Alert

Updates on financial reporting and auditing

Issue 6 (January 2010)

Dear members,

Educational points on HKAS 1 identified from reviews of published financial statements under the Institute's professional standards monitoring programme

1. The Institute has been operating a programme of professional standards monitoring for more than 20 years. Under the programme, reviews of published financial statements, predominantly of listed companies, are carried out to identify any potential issues relating to the practical application of financial reporting standards. The ultimate aim of the programme is to enhance the overall quality of financial reporting in Hong Kong.

2. The Institute's Standard and Quality division believes that it will be useful to draw members' attention to some common issues identified from reviews under the programme in the current financial reporting season.

3. In the past, these observations were published in the Quality Assurance Department's annual reports. From now on, such educational points will be communicated by means of Financial Reporting and Auditing Alert, so that members can benefit from them in a timely manner.

4. In this issue of the alert, we set out a summary of common observations relating to the application of HKAS 1 *Presentation of Financial Statements*. Although the observations are identified from reviews of financial statements of listed companies, they are also equally applicable to private entities.

HKAS 1 *Presentation of financial statements*

5. HKAS 1 applies to all general purpose financial statements prepared and presented in accordance with HKFRSs. It sets out overall requirements for the "presentation" of financial statements, guidelines for their structure and minimum requirements for their content. Recognition, measurement and disclosure of specific transactions and other events are dealt with in other standards and in interpretations.

6. HKAS 1 (Revised) has been issued and is applicable for accounting periods beginning on or after 1 January 2009. Our reviews covered the period before HKAS 1 (Revised) became effective so we have focused on reporting issues relating to HKAS 1 that will remain relevant for HKAS 1 (Revised).

7. Some of the most common missing or insufficient disclosures required under HKAS 1 that have been identified by our reviews are set out below.

- Capital management

  HKAS 1 requires an entity to disclose information in respect of the entity's objectives, policies and processes for managing capital. In some instances disclosures appear to have been based on locally available specimen financial statements and had not been tailored to address the specific circumstances of the reporting company.

  HKAS 1 also requires an entity to provide both qualitative and quantitative information on capital management. Many entities disclosed qualitative descriptions of capital management, but there was often no disclosure of quantitative data.

- Comparative information

  When comparative amounts are reclassified due to changes in presentation in the current year's financial statements, HKAS 1 requires an entity to provide information on the nature, amount and reason for each item or class of items for the reclassifications. When it is impracticable to reclassify the comparatives, the entity also needs to disclose the reason for not reclassifying and the nature of the reclassification adjustments that would have been made.

  In some of the cases reviewed, the companies only disclosed that reclassifications were made to conform to the current year presentation without addressing the additional detail required by HKAS 1.

- Current/non-current distinction

  For each asset and liability line item that "combines" amounts expected to be recovered or settled (a) no more than twelve months after the balance sheet date and (b) more than twelve months after the balance sheet date, HKAS 1 requires disclosure of the amount expected to be recovered or settled after more than twelve months.

  For example, properties under development which are intended to be held for sale within an entity's normal operating cycle are included in current assets. The carrying value of the properties that are expected to be completed and available for sale more than twelve months after the balance sheet date should be disclosed.

  The expected timing of asset realization is important for classification of an asset. For example, it is very common that a holding company classifies all amounts due from subsidiaries and related companies as "current" assets every year. However, financial statements are often not clear on whether they meet the definition of current assets (i.e. expected to be realized within twelve months from the balance sheet date) to support this classification.

- Other disclosures or presentation matters required by HKAS 1 that are often overlooked are:

  i. A description in the financial statements on the nature, terms and conditions (as appropriate) of significant items or transactions in the financial statements. For example some companies disclose significant "other receivables" and "other payables" in the financial statements, but have no relevant description in the notes for these significant balances.

  ii. Presentation of additional line items, headings and subtotals on the face of the financial statements is needed when relevant to an understanding of the entity's financial position and performance.

  iii. A description of the nature and purpose of each reserve within equity, e.g. capital reserve, capital redemption reserve and contributed surplus reserve.

  iv. A summary of significant accounting policies that set out the measurement basis used in preparing the financial statements and that are relevant to an understanding of the financial statements. Examples of accounting policies that are often missed are related parties, payables, contingent liabilities and accounting treatment for acquisition of additional interest in a company.

  v. Disclosures on critical accounting judgements and sources of estimation uncertainty are either missed or addressed by "boilerplate" disclosures drawn from available specimen financial statements without tailoring to the entity's circumstances.

  vi. Income and expenses shall not be offset unless required or permitted by a standard or an interpretation. However, it is sometimes noted in financial statements that income or expenses are offset with no explanation disclosed.

  vii. The name of the parent and the ultimate parent of a listed entity.

8. We would like to highlight that the above is not an exhaustive list. We therefore strongly recommend members to read HKAS 1 carefully and in full.

9. Since the revised HKAS 1 will be applicable in the financial statements of December 2009 year end, members may find it useful to refer to the "Staff summary of financial reporting standards" prepared by the standards setting department of the Institute. We believe that members can obtain a quick overall view of the main features of HKAS 1 (Revised), including changes from previous requirements by reading the staff summary. The summary is available in the "technical resources" section of the Institute's website at the following link:

   http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/staff-summary/

10. The TechWatch sections in July and December 2009 issues of the Institute's *A Plus* also provide key highlights on the requirements of HKAS 1 (Revised). Members can access the articles in the following links:

    July 2009 issue:
    http://app1.hkicpa.org.hk/APLUS/0907/Techwatch80.pdf

    December 2009 issue:
    http://app1.hkicpa.org.hk/APLUS/0912/Techwatch85.pdf

Sincere regards,

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