Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Minutes of the 243rd meeting of the Financial Reporting Standards Committee held on Tuesday, 29 May 2018 at 8:30 a.m. in the Board Room of the Hong Kong Institute of Certified Public Accountants, 37/F., Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong.

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| Members present: | Ms. | Shelley So (Chairman), PricewaterhouseCoopers |
| | Mr. | Ernest Lee (Deputy Chairman), Deloitte Touche Tohmatsu |
| | Mr. | Ramil Clemena, BlackRock Asset Management North Asia Ltd |
| | Ms. | Candy Fong, Foremost Advisers Ltd |
| | Ms. | Cynthia Leung, Financial Reporting Council |
| | Mr. | Joe Ng, Ernst & Young |
| | Mr. | Steve Ong, Stock Exchange of Hong Kong Limited (Dial-in) |
| | Mr. | Simon Riley, BDO Limited |
| | Ms. | Sanel Tomlinson, KPMG |
| | Mr. | Guochang Zhang, The University of Hong Kong |
| Guest present: | Ms. | Elza Yuen, PricewaterhouseCoopers (for item 2 only) |
| Staff in attendance: | Ms. | Christina Ng, Director, Standard Setting |
| | Ms. | Winnie Chan, Associate Director, Standard Setting |
| | Ms. | Kam Leung, Associate Director, Standard Setting |
| | Ms. | Katherine Leung, Associate Director, Standard Setting |
| | Ms. | Eky Liu, Associate Director, Standard Setting |
| | Mr. | Anthony Wong, Associate Director, Standard Setting |
| | Ms. | Daisy Xia, Manager, Standard Setting |
| Apologies: | Mr. | James Fawls, HSBC |
| | Ms. | Kelly Kong, Jardine Matheson & Co., Limited |
| | Ms. | Susanna Lau, Securities and Futures Commission |
| | Mr. | Gary Poon, Poon & Co. |
| | Mr. | Gary Stevenson, RSM Hong Kong |

Action

**1. Minutes, work program and liaison log**

A few comments were noted on the minutes of the 242nd meeting. Revised minutes to be approved out-of-session. — SSD

The Committee noted the developments outlined in the FRSC and SSD work program and liaison log.

**2. Accounting for connection fee under HKFRS 15 *Revenue from Contracts with Customers***

Ms. Yuen, Director at PricewaterhouseCoopers, presented the accounting considerations for recognising revenue from utility connection fees and a fact pattern of the gas supply industry in the People's Republic of China. The fact pattern is as follows:

- A gas company has exclusive rights to connect and supply gas to a new housing area.
- The housing developer pays a non-refundable connection fee to the gas company for connecting and constructing pipeline networks and transmission facilities for the new housing area.
- Separate contracts entered between the gas company and house owners for the gas supply service. House owners are not committed

and are not required to use gas, but the service is available to them.

- The connection fee paid by the developer and the charges for on-going gas supply are at regulated rates.
- There are specific regulations and policies in PRC governing the gas supply industry.

The question raised was whether gas companies recognise the non-refundable connection fee as revenue:

- immediately when the gas company completes the connection service; or
- over a period of time during which the gas company supplies gas to house owners.

FRSC members considered the following:

- If the provision of connection service and gas supply service are viewed as a single contract, it would be appropriate for the gas company to recognise connection fees as revenue over the period when gas supply service is provided to house owners.
- If the provision of connection service and gas supply service are two separate contracts, it would be appropriate for the gas company to recognise connection fees as revenue when the connection service is completed.
- If there is a distinct service for the construction of facilities, it would be appropriate for the gas company to recognise a portion of transaction price related to construction of relevant facilities over the period when the construction work is performed.
- There is diversity in practice re accounting for the courtyard facilities. Some members considered that they are the assets of gas companies while the other considered that they are assets of the developer or house owner.

The Committee recommended that the Ministry of Finance, the accounting standard-setter of PRC, considers and provides its views on the accounting for both the connection fee and pipeline facilities before the FRSC and/or its Revenue Advisory Panel discusses this further. SSD/ Revenue Advisory Panel

## 3. Definition of a business

Further to the April FRSC meeting, the Committee noted that FRSC chair and SSD staff met with IASB vice-chair Sue Lloyd and IASB technical director Peter Clark to reiterate FRSC's concerns on the optional 'concentration test' (previously known as 'screening test' in the exposure draft ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests*).

Ms. Lloyd and Mr. Clark acknowledged the FRSC's concerns. They commented that the IASB is aware that applying the concentration test, in some cases, could result in business combinations incorrectly identified as asset acquisitions. The risk of such outcomes however, as analysed by IASB staff, is minimized through the design of the test. On balance, as there is no one best solution to respond to the requests for simplifying the identification of a business, the IASB considered an optional 'concentration test' would best meet the aim of reducing cost and complexity.

The Committee also noted that the draft amendments to IFRS 3 *Business Combinations*, as a whole, have largely addressed FRSC's comments on other aspects of ED/2016/1 and provided improved guidance on the definition of a business. The Committee agreed that SSD should comment on the draft amendments specifically, to ensure the IASB explains its rationale for incorporating an optional concentration test as well as the circumstances when it is and is not appropriate to apply the concentration test.

As drafting comments on the amendments to IFRS 3 will be provided to the IASB, the Committee also agreed that it is no longer necessary to write to the IASB to reiterate the Committee's concerns, which it planned on doing. SSD and FRSC will monitor and report to the IASB issues (if any) relating to the determination of a business, and in particular, the application of the concentration test. SSD

Finally, the Committee agreed that SSD will communicate and educate stakeholders on the amendments when they are issued; and that the Business Combinations and Reporting Entity Advisory Panel will discuss the application of the amendments to different industries (for example, for the retail property market industry).

[Post-meeting note: Comments on the draft amendments to IFRS 3 were sent to IASB staff on 30 May 2018.]

## 4. Exposure Draft ED/2018/1 *Accounting Policy Changes*

The Committee considered the staff's preliminary views on ED/2018/1 and provided direction on what views could form the basis of the Institute's submission. A draft submission will be considered for approval at the next FRSC meeting or out-of-session. SSD

## 5. Revised Conceptual Framework for Financial Reporting

The Committee noted that the IASB issued a revised *Conceptual Framework for Financial Reporting* on 29 March 2018 (revised Framework). The IASB and the IFRS Interpretations Committee will start using the revised Framework immediately when revising or developing new standards or interpretations. However, changes to the revised Framework will have no immediate effect on the financial statements of most reporting entities. Preparers of financial statements could be immediately affected by the changes only if they use the revised Framework to develop an accounting policy when no standard applies to a particular transaction or other event, or when a standard allows a choice of accounting policy. Other than these circumstances, preparers will apply the revised Framework from the annual periods beginning on or after 1 January 2020.

The Committee received an overview of the key changes of the revised Framework and noted that its comments and concerns, in response to the IASB ED/2015/1 and ED/2015/4, have largely been addressed. The Committee observed that the revised liability definition focuses on an entity's 'obligation', which is 'a duty or responsibility that an entity has no practical ability to avoid'. Some Committee members believed that economic compulsion is implied in the revised liability definition, but questioned how this would be applied in the IASB's Financial Instruments with Characteristics of Equity (FICE) project. These members proposed that SSD recommends to the IASB's project staff to consider rationalizing the application of the revised liability definition in the upcoming IASB FICE discussion paper.

The Committee considered and approved the revised Framework at the meeting. SSD will monitor the application of the revised Framework. SSD

## 6. Digital Currencies

The Committee received an update on the developments of digital currencies and initial coin offerings (ICO) in Hong Kong and other jurisdictions.

Digital currency refers to a form of exchange that exists only digitally and is not linked to any physical currency. Currently, there is no specific global accounting standard for digital currencies. In the absence of specific accounting requirements, diversity in accounting for digital currencies have been noted across jurisdictions.

In Hong Kong, there is no specific legislation or regulation on digital currencies and ICO. SSD reported an increasing prevalence of digital currencies and ICO and the common accounting treatments in Hong Kong.

The Committee noted recent standard-setting developments around the world, in particular:

- In March 2018, the Accounting Standards Board of Japan published a new Japanese standard that sets out the accounting requirements for holders of digital currencies as a method of payment. This is a result of the amendments to the Japan Payment Services Act which defines digital currency and recognises it as a means of payment. The Japanese standard prescribes digital currencies as a new category of asset that is measured at market price through profit or loss if an active market exists. If an active market does not exist, they are measured at cost.
- At its April 2018 Accounting Standards Advisory Forum meeting, IASB staff discussed three possible standard-setting activities to address the accounting for digital currencies. In general, ASAF members supported IASB staff's proposal to explore the following two options:
  (a) Developing a new standard for non-financial investments that are not covered by existing standards; and
  (b) Amending the scope of existing standards to include transactions or items that have specified characteristics.

Some Committee members supported the IASB to develop a new standard for digital currencies in view of its increasing prevalence and diversity in accounting practice. One Committee member suggested the IASB broadens the scope of the project by considering the potential exchange of other virtual assets in the future if such a project were to be undertaken. One other Committee member did not consider the need to undertake standard-setting activities for digital currencies because practices have already developed ways to account for it. This member was also aware of the resource constraints of the IASB to develop a new standard.

The Committee considered that other than the accounting issues, there are also auditing and valuation issues arising from digital currencies. The Committee agreed with the SSD proposal to set up a Task Force that comprises experts from accounting, auditing and valuation, with experience in dealing with digital currencies, to consider relevant issues and recommendations. SSD/ Task Force

**7. Deferred Tax – Two-tiered profits tax regime**

The Committee considered the draft FAQs on 'substantively enacted' as referred in HKAS 12 *Income Taxes* and the application of HKAS 12 in light of the two-tiered profits tax regime. The FAQs will be finalised out-of-session. SSD

[Post-meeting note: The FAQs was posted to the HKICPA website on 16 June 2018.]

**8. HKFRS 17 *Insurance Contracts***

The Committee noted developments on the new insurance contracts standard (IFRS 17), in particular:

- Singapore adopted IFRS 17 in March 2018 and China has added IFRS 17 to its convergence program;
- its Hong Kong Insurance Implementation Support Group held four meetings to date and discussed local submissions received and the IASB's Transition Resource Group meeting papers; and
- SSD will meet with the Insurance Authority in July to discuss possible ways to use HKFRS 17 reporting requirements as a starting point for the Insurance Authority's new risk-based capital reporting requirements for valuation. SSD

**9. Other business**

(i) Profits tax implications of adopting HKFRS 15

Staff provided an update on a meeting held by the Institute and the Inland Revenue Department (IRD) on 18 May 2018. Among other things, the meeting discussed company profits tax implications of adopting HKFRS 15. Specifically, the following areas were discussed:

*Tax treatment of transitional adjustments*

HKFRS 15 requires either 'full retrospective' or 'modified retrospective' adjustments when an entity first applies the Standard. Prior period adjustments are made to the opening retained earnings at the date of initial application. Some stakeholders are concerned that such transitional adjustments may result in double taxation (i.e. income from previous years are taxed again in the current year, if prior year income is recognised in current year as a result of HKFRS 15) or profits drop out (i.e. income from current year is adjusted to be recognised earlier and therefore is excluded from current year tax).

The IRD explained that income and expenses that were assessed or deducted (and not yet assessed or deducted) in prior years of assessment, but are adjusted to be recognised in the year when HKFRS 15 is first applied, will not be taxed or deducted again subject to specific provisions of the Inland Revenue Ordinance or case law.

*Taxability of variable consideration*

The general tax rule in Hong Kong states that profits are to be taxed when they are earned or realized. It is not clear whether the HKFRS 15's requirements of recognising some or all of the variable consideration as revenue would be considered as 'earned or realized' in the eyes of IRD. The IRD explained that, for profits tax purposes, realized profits refers to the profits earned from business transactions carried out by the company. It is noted that an entity only recognises revenue (both fixed and variable considerations) under HKFRS 15 when it satisfies a performance. IRD considered that the revenue so recognised meets the principle of realized profits. Therefore, variable consideration should be included in the assessable profits, subject to specific provisions of the IRO or case law.

The Committee noted that detailed meeting notes will be published on the Institute's website in Q3 or Q4 of 2018.

(ii) Application of new accounting standards in an Accountant's Report for IPOs

Committee members reflected on the discussion with members of the Hong Kong Standard on Investment Circular Reporting Panel (HKSIR panel), which took place on 23 May, and the HKSIR's draft FAQ on applying the major new accounting standards in Accountant's Reports for IPO. This applies to existing HKFRS/IFRS preparers, not first time adopters.

Committee members thought the fundamental question, which is whether not consistently applying accounting policies arising from the new accounting standards in Accountant's Reports throughout the current and prior periods including the track record period complies with Chapter 4 of the Main Board Listing Rules, remains unclear. Committee members advised SSD to notify the Hong Kong Stock Exchange (HKEx) that such a question has been raised by its stakeholders that are planning or preparing to list on the HKEx.

[Post-meeting note: On 4 July 2018, HKICPA wrote to the HKEx Listing Department about the subject matter. The letter also informed that questions on the subject matter will be directed to the HKEx Listing Department. The HKSIR panel decided not to issue an FAQ on the subject matter.]

There being no further business, the meeting closed at 12:15 p.m.

SHELLEY SO
CHAIR

11 July 2018