

HKAS 40 proposes to retain the current requirement in SSAP 13 that the fair value of investment property be determined on the basis of a valuation by a qualifier valuer annually and by an independent valuer at least every three years and, in either case, by a valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.
IAS 40 does not contain a comparable requirement.