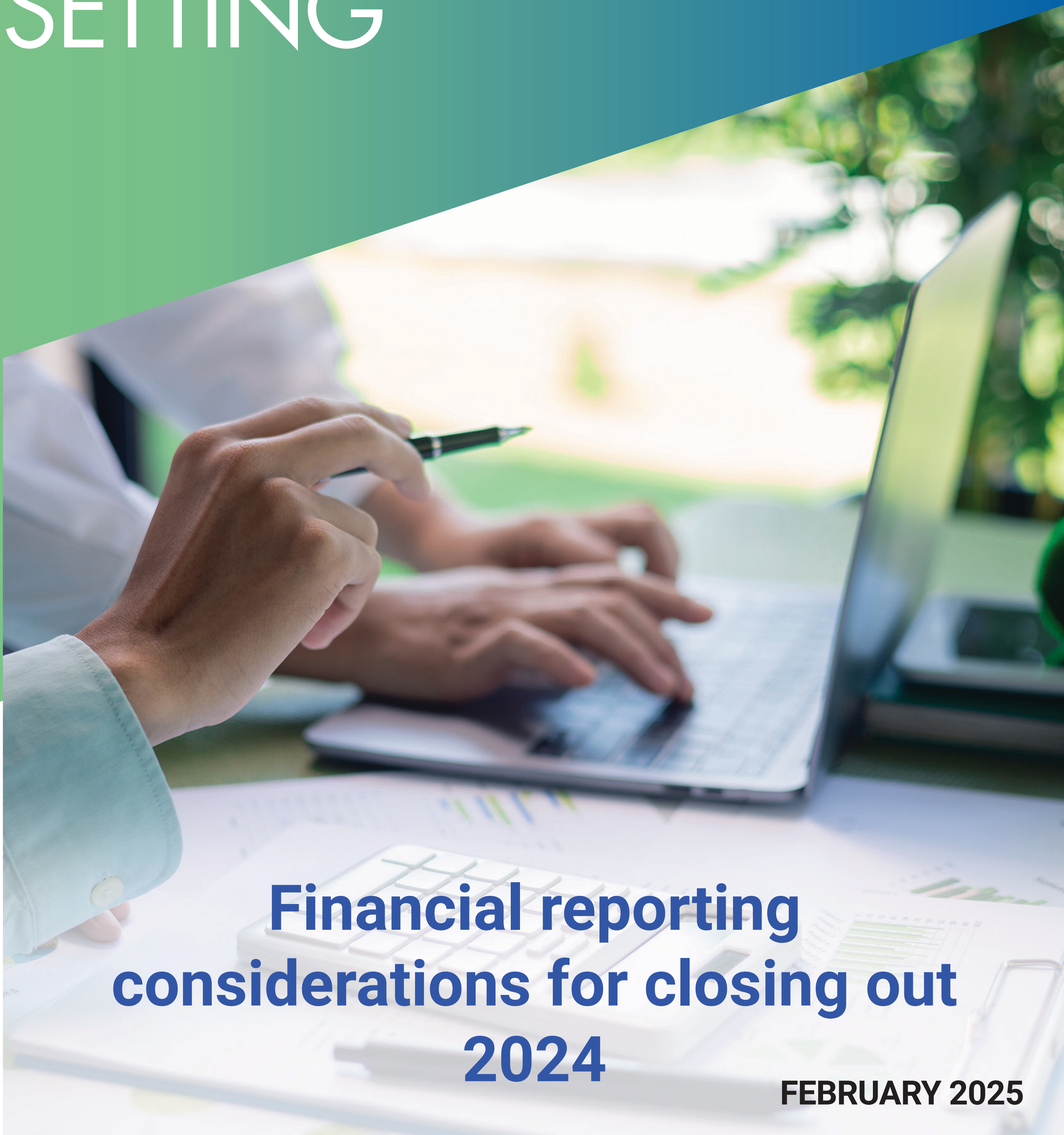
STANDARD SETTING



# Financial reporting considerations for closing out 2024

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

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# Introduction

This publication highlights key financial reporting reminders and topical areas that are relevant and beneficial for preparers in the preparation of their annual financial statements with December 2024 year-end, in accordance with HKFRS Accounting Standards. The insights provided may be also applicable to future reporting periods.

The first section summarizes the amended HKFRS Accounting Standards that are mandatory effective for annual periods beginning on or after 1 January 2024. The second section covers topical areas that are relevant for the preparation of 2024 and subsequent financial statements. Finally, the third section provides a high-level discussion of the key areas and financial implications of the major new and amended HKFRS Accounting Standards that will be effective after 1 January 2025.

It is important to note that this publication is not intended to be comprehensive, nor does it purport to address all the potential issues relevant to an entity's financial statements. Entities are advised to exercise judgement and refer to HKFRS Accounting Standards in the HKICPA's Members' Handbook for further guidance relevant to their own facts and circumstances.

# I. Amended HKFRS Accounting Standards mandatorily effective on 1 January 2024

There are no new HKFRS Accounting Standards effective for annual periods beginning on or after 1 January 2024. Instead, all changes relate to amendments to existing HKFRS Accounting Standards, as summarized in the table below. In addition to the summary below, entities are recommended to refer to the publication Closing Out 2023[1], as well as relevant technical training activities, to gain a thorough understanding of the amendments and their implications.

Paragraph 28 of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires specific disclosures on initial application of a HKFRS Accounting Standard if there is an effect on the current or prior periods. Entities should provide clear and sufficiently granular disclosures tailored to their specific circumstances.

| **HKFRS Accounting Standard** | **Key aspects** | **Prospective or retrospective application and key reminders** |
|---|---|---|
| ***Amendments to HKAS 1[2]: Classification of Liabilities as Current or Non-current, Non-current Liabilities with Covenants***<br>***- Clarify the requirements for classifying liabilities as current or non-current.***<br>***- Require new disclosures for non-current liabilities that are subject to covenants within 12 months after the reporting period.*** | | |
| HKAS 1 *Presentation of Financial Statements* | Classification of a liability<br>▪ Clarify that the right to defer settlement[3] must exist at the reporting date and have substance.<br>▪ Remove the word 'unconditional' in HKAS 1.69(d).<br>▪ Clarify that classification is unaffected by management's intention or expectations and events after the reporting date.<br>▪ Specify that only loan covenants with which an entity must comply on or before the reporting date affect the classification. | Classification of a liability<br>▪ Retrospective application in accordance with HKAS 8.<br>▪ Certain requirements are carried forward unchanged to HKFRS 18 *Presentation and Disclosure in Financial Statements*, which will replace HKAS 1 on 1 January 2027.<br>▪ Entities need to carefully consider the impact of the amendments on existing and planned loan agreements and convertible instruments.<br><br>Disclosure<br>▪ In case where entity has difficulties in repaying the debt after the year end, |

[1] Closing Out 2023, Section III (P.14-20).

[2] Amendments to HKAS 1 encompass two amendments, namely the 2020 Amendments regarding *'Classification of Liabilities as Current or Non-current'* and the 2022 Amendments regarding '*Non-current Liabilities with Covenants*'. These two amendments are required to be applied together on 1 January 2024. Hong Kong Interpretation 5 (Revised) *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* has been updated to incorporate the references to the 2020 and 2022 Amendments.

[3] Refers to the right to defer settlement of a liability for at least 12 months after the end of the reporting period. See HKAS 1.69(d).

| HKFRS Accounting Standard | Key aspects | Prospective or retrospective application and key reminders |
|---|---|---|
| | ▪ Clarify the meaning of 'settlement'[4] in the context of classification.<br>▪ Classification of a liability as current or non-current is not affected by the settlement terms of a conversion option which is classified as equity instrument under HKAS 32 *Financial Instruments: Presentation*.<br><br><u>Disclosure</u><br>▪ Introduce new disclosures to enable financial statement users to understand the risk that non-current liabilities with covenants may become repayable within 12 months after the reporting date[5]. | disclosures regarding the going concern assessment under HKAS 1 and liquidity risk under HKFRS 7 *Financial Instruments: Disclosures* may be relevant. |
| ***Amendments to HKFRS 16[6]: Lease Liability in a Sale and Leaseback***<br>***- Explain how a seller-lessee subsequently measures the lease liability arising from a sale and leaseback where the transfer of asset satisfies the requirements in HKFRS 15 Revenue from Contracts with Customers to be accounted for as a sale.*** | | |
| HKFRS 16 *Leases* | ▪ Require an entity to recognize a lease liability at the date of sale and leaseback transaction, even if all of the lease payments are variable, and regardless of whether they depend on an index or rate.<br>▪ Require that lease liability arising from a leaseback is subsequently measured in a way that no gain or loss is recognized that relates to the right of use (ROU) retained.<br>▪ Add a new Illustrative Example 25 to demonstrate the application of the amendments. | ▪ Retrospective application to sale and leaseback transactions (that include variable lease payments) entered into on or after the initial application date of HKFRS 16 (i.e. 1 January 2019 for December year-end financial statements).<br>▪ Disclose quantitative and qualitative information specific to sale and leaseback transactions required by HKFRS 16[7]. |

[4] For the purpose of classifying a liability as current or non-current, settlement refers to a transfer to the counterparty of cash, or other economic resources (e.g. goods or services) or the entity's own equity instruments, that results in the extinguishment of the liability. See HKAS 1.76A-76B for details.

[5] HKAS 1.76ZA.

[6] HKFRS 16.102A, C2 and C20E.

[7] HKFRS 16.51, 59(d), B48 and B52.

| HKFRS Accounting Standard | Key aspects | Prospective or retrospective application and key reminders |
|---|---|---|
| ***Amendments to HKAS 7 and HKFRS 7[8]: Supplier Finance Arrangements***<br>***- Add disclosure requirements to enhance the transparency of supplier finance arrangement (SFA) and their effects on an entity's liabilities, cash flows and exposure to liquidity risk.*** | | |
| HKAS 7 *Statement of Cash Flows* and HKFRS 7 *Financial Instruments: Disclosures* | HKAS 7<br>▪ Clarify the characteristics of SFAs.<br>▪ Disclose the terms and conditions of SFAs in place.<br>▪ Disclose at the beginning and end of the reporting period:<br>- Carrying amounts and associated line items of financial liabilities that are part of SFAs.<br>- Carrying amounts and associated line items of financial liabilities for which suppliers have received payments from finance providers.<br>- Range of payment due dates for both financial liabilities associated with SFAs and comparable trade payables that are not part of a SFA.<br>▪ Disclose the type and effect of non-cash changes in the carrying amounts of financial liabilities.<br>HKFRS 7<br>▪ Add SFA as an example of when an entity may need to disclose information of concentration of liquidity risk with finance providers. | ▪ Transition reliefs provided. Entities are not required to disclose certain comparative information in the first year of adoption of the amendments[9].<br>▪ Entities should exercise judgement in determining whether the nature or function of the liabilities related to the SFAs is sufficiently different from those of 'trade and other payables', and therefore it warrants a separate presentation in the statement of financial position.<br>▪ Other reminders:<br>- disclose separately terms and conditions of multiple SFAs that have dissimilar terms and conditions[10].<br>- disclose explanatory information about the range of payment due dates or additional ranges if the ranges are wide[11]. |

[8] HKAS 7.44F-H, 62-63 and HKFRS 7.44JJ, B11F(j), IG18 and IG18A.

[9] See HKAS 7.63 for details of transition reliefs when the entity first applies the Amendments to HKAS 7 and HKFRS 7.

[10] HKAS 7.44H(a).

[11] HKAS 7.44H(b)(iii).

The following table summarizes the relevant educational guidance and support activities for the above Amendments.

| | Educational guidance and support |
|---|---|
| **All** of the above Amendments | ▪ Closing Out 2023<br>▪ E-learning CPD courses:<br>- Annual Accounting Update 2023<br>- 2024 SMP Symposium – Module one<br>- Annual Accounting and Sustainability Update 2024<br>- Year-end Financial Reporting Reminders for 2024 |
| Amendments to HKAS 1 | ▪ Educational publication issued in June 2023 provides four illustrative examples to explain the application of the Amendments:<br>- Term loan with financial covenants<br>- Term loan with non-financial covenants/conditions<br>- Revolving loan facility<br>- Convertible bonds<br>▪ A-Plus technical article issued in April 2023<br>▪ E-learning CPD course:<br>- Classification of Liabilities as Current or Non-current |

# II. Topical issues

In this section, we set out topical issues relevant to the preparation of financial statements with December 2024 year end. While certain issues persist from the previous years, new emerging issues have surfaced that warrant careful consideration. This year, we discuss recent updates on local laws and regulations, covering several topics of particular relevance to entities reporting in Hong Kong. We highlight the financial implications of these issues to raise awareness and understanding.

### *1. Macroeconomic uncertainties and their financial reporting implications*

As an international financial centre, companies in Hong Kong engage in global business activities, playing a vital role in facilitating global capital flows, driving regional economic development and connecting businesses across borders. Consequently, Hong Kong's economy is influenced by the macroeconomic environment both regionally and globally. The uncertainties inherent in the macroeconomic environment impact companies in diverse ways, depending on their industries and specific circumstances. This section explores the financial reporting implications of macroeconomic uncertainties.

One significant uncertainty relates to interest rates in Hong Kong. Due to the Hong Kong dollar's peg to the US dollar, local interest rates closely track those of the US Federal Reserve, consequently impacting Hong Kong's economy. Interest rates in Hong Kong have remained relatively high in 2024, albeit with some softening[12,13]. The persistent high interest rates and ongoing inflationary pressures continue to have implications for entities' financial reporting. We recommend that entities refer to Closing Out 2022 and Closing Out 2023, which extensively discuss these impacts on the following areas of financial reporting:

- Impairment of non-financial assets applying HKAS 36 *Impairment of Assets*
- The expected credit loss (ECL) assessment under HKFRS 9 *Financial Instruments*
- Leases applying HKFRS 16 *Leases*
- Revenue recognition applying HKFRS 15 *Revenue from Contracts with Customers*
- Events after the reporting date applying HKAS 10 *Events after the Reporting Period*
- Recognition of deferred tax assets applying HKAS 12 *Income Taxes*
- Going concern assessment and estimation uncertainty and judgement application under HKAS 1 *Presentation of Financial Statements*
- Current and non-current classification of financial liabilities, especially non-current liabilities with loan covenants under HKAS 1.

While entities should ensure that proper recognition and measurements are reflected in their primary financial statements, it is equally crucial to provide sufficient and clear disclosures for high-quality financial reporting. We highlight some common risk disclosure areas in the following table which may be relevant during times of uncertainties. Please note that it is not an exhaustive checklist. Entities should refer to HKFRS Accounting Standards to ensure sufficient disclosures according to their specific circumstances.

| ***Risk exposures (not exhaustive)*** | ***Examples of disclosures (not exhaustive)*** |
|---|---|
| Interest rate risk | ▪ Entities exposed to interest rate risks from floating-rate financial instruments should provide a sensitivity analysis showing how profit or loss and equity would have been affected by reasonably possible changes in interest rates, and a description of the methods and assumptions used. [HKFRS 7.40(a)-(b)] To enhance transparency, they should consider presenting the analysis for different classes of financial instruments.<br>▪ Entities that account for fixed-rate financial instruments at fair value through profit or loss are also exposed to interest rate risk, as changes in market interest rates can lead to changes in the fair value of such financial instruments. Therefore, the sensitivity analysis for market risk under HKFRS 7.40[14] may still be relevant.<br>▪ If an entity changes the methods and/or assumptions used in preparing the sensitivity analysis, they are required to disclose the changes and reasons for them. [HKFRS 7.40(c)] |

[12] Hong Kong Economy – The Government of Hong Kong Special Administrative Region webpage: https://www.hkeconomy.gov.hk/en/pdf/assets.pdf

[13] Documents for Legislative Council LC Paper No. CB(1)1570/2024(03) dated 25 November 2024 (P.7, para 13).

[14] Appendix A of HKFRS 7: Market risk is defined as *'The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk'*.

| *Risk exposures (not exhaustive)* | *Examples of disclosures (not exhaustive)* |
|---|---|
| Liquidity risk | ▪ The macroeconomic environment may impact entities' strategies for managing liquidity risk and financing arrangements. For example, entities may make use of SFA (also known as 'reverse factoring arrangements'), triggering the need for new disclosures on SFA as detailed in Section I above.<br>▪ Entities might also engage in 'factoring arrangements'. When financial assets, like trade receivables with recourse, do not meet the derecognition criteria under HKFRS 9[15], both the financial assets and related financial liabilities would be presented in the entity's financial statements. It is crucial to include relevant maturity analysis in the liquidity risk disclosures for such financial liabilities based on the agreed terms and conditions with the factors. This analysis is based on undiscounted contractual cash flows that include both principal and interest payments. [HKFRS 7.39, B11-B11F]<br>▪ In response to macroeconomic challenges, entities might undergo restructuring exercises as part of their liquidity risk management strategy. Disclosures of the entity's objectives, policies and processes for managing the risk and the method used to measure the risk tailored to entities' own circumstances[16] should be provided.<br>▪ Higher inflation and interest rates might hamper the financial performance and position of an entity, which in turn affects its compliance with loan covenants. The new disclosure requirement under HKAS 1.76ZA requires disclosure of information enabling financial statement users to understand the risk that liabilities classified as non-current could become repayable within 12 months after the reporting period. |
| Fair value volatility | ▪ Changes in macroeconomic conditions may prompt an entity to adjust its valuation measurements by using different inputs, assumptions and valuation techniques. For example, the fair value of investment properties, previously determined using the market approach during an active property market, may shift to the income approach when the property market becomes sluggish and lacks comparable transactions. Consequently, the fair value measurement, previously categorized as Level 2, may shift to Level 3, requiring additional Level 3 disclosures[17], that include quantitative information about the significant unobservable inputs used in the fair value measurement. Significant changes in valuation measurements, such as changes in valuation techniques and the reasons thereof, should also be disclosed.<br>▪ Entities that previously asserted in the financial statements that the carrying amounts of certain assets and liabilities not measured at fair |

[15] See HKFRS 9.3.2.3 to 3.2.22 for the requirements regarding derecogntion and transfer of financial assets.

[16] For detailed requirements, please refer to HKFRS 7.33(a)-(c) (for each type of risk arising from financial instruments) and HKFRS 7.39(c) (for liquidity risk).

[17] See HKFRS 13.93(d)-(h) for disclosures specific to Level 3.

| *Risk exposures (not exhaustive)* | *Examples of disclosures (not exhaustive)* |
|---|---|
| | value approximate their fair value[18] should revisit the appropriateness of this assertion in environments with high interest rates. |
| Credit risk | ▪ Credit risk tends to increase in economic downturns when debtors, whether individual or corporates, experience lower income or revenue level, making it challenging for them to repay the debts. Higher interest rates also increase the cost of borrowings, further challenging the debtors. These factors increase the likelihood of defaults, leading to a rise in credit risk and potential deterioration of credit ratings. The impacts are not limited to the measurement of ECL under HKFRS 9, but also extend to credit risk disclosures in HKFRS 7[19].<br>▪ The following are some examples of the effects:<br>- Updating disclosures related to credit risk management practices to explain how entities manage and address the increased credit risk of debtors.<br>- Recognizing a higher level of ECL due to increased risk of default, necessitating disclosures that explain changes in loss allowances.<br>- Collateral negotiations with debtors affecting ECL measurement, requiring relevant disclosure to explain the effect of collateral on ECL measurement.<br>- Industry-specific sensitivities to macroeconomic changes may lead to credit risk concentration within particular sectors, warranting disclosures regarding significant credit risk concentration.<br>- Changes in debtors' credit ratings impacting disclosure of credit risk exposure by credit risk rating. |

## *2. Accounting implications of recent updates on laws and regulations*

In an evolving world, entities must stay updated on the developments of laws and regulations, remaining vigilant about compliance to fulfil their obligations. Some laws and regulations may impact financial reporting. Being aware of these implications can help prevent last-minute challenges and facilitate proactive planning. This year, we highlight the latest legal updates and their financial reporting implications relevant for entities in Hong Kong.

### *A. Granting tax deductions for lease reinstatement costs in Hong Kong*

On 18 December 2024, the Legislative Council passed the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024, which was gazetted by the HKSAR Government as the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and

[18] See HKFRS 13.97 and HKFRS 7.25-26 and 29 for relevant requirements.

[19] HKFRS 7.35A-38 require disclosure of an entity's credit risk management practices, quantitative and qualitative information about amounts arising from ECL and the entity's credit risk exposure. HKFRS 7.34(c) and B8 set out requirements on significant concentration of credit risk.

Structures) Ordinance 2024 (the Amendment Ordinance) on 27 December 2024. Since the Bill was passed after its Third Reading on 18 December 2024, it is considered to be substantively enacted on that date in the context of HKAS 12. Consequently, entities should consider deferred tax implications of the Bill[20], as further discussed in the examples below.

The Amendment Ordinance gives effect to two enhancement measures for deduction of expenses under profits tax in the 2024-25 Budget[21], effective from the year of assessment 2024/25. One of these enhancements introduces a tax deduction for expenses incurred for reinstating leased premises to their original condition (reinstatement cost).

The Amendment Ordinance sets out five conditions that must be satisfied to qualify for tax deduction for reinstatement costs:

1) The reinstatement costs have been actually incurred by the taxpayer;
2) the taxpayer is a lessee of the lease;
3) the taxpayer has a reinstatement obligation for the premises;
4) the reinstatement costs do not relate to any provisions made under HKFRS 16 *Leases* or any other similar accounting standards (e.g. the depreciation and interest expenses of the capitalized reinstatement costs recognized in the financial statements); and
5) the amount of the reinstatement cost is reasonable in the circumstances.

As noted from conditions 1) and 4), tax deduction can only be claimed for lease reinstatement costs actually incurred or paid. These deductions do not relate to any provisions made under HKFRS 16 or any other similar accounting standards. In other words, any accounting provisions that recognize reinstatement costs as part of the ROU assets or their depreciation are not eligible for deductions. The resulting accounting implications will be that taxpayers may need to make tax adjustments in their profit tax computations and provide for deferred tax during the lease period. This is illustrated in the following two examples:

[20] HKAS 12.47 requires that *'Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period'* (underline added). Please see Part D, *'Implementation of Pillar Two Global Minimum Tax in Hong Kong'*, below for a discussion of the FAQ published by the HKICPA regarding the consideration of when a tax law is considered 'substantively enacted' in the context of Hong Kong.

[21] On 28 February 2024, the Financial Secretary of the HKSAR Government announced in the 2024-25 Budget that the HKSAR Government would introduce a profit tax deduction for expenses incurred for reinstating the condition of the leased premises to their original condition (reinstatement costs), and remove the time limit for claiming industrial and commercial building allowances commencing from the year of assessment 2024/25.

*<u>Example 1 – Lease entered into **before** the Amendment Ordinance is substantively enacted</u>*

*Fact pattern I*

- Entity A entered into a lease in Hong Kong, effective from 1 July 2024 for a term of five years and was required to reinstate the premise to the original condition at the end of the lease term.
- At the commencement date of the lease, a ROU asset corresponding to the same amount recognized for provision for reinstatement cost of HK$100K[22] was recognized.
- The reporting date of Entity A is 31 December 2024.
- The income tax rate is 16.5%.

| | Carrying amount HK$'000 (A) | Tax base [Note 3] HK$'000 (B) | Temporary Difference HK$'000 (A) – (B) | Deferred tax implication HK$'000 |
|---|---|---|---|---|
| ***1 July 2024 (Before the Amendment Ordinance substantively enacted)*** | | | | |
| Reinstatement provision [Note 1] | 100 | 100 | - | - |
| ROU asset [Note 6] | 100 | - | 100 | **No** deferred tax impact in view of initial recognition exception [Note 4] |
| ***18 December 2024 (Amendment Ordinance substantively enacted)*** | | | | |
| Reinstatement provision | 100 | - | 100 | Deferred tax asset = 100 X 16.5% = 16.5 [Note 5] |
| ROU asset [Note 6] | 90 [Note 2] | - | 90 | **No** deferred tax impact in view of initial recognition exception [Note 4] |

Note 1: The amount is recognized and measured applying HKAS 37 *Provisions, Contingent Liabilities and Contingent Asset*. See HKFRS 16.25. For simplicity, the discounting impact and future changes in reinstatement provision are ignored. We also assume that the ROU asset has no impairment issue.

Note 2: The depreciation of the ROU asset related to the reinstatement provision every year = HK$100K / 5 = $20K per year. As the Amendment Ordinance was substantively enacted on 18 December 2024, close to Entity A's reporting date of 31 December 2024, the depreciation for the period from 1 July 2024 to 18 December 2024 approximates = HK$20K/2 = HK$10K. Therefore, the ROU asset at 18 December 2024 = HK$100K – HK$10K = HK$90K.

Note 3: Tax base of asset = carrying amount – future taxable amounts + future deductible amounts [HKAS 12.7]
Tax base of liability = carrying amount – future deductible amounts + future taxable amounts [HKAS 12.8]

Note 4: See HKAS 12.15(b) and 24 for the exception to initial recognition of an asset and liability.

Note 5: The recognition of a deferred tax asset is subject to the assessment of the availability of sufficient future taxable profits, as required by HKAS 12.24.

Note 6: The corresponding lease liability is not presented in this table.

[22] HKFRS 16.24 sets out the composition of the ROU asset, which includes *'an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories'*.

*<u>Example 2 – Lease entered into **after** the Amendment Ordinance is substantively enacted</u>*

*Fact pattern II*

- With the same information as in fact pattern I, except that the lease was commenced on 31 December 2024, which is <u>after</u> the Amendment Ordinance is substantively enacted.

| | Carrying amount HK$'000 (A) | Tax base HK$'000 (B) | Temporary Difference HK$'000 (A) – (B) | Deferred tax implication HK$'000 |
|---|---|---|---|---|
| ***31 December 2024 (after the Amendment Ordinance substantively enacted)*** | | | | |
| Reinstatement provision | 100 | - | 100 | Deferred tax asset = 100 X 16.5% = 16.5 [Notes 8, 9] |
| ROU asset [Note 10] | 100 [Note 7] | - | 100 | Deferred tax liability = 100 X 16.5% = 16.5 [Note 8] |

Note 7: Assume the depreciation of ROU asset is negligible as the lease was entered on 31 December 2024.

Note 8: The exception to initial recognition of an asset and liability under HKAS 12.15(b) and 24 does not apply in this case, as the transaction results in equal taxable and deductible temporary differences, which is HK$100K in this example. Refer to <u>Closing Out 2023 (Section II, P.11-12)</u> which summarized key aspects of *<u>Amendments to HKAS 12 Income Taxes – Deferred Tax related to Assets and Liabilities arising from a Single Transaction</u>*, which became effective from 1 January 2023. According to these Amendments, the initial recognition exception no longer applies to transactions that give rise to equal taxable and deductible temporary differences on initial recognition. Please refer to HKAS 12.22A for the requirement.

Note 9: Refer to Note 5 in Example 1 regarding the requirement for the recognition of a deferred tax asset under HKAS 12.24.

Note 10: The corresponding lease liability is not presented in this table.

The key differences between Example 1 and Example 2 are that in Example 1, there is no deferred tax impact on the initial recognition of reinstatement provision and ROU asset but there will be an <u>immediate</u> profit or loss impact when deferred tax asset is recognized on the date the Amendment Ordinance is substantively enacted. In Example 2, deferred tax asset and deferred tax liability are recognized respectively upon the initial recognition of reinstatement provision and ROU asset.

In both examples, a deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which it can be utilized[23]. After initial recognition, entities should assess any implications for deferred tax that might arise from other changes, such as depreciation of ROU assets and changes in estimate of reinstatement provision.

[23] HKAS 12.24.

## B. *Update on Hong Kong Land Leases – Extensions by the HKSAR Government*

In July 1997, the HKSAR Government promulgated the land policy stating that leases not containing a right of renewal (excluding short term tenancies and special purpose leases)(hereafter referred to 'Non-renewable Leases') may be extended at the sole discretion of the HKSAR Government for a term of 50 years upon expiry without an additional premium, but an annual government rent of 3% rateable value is required.

To streamline the procedures for extending Non-renewable Leases, the Extension of Government Leases Ordinance (Cap.648)[24](Ordinance) came into effect on 5 July 2024. The first 'Extension Notice' was published in the Gazette, covering the lease expiry period from 5 July 2024 to 31 December 2030 (both days inclusive). The Ordinance establishes a new statutory mechanism for lease extension. The Lands Department will publish Extension Notices in the Government Gazette regularly 6 years before the expiry of applicable leases (Regular Renewal Schedule), as illustrated in Diagram 1 below. Under the Ordinance, the HKSAR Government will normally extend applicable leases unless in a remote scenario where there are public interest considerations against the extension of any particular lease (meaning that the lease specified in a 'Non-extension List')[25].

*Diagram 1 – Schedule of publication date of Extension Notice and the land lease covered*

| **Publication date of Extension Notice in the Gazette** | **Specified lease expiry period being covered** |
|---|---|
| 5 July 2024 | 5 July 2024 to 31 December 2030 |
| End-December 2024[26] | 1 January to 31 December 2031 |
| End-December 2025 | 1 January to 31 December 2032 |
| (and so on) | |

Under the Ordinance, land leases are extended for a term of 50 years without additional premium, but an annual government rent of 3% rateable value is required. Interests and rights under the original lease will be carried forward to the extended lease term. Owners are not obligated to conduct any procedures, or execute lease extension documents with the HKSAR Government or rearrange mortgages.

For accounting purposes, the implications of extension of Hong Kong land leases are analyzed separately for leases renewed via the Extension Notice and those yet to be renewed.

[24] Please refer to a leaflet published by the Lands Department which provides a summary of the Ordinance.

[25] The Ordinance is applicable to general purpose leases expiring on or after 5 July 2024 without a right of renewal. These are leases for general commercial, residential or industrial uses. The Lands Department will publish a set of 'Extension Notice' and 'Non-extension List' in the Gazette at the end of each year. Applicable leases extended in accordance with the Ordinance will not be individually listed on the 'Extension Notice'. The 'Extension Notice' will specify that all applicable leases that are due to expire in the specified lease expiry period will be extended in accordance with the Ordinance. Only leases which are not extended will be specified individually on the 'Non-extension list' published on the same day.

[26] The HKSAR Government issued its Second Extension Notice on 27 December 2024.

*(i)* *Leases renewed via the Extension Notice*

According to Appendix A of HKFRS 16, a 'lease modification' is defined as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease – e.g. adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term.

For those leases that do not contain a right of renewal, the extension of land leases under the Ordinance, which increases the scope of the lease and is not a part of the original terms and conditions of respective leases, constitutes a lease modification. Consequently, lessees account for such extensions applying the relevant requirements in HKFRS 16[27] from the effective date of the modification – the date when both parties agree to a lease modification[28] – the publication date of the Extension Notice.

It is important to note that from the effective date of modification, entities should depreciate the net carrying amount of ROU asset (i.e. cost minus accumulated depreciation) over the revised lease term. For example, if the Extension Notice issued on 5 July 2024 extends the lease term from 31 December 2030 to 31 December 2080 for 50 years, lessee should depreciate the ROU asset over the revised lease term, from 5 July 2024 to 31 December 2080.

*(ii)* *Leases not yet renewed*

As the HKSAR Government's intention to renew leases and management's expectation of renewal are not sufficient grounds for a lessee to include such extensions in the determination of the lease term, leases not yet renewed will continue to be accounted for based on their existing terms and no significant impact is expected.

However, entities should anticipate the timing of lease renewals based on the Regular Renewal Schedule and be prepared to account for them in the appropriate financial year. For example, the Extension Notice will be published near the end of December each year as per the Regular Renewal Schedule. Therefore, entities with December year-end financial statements, should account for their leases covered by the Extension Notice in the financial statements for the same year as the publication of the Extension Notice. However, in cases where the financial year does not end in December (e.g. September year-end), land leases might be renewed after the reporting period but before the financial statements are authorized for issue. Information as required by paragraph 21 of HKAS 10 *Events after the Reporting Period* should be disclosed if material.

[27] HKFRS 16.44-46 set out the accounting requirements of lease modification. Different accounting treatments will be applied depending on the nature of the modifications, e.g. whether the modification is considered as a separate lease, and whether the modification increases or decreases the scope of the lease.

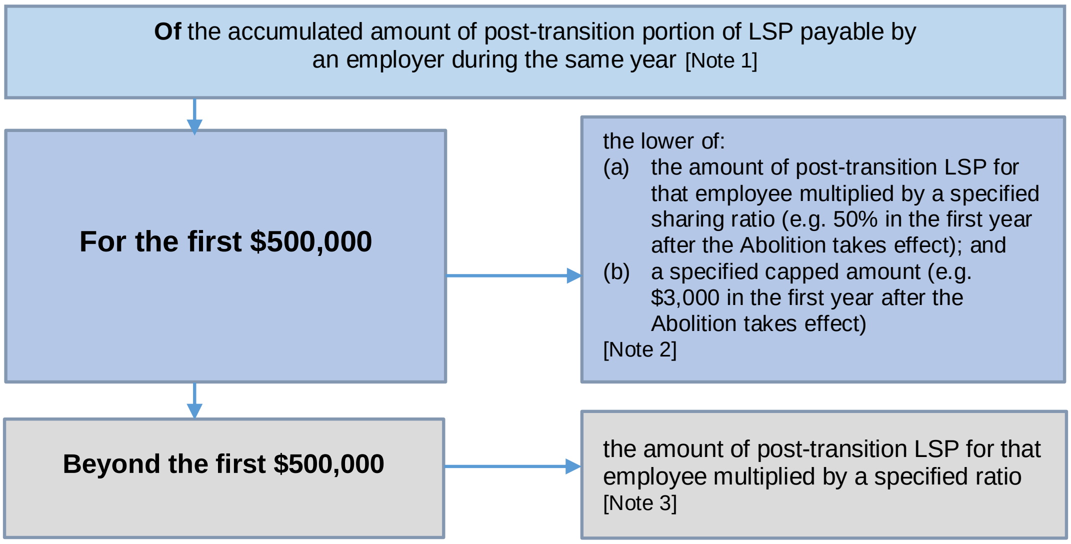
[28] HKFRS 16.Appendix A.

## C. *Accounting for Long Service Payment subsidies*

In June 2022, the HKSAR Government gazetted the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Ordinance 2022 to abolish the Mandatory Provident Fund (MPF)-Long Service Payment (LSP) and Severance Payment (SP) offsetting mechanism. The Abolition will be effective from 1 May 2025 (the Transition Date). The HKICPA issued a financial reporting alert in February 2023, followed by detailed educational guidance in July 2023 to explain the accounting implications of the Abolition.

On 22 November 2024, the Finance Committee of the Legislative Council approved the creation of a commitment for implementing the subsidy scheme for the Abolition (LSP Subsidy). Under the scheme, the HKSAR Government will subsidize a portion of the post-transition LSP payable by employers for 25 years. The subsidy covers up to a specified amount per employee per year, with the employers' sharing ratio and capped amounts progressively increasing over time. The following diagram illustrates the employer's share of post-transition LSP:

*Diagram 2 – An employer's share of the post-transition LSP*




Note 1: The $500,000 threshold refers to whether the accumulated amount of post-transition portion of LSP payable by an employer during the same year exceeds $500,000.

Note 2: The specified employer's sharing ratio and the capped amount, as referred to in (a) and (b) in this box apply to each employee.

Note 3: The specified employer's sharing ratio and the capped amount increase progressively over the 25-year subsidy period. Please refer to the table enclosed in Legislative Council Finance Committee paper FCR(2024-25)37 discussed on 22 November 2024.

In view of these developments, as an extension of the July 2023 educational publication, the HKICPA published another educational publication in January 2025 to provide guidance on the accounting implications of the LSP subsidy. The publication highlights that, as a generally acceptable method, the LSP subsidy is considered as a government grant under HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, and is recognized when there is reasonable assurance that the employer will comply with the conditions attaching to the government grant and the grant will be received[29]. Typically, this assurance is met when the employer has paid or is about to pay the LSP to the employee and is eligible to claim the LSP subsidies from the HKSAR Government. The subsidy as a compensation for LSP expenses incurred by the employer is recognized in profit or loss in the period it becomes receivable[30]. There may be exceptions where the reasonable assurance threshold might be met earlier. Each case should be assessed individually based on its facts and circumstances. The Financial Reporting Standards Committee (FRSC) of the HKICPA acknowledges that there may be other acceptable accounting alternatives to account for the LSP subsidy. Entities should ensure that the method adopted is justifiable and complies with HKFRS Accounting Standards, and they should disclose the accounting policy information if material.

### *D. Implementation of Pillar Two Global Minimum Tax in Hong Kong*

On 27 December 2024[31], the HKSAR Government published in the Gazette the Inland Revenue (Amendment) (Minimum Tax for Multinational Enterprise Groups) Bill 2024 (Bill) for implementing the Global Minimum Tax (GMT) and Hong Kong Minimum Top-up Tax (HKMTT) rules in Hong Kong. Upon enactment, the GMT and HKMTT will be implemented for fiscal years beginning on or after 1 January 2025. The Bill went through its First Reading, and the Second Reading debate in the Legislative Council commenced on 8 January 2025.

Amendments to HKAS 12 *Income Taxes – International Tax Reform – Pillar Two Model Rules* introduce new disclosure requirements on Pillar Two income taxes. When applying the Amendments, entities should consider whether (1) the legislation is enacted or substantively enacted but not yet in effect at the reporting date; or (2) the legislation is in effect[32].

In the context of Hong Kong, the need for disclosure under (1) depends on when the legislation is considered as 'substantively enacted'. A FAQ published by the HKICPA states that for the purpose of accounting for income taxes, the FRSC considers that a bill to be substantively enacted after passing the Third Reading[33]. This is because the legislative procedures after the Third Reading appear to be a formality, and there is usually reasonable certainty that a bill will be passed in law after the Third Reading. Accordingly, since the Bill underwent its First Reading in January 2025, the disclosures for (1) required by the Amendments to HKAS 12 are not relevant for entities with December 2024 year end. The disclosures for (2) required by the Amendments to HKAS 12 are also not relevant as the legislation is not in effect during the reporting period. However, to assist financial statements users in better understanding the

[29] HKAS 20.7.

[30] HKAS 20.20.

[31] As mentioned in Closing Out 2023 (Section II, P.13), the HKSAR Government released a consultation paper on 21 December 2023, regarding the implementation of the global minimum tax and the domestic minimum top-up tax in Hong Kong, with consultation period of 3 months, ending on 20 March 2024. This Bill incorporated feedback received during the consultation.

[32] See Closing Out 2023 (Section II, P.12-13) for a summary.

[33] Extracted from FAQ: According to the Basic Law of HKSAR, after a bill has been gazetted, it has to pass through three readings in the Legislative Council (LegCo) before it is enacted. A bill is subject to debate and vote in the Second and Third Readings. If a bill is rejected during either of those Readings, no further proceedings shall be taken on it. A bill passed by LegCo after the Third Reading shall take effect only after it is signed and promulgated by the Chief Executive.

development and related impact of the Pillar Two legislation in Hong Kong on entities, entities are encouraged to provide relevant disclosures in accordance with HKAS 1.17(c).

Furthermore, depending on the progress of the legislative process in Hong Kong, if the legislation is enacted or substantively enacted after the reporting period but before the financial statements are authorized for issue, the disclosure requirements under HKAS 10.21 will apply. An estimation of the relevant financial effect should be disclosed.

In respect of (2), a Hong-Kong based multinational company or a group with subsidiaries often operates in different jurisdictions, which may have varying statuses regarding the implementation of their Pillar Two legislation at the reporting date. Some jurisdictions might have Pillar Two legislation in effect during the reporting period, leading the affected entities to recognize related income taxes in the statement of profit or loss. In such cases, current tax expenses related to Pillar Two income taxes should be separately disclosed in the financial statements.

The following diagram highlights the accounting implications of Pillar Two legislations.

*Diagram 3 – Accounting implications of Pillar Two legislations in different scenarios*

<table>
<tr><th colspan="4">Reporting for financial statements applying<br>Amendments to HKAS 12 – International Tax Reform – Pillar Two Model Rules</th></tr>
<tr><td rowspan="2">Scenario</td><td>I [Note 1]</td><td>II</td><td>III</td></tr>
<tr><td>Pillar Two legislation enacted or substantively enacted <u>after</u> the end of the reporting period but before financial statements are authorized for issue</td><td>Pillar Two legislation enacted or substantively enacted but <u>not yet in effect</u> at the end of the reporting period</td><td>Pillar Two legislation enacted or substantively enacted and <u>in effect</u> at the end of the reporting period</td></tr>
<tr><td>Accounting implications</td><td>No top-up tax payable<br>→ only mandatory disclosures apply</td><td>No top up tax payable<br>→ only mandatory disclosures apply</td><td>Top-up tax payable<br>+ mandatory disclosures</td></tr>
<tr><td rowspan="2">Relevant HKAS 12 or other requirements</td><td rowspan="2">▪ Not covered by HKAS 12, but required under HKAS 10 to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made [Note 3]</td><td colspan="2">Disclose the fact that the exception to recognizing and disclosing information of deferred tax assets and liabilities related to Pillar Two income taxes has been applied. [Note 2]</td></tr>
<tr><td>▪ Disclose known or reasonably estimable exposure to Pillar Two income taxes arising from relevant jurisdiction at the reporting date, both qualitative and quantitative information [Note 4]</td><td>▪ Disclose separately its current tax expense (income) related to Pillar Two income taxes [Note 5]</td></tr>
</table>

Note 1: This may be in the case for Hong Kong, if the Bill is enacted or substantively enacted after the end of the reporting period but before the financial statements are authorized for issue.

Note 2: HKAS 12.88A.

Note 3: The extent of information required by HKAS 10 should be similar to HKAS 12.88C-88D to enable financial statement users to understand the entity's exposure to Pillar Two income taxes arising from that jurisdiction.

Note 4: HKAS 12.88C-88D.

Note 5: HKAS 12.88B

The scenarios described above can arise within an entity's consolidated financial statements, where the entity and its group companies operate in various jurisdictions with different status of development of Pillar Two Model Rules. It is crucial to provide appropriate disclosures in light of the circumstances. As the Amendments to HKAS 12 became effective in 2023, entities should ensure the disclosures are updated for their 2024 financial statements.

### *3. Climate-related matters on financial reporting and connectivity*

We started discussing the implication of climate-related reporting in Closing Out 2021, with updates provided in Closing Out 2022 and Closing Out 2023. This year, we highlight the following recent major developments.

#### *A. Hong Kong Sustainability Disclosure Standards and Connectivity*

There have been significant developments in the sustainability reporting landscape in Hong Kong in 2024. The publication of the Roadmap on Sustainability Disclosure in Hong Kong (Roadmap)[34] by the Financial Services and the Treasury Bureau on 10 December 2024, sets out Hong Kong's approach to require publicly accountable entities[35] (PAEs) to adopt the International Sustainability Standards Board (ISSB) Standards. The Roadmap lays down a clear pathway for large PAEs to fully adopt the ISSB Standards no later than 2028 with the following key milestones:

| | ***Details of respective milestones and their status*** |
|---|---|
| ***Milestone 1*** – Development of Hong Kong Sustainability Disclosure Standards | ▪ Being a significant step in Hong Kong's sustainability reporting journey, on 12 December 2024, the HKICPA published HKFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and HKFRS S2 *Climate-related Disclosures* (collectively referred to as HKFRS Sustainability Disclosure Standards or HKFRS SDS). HKFRS SDS are fully aligned with the ISSB Standards. |
| ***Milestone 2*** – Compliance with the Hong Kong Exchanges and Clearing Limited (HKEX)'s New Climate Requirements | ▪ All Main Board issuers are required to disclose against the New Climate Requirements modelling on IFRS S2 *Climate-related Disclosures* on a "comply or explain" basis from 1 January 2025 (except for the mandatory disclosure requirement on Scope 1 and 2 greenhouse emissions applying to all issuers from 1 January 2025).<br>▪ Issuers that are Hang Seng Composite LargeCap Index constituents are further required to disclose against the New Climate Requirements from 1 January 2026. |

[34] Roadmap P.5.

[35] As set out in the Inaugural Jurisdictional Guide published by the IFRS Foundation in May 2024, PAEs are (a) entities whose securities are traded in a public market or entities in the process of issuing securities for trading in a public market; and (b) entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses (for example, banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks) and have a significant weight in the jurisdiction, regardless of their ownership structure or listed status.

| | *Details of respective milestones and their status* |
|---|---|
| | ▪ HKEX will consult the market in 2027 on mandating sustainability reporting against HKFRS SDS for listed PAEs under a proportionate approach, with an expected effective date of 1 January 2028. |
| ***Milestone 3*** – Compliance by non-listed PAEs | Subject to stakeholders' comments and feedback, relevant financial regulators will require financial institutions carrying a significant weight (being non-listed PAEs) to apply HKFRS SDS no later than 2028. |

The Roadmap indicates that Main Board issuers will be first impacted by the New Climate Requirements specified in the Listing Rules, with the mandate eventually extending to include both listed and non-listed PAEs applying HKFRS SDS by 2028. While the publication of HKFRS SDS has no immediate impact on PAEs and its adoption remains voluntary currently, PAEs should actively familiarize themselves with HKFRS SDS to ensure smooth implementation by 2028.

To support the implementation of HKFRS SDS, the HKICPA offers resources including:

- E-learning: Charting Sustainability Reporting in Hong Kong – Public briefing on HKFRS S1 and S2
- Resource Centre for Sustainability Standards[36]
- Sustainability Information Centre[37]
- Frequently-asked questions

In light of the above recent developments, achieving connectivity between sustainability reporting and financial reporting has become increasingly crucial for entities reporting in Hong Kong, especially listed entities. Ensuring consistency and complementarity between financial statements disclosures and sustainability reporting disclosures is key to achieving this connectivity. An effective and robust connectivity can empower stakeholders to obtain a holistic and comprehensive view of an entity's financial performance, financial position and cash flows. In terms of climate-related risks, stakeholders can gain a deeper insight into an entity's exposure to these risks, management's strategies to manage and address them in their operations and the resulting financial implications.

The International Accounting Standards Board (IASB) and ISSB recognize the importance of connectivity between their respective requirements in enabling the provision of high-quality financial information to capital markets. A new dedicated webpage 'Connecting IFRS Accounting and IFRS Sustainability' has been launched, containing all related resources and updates. Entities are recommended to refer to the resources in the webpage, particularly the webcast series 'Connectivity between the financial statements and sustainability-related financial disclosures', which include illustrative scenarios, to gain insights on achieving connectivity.

[36] It is a centralized hub for technical publications and reference materials relevant to sustainability reporting, assurance and ethics. It also provides guidance materials covering topics such as the applicability of HKFRS SDS (i.e. which entities must apply the standards and by when) and their interaction with the New Climate requirements under the amended Listing Rules.

[37] It is a collection of thought leadership articles and learning resources to help stakeholders keep abreast of local and international developments.

## B. *Other developments of IFRS Accounting Standards related to climate*

In 2024, the IASB engaged in several financial reporting projects, notably covering climate risk and connectivity, as highlighted below. Entities should vigilantly and robustly assess the potential impacts of these projects on their financial statements. For example, entities should assess whether they have any climate-related commitments that should be recognized as a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* by considering the project in (i) below. Regarding (iv), although the current impact on entities operating in Hong Kong is limited, there could be potential implications for their investments in entities operating in other jurisdictions engaging in the sale and purchase of nature-dependent electricity.

(i) In April 2024, the IFRS Interpretation Committee (IFRS IC) published an agenda decision – *Climate-related Commitments (IAS 37)* on whether a company's commitment to reduce or offset its greenhouse gas emissions creates a constructive obligation and, if so, whether that constructive obligation meets the criteria in IAS 37 for recognizing a provision.

(ii) In July 2024, the IASB published the Exposure Draft *Climate-related and Other Uncertainties in the Financial Statements*. The Exposure Draft proposes eight examples illustrating how an entity applies the requirements in IFRS Accounting Standards to report the effects of climate-related and other uncertainties in its financial statements. These examples aim to improve the reporting of the effects of climate-related and other uncertainties in the financial statements and to strengthen connections between financial statement disclosures and sustainability disclosures. The consultation closed on 28 November 2024. The IASB will start deliberating the feedback in February 2025, which will be a joint meeting with ISSB[38].

(iii) On 12 November 2024, the IASB published the Exposure Draft *Provision – Targeted Improvements*. The proposed amendments clarify how entities assess when to record provisions and how to measure them, which in turn assist entities in applying the requirements of IAS 37 to climate-related obligations, such as decommissioning or environmental rehabilitation obligations as well as emission credits. The Exposure Draft also amends the Guidance on implementing IAS 37 by adding examples to illustrate fact patterns that have been the subjects of IFRS IC agenda decision, namely July 2022 Agenda Decision – *Negative Low Emission Vehicle Credits (IAS 37)*[39] and the abovementioned IFRS IC April 2024 Agenda Decision on *Climate-related Commitments (IAS 37)*.

(iv) Given the rising use of power purchase agreements to acquire nature-dependent electricity and the need for better representation of these contracts in financial

[38] Please refer to IASB's project page for the development of this project.

[39] See relevant discussion in Closing Out 2023 –Section I, P.7.

statements, the IASB published its targeted amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* on 18 December 2024, after considering the stakeholders' feedback on the Exposure Draft *Contracts for Renewable Electricity*. These amendments are required to be applied for reporting periods on or after 1 January 2026, with early adoption permitted.

# III. HKFRS Accounting Standards issued but not yet effective

The final part of this publication provides an overview of HKFRS Accounting Standards that have been issued but are not yet effective. In accordance with HKAS 8[40], entities need to disclose in their December 2024 financial statements the possible impact of initial application of the new or amended HKFRS Accounting Standards. Accordingly, entities should familiarize themselves with the requirements of the new or amended HKFRS Accounting Standards, and assess their impacts based on their own circumstances. We highlight below three amendments or Standards that we consider particularly relevant to entities reporting in Hong Kong.

### *1. Amendments to HKFRS 9 Financial Instruments and HKFRS 7 Financial Instruments: Disclosures – Amendments to the Classification and Measurement of Financial Instruments*

In May 2024, the IASB issued *Amendments to the Classification and Measurement of Financial Instruments*, which amended IFRS 9 and IFRS 7, to address the matters identified during the post-implementation review of the classification and measurement of IFRS 9 and clarify stakeholders' concerns and emerging issues. The HKICPA issued the equivalent *Amendments to HKFRS 9 and HKFRS 7* in August 2024. A summary of the key amendments and their implications is set out below.

***Effective date:*** Annual reporting periods beginning or after 1 January 2026. Earlier application of either all the amendments at the same time or only the amendments related to classification of financial assets plus related disclosures permitted.

***Initial application***: Amendments to be applied retrospectively. Restatement of prior periods not required, and only permitted without the use of hindsight. Disclosure of information of financial assets that change the measurement category due to the Amendments required.

*A. Initial recognition or derecognition of financial assets and liabilities*

| ***Highlights of the Amendments*** | ***Implications and relevant considerations (not exhaustive)*** |
|---|---|
| *A1. Date of initial recognition or derecognition of financial assets and liabilities – general principles[41]* | |
| ▪ Clarify the existing requirements of HKFRS 9 that financial assets or financial | ▪ Unless using an electronic payment system that meets the specified criteria in HKFRS 9.B3.3.8 |

[40] HKAS 8.30-31.

[41] HKFRS 9.B3.1.2A

| Highlights of the Amendments | Implications and relevant considerations (not exhaustive) |
|---|---|
| liabilities are recognized when the entity becomes a party to the contractual provisions of the instrument.<br>▪ Clarify that financial assets are derecognized when the entity's rights to the contractual cash flows (CCFs) expire or are transferred.<br>▪ Clarify that a financial liability is derecognized on the 'settlement date', i.e. the date on which the financial liability is extinguished because the related obligation specified in the contract is discharged, cancelled, expires or the liability otherwise qualifies for derecognition (see **A2** below). | (refer to **A2** below), entities cannot derecognize a financial asset or financial liability until the amount has cleared in the receiving entity's bank account[42]. These requirements apply to payments made via cheque, debit card or credit card and other electronic transfers that do not satisfy the conditions in HKFRS 9.B3.3.8.<br>▪ Consequently, entities whose financial reporting processes do not align with the clarifications provided in the Amendments might be affected. As such, entities should revisit their processes and assess whether the accounting policy for derecognition of financial assets and financial liabilities conform to the Amendments.<br>▪ See an example below to understand the impact of the Amendments. |
| *A2. Derecognition of a financial liability through electronic transfer*[43] | |
| ▪ Introduce an accounting policy option that an entity is permitted to deem a financial liability (or part of it) to be settled in cash using an electronic payment system as discharged before the settlement date if certain conditions are met and derecognize the financial liability before the settlement date.<br>▪ Require that the above accounting policy option is applied to all settlements made through the same electronic payment system if elected.<br>▪ The accounting policy option can be applied for electronic payments on a system-by-system basis. | ▪ No significant impact is expected on entities operating in Hong Kong and Mainland China where the electronic payment systems generally are operated on a real-time basis.<br>▪ The Amendments apply to specific scenarios of payments made using an electronic payment system for financial liabilities. To assess whether the specified conditions will be met, additional work is needed to analyze the contractual and legal requirements for each electronic payment system in each jurisdiction. This work could be complex, particularly in case of cross-border payments.<br>▪ Entities' financial reporting processes might be affected, e.g. some entities that, prior to the Amendments, derecognized financial liabilities only upon cash receipts. |

*Example – derecognition of a financial liability through a cheque payment*

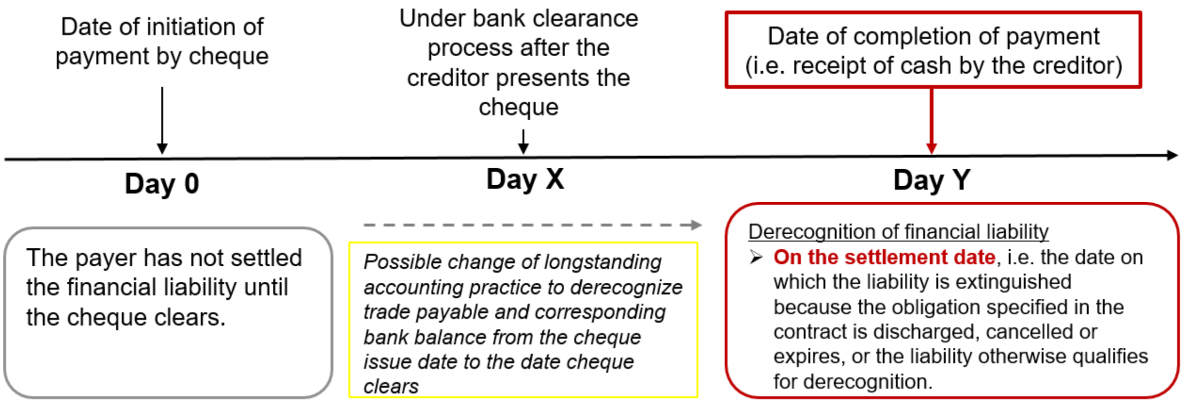
In Hong Kong, it is common for companies to derecognize their financial liabilities upon the issuance of cheques to their creditors. At each month-end, they perform bank reconciliation procedures to reconcile any differences in the closing balance between the bank ledger and bank statements (e.g. cheques not yet cleared by the bank). The Amendments could change this current practice by clarifying that entities can derecognize their financial liabilities only

[42] HKFRS 9.BC 3.55 and BC3.60.

[43] HKFRS 9.B3.1.2A, B3.3.8 – B3.3.10.

when cheques are cleared by the bank, instead of when they are issued, as illustrated in diagram below.

*Diagram 4 – Derecognition of trade payable settled by cheque*




Under the Amendments, the debtor should derecognize trade payable on Day Y when the creditor receives the cash, as opposed to Day 0 when the debtor issues the cheque. Similarly, a creditor derecognizes a trade receivable upon receiving cash from the debtor after the cheque has been cleared by the bank. In preparation for adopting the Amendments, we consider it crucial that entities review their derecognition practices for financial assets and financial liabilities to ensure compliance with the Amendments.

## *B. Classification of financial assets*

| ***Highlights of the Amendments*** | ***Implications and relevant considerations (not exhaustive)*** |
|---|---|
| *B1. Classification of financial assets – contractual terms that are consistent with a basic lending arrangement*[44] | |
| ▪ Provides guidance on how an entity assesses whether CCFs of a financial asset, with contingent features, are consistent with a basic lending arrangement, specifically:<br>- whether the CCFs that could arise before and after the change in CCFs would meet the SPPI[45] test.<br>- whether the nature of contingent event relates directly to, and the CCFs change in the same direction as, changes in basic lending risks and costs.<br>- whether SPPI test may still be met when the nature of contingent event does not relate | ▪ The Amendments provide additional application guidance for <u>all</u> financial assets whose CCFs could change as a result of contingent events[46]. Therefore, entities should reassess whether their financial assets with contingent features are impacted by the Amendments.<br>▪ Judgement may be needed in assessing whether financial assets containing contingent features satisfy the SPPI under the Amendments, e.g. what is considered as 'significantly different' in applying the new requirements of HKFRS 9.B.4.1.10A. |

[44] HKFRS 9.B4.1.8A, B4.1.10, B4.1.10A and B4.1.13-14

[45] SPPI refers to 'solely payments of principal and interest on the principal amount outstanding'.

[46] Given the principle-based approach of IFRS 9 (HKFRS 9 equivalent), the Amendments are not specific to environmental, social and governance (ESG)-linked instruments. See HKFRS 9.BC4.254-4.256 for the IASB's relevant consideration.

| *Highlights of the Amendments* | *Implications and relevant considerations (not exhaustive)* |
|---|---|
| directly to changes in basic lending risks and costs.<br>▪ Add examples of financial assets that have, or do not have, CCFs that are SPPI. | ▪ There could be a change in the measurement category of existing financial assets as a result of applying the Amendments. If so, entities should provide the relevant disclosures according to the transition provisions[47]. |
| *B2. Classification of financial assets – financial assets with non-recourse features[48]* | |
| ▪ Enhance the description of the term 'non-recourse', specifying that a financial asset has non-recourse features if an entity's ultimate right to receive cash flows is <u>contractually</u> limited to the cash flows generated by specified assets. That means, the entity is primarily exposed to the specified assets' performance risk, not the debtor's credit risk.<br>▪ Clarify the difference between a non-recourse loan and a collateralized loan[49].<br>▪ Clarify how to perform the 'look-through' assessment to the underlying assets for financial asset with non-recourse feature to assess if such a financial asset still meets SPPI. | ▪ Entities should reassess the impact of the Amendments on the classification of their financial assets, such as:<br>- financial assets initially considered in-substance non-recourse without contractual terms, given that the Amendments[50] clarify that non-recourse feature must be contractual;<br>- financial assets which are collateralized loans but accounted for as non-recourse, and vice versa.<br>▪ Be mindful of the disclosure requirements and transitional provision if there is a change in measurement category as mentioned above. |
| *B3. Classification of financial assets – contractually linked instruments (CLI)[51]* | |
| ▪ Clarify the characteristics of CLI, which have a waterfall payment structure that creates concentration of credit risk and results in a disproportionate allocation of cash shortfalls from the underlying pool between tranches.<br>▪ Clarify that CLI with non-recourse features are to be assessed only in accordance with CLI requirements under HKFRS 9.<br>▪ Clarify that CLI are not created when multiple debt instruments of differing seniority are issued to facilitate lending with enhanced credit protection to a creditor (or a group of creditors).<br>▪ Clarify that the reference to instruments in the underlying pool can include financial instruments not within the scope of HKFRS 9 but with CCFs equivalent to SPPI, such as lease receivables. | ▪ Entities should reassess the impact of the Amendments on the classification of their financial assets currently treated as CLI. For example, those multiple debt instruments of different seniority issued for credit protection of creditor cannot be accounted for as CLI under the Amendments.<br>▪ Be mindful of the disclosure requirements and transitional provision if there is a change in measurement category as mentioned above. |

47 HKFRS 9.7.2.

48 HKFRS 9.B4.1.16, B4.1.16A and B4.1.17.

49 HKFRS 9.BC4.280.

50 HKFRS 9.B4.1.16A and BC4.286.

51 HKFRS 9.B4.1.20, B4.1.20A, B4.1.21 and B4.1.23.

## *C. Disclosures*

| ***Highlights of the Amendments*** | ***Implications and relevant considerations (not exhaustive)*** |
|---|---|
| *C1. Disclosures – investments in equity instruments designated at fair value through other comprehensive income (FVTOCI)*[52] | |
| ▪ Require additional disclosures for FVTOCI investments:<br>- the change in fair value in OCI during the period, showing separately, the amounts relating to investments derecognized in the period, and those held at the end of the reporting period for each class of investment.<br>- the aggregate fair value of investments for each class of investment (as opposed to fair value of each such investment before the Amendments) at the end of the reporting period, and<br>- any transfer of cumulative gains and losses within equity for investments derecognized in the period. | ▪ The grouping of investments into classes should be performed based on the requirements of HKFRS 7.6.<br>▪ The applicability of the new disclosure regarding the transfer of cumulative gains or losses within equity depends on the entities' existing accounting policy on whether to transfer these cumulative gains or losses. |
| *C2. Disclosures – contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event*[53] | |
| ▪ Add new disclosures for financial assets and liabilities that contain contingent features (including those that are ESG-linked) to:<br>- each class of financial asset measured at amortized cost or FVTOCI and<br>- each class of financial liability at amortized cost.<br>▪ The new disclosures include:<br>- a qualitative description of the nature of the contingent event;<br>- quantitative information about the possible changes to CCFs that could result from those contractual terms; and<br>- the gross carrying amount of financial assets and the amortized cost of financial liabilities subject to those contractual terms.<br>▪ Add the same disclosure requirements to HKFRS 19 *Subsidiaries without Public Accountability: Disclosures* | ▪ New disclosures are applicable to <u>both</u> financial assets and financial liabilities whose cash flows would change due to a contingent event, and not only financial assets whose classification requirements have been amended.<br>▪ The new disclosures are not required for financial instruments measured at fair value through profit or loss, as the changes in fair value are considered to provide sufficient information to enable users to assess the future cash flows of those instruments.<br>▪ The grouping of investments into classes should be performed based on the requirements of HKFRS 7.6.<br>▪ Judgement may be needed in the following:<br>- determination of the nature and extent of qualitative and quantitative disclosures required by the Amendments, considering the complexity of the instruments and materiality.<br>- appropriate level of aggregation or disaggregation of information for disclosures. |

[52] HKFRS 7.11A and 11B.

[53] HKFRS 7.20B, 20C and 20D.

## *2. HKFRS 18 Presentation and Disclosure in Financial Statements*

In July 2024, the HKICPA issued HKFRS 18 together with the consequential amendments to other HKFRS Accounting Standards[54], following the issuance of IFRS 18 *Presentation and Disclosure in Financial Statements* and consequential amendments to other IFRS Accounting Standards in April 2024. HKFRS 18, which replaces HKAS 1 *Presentation of Financial Statements*, is effective for annual periods beginning on or after 1 January 2027, with early application permitted. Requirements in HKAS 1 that are unchanged have been 'brought forward' into HKFRS 18 and other HKFRS Accounting Standards.

Although HKFRS 18 will not affect how companies measure financial performance, it will affect how companies present and disclose financial performance. As shown in the table below, HKFRS 18 introduces three sets of new requirements to improve entities' reporting of financial performance and give investors a better basis for analyzing and comparing entities. These requirements affect all entities in all industries as to how they present and disclose financial performance in financial statements.

| ***Areas*** | ***Highlights of key requirements*** |
|---|---|
| 1. Statement of profit or loss[55] | ▪ More structured statement of profit or loss by requiring:<br>i) Classification of all income and expenses into one of the five categories – operating, investing, financing, income taxes and discontinued operation. The first three are new categories.<br>ii) Presentation of two new defined subtotals and totals – 'operating profit' and 'profit or loss before financing and income taxes'.<br>▪ For the purpose of (i), an entity assesses whether it has a 'main business activity' of investing in assets or providing financing to customers, which would require specific classification.<br>▪ Require entities to classify foreign exchange differences in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences. However, if classifying such a way would involve undue cost or efforts, entities are permitted to classify foreign exchange differences in the operating category.<br>▪ Include specific requirements for classifying fair value gains and losses on derivatives and hedging instruments, and for classifying income and expenses from hybrid contracts. |
| 2. Management-defined performance measures (MPMs)[56] | ▪ Define MPM as a subtotal of income and expenses that an entity uses in public communications outside financial statements, to communicate management's view of an aspect of the financial performance of the entity as a whole to users. However, subtotals of |

[54] This includes narrow-scope amendments to HKAS 7, HKAS 33 *Earnings per Share* and HKAS 8. HKAS 8 is re-titled *'Basis of Preparation of Financial Statements'* to better reflect its amended content.

[55] HKFRS 18.46-85, B29-B85.

[56] HKFRS 18.117-125, B113-B142.

| Areas | Highlights of key requirements |
|---|---|
| | income and expenses listed by HKFRS 18 or specifically required by HKFRS Accounting Standards are not MPMs.<br>▪ Require disclosure of all of an entity's MPMs in a single note, including a reconciliation between the measure and the most directly comparable subtotal specified by HKFRS 18 or total or subtotal specially required by other HKFRS Accounting Standards, and a description of how the measure communicates management's view and the calculation of the measure.<br>▪ Provide a statement that the measure reflects management's view of an aspect of financial performance of the company as a whole and is not necessarily comparable to measures sharing similar labels or descriptions provided by other companies. |
| 3. Aggregation and disaggregation[57] | ▪ Provide guidance for entities on grouping transactions and other events into the line items in the primary financial statements and information disclosed in the notes. Entities are required to:<br>i) Aggregate items that have similar characteristics and disaggregate items that have different characteristics;<br>ii) Group items in a way that does not obscure material information or reduce the understandability of the information presented;<br>iii) Use meaningful labels or descriptions for aggregated items, and use the label 'other' only when entities are unable to find a more informative label; and<br>iv) Place items in the primary financial statements and the notes to fulfil their complementary roles.<br>▪ Require entities to present the operating category expenses based on their nature or their function. Entities that present expenses classified by function are required to disclose in the notes the five specified operating expenses by nature, namely the amount of depreciation, amortization, employee benefits, impairment losses and write-downs of inventories included in each line item in the operating category of statement of profit or loss[58]. |

The implementation of HKFRS 18 will have a broad impact on various entities and industries. The HKICPA released two A-Plus technical articles in January and July 2024. Entities are encouraged to read them to gain insights into the implications of HKFRS 18. Moreover, the HKICPA has developed a dedicated webpage focusing on HKFRS 18, which includes the project summaries and effects analysis, providing another helpful resources to assist in the implementation of this new major Standard.

Restatement of comparative period and compliance with the disclosure requirements under HKFRS 18.C3 on transition are required. Entities with interim reporting obligations should be

[57] HKFRS 18.41-43, B16-B26.

[58] HKFRS 18.78-85 and B80-B85.

aware of the amendments to HKAS 34 *Interim Financial Reporting* and related transition provisions in HKFRS 18.C4-C5.

To ensure smooth transition, we advise entities to start preparing for the implementation of HKFRS 18 as soon as possible. The following are some key reminders for the transition:

(i) Entities should carefully assess whether they are engaged in specified main business activities, as the classification of income and expenses in their statements of profit or loss depends on their main business activities. The main business of a subsidiary is not necessarily the main business of a consolidated group.

(ii) Entities' current reporting practices, internal processes, accounting systems and internal controls may be impacted by the following:
   - changes in the structure of their statements of profit or loss,
   - assessment of specified main business at each reporting entity level, and
   - requirements for aggregation and disaggregation, including the need for (1) more descriptive labels for items currently aggregated and labelled as 'other' in the financial statements, and (2) capturing relevant information to fulfil the disclosures on the five specified operating expenses by nature.

(iii) Management and those charged with governance should proactively communicate the expected implications of HKFRS 18 to stakeholders. Non-GAAP measures that meet the definition of MPMs shall be included in financial statements and subject to audit. The disclosure requirements for MPMs might heighten communication endeavors and engagements with investors, prompting entities to reassess their external communication strategies to ensure effective public communication on non-GAAP measures while complying with HKFRS 18 requirements.

### *3. HKFRS 19 Subsidiaries without Public Accountability: Disclosures*

In July 2024, the HKICPA issued HKFRS 19, the equivalent of IFRS 19 *Subsidiaries without Public Accountability: Disclosures* issued by the IASB in May 2024. HKFRS 19 is a disclosure-only and optional standard which allows eligible subsidiaries to apply HKFRS Accounting Standards with reduced disclosures. The objective of HKFRS 19 is to reduce the costs of preparing financial statements for eligible subsidiaries, while maintaining the usefulness of those financial statements for their users.

An eligible subsidiary may elect to apply HKFRS 19 in its consolidated, separate or individual financial statements for annual periods beginning on or after 1 January 2027. Early application is permitted. A subsidiary[59] is eligible for applying HKFRS 19 if meeting these two conditions[60]:

(i) It does not have public accountability (See Diagram 5); and

(ii) Its ultimate or intermediate parent produces consolidated financial statements available for public use that comply with HKFRS Accounting Standards.

*Diagram 5 – What is public accountability[61]?*

| **An entity has public accountability if (a) or (b) is met** | |
|---|---|
| (a) Debt or equity instruments of an entity are traded in a public market; or it is in the process of issuing such instruments for trading in a public market | (b) It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. |
| **Examples of public market**: a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets | **Examples of entities**: banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks |

The following are some key points for application of HKFRS 19:

(i) As HKFRS 19 is part of HKFRS Accounting Standards, an eligible subsidiary that applies HKFRS 19 and complies with HKFRS Accounting Standards is required to state as part of its explicit and unreserved statement of compliance with HKFRS Accounting Standards that HKFRS 19 has been adopted[62].

(ii) An entity that has elected to apply HKFRS 19 may later revoke that election[63]. An entity is permitted to elect to apply HKFRS 19 more than once. For example, an entity that applied HKFRS 19 in a prior period but not in the immediately preceding period may elect to apply HKFRS 19 in the current period.

(iii) Entities, which prepare their financial statements for the immediately preceding period under *Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard* or *HKFRS for Private Entities Accounting Standard* and elect to apply HKFRS 19 and other HKFRS Accounting Standards in the current period, are considered a first-time adopter of HKFRS Accounting Standards and thus the disclosure requirements in HKFRS 19 relating to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* will apply. This is because those reporting frameworks are not HKFRS Accounting Standards[64].

[59] Appendix A of HKFRS 10 *Consolidated Financial Statements* defines 'subsidiary' as *'an entity that is controlled by another entity'*.

[60] HKFRS 19.7.

[61] HKFRS 19.11-12.

[62] HKFRS 19.20.

[63] HKFRS 19.13 and BC 96-98.

[64] HKFRS 19.BC 107.

(iv) Unless otherwise specified, an eligible subsidiary applying HKFRS 19 applies the requirements of recognition, measurement and presentation in other HKFRS Accounting Standards to a transaction, event or condition and applies the disclosure requirements under the subheading of that HKFRS Accounting Standard in HKFRS 19. For example, an entity applies the recognition, measurement and presentation requirements under HKAS 2 *Inventories* to account for its inventories and applies HKFRS 19.164 under the subheading HKAS 2 *Inventories* in HKFRS 19 for disclosure.

(v) Eligible subsidiaries voluntarily applying HKFRS 8 *Operating Segments* and HKAS 33 *Earnings per Share* should continue to refer to these HKFRS Accounting Standards for all relevant disclosure requirements.

(vi) If an entity applying HKFRS 19 also applies HKFRS 17 *Insurance Contracts*, it is required to apply all the disclosure requirements in HKFRS 17, as there are no reductions in the disclosure requirements for HKFRS 17 at this stage.

(vii) Entities previously applying HKFRS Accounting Standards and have decided to apply HKFRS 19 should identify the disclosure requirements that no longer apply and information that no longer needs to be gathered. Financial reporting systems and processes may need to be adjusted to accommodate the reduced disclosure requirements.

We recommend that entities utilize the following resources to understand and implement HKFRS 19:

(i) Our A-Plus technical article published in October 2024: This article not only explains the application of HKFRS 19, but also discusses the expected benefits and costs of adopting HKFRS 19. It serves as a starting point for entities to assess whether they should apply HKFRS 19, taking into account their own circumstances.

(ii) The IFRS 19 disclosure tracker: This tracker lists the disclosure requirements in IFRS 19 and maps them to their equivalents in other IFRS Accounting Standards. It is intended to be a 'living document' that will be updated with changes to disclosure requirements in other IFRS Accounting Standards and the corresponding changes to IFRS 19 itself.

# Appendix – New and amended HKFRS Accounting Standards as well as Agenda Decisions issued by the IFRS IC

The following amended standards and interpretation became effective as of 1 January 2024:

| Standards and Interpretation | Description |
|---|---|
| Amendments to HKAS 1 *Presentation of Financial Statements – Classification of Liabilities as Current or Non-current* | The amendments to HKAS 1 clarify how to classify debt and other liabilities as current or non-current and deal with the classification of non-current liabilities with covenants. |
| Amendments to HKAS 1 *Presentation of Financial Statements – Non-current Liabilities with Covenants* | |
| Amendments to HKFRS 16 *Leases – Lease Liability in a Sale and Leaseback* | The amendments to HKFRS 16 add subsequent measurement requirements for the lease liability arising from a sale and leaseback transaction, where the transfer of the asset satisfies the requirements in HKFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale. |
| Amendments to Hong Kong Interpretation 5 (Revised) *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* | HK Interpretation 5 has been updated to incorporate the references to the above amendments to HKAS 1. |
| Amendments to HKAS 7 *Statement of Cash Flows* and HKFRS 7 *Financial Instruments: Disclosures – Supplier Finance Arrangements* | The amendments introduce new disclosure requirements to enhance the transparency of supplier finance arrangements and their effects on an entity's liabilities, cash flows and exposure to liquidity risk. |

The following new and amended standards and interpretation have been issued but are not yet effective as of 1 January 2024. They are available for early adoption.

| Effective from annual periods beginning on or after (in chronological order): | New and amended HKFRS Accounting Standards and Interpretation |
|---|---|
| 1 January 2025 | Amendments to HKAS 21 *The Effects of Changes in Foreign Exchange Rates – Lack of Exchangeability* |

| **Effective from annual periods beginning on or after (in chronological order):** | **New and amended HKFRS Accounting Standards and Interpretation** |
|---|---|
| 1 January 2026 | Amendments to HKFRS 9 *Financial Instruments* and HKFRS 7 *Financial Instruments: Disclosures – Amendments to the Classification and Measurement of Financial Instruments* |
| 1 January 2026 | *Annual Improvements to HKFRS Accounting Standards — Volume 11*:<br>• Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*<br>• Amendments to HKFRS 7 *Financial Instruments: Disclosures* and Guidance on Implementing HKFRS 7<br>• Amendments to HKFRS 9 *Financial Instruments*<br>• Amendments to HKFRS 10 *Consolidated Financial Statements*<br>• Amendments to HKAS 7 *Statement of Cash Flows* |
| 1 January 2027 | HKFRS 18 *Presentation and Disclosure in Financial Statements* |
| 1 January 2027 | Amendments to Hong Kong Interpretation 5 *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* |
| 1 January 2027 | HKFRS 19 *Subsidiaries without Public Accountability: Disclosures* |
| A date to be determined by the IASB | Amendments to HKFRS 10 *Consolidated Financial Statements* and HKAS 28 *Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* |

The following agenda decisions were published by the IFRS IC in 2024:

| **Publication month** | **Agenda Decisions** |
|---|---|
| January 2024 | • Merger between a Parent and Its Subsidiary in Separate Financial Statements – IAS 27 *Separate Financial Statements* |
| April 2024 | • Payments Contingent on Continued Employment during Handover Periods – IFRS 3 *Business Combinations*<br>• Climate-related Commitments – IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* |
| July 2024 | • Disclosure of Revenues and Expenses for Reportable Segments – IFRS 8 *Operating Segments* |

## About the Standard Setting Department

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorized by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants in Hong Kong. The due process documents of the Standard Setting Department (SSD) explain the processes and procedures for developing local standards and adopting international standards.

To find out more about how SSD contributes to international standard-setting, please visit: https://www.hkicpa.org.hk/en/Standards-setting/Standards/How-we-set-standards-and-contribute-to-international-standards

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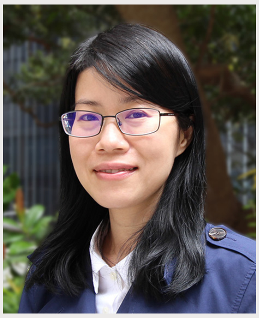

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