# STANDARD SETTING

# Financial reporting considerations for closing out 2023

FEBRUARY 2024

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

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# Introduction

Every year, we publish a publication to highlight key financial reporting reminders and topical issues that we consider are relevant and helpful for preparers in the preparation of their annual HKFRSs financial statements with a December year-end. Those discussions may also be applicable to future reporting periods.

In this year's publication, the first section focuses on the topical issues that are expected to be relevant to most entities in Hong Kong. The second section provides an overview of the new and amended HKFRSs which are mandatorily effective for annual periods beginning on or after 1 January 2023. The third section highlights the key amendments to HKFRSs that are effective on 1 January 2024 and thereafter.

This publication is not intended to be comprehensive nor does it necessarily cover all the potential issues relevant to an entity's financial statements. Entities should exercise judgement and refer to HKFRSs in the HKICPA's Members' Handbook for further reference as appropriate in light of their own facts and circumstances.

# I. Topical issues

The financial reporting issues encountered by entities are influenced by various factors. Those factors include the external macroeconomic environment and circumstances specific to the entities, such as their business nature and financial strength. Entities should continually evaluate the impact of recurring issues and identify new issues as they arise. This section highlights three topical issues for entities reporting in Hong Kong to consider when preparing their December 2023 financial statements. Among these issues, the 'Accounting implication of the abolition of MPF-LSP offsetting mechanism in Hong Kong' is a new topic discussed this year, whereas the other two are recurring issues with updated commentary.

### *1. The lingering impact of economic challenges and uncertainties on financial reporting*

Some entities have managed to recover from the impact of COVID-19[1], but they continue to face various economic challenges and uncertainties that emerged over the past two years. In our 2023 publication, we extensively discussed the impact of higher inflation, rising interest rates and other macroeconomic and geopolitical uncertainties on the following aspects of financial reporting relevant to Hong Kong entities:

- 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*
- Other considerations: recognition of deferred tax assets, going concern assessment, estimation uncertainty and judgement applied

Considering the persistent effects brought by the macroeconomic and geopolitical uncertainties, we believe that many of the abovementioned areas remain relevant for financial reporting in 2023. Specifically, the high interest rate and inflationary pressure have substantial impact on those aspects of financial reporting that involve forecasting future cash flow projections and estimating present value. This impact is particularly notable in the assessment of impairment for non-financial assets under HKAS 36, financial assets under HKFRS 9 and fair value measurement under HKFRS 13 *Fair Value Measurement*. Entities are recommended to refer to the 2023 publication for more details.

Apart from the areas mentioned above, entities should consider any other impacts brought by the economic challenges and assess them accordingly. For example, macroeconomic downturns and uncertainties may worsen an entity's ability to meet covenants in long-term loan arrangements. As required by HKAS 1 *Presentation of Financial Statements*, if an entity

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[1] Please refer to our prior publications on discussions of COVID-19-related financial impact (2023: Financial reporting considerations for closing out 2022, 2022: Financial reporting considerations for closing out 2021; 2021: Alert Issue 37, 2020: Alert Issue 33).

breaches a loan covenant on or before the reporting period with the effect that the loan becomes payable on demand, it classifies the loan as current, even if the lender agreed, after the reporting period and before the authorization of the financial statements for issue, not to demand payment as a consequence of the breach. The entity classifies the loan as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least 12 months after that date[2].

### *2. Accounting implication of the abolition of MPF-LSP offsetting mechanism in Hong Kong*

In June 2022, the Government of the HKSAR gazetted the Employment and Retirement Schemes Legislation (Offsetting Arrangement) (Amendment) Ordinance 2022 (the Amendment Ordinance) to abolish the use of the accrued benefits of employers' mandatory contributions under the Mandatory Provident Fund (MPF) System to offset severance payment (SP) and LSP (hereafter referred to as the 'Abolition'). The Government has announced that the Abolition will take effect on 1 May 2025 ('the transition date')[3]. The Amendment Ordinance has two main effects:

(i) The accrued benefits derived from an employer's mandatory MPF contributions cannot be used to offset post-transition LSP or SP after the transition date; and

(ii) The last month's salary immediately preceding the transition date (instead of the date of termination of employment) is used to calculate the portion of LSP or SP in respect of the employment period before the transition date.

Before the Abolition, most entities in Hong Kong do not report a LSP liability on their statement of financial position. This is because they consider that the full amount of accrued benefits related to employer's MPF contributions that is expected to be available could offset the LSP liability upon payment, and the resulting net liability has been immaterial for their financial statements. The Abolition is likely to have a widespread impact on financial reporting of most, if not all, entities in Hong Kong as the accounting for the employer's obligations under LSP could become material following the Abolition. The extent and pervasiveness of the impact depend on the facts and circumstances of the entities such as the composition, salary and staff turnover of their workforce. Financial statements of entities with a significant employee base in Hong Kong are expected to be significantly impacted by the Abolition.

In view of the complexity of the accounting issues and the pervasive impact arising from the Abolition, the HKICPA issued a financial reporting alert in February 2023 followed by a comprehensive educational guidance in July 2023 which provides detailed guidance and illustrative examples on the accounting implication of the Abolition. In particular, the publication

[2] See HKAS 1.74 & 75 for the relevant requirements. An amendment to HKAS 1 (effective from 1 January 2024) has been made regarding the right to defer settlement. For more information of this amendment, please refer to Section III.1 of this publication.

[3] See also the webpage of the Labour Department for information.

discusses two acceptable approaches to account for the offsetting mechanism and the impact of the Abolition. The two approaches are:

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|---|---|
| Approach 1 | Account for the amount expected to be offset as a deemed employee contribution towards his LSP benefits in terms of HKAS 19.93(a) |
| Approach 2 | Account for the employer MPF contributions and the offsetting mechanism as a funding mechanism for the LSP obligation |

The educational guidance provides new information to help entities assess their situation and account for the impact arising from the Abolition. The explanatory material in the guidance may provide additional insights that might change an entity's understanding of the principles and requirements in HKFRSs, and because of this, an entity might determine that it needs to change its related accounting policy.

In determining the accounting policy, the following are some key reminders and points for consideration:

(i) The two approaches characterize the nature of the employer's right to accrued benefits arising from its MPF contributions differently, resulting in different outcomes in the recognition, measurement, presentation and disclosures in the financial statements. In particular, the two approaches could result in a different extent and/or direction of change to the LSP liability before and after the enactment of the Amendment Ordinance. Therefore, entities are strongly advised to refer to the educational guidance to fully understand the bases of the two approaches and their effects on the financial statements. In addition, when deciding on the accounting policy, entities must keep in mind that a voluntary change in accounting policy is permitted only if the change results in the financial statements providing reliable and more relevant information about the effects of the offsetting mechanism and the Abolition[4]. The change shall be applied retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to impracticability constraint[5].

(ii) Entities are expected to determine their accounting policy and implement the necessary policy change on a timely basis, subject to having sufficient time to do so[6]. Determining how much time is sufficient to implement the change is a matter of judgement that depends on an entity's particular facts and circumstances[7].

[4] See HKAS 8.14(b).

[5] See HKAS 8.50-53.

[6] By analogy to the time allowed for entities to implement changes resulting from agenda decisions published by the IFRS IC (paragraph 8.6 of the IASB and IFRS IC Due Process Handbook).

[7] According to the article 'Agenda decisions – time is of the essence', Sue Lloyd, the former Vice-Chair of the IASB, thinks that, as a rule of thumb, it is fair to say that we had in mind a matter of months rather than years in considering the effects of IFRS IC agenda decisions and implementing the accounting policy changes arising from the IFRS IC agenda decisions.

(iii) Regardless of which accounting policy is adopted, entities should provide clear disclosures of their accounting policy and disclosures in their December 2023 and subsequent financial statements to the extent material[8]. These include disclosures relating to MPF and LSP as required by HKAS 19.53-54 and 135-152, a description of the plan amendment as required by HKAS 19.139(c) and information set out in HKAS 8.29 if the entity has changed its related accounting policy.

(iv) Given the complexity of the matter, entities are strongly encouraged to take action now to assess the impact of the Abolition on financial reporting and develop an implementation plan for the change in accounting policy if necessary. It may be beneficial for entities to engage with auditors or consult accounting advisors to determine an acceptable approach. Furthermore, entities should evaluate their internal capabilities or consider consulting a professional valuer to assist in measuring the LSP liability, which is subject to actuarial assumptions and estimations.

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

Climate-related risks have become an increasingly important topic in recent years. We have discussed climate-related reporting in our 2022 and 2023 publications. As highlighted in our 2022 publication, climate risks will affect entities to varying degrees in coming years. It is crucial to rigorously assess how climate risks, together with other similar uncertainties, may impact operations and financial performance, regardless of whether the entity actively manages climate risks. The following are some reminders on climate reporting from two perspectives, financial reporting and connectivity.

*(i) Financial reporting perspective*

a. The assessment of materiality of the impact of climate risks on financial reporting should be based on both quantitative and qualitative factors[9]. Consequently, entities that previously determined the impact of climate risks on their financial statements was not quantitatively material, would need to conduct their assessment qualitatively, which could result in a different conclusion thereafter.

b. There is currently no single explicit standard on climate-related matters in HKFRSs. In our prior publications, we recommended readers to refer to the two educational materials published by the IASB in November 2020 and November 2019, to determine how to incorporate climate-related matters into their financial statements. An updated version was published by the IASB in July 2023 in light of the developments including the issuance of IFRS Sustainability Disclosure Standards in June 2023 (see below for more information). The updated version is aimed at helping companies, by considering the ISSB's Standards and the educational materials together, better identify matters

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[8] Refer to Section II of this publication for information on the disclosure requirements of material accounting policy information as required by the Amendments to HKAS 1, which became effective on 1 January 2023.

[9] See HKFRS Practice Statement 2 *Making Materiality Judgements* for the relevant guidance.

including climate change, that affect the financial statements and apply the applicable financial reporting standards.

c. For various reasons, different governments worldwide are implementing different measures to promote energy efficiency and reduce carbon emissions. In July 2022, the IFRS IC published an agenda decision titled *'Negative Low Emission Vehicle Credits – IAS 37 Provisions, Contingent Liabilities and Contingent Assets'* to address a question of whether particular measures to encourage reduction in vehicle carbon emissions give rise to obligation that meets the definition of a liability in IAS 37.

   In the fact pattern submitted, an entity has produced or imported vehicles with average fuel emissions exceeding the government target, resulting in the entity receiving negative emission credits. The measures require the entity to eliminate the negative credits by obtaining and surrendering positive credits. Failure to do so may result in the government imposing sanctions on the entity, such as restricting its access to the market in the future. The question is whether the entity has a liability in such situation. The IFRS IC noted that determining whether the entity has a liability requires consideration of: 1) whether settling an obligation to eliminate negative credits would result in an outflow of resources embodying economic benefits; 2) which event creates a present obligation to eliminate negative credits; and 3) whether the entity has no realistic alternative to settling the obligation. Once such an obligation is identified, the entity should apply relevant requirements in IAS 37 to measure the liability.

   We anticipate that similar fact patterns are likely to emerge in the future, as governments worldwide are placing emphasis on addressing climate-related risks. Entities should assess the potential impact of this agenda decision on their financial statements, if they encounter similar circumstances as described in the submission to the IFRS IC.

d. Emerging issues are arising associated with climate-related initiatives. For instance, some entities are transitioning towards acquiring electricity from renewable energy resources through various types of power purchase agreements (PPAs). Entities need to carefully determine the appropriate accounting treatment for such arrangements based on specific fact patterns, particularly those discussed by the IFRS IC in its June 2023 meeting in response to a submission relating to the application of the 'own-use' exception in IFRS 9.2.4 to physically delivery contracts for the purchase of renewable energy. At that meeting, the IFRS IC considered that the principles and requirements in IFRS 9 do not provide an adequate basis for an entity to determine the required accounting for some physical PPAs in a consistent way, and referred the matter to the IASB for further consideration. In its December 2023 meeting, the IASB decided to explore narrow-scope standard setting for PPAs and plans to publish an exposure draft on the PPA project in April 2024[10].

[10] Refer to the IASB project page for the development of this project.

*(ii) Connectivity perspective*

Ensuring connectivity between information on climate-related matters disclosed in the financial statements and non-financial reporting, such as sustainability reports, is crucial. While disclosures should be transparent and entity-specific, they should also be consistent with other information provided elsewhere, including sustainability reporting as mentioned.

*Update on the development of professional standards related to sustainability and reporting of climate-related risks and other uncertainties*

(i) In June 2023, the ISSB published its first two IFRS Sustainability Disclosure Standards, namely IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*. These standards are subject to local adoption. As the statutory standard setter for the Sustainability Disclosure Standards concerning the practice of accounting, the HKICPA is working closely with the Green and Sustainable Finance Cross-Agency Steering Group[11] to assess the suitability of IFRS Sustainability Disclosure Standards for use in Hong Kong. Entities should stay informed about the progress of the development of Hong Kong sustainability standards.

(ii) In 2023, the IASB added a narrow-scope maintenance project *Climate-related and Other Uncertainties in the Financial Statements* to its work plan to consider whether and how entities can provide better information about the effects of climate-related and other uncertainties in their financial statements. This project and the work of the ISSB complement each other and illustrate how the work of the two boards is connected[12]. The project will not create a new IFRS Accounting Standard on climate. The IASB planned to decide its project direction in April 2024.

[11] This Steering Group was established in May 2020, which is co-chaired by the Hong Kong Monetary Authority and the Securities and Futures Commission. Other members include the Accounting and Financial Reporting Council, the Environment and Ecology Bureau, the Financial Services and the Treasury Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority and the Mandatory Provident Fund Schemes Authority. The Steering Group aims to co-ordinate the management of climate and environmental risks to the financial sector, accelerate the growth of green and sustainable finance in Hong Kong and support the Government's climate strategies.

[12] A webcast was released in July 2023, jointly presented by Linda Mezon-Hutter, Vice-Chair of the IASB and Sue Lloyd, Vice-Chair of the ISSB. They discussed the progress made in facilitating connection between financial statements and sustainability-related financial disclosures and share examples of connected and complementary work between the two boards.

## II. New and amended HKFRSs mandatorily effective on 1 January 2023

Among the new and amended HKFRSs that are mandatorily effective for annual periods beginning on or after 1 January 2023, HKFRS 17 *Insurance Contracts* is the only major new standard whereas the others are amendments to existing HKFRSs and a practice statement. The table below provides an overview of the key aspects of the new and amended requirements and corresponding considerations. We hope this table can facilitate entities to assess the relevance or extent of the impact of these standards with regard to their own circumstances.

| HKFRSs and practice statement | Key aspects | Key matters for consideration (not exhaustive) |
|---|---|---|
| ***New Standard*** | | |
| HKFRS 17 *Insurance Contracts* and consequential amendments | ▪ Replace HKFRS 4 *Insurance Contracts*, by introducing new and comprehensive requirements on accounting for insurance contracts.<br>▪ Apply to all types of insurance contracts[13] (i.e. life, non-life, direct insurance, reinsurance), regardless of the types of entities which issue them, and investment contracts with discretionary participation features. A few exceptions apply.<br>▪ Establish new principles and detailed requirements for recognition, measurement, presentation and disclosures, including:<br>i) Set out three measurement models. The default model is general measurement model (GMM), supplemented by<br>- simplified approach mainly for short-term contracts (optional premium allocation approach) | ▪ HKFRS 17 applies not only to insurers but also to other entities, provided that their issued contracts meet the definition of insurance contracts under HKFRS 17[15] and do not fall into the specified scope exclusions in HKFRS 17.7, which would require them to use another HKFRS.<br>▪ Entities, including non-insurers, should understand HKFRS 17 to identify and account for any contracts falling within its scope.<br>Non-insurers should not assume that HKFRS 17 does not apply to them. Entities should proactively review their contracts and consider whether they fall within the scope of HKFRS 17, taking into account any exceptions available.<br>▪ Various types of contracts issued by non-insurers may potentially fall within the scope of HKFRS 17 (e.g. financial guarantees, performance guarantees, fixed fee maintenance contracts depending on facts and circumstances). |

[13] See HKFRS 17.3 & 4.

[15] Any contracts that transfers a non-financial risk from one party to another may meet the definition of an insurance contract if such risk is assessed to be significant. See Appendix A of HKFRS 7 for the definition of insurance contract. HKFRS 17.B17-B23 for further guidance on assessment of whether the insurance risk is significant.

| HKFRSs and practice statement | Key aspects | Key matters for consideration (not exhaustive) |
|---|---|---|
| | - specific modifications for contracts with direct participation features (variable fee approach)<br><br>ii) Measure groups of contracts based on estimates of present value of future cash flows that are expected to arise when the entity fulfils the contracts, a risk adjustment for non-financial risk and CSM[14].<br><br>iii) Recognize insurance revenue in each reporting period which represents changes in liabilities for remaining coverage that relate to services for which the entity expects to receive consideration and an allocation of premiums relating to recovery of insurance acquisition cash flow.<br><br>iv) Exclude the investment components in insurance revenue and insurance service expenses.<br><br>v) Require extensive disclosures of recognized amounts from insurance contracts and the nature and extent of risks arising from the contracts. | ▪ The introduction of new measurement models in HKFRS 17 may also have varying effects on profit, equity and key performance indicators. Consequently, affected entities should also consider any impact on their data, information systems, processes and controls for financial reporting.<br><br>▪ To enhance entities' understanding of HKFRS 17 and its application, the HKICPA has issued various publications since 2018. Among them, we highly recommend entities refer to the following two educational publications issued in 2023, which illustrate the journal entries in different scenarios applying the models specified in HKFRS 17. They are useful reference for gaining initial understanding of HKFRS 17:<br>▪ HKFRS 17 *Insurance Contracts* – Journal Entries<br>▪ HKFRS 17 *Insurance Contracts* – Journal Entries on Reinsurance Contracts Held |
| ***Amended Standards and Practice Statement*** | | |
| Amendments to HKAS 1 *Presentation of Financial Statements* and HKFRS Practice Statement 2 *Making Materiality Judgements –* | ▪ Require entities to disclose their 'material accounting policy information' instead of 'significant accounting policies'.<br><br>▪ Add guidance on applying the concept of materiality to accounting policy disclosures. Diagram 1 in HKFRS Practice | ▪ The amendments are helpful in particular the introduction of the 'four-step materiality process' with indicators of when accounting policy information would be material to users.<br><br>▪ Entities should revisit their accounting policy disclosures and |

[14] GMM in HKFRS 17 is also known as the 'building block approach' as it is developed using four building blocks for measuring a group of insurance contracts. Diagram 2 in HKFRS 17 *Insurance Contracts* – Journal Entries explains the nature of these four building blocks on initial recognition of insurance contract liability. They are: 1) expected future cash flows, 2) time value of money, 3) risk adjustment and 4) contractual service margin (CSM).

| HKFRSs and practice statement | Key aspects | Key matters for consideration (not exhaustive) |
|---|---|---|
| *Disclosure of Accounting Policies* | Statement 2 demonstrates the application of the 'four-step materiality process'.<br><br>▪ Provide examples of the situations where standardized information summarizing or duplicating the requirements of HKFRS may be considered material accounting policy information. | focus on those that are material based on the amended requirements. Judgement may be needed in determining whether an accounting policy is material. Both qualitative and quantitative factors should be considered in the assessment.<br><br>▪ Information disclosed should be relevant, entity-specific and not boilerplate. Accounting policy disclosure that is not material can be removed. The amended HKAS 1 is explicit that if an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information. |
| Amendments to HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors – Definition of Accounting Estimates* | ▪ Replace the definition of 'a change in accounting estimates' with a definition of 'accounting estimates'[16].<br><br>▪ Clarify the distinction of changes in accounting estimates, changes in accounting policies and correction of errors with examples to explain how to apply the definition of 'accounting estimates'.<br><br>▪ Clarify that the effects of a change in an input or in a measurement technique used to develop an accounting estimate are changes in accounting estimates unless they result from correction of prior period errors. | ▪ The amendments require prospective application from the effective date. Entities should understand the requirements of the amendments to appropriately determine whether the changes occurring from the effective date are to be treated as changes in accounting estimates, accounting policies or correction of errors. |
| Amendments to HKAS 12 *Income Taxes – Deferred Tax related to Assets and Liabilities arising* | ▪ Narrow the scope of the initial recognition exemption such that it no longer applies to transactions that give rise to equal taxable and deductible temporary differences | ▪ Before the amendments, it was unclear whether HKAS 12 required the recognition of deferred taxes for the temporary differences or whether initial recognition exemption applied to |

[16] Under the new definition, accounting estimates are *'monetary amounts in financial statements that are subject to measurement uncertainty'* [HKAS 8.5].

| HKFRSs and practice statement | Key aspects | Key matters for consideration (not exhaustive) |
|---|---|---|
| *from a Single Transaction* | on initial recognition, e.g. leases and decommissioning obligations.<br>▪ Apply the initial recognition exemption only if the recognition of a lease asset and lease liability (or decommissioning liability and decommissioning asset component) gives rise to taxable and deductible temporary differences that are not equal.<br>▪ When the resulting deferred tax assets and liabilities are not equal, the difference between deferred tax asset and liability shall be recognized in profit or loss.<br>▪ Add an illustrative example to explain how the amendments are applied. | transactions which had simultaneous recognition of an asset and a liability. It had been an accounting policy choice for entities to determine whether to recognize deferred tax assets and liabilities.<br>▪ Entities that had not previously recognized deferred tax assets and liabilities before the amendments should assess and quantify the impact, and make retrospective adjustments. The amendments apply to transactions that occur on or after the beginning of the earliest comparative period presented. |
| Amendments to HKAS 12 *Income Taxes – International Tax Reform – Pillar Two Model Rules*[17] | ▪ Clarify that HKAS 12 applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes.<br>▪ Introduce a mandatory temporary exception in HKAS 12 from recognizing and disclosing deferred tax assets and liabilities related to Pillar Two income taxes.<br>▪ Introduce new disclosure requirements[18], including the exposure to Pillar Two income taxes and the current tax expense/income related to Pillar | ▪ Notwithstanding the temporary exception, entities are required to provide new disclosures required by the amendments.<br>▪ In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, entities shall disclose known or reasonably estimable information, both qualitatively and quantitatively, to assist users in understanding the entity's exposure to Pillar Two income taxes at the end of the reporting period[19].<br>▪ As the HKSAR Government plans to launch the global minimum tax and domestic minimum top-up tax in Hong Kong in 2025 after getting |

[17] The temporary exception to the requirements in HKAS 12 for accounting for deferred taxes related to Pillar Two income taxes are required to be applied immediately upon the issuance of the amendments. New disclosures as set out in the amendments shall be provided for annual reporting periods beginning on or after 1 January 2023.

[18] See HKAS 12.88A-D.

[19] See HKAS 12.88C and 88D for details.

| HKFRSs and practice statement | Key aspects | Key matters for consideration (not exhaustive) |
| --- | --- | --- |
| | Two income taxes, and known or reasonably estimable information that helps users understand the entity's exposure to Pillar Two income taxes arising from Pillar Two legislation. | the Legislative Council's approval on its legislative proposal in the second half of 2024[20], entities are required to take action now to assess the impact of Pillar Two model rules given the complexity of those rules.<br>▪ Entities with overseas operations should also closely monitor the development of the Pillar Two Model Rules in their respective jurisdictions and assess their impact promptly to avoid any potential issues. |

In addition to the specified provisions of relevant standards such as transitional disclosures when applying HKFRS 17, entities are reminded to provide the required disclosures on initial application of a new and amended HKFRS under HKAS 8[21]. While the extent of disclosures is determined based on materiality, entities should ensure that the disclosures are entity-specific, clear and sufficient granular to help financial statement users understand the impact of adopting the standards.

Entities should present a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements required in HKAS 1.38A, if retrospective application of a new accounting policy has a material effect on the statement of financial position at the transition date[22]. This is particularly relevant to insurance companies as it is widely expected that HKFRS 17 would have a material impact on their financial statements when it is first applied in 2023.

[20] The Pillar Two model rules, which set forth a global minimum tax rate of 15%, apply to constituent entities that are members of a multinational enterprise group with annual revenue of EUR 750 million or more in the consolidated financial statements of the ultimate parent entity in at least two of the last four years.

As announced in the 2023/2024 budget in February 2023, Hong Kong plans to implement the 15% global minimum tax on in-scope multinational enterprise groups and the domestic minimum top-up tax in Hong Kong starting from 2025 onwards. On 21 December 2023, the HKSAR Government published its consultation paper on 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. The HKSAR Government aims to develop the legislative proposal for submission to the Legislative Council in the second half of 2024.

[21] See HKAS 8.28 for details.

[22] See HKAS 1.40A.

# III. Amendments to HKFRSs effective on 1 January 2024 and thereafter

For the new and amended HKFRSs that have been issued but are not yet effective, entities should analyze their impacts based on their own circumstances and disclose the required information in accordance with HKAS 8[23] in their December 2023 financial statements. We highlight below three issued amendments that may be particularly relevant to entities reporting in Hong Kong.

### 1. *Amendments to HKAS 1 Presentation of Financial Statements – Classification of Liabilities as Current or Non-current, Non-current Liabilities with Covenants*

The IASB issued amendments to IAS 1 – *Classification of Liabilities as Current or Non-current* in January 2020, which were partially further amended by *Non-current Liabilities with Covenants* amendments issued in October 2022. The HKICPA issued the equivalent amendments to HKAS 1 in August 2020 ('2020 Amendments') and December 2022 ('2022 Amendments'). The 2020 Amendments clarify certain aspects of how entities classify liabilities as current or non-current. The 2022 Amendments clarify how conditions with which an entity must comply in a loan arrangement affect the loan classification as current or non-current. Both amendments are effective for annual reporting periods beginning on or after 1 January 2024, with early adoption permitted. They are to be applied as a package retrospectively according to HKAS 8.

Both amendments affect only the classification of liabilities as current or non-current in the statement of financial position and certain note disclosures. There is no impact on the recognition or measurement of these liabilities. However, they may result in a change in the classification of an entity's liability, either from current to non-current or vice versa. This change could potentially impact entities' compliance with loan covenants.

The classification of liabilities conveys important information to financial statement users about an entity's working capital, solvency and liquidity. We highlight below the key requirements of the Amendments to assist entities in assessing their impact:

| ***Highlights of the Amendments*** | ***Implications and relevant considerations*** |
|---|---|
| *A. A right to defer settlement for at least 12 months* | |
| • The word 'unconditional' has been removed from HKAS 1.69 so that this paragraph no longer refers to an 'unconditional' right to defer settlement. Instead, an entity's right to defer settlement of a liability for least 12 months after the reporting date must have substance[24] and must exist at the reporting date. | • As discussed in Section I.1 above, macroeconomic challenges can affect an entity's ability to meet covenant requirements. Consequently, there could be an impact on the assessment of the entity's right to defer settlement and the relevant |

[23] See HKAS 8.30-31.

[24] Terms that have no substance are disregarded. Please refer to paragraph 4.61 of *Conceptual Framework for Financial Reporting* for guidance on evaluating whether the term has 'no substance'.

| *Highlights of the Amendments* | *Implications and relevant considerations* |
|---|---|
| • Classification of a liability is <u>unaffected</u> by:<br>- management's intentions or expectations about whether the entity will exercise its right to defer settlement.<br>- events after the reporting date (e.g. the receipt of a waiver or a breach of covenant).<br><br>• The right to defer settlement may be subject to an entity complying with conditions (loan covenants). Only loan covenants with which an entity must comply <u>on or before</u> the reporting date <u>affect</u> the classification of a liability as current or non-current.<br><br>• Loan covenants with which an entity must comply <u>after</u> the reporting date <u>do not affect</u> the classification of a liability at the reporting date. However, disclosures about the future covenants are required. See Part C below. | classification of liability as current or non-current.<br><br>• It is the presence of the right to defer settlement that determines the classification. Management's intentions or expectations regarding whether the entity will exercise its right to defer settlement or opt for early settlement is irrelevant for the liability classification purposes.<br><br>Entities should reassess the appropriateness of their liability classification if they previously considered management's intentions to determine the classification. |
| *B. Settlement by way of own equity instruments* | |
| • 'Settlement' refers to a transfer to the counterparty that results in the extinguishment of a liability. It could be of cash, or other economic resources (e.g. goods or services), or the entity's own equity instruments, unless the amended HKAS 1.76B applies.<br><br>• The Amendments clarify how an entity classifies a liability that can be settled in its own equity instruments, typically convertible debt. When a liability has terms that could, at the option of the counterparty, result in its settlement by the transfer of the entity's own equity instruments (conversion options), these conversion options <u>do not affect</u> the classification of such a liability as current or non-current if the conversion option is accounted for as equity under HKAS 32.<br><br>• In other cases (i.e. conversion option recognized as a liability under HKAS 32), those options affect the current or non-current classification of the host liability of the convertible debt. | • The Amendments clarify that the transfer of the entity's own equity instruments is a form of settlement. This clarification might result in a significant change for entities that currently classify the host liability of a convertible bond as current or non-current solely based on the date of required cash payment and any early redemption options, without taking into account the conversion options. This is because the exercise of such options neither has any cash flow effect nor affects the liquidity position of the issuers.<br><br>Accordingly, the classification of certain liabilities may change from non-current to current as a result of the Amendments. |
| *C. Disclosures* | |
| • An entity shall disclose information[25] in the notes to enable financial statement users to understand the risk of non-current liabilities becoming repayable within 12 months after the | • Under the Amendments, entities are now required to provide new disclosures for liabilities subject to covenants, even if the liabilities are classified as non-current at the |

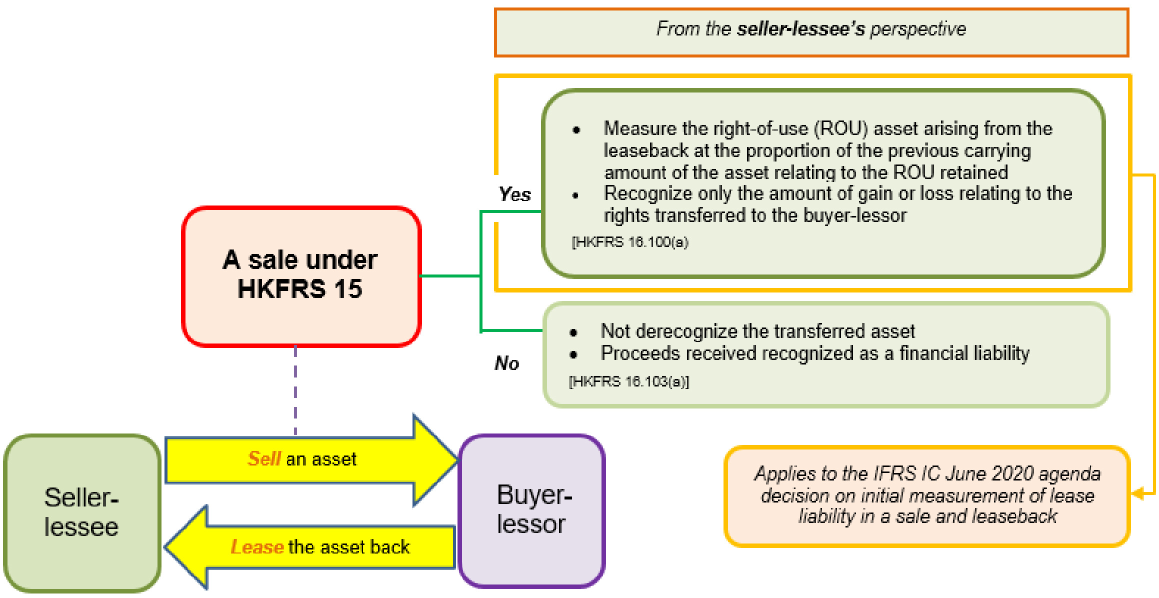
[25] See HKAS 1 (amended).76ZA for details of the required disclosures.

| Highlights of the Amendments | Implications and relevant considerations |
|---|---|
| reporting date, when its right to defer settlement is subject to the entity's compliance with future covenants within 12 months after the reporting date. | reporting date, as there are risks that they could become repayable early. |

Overall, the Amendments may change the classification of certain loan arrangements and, as a result, may require restating the comparative figures in the 2024 financial statements. Therefore, it is important for entities to take actions now, which include reviewing the existing classification of their loan arrangements and assessing if the Amendments will change their classification. If it is assessed that certain non-current liabilities will be reclassified as current, entities may want to consider renegotiating covenants or other terms of the agreements with banks or other financial institutions. For more understanding of the Amendments, entities may refer to an educational publication issued by the HKICPA in June 2023. The publication provides examples that illustrate the application of the Amendments in classifying some common loan arrangements[26] in Hong Kong.

### *2. Amendments to HKFRS 16 Leases – Lease Liability in a Sale and Leaseback*

A sale and leaseback transaction is a transaction in which the owner of an asset sells the asset and leases that asset back from the buyer for a period of time. The following simplified diagram demonstrates a sale and leaseback transaction from the perspective of seller-lessee:




In June 2020, the IFRS IC discussed a submission about a sale and leaseback transaction with variable lease payments. The IFRS IC concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity, at the date of transaction, to determine the

[26] The term 'loan arrangement' is not defined in the HKFRS. Entities should exercise judgement to determine what constitutes a loan arrangement within the context of the revised HKAS 1.

accounting for the sale and leaseback transaction described in the submission. However, improvements could be made to IFRS 16 as it does not include specific subsequent measurement requirements for sale and leaseback transactions. Particularly, it was unclear how to subsequently account for the liability arising from a leaseback when the lease payments include payments that do not meet the definition of 'lease payments' in IFRS 16[27], such as payments include variable lease payments that do not depend on an index or rate as described in the submission. Accordingly, the IASB issued amendments to IFRS 16 in September 2022 to address the issue of subsequent measurement of lease liability. The equivalent Amendments to HKFRS 16 were issued by the HKICPA in November 2022.

| ***Highlights of the Amendments*** | ***Implications*** |
|---|---|
| • A lease liability shall be recognized at the date of the 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>• HKFRS 16.102A requires a seller-lessee to subsequently measure the lease liability arising from a leaseback in a way that it does not recognize any amount of the gain or loss that relates to the ROU it retains. | • The Amendments only affect the seller-lessee's accounting for a sale and leaseback transaction that satisfies the requirements of HKFRS 15. There is no change to the buyer-lessor accounting.<br>• Sale and leaseback transactions where some or all the lease payments are variable lease payments that do not depend on an index or rate (and are not in-substance fixed payments) may be most likely impacted.<br>• The Amendments can prevent a seller-lessee from recognizing a gain on the ROU it retains solely due to a remeasurement (e.g. following a lease modification or change in the lease term) if it had applied the subsequent measurement requirements for lease liabilities unrelated to a sale and leaseback transaction. This could have been the case, particularly in a leaseback that includes variable lease payments that do not depend on an index or rate, as these payments are excluded from 'lease payments' as defined in Appendix A of HKFRS 16[28]. |
| • A new Illustrative Example 25 is added to demonstrate the application of the amended HKFRS 16.29-46 and 102A in a sale and leaseback with variable lease payments. Example 25 incorporates the example included in the IFRS IC's June 2020 agenda decision on initial lease liability measurement.<br>• Example 25 illustrates two approaches that can meet the requirements in HKFRS 16.102A | • The inclusion of the example in the IFRS IC's June 2020 agenda decision should not affect the current practice of initial measurement of sale and leaseback transactions, as entities should have already applied the agenda decision before the effective date of the Amendments.<br>• A seller-lessee may adopt either approaches in the Example, provided that the approaches |

[27] See HKFRS 16.26-28 for the requirements of initial measurement of lease liability. HKFRS 16.27 sets out the lease payments that should be included in the measurement of the lease liability at the commencement date.

[28] HKFRS 16 (amended).BC267ZA.

| Highlights of the Amendments | Implications |
|---|---|
| for subsequent measurement of lease liability that entail the following:<br>- Increase the carrying amount of lease liability to reflect interest on the lease liability;<br>- Reduce the carrying amount of lease liability with an amount of 'lease payments' that was determined at the commencement date of the lease; and<br>- Recognize in profit or loss as a variable lease payment, the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. | meet the subsequent measurement requirements. |

The following are some important reminders for the affected entities:

(i) The Amendments require 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). Entities should examine their sale and leaseback transactions entered into after 2019, reassess their current accounting and determine if restatement of comparatives is necessary.

(ii) Although the Amendments do not require additional disclosures except for the early adoption disclosures, entities should disclose material accounting policy information related to the initial and subsequent measurement of 'lease payments' and 'revised lease payments' for sale and leaseback transactions, as seller-lessee can adopt different approaches as long as the requirements are met.

(iii) Entities should disclose quantitative and qualitative information specific to their sale and leaseback transactions as required by HKFRS 16[29], to help users understand the implications of these transactions, e.g. reasons for entering them, the prevalence, the key terms and conditions, the payments that are not included in the lease liability measurement and the cash flow effects of the transactions in the reporting period.

### ***3. Amendments to HKAS 7 Statement of Cash Flows and HKFRS 7 Financial Instruments: Disclosures – Supplier Finance Arrangements***

Supplier finance arrangements (SFA) are often referred to as supply chain finance, payables finance and reverse factoring arrangements. In May 2023, the IASB issued amendments to IAS 7 and IFRS 7, which were originated from an IFRS IC agenda decision in 2020 addressing the presentation of liabilities and the associated cash flows arising from SFA as well as the

[29] HKFRS 16.51, 59, B48 and B52.

required disclosures[30]. The IASB recognized that the existing disclosure requirements in IFRS Accounting Standards may not fully meet user information needs and hence amended IAS 7 and IFRS 7. The HKICPA issued the equivalents amendments to HKAS 7 and HKFRS 7 in July 2023. The Amendments, which are effective on 1 January 2024, introduce the following key changes:

| |
|---|
| **Two additional disclosure objectives in HKAS 7[31]:**<br><br>Disclose information of SFAs that enables financial statements users to<br>1. assess how SFAs affect an entity's liabilities and cash flows; and<br>2. understand the effect of SFAs on an entity's exposure to liquidity risk. |
| ***Amendments to HKAS 7*** |
| Characteristics of SFAs[32]<br>• Clarify the characteristics of SFAs.<br>• Explain that arrangements that are solely credit enhancements for the entity or instruments used by the entity to settle directly with a supplier the amounts owed are not SFAs.<br><br>Disclosures[33]<br>• Add specific disclosure requirements to provide information on the impact of SFAs on liabilities and cash flows, including:<br>i) the terms and conditions of SFA,<br>ii) at the beginning and end of the reporting period,<br>- the carrying amounts of SFA financial liabilities and their related line items presented,<br>- the carrying amount of related financial liabilities and the line items presented, for which suppliers have received payment from finance providers,<br>- the range of payment due dates for both financial liabilities owed to the finance providers and comparable trade payables that are not part of those arrangements, and<br>iii) the type and effect of non-cash changes in the carrying amounts of SFA financial liabilities.<br>• Disclose aggregate information about SFAs unless individual arrangements have dissimilar terms and conditions. |
| ***Amendments to HKFRS 7*** |
| Liquidity risk disclosures[34]<br>• Include SFAs as an example of other factors for consideration in disclosing the quantitative liquidity risk disclosures required by HKFRS 7. |
| ***Transition[35] (Amendments to HKAS 7 & HKFRS 7)*** |
| • Provide certain transition reliefs in the first year of application: e.g. no comparative disclosure is required. |

[30] Please refer to our discussions of the main points of this agenda decision in P.12-13 of our 2022 publication.

[31] See HKAS 7.44F for details.

[32] See HKAS 7.44G for details.

[33] See HKAS 7.44H for details.

[34] See HKFRS 7.B11F, IG18A.

[35] See HKAS 7.63, HKFRS 7.44JJ.

SFAs have gained increasing popularity as a financing option worldwide. The Amendments are particularly crucial for entities extensively using SFAs in their operations. Given the short implementation period of the Amendments, the following are some suggested steps that entities should take now:

(i) Entities should firstly identify and prepare a complete list of SFAs. It is important to note that the Amendments do not explicitly define a SFA but set out its characteristics. Judgement may be required to determine if financing arrangements meet those characteristics and, hence fall within the scope of the Amendments.

(ii) Entities should consider how they can effectively collect the required SFA information to meet the new disclosure requirements while ensuring accuracy and completeness, particularly when some of them is not readily available. There may be a need to engage in discussions with finance providers to obtain their legal permission for accessing relevant information, such as the amounts that finance providers have settled payments, and introduce new processes and controls in financial reporting systems for capturing and recording the information.

# Appendix – New and revised HKFRSs as well as Agenda Decisions issued by the IFRS IC

The following new and amended standards and practice statement became effective as of 1 January 2023:

| Standards | Description |
|---|---|
| Amendments to HKAS 1 *Presentation of Financial Statements* and HKFRS Practice Statement 2 *Making Materiality Judgements – Disclosure of Accounting Policies* | The amendments to HKAS 1 require companies to disclose their material accounting policy information rather than their significant accounting policies. The amendments to HKFRS Practice Statement 2 provide guidance on how to apply the concept of materiality to accounting policy disclosures. |
| Amendments to HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors – Definition of Accounting Estimates* | The amendments clarify how companies should distinguish changes in accounting policies from changes in accounting estimates. That distinction is important because changes in accounting estimates are applied prospectively only to future transactions and other future events, but changes in accounting policies are generally applied retrospectively to past transactions and other past events. |
| Amendments to HKAS 12 *Income Taxes – Deferred Tax related to Assets and Liabilities arising from a Single Transaction* | The amendments narrow the scope of the recognition exemption in HKAS 12.15 and HKAS 12.24 so that it no longer applies to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences. |
| Amendments to HKAS 12 *Income Taxes – International Tax Reform – Pillar Two Model Rules*[36] | The amendments provide entities with temporary relief from accounting for deferred taxes arising from the OECD's Pillar Two model rules. The amendments also introduce targeted disclosure requirements to help investors understand an entity's exposure to income taxes arising from the rules. |
| HKFRS 17 *Insurance Contracts* and the following amendments<br>• Amendments to HKFRS 17 *Insurance Contracts* | This new standard, which superseded HKFRS 4 *Insurance Contracts*, was initially issued in 2018 with an effective date of 1 January 2021. |

[36] Entities are required to apply the temporary exception to account for deferred taxes related to Pillar Two income taxes immediately upon the issuance of the Amendments, and to provide the new disclosures as set out in the Amendments for annual reporting periods beginning on or after 1 January 2023.

| **Standards** | **Description** |
|---|---|
| • Initial Application of HKFRS 17 and HKFRS 9 – *Comparative Information* | Amendments to HKFRS 17, issued in 2020, were designed to:<br>• reduce costs by simplifying some requirements in the standard;<br>• make financial performance easier to explain; and<br>• ease transition by deferring the effective date of the standard to 1 January 2023 and by providing additional relief to reduce the effort required when applying HKFRS 17 for the first time.<br><br>Amendment on '*Initial Application of HKFRS 17 and HKFRS 9 – Comparative information'* is a transition option relating to comparative information about financial assets presented on initial application of HKFRS 17. The amendment aims at helping entities to avoid temporary accounting mismatches between financial assets and insurance contract liabilities, and therefore improve the usefulness of comparative information for financial statement users. |

The following amended standards and interpretation have been issued but are not yet effective as of 1 January 2023. They are available for early adoption.

| **Effective from annual periods beginning on or after:** | **Amended Standards and Interpretation** |
|---|---|
| 1 January 2024[37] | Amendments to HKAS 1 *Presentation of Financial Statements – Classification of Liabilities as Current or Non-current* |
| 1 January 2024[37] | Amendments to HKAS 1 *Presentation of Financial Statements – Non-current Liabilities with Covenants* |
| 1 January 2024 | Amendments to HKFRS 16 *Leases – Lease Liability in a Sale and Leaseback* |
| Should only be applied when an entity applies the Amendments to HKAS 1 as referred to in the above as a package | Hong Kong Interpretation 5 (Revised) *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* |

[37] Both amendments are to be applied as a package.

| Effective from annual periods beginning on or after: | Amended Standards and Interpretation |
|---|---|
| 1 January 2024 | Amendments to HKAS 7 *Statement of Cash Flows* and HKFRS 7 *Financial Instruments: Disclosures – Supplier Finance Arrangements* |
| 1 January 2025 | Amendments to HKAS 21 *The Effects of Changes in Foreign Exchange Rates – Lack of Exchangeability* |
| 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 2023:

| IFRS IC Update | Agenda Decisions |
|---|---|
| April 2023 | • Definition of a Lease – Substitution Rights – IFRS 16 *Leases* |
| October 2023 | • Guarantee over a Derivative Contract – IFRS 9 *Financial Instruments*<br>• Homes and Home Loans Provided to Employees<br>• Premiums Receivable from an Intermediary – IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments* |

## 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:
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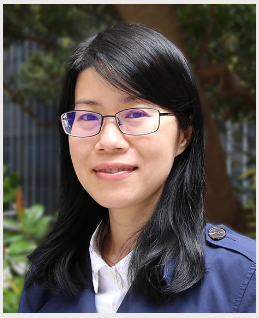

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