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

MEMBERS' HANDBOOK

Update No. 114

(Issued 29 March 2012)

This Update relates to the issuance of:

- Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* – Government Loans

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing pages i - ii & replace with revised pages i - ii.	Revised contents pages
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (Standard)	Replace cover page and page 3 with revised cover page and page 3. Insert pages 31 – 32 after page 30.	- Note 1
HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (Basis for Conclusions)	Replace cover page and page 3 with revised cover page and page 3. Insert pages 32 – 33 after page 31.	- Note 1
HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (Implementation Guidance)	Replace cover page and page 2 with revised cover page and page 2. Insert pages 32A – 32B after page 32.	- Note 1

Note:

1. The amendments add an exception to the retrospective application of HKFRSs to require that first-time adopters apply the requirements in HKFRS 9 *Financial Instruments* and HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to government loans existing at the date of transition to HKFRSs. This means that first-time adopters shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. However, entities may choose to apply the requirements of HKFRS 9 and HKAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. These amendments give first-time adopters the same relief as existing preparers of HKFRS financial statements.

   Entities are required to apply these amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

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MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to March 2012)

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

HKFRS 1 (Revised)
Revised ~~February~~ March 2012

Effective for annual periods
beginning on or after 1 July 2009

Hong Kong Financial Reporting Standards 1 (Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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Appendix H
Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* – Government Loans – effective for annual periods beginning on or after 1 January 2013

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standards and this appendix will be deleted.

In order to explain the application of this amendment, the following paragraph has been added to the introduction:

IN8 Paragraphs B10 and B11 (introduced by *Government Loans* in March 2012) refer to HKFRS 9. If an entity applies this HKFRS but does not yet apply HKFRS 9, the references in paragraphs B10 and B11 to HKFRS 9 shall be read as references to HKAS 39 *Financial Instruments: Recognition and Measurement*.

Paragraphs 39N and 39O are added and B1 is amended (new text is underlined and deleted text is struck through).

39N *Government Loans* (Amendments to HKFRS 1), issued in March 2012, added paragraphs B1(f) and B10–B12. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

39O Paragraphs B10 and B11 refer to HKFRS 9. If an entity applies this HKFRS but does not yet apply HKFRS 9, the references in paragraphs B10 and B11 to HKFRS 9 shall be read as references to HKAS 39 *Financial Instruments: Recognition and Measurement*.

B1 An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);

(b) hedge accounting (paragraphs B4–B6);

(c) non-controlling interests (paragraph B7);

(d) classification and measurement of financial assets (paragraph B8); ~~and~~

(e) embedded derivatives (paragraph B9)~~.~~ <u>; and</u>

<u>(f) government loans (paragraphs B10–B12).</u>

After paragraph B9 a heading and paragraphs B10–B12 are added.

Government loans

B10 A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with HKAS 32 *Financial Instruments: Presentation*. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in HKFRS 9 *Financial Instruments* and HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to government loans existing at the date of transition to HKFRSs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with HKFRS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to HKFRSs as the carrying amount of the loan in the opening HKFRS statement of financial position. An entity shall apply HKFRS 9 to the measurement of such loans after the date of transition to HKFRSs.

B11 Despite paragraph B10, an entity may apply the requirements in HKFRS 9 and HKAS 20 retrospectively to any government loan originated before the date of transition to HKFRSs, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

B12 The requirements and guidance in paragraphs B10 and B11 do not preclude an entity from being able to use the exemptions described in paragraphs D19–D19D relating to the designation of previously recognised financial instruments at fair value through profit or loss.

HKFRS 1 (Revised) BC
Revised ~~February~~ March 2012

Effective for annual periods
beginning on or after 1 July 2009

Basis for Conclusions on
Hong Kong Financial Reporting Standards 1 (Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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Appendix
Amendments to the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Government Loans – effective for annual periods beginning on or after 1 January 2013

This Basis for Conclusions accompanies, but is not part of, the amendments.

Paragraph BC74 is amended (new text is underlined and deleted text is struck through).

Retrospective designation

BC74 The Board considered practical implementation difficulties that could arise from the retrospective application of aspects of IAS 39:

(a) hedge accounting (paragraphs BC75–BC80);

(b) government loans (paragraphs BC80A–BC80E);

~~(b)~~ (c) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs (paragraphs BC81–BC83); and

~~(c)~~(d) ‘day 1’ gain or loss recognition (paragraph BC83A).

After paragraph BC80, a heading and paragraphs BC80A–BC80E are added

Government loans

BC80A IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (as revised in May 2008) introduced a requirement that government loans with a below-market rate of interest shall be measured at fair value on initial recognition. At the time this requirement was added, the Board recognised that applying it retrospectively may require entities to measure the fair value of loans at an earlier date. Accordingly, the Board decided that entities should apply this requirement in IAS 20 prospectively, with earlier application permitted.

BC80B In 2011 the application of this requirement by first-time adopters was brought to the Board’s attention. The Board noted that the general requirement in IFRS 1 for first-time adopters to apply IFRSs retrospectively at the date of transition to IFRSs could require some entities to measure such government loans at fair value at a date before the date of transition to IFRSs. This may lead to an entity applying hindsight if it must derive a fair value that needs significant unobservable inputs. Accordingly, the Board decided to add an exception to the retrospective application of IFRSs to require that first-time adopters shall apply the requirements of IAS 20 prospectively to government loans existing at the date of transition to IFRSs, unless the necessary information was obtained at the time of initially accounting for that loan. As a result of not applying IAS 20 and IFRS 9 retrospectively to government loans at the date of transition, the corresponding benefit of the government loan at a below-market rate of interest is not recognised as a government grant.

BC80C The Board proposed the exception in October 2011 in the exposure draft *Government Loans* (proposed amendments to IFRS 1). In recognition of comments on the exposure draft, the Board revised paragraph B10 to specify that an entity applies IAS 32 *Financial Instruments: Presentation* to classify the government loans as a financial liability or an equity instrument, and to limit the scope of the exemption to matters of recognition and measurement. This will give first-time adopters the same relief as existing preparers and will mean that if a first-time adopter had classified government loans in equity under its previous GAAP, it will reclassify those loans as liabilities, if those loans meet the definition of a financial liability in IAS 32. The

Board also clarified that an entity should use its previous GAAP carrying amount of such loans at the date of transition to IFRSs as the carrying amount in the opening IFRS statement of financial position. IFRS 9 should be applied to such loans subsequently.

BC80D Some respondents to the exposure draft asked why the retrospective application of IAS 20 should be optional, rather than mandatory, if the information needed to apply IFRS 9 had been obtained. The Board thought that mandatory restatement could require an onerous search to determine whether this information had been obtained when initially accounting for loans that were received many years ago.

BC80E The Board noted that prohibiting the application of this option on a loan-by-loan basis might introduce further complexity into IFRS 1. This is because it may raise further questions, such as whether the retrospective application would be permitted for all the loans for which the information needed was obtained at the time, even if there are other similar loans for which the fair value information was not obtained at that time; and whether the retrospective application should be restricted to all loans received after a certain date and for which all necessary information was obtained to enable retrospective application. The Board concluded that the exception proposed in paragraph B11 should be available on a loan-by-loan basis.

HKFRS 1 IG (Revised)
Revised ~~February~~ March 2012

Effective for annual periods
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Guidance on Implementing
Hong Kong Financial Reporting Standards 1(Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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Appendix
Amendments to guidance on implementing IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Government Loans – effective for annual periods beginning on or after 1 January 2013

This guidance accompanies, but is not part of, IFRS 1.

A heading, paragraphs IG66 and IG Example 12 are added. The editorial note after IG65 has been amended and moved accordingly.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

IG66 Paragraph B10 of the IFRS requires a first-time adopter to use its previous GAAP carrying amount of government loans existing at the date of transition to IFRS as the IFRS carrying amount of such loans at that date. A first-time adopter applies IAS 32 *Financial Instruments: Presentation* to classify such a loan as a financial liability or an equity instrument. Subsequently, the first-time adopter applies IFRS 9 to such a loan. To do so, the entity calculates the effective interest rate by comparing the carrying amount of the loan at the date of transition to IFRSs with the amount and timing of expected repayments to the government. IG Example 12 illustrates accounting for such a loan.

[*Paragraphs IG6~~6~~7–IG200 reserved for possible guidance on future standards*]

IG Example 12 Government loan at a below-market rate of interest at the date of transition to IFRSs

To encourage entities to expand their operations in a specified development zone where it is difficult for entities to obtain financing for their projects, the government provides loans at a below-market rate of interest to fund the purchase of manufacturing equipment.

Entity S's date of transition to IFRSs is 1 January 20X2.

In accordance with the development scheme, in 20X0 Entity S receives a loan at a below-market rate of interest from the government for CU100,000. Under previous GAAP, Entity S accounted for the loan as equity and the carrying amount under previous GAAP was CU100,000 at the date of transition to IFRSs. The amount repayable will be CU103,030 at 1 January 20X5.

No other payment is required under the terms of the loan and there are no future performance conditions attached to the loan. The information needed to measure the fair value of the loan was not obtained at the time of initially accounting for the loan.

The loan meets the definition of a financial liability in accordance with IAS 32. Entity S therefore reclassifies the government loan as a liability. It also uses the previous GAAP carrying amount of the loan at the date of transition to IFRSs as the carrying amount of the loan in the opening IFRS statement of financial position. Entity S therefore reclassifies the amount of CU100,000 from equity to liability in the opening IFRS statement of financial position. In order to measure the loan after the date of transition to IFRSs, the effective interest rate starting 1 January 20X2 is calculated as below:

$$= \sqrt[3]{\left(\frac{103{,}030}{100{,}000}\right)} - 1$$

= 0.01

continued…

…continued

The carrying amounts of the loan are as follows:

Date	Carrying amount	Interest expense	Interest payable
	CU	CU	CU
1 January 20X2	100,000		
31 December 20X2	101,000	1,000	1,000
31 December 20X3	102,010	1,010	2,010
31 December 20X4	103,030	1,020	3,030