*Hong Kong Financial Reporting Standard*

# Annual Improvements to HKFRSs 2011-2013 Cycle

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

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# Introduction

This document sets out amendments to Hong Kong Financial Reporting Standards (HKFRSs) and the related Bases for Conclusions and guidance made in response to the International Accounting Standards Board's Annual Improvements process.

These amendments result from proposals that were contained in the Exposure Draft of *Annual Improvements to HKFRSs 2011–2013 Cycle* published in November 2012.

The Annual Improvements process provides a vehicle for making non-urgent but necessary amendments to HKFRSs.

The effective date of each amendment is included in the HKFRSs affected.

## Standards addressed

The following table shows the topics addressed by these amendments.

| Standard | Subject of amendment |
|---|---|
| HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* | Meaning of ‘effective HKFRSs’. |
| HKFRS 3 *Business Combinations* | Scope exceptions for joint ventures. |
| HKFRS 13 *Fair Value Measurement* | Scope of paragraph 52 (portfolio exception). |
| HKAS 40 *Investment Property* | Clarifying the interrelationship between HKFRS 3 and HKAS 40 when classifying property as investment property or owner-occupied property. |

# Amendment to the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*

A footnote is added to paragraph BC11 and paragraph BC11A is added. New text is underlined.

## Current version of IFRSs

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions.[1] This:

(a) ...

BC11A Paragraph 7 requires an entity to use the IFRSs that are effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS permits early application. Notwithstanding the advantages, set out in paragraph BC11, of applying a more recent version of an IFRS, paragraphs 7–8 permit an entity to use either the IFRS that is currently mandatory or the new IFRS that is not yet mandatory, if that new IFRS permits early application. Paragraph 7 requires an entity to apply the same version of the IFRS throughout the periods covered by the entity's first IFRS financial statements. Consequently, if a first-time adopter chooses to early apply a new IFRS, that new IFRS will be applied throughout all the periods presented in its first IFRS financial statements on a retrospective basis, unless IFRS 1 provides an exemption or an exception that permits or requires otherwise.

[1] *Annual Improvements Cycle 2011–2013* clarified that this paragraph does not require an entity to use a more recent version of an IFRS. It only explains the advantages of applying a more recent version of an IFRS. See paragraph BC11A for further details.

# Amendment to
# HKFRS 3 *Business Combinations*

Paragraph 2 is amended and paragraph 64I is added. New text is underlined and deleted text is struck through.

## Scope

2 This HKFRS applies to a transaction or other event that meets the definition of a business combination. This HKFRS does not apply to:

(a) the accounting for the formation of a ~~joint venture~~ joint arrangement in the financial statements of the joint arrangement itself.

(b) ...

### Effective date

...

64I *Annual Improvements Cycle 2011–2013* issued in January 2014 amended paragraph 2(a). An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

# Amendment to the Basis for Conclusions on IFRS 3 *Business Combinations*

After paragraph BC61 a subheading and paragraphs BC61A–BC61E are added. After paragraph BC434D a heading and paragraph BC434E are added.

## Joint ventures and combinations of entities under common control

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*Annual Improvements Cycle 2011–2013*

BC61A The IASB observed that there was uncertainty about whether paragraph 2(a) of IFRS 3, which excludes the formation of joint ventures from the scope of IFRS 3, should have been amended to refer to joint arrangements when IFRS 11 was issued. IFRS 11 had changed the use of the term 'joint venture' from having a general meaning that included 'jointly controlled operations', 'jointly controlled assets' and 'jointly controlled entities', to meaning a specific type of joint arrangement, which does not include 'joint operations'. The IASB did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for 'the formation of a joint venture' when it replaced IAS 31 with IFRS 11 *Joint Arrangements*, although it had not intended to change the scope of IFRS 3.

BC61B There was also uncertainty about whether the scope exclusion in paragraph 2(a) of IFRS 3 addresses:

(a) the accounting by the joint arrangements themselves in their financial statements only; or also

(b) the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

BC61C The IASB noted that paragraph 2(a) of IFRS 3 should exclude formations of every type of joint arrangement (ie joint ventures and joint operations) from the scope of IFRS 3. It also noted that paragraph 2(a) of IFRS 3 excludes, from the scope of IFRS 3, only the accounting by the joint arrangements themselves in their financial statements.

BC61D The IASB concluded that paragraph 2(a) of IFRS 3 should be amended to address all types of joint arrangements and to remove uncertainty about the financial statements to which it applies.

BC61E Consequently, the IASB amended paragraph 2(a) of IFRS 3 to:

(a) exclude the formation of all types of joint arrangements from the scope of IFRS 3 by replacing 'joint venture' with 'joint arrangement'; and

(b) clarify that the only scope exclusion needed from the scope of IFRS 3 is the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

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## Scope exceptions for joint ventures

BC434E *Annual Improvements Cycle 2011–2013* issued in December 2013 amended paragraph 2(a) and added paragraph 64I to clarify the scope exception in paragraph 2(a) of IFRS 3. It took into consideration the transition provisions and effective date of the amendment to IFRS 3. In order to be consistent with the prospective initial application of IFRS 3, the IASB decided that an entity shall apply the amendment to IFRS 3 prospectively for annual periods beginning on or after 1 July 2014.

# Amendment to
# HKFRS 13 *Fair Value Measurement*

Paragraph 52 is amended and paragraph C4 is added. New text is underlined and deleted text is struck through.

### Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

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52 The exception in paragraph 48 applies only to financial assets, ~~and~~ financial liabilities and other contracts within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement* or HKFRS 9 *Financial Instruments*. The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, HKAS 39 or HKFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities in HKAS 32 *Financial Instruments: Presentation*.

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# Appendix C
# Effective date and transition

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C4 *Annual Improvements Cycle 2011–2013* issued in January 2014 amended paragraph 52. An entity shall apply that amendment for annual periods beginning on or after 1 July 2014. An entity shall apply that amendment prospectively from the beginning of the annual period in which HKFRS 13 was initially applied. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

# Amendment to the Basis for Conclusions on IFRS 13 *Fair Value Measurement*

After paragraph BC119 a subheading and paragraphs BC119A–BC119B are added. Paragraph BC230A is added.

### Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

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*Scope of paragraph 52*

BC119A After issuing IFRS 13, the IASB was made aware that it was not clear whether the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the ‘portfolio exception’) includes all contracts that are within the scope of IAS 39 or IFRS 9. The exception is set out in paragraph 48 and the scope of the exception is set out in paragraph 52. In particular, the IASB was asked whether the scope of the portfolio exception included contracts that are accounted for as if they were financial instruments, but that do not meet the definitions of financial assets or financial liabilities in IAS 32. Examples of such a situation would be some contracts to buy or sell a non-financial item that can be settled net in cash by another financial instrument or by exchanging financial instruments as if the contracts were financial instruments within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9.

BC119B The IASB did not intend to exclude from the scope of the portfolio exception any contracts that are within the scope of IAS 39 or IFRS 9. Consequently, the IASB amended paragraph 52 of this Standard to clarify that the portfolio exception applies to all contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32.

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## Effective date and transition

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BC230A *Annual Improvements Cycle 2011–2013* issued in December 2013 amended paragraph 52 and added paragraph C4 to clarify the scope of the portfolio exception. It considered the transition provisions and effective date of the amendments to IFRS 13. It decided that an entity should apply that amendment for annual periods beginning on or after 1 July 2014. In order to be consistent with the prospective initial application of IFRS 13, the IASB decided that an entity would apply the amendment to IFRS 13 prospectively from the beginning of the annual period in which IFRS 13 was initially applied.

# Amendment to HKAS 40 *Investment Property*

Before paragraph 6, a heading is added. Paragraph 14A is added. After paragraph 84 a heading and paragraphs 84A and 85D are added. Paragraphs 6 and 14 have been included for ease of reference but are not amended. New text is underlined.

## <u>Classification of property as investment property or owner-occupied property</u>

**6** **A *property interest* that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33–55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74–78.**

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14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7–13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.

<u>14A</u> <u>Judgement is also needed to determine whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of HKFRS 3 *Business Combinations*. Reference should be made to HKFRS 3 to determine whether it is a business combination. The discussion in paragraphs 7–14 of this Standard relates to whether or not property is owner-occupied property or investment property and not to determining whether or not the acquisition of property is a business combination as defined in HKFRS 3. Determining whether a specific transaction meets the definition of a business combination as defined in HKFRS 3 and includes an investment property as defined in this Standard requires the separate application of both Standards.</u>

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## Transitional provisions

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### Cost model

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### <u>Business Combinations</u>

<u>**84A**</u> <u>***Annual Improvements Cycle 2011–2013*** **issued in January 2014 added paragraph 14A and a heading before paragraph 6. An entity shall apply that amendment prospectively for acquisitions of investment property from the beginning of the first period for which it adopts that amendment. Consequently, accounting for acquisitions of investment property in prior periods shall not be adjusted. However, an entity may choose to apply the amendment to individual acquisitions of investment property that occurred**</u>

**prior to the beginning of the first annual period occurring on or after the effective date if, and only if, information needed to apply the amendment to those earlier transactions is available to the entity.**

## Effective date

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85D *Annual Improvements Cycle 2011–2013* issued in January 2014 added headings before paragraph 6 and after paragraph 84 and added paragraphs 14A and 84A. An entity shall apply those amendments for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

# Amendment to the Basis for Conclusions on IAS 40 *Investment Property*

After paragraph BC17 a heading and paragraphs BC18–BC22 are added.

## Classification of property as investment property or owner-occupied property

### Acquisition of investment property: interrelationship with IFRS 3

BC18 The IFRS Interpretations Committee (the 'Interpretations Committee') reported to the Board that practice differed in delineating the scope of IFRS 3 *Business Combinations* and IAS 40:

(a) some considered both Standards as mutually exclusive if investment property with associated insignificant ancillary services, as specified in paragraph 11 of IAS 40, is acquired. They view property, together with any associated insignificant ancillary services, as being a single 'unit of account' and they consider this unit of account to be one asset called 'investment property'.

(b) others did not view IFRS 3 and IAS 40 as being mutually exclusive if investment property with associated insignificant ancillary services, as specified in paragraph 11 of IAS 40, is acquired; nor did they view the definitions of a business as defined in Appendix A of IFRS 3 and investment property as defined in paragraph 5 of IAS 40 as being interrelated. They think that an entity that acquires investment property has to determine whether it meets both definitions.

BC19 The Board noted that paragraphs 7–14 of IAS 40 have been developed to differentiate investment property from owner-occupied property and to define the scope of IAS 40 to distinguish it from the scope of IAS 16 *Property, Plant and Equipment*. In addition, neither IFRS 3 nor IAS 40 contains a limitation in its scope that restricts its application when the other Standard applies, ie there is nothing within the scope of each Standard to suggest that they are mutually exclusive. The Board also noted that the wording of IAS 40 is not sufficiently clear about the interrelationship between the two Standards.

BC20 The Board agreed with the proponents of the view presented in paragraph BC18(b) that IFRS 3 and IAS 40 are not mutually exclusive. It amended IAS 40 to state explicitly that judgement is also needed to determine whether the transaction is the acquisition of an asset or a group of assets or is a business combination within the scope of IFRS 3. That judgement is not based on paragraphs 7–14 of IAS 40 but is instead based on the guidance in IFRS 3. Only the judgement needed to distinguish investment property from owner-occupied property is based on those paragraphs.

BC21 Consequently, the Board clarified the interrelationship between the two Standards by adding paragraph 14A and a heading before paragraph 6 to IAS 40.

### Effective date and transition

BC22 *Annual Improvements Cycle 2011–2013* issued in December 2013 added headings before paragraph 6 and after paragraph 84 and added paragraphs 14A, 84A and 85D to clarify the interrelationship between IFRS 3 and IAS 40. It considered the provisions for transition and the effective date of the amendment to IAS 40. The Board noted that applying IFRS 3 to transactions that have previously been accounted for as the acquisition of an asset or a group of assets might involve the use of hindsight when determining the fair values, at acquisition date, of the identifiable assets acquired and of the liabilities assumed as part of the business combination transaction. However, it also noted that the amendment is only a clarification of the interrelationship between IFRS 3 and IAS 40. Consequently, it decided that an entity would apply the amendments to IAS 40 prospectively for annual periods beginning on or after 1 July 2014, but an entity may choose to apply the amendment to individual transactions that occurred prior to the beginning of the first annual period occurring on or after the effective date only if the information needed is available to the entity.