

buildings in a manner that differs from its highest and best use in order to continue our current manufacturing operations. This is consistent with and integral to our long-term strategy and core operations. We do not intend to convert these operations in the foreseeable future.

22-900 Transitional provisions

Appendix C contains the transitional provisions.

HKFRS 13 shall be applied prospectively for annual periods beginning on or after 1 January 2013 and earlier application is permitted (para C1 and C2).

HKFRS 13 makes a number of significant amendments to other HKFRS. These primarily include:

- aligning terminology, eg changing "market value" to "fair value";
- improving consistency in describing fair value measurements, eg "determining" or "estimating" fair values is changed to "measuring" fair values;
- adding new disclosures such as in HKAS 36 where entities measure recoverable amounts using fair value less costs to sell;
- clarifying the differences between fair value less costs to sell (this term has been changed to fair value less costs of disposal by HKFRS 13) and value in use per HKAS 36.

HKFRS 13 *Illustrative Examples* contains several hypothetical situations which demonstrate the breadth and depth of judgment required when applying HKFRS 13. Although some aspects within the examples may be present in an actual scenario, entities must consider all relevant facts and circumstances when applying HKFRS 13 to specific cases. These examples can be obtained from www.hkicpa.org.hk.

22-950 Comparison with International Financial Reporting Standards

HKFRS 13 is based on IFRS 13 "Fair Value Measurement". There are no major textual differences between HKFRS 13 and IFRS 13. Compliance with HKFRS 13 will ensure compliance with IFRS 13.

Chapter HK(IFRIC) INTERPRETATIONS

	Page
23 HK(IFRIC)-Int 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities"	403
24 HK(IFRIC)-Int 2 "Members' Shares in Co-operative Entities and Similar Instruments"	407
25 HK(IFRIC)-Int 4 "Determining whether an Arrangement contains a Lease"	413
26 HK(IFRIC)-Int 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds"	419
27 HK(IFRIC)-Int 6 "Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment"	423
28 HK(IFRIC)-Int 7 "Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies"	427
29 HK(IFRIC)-Int 8 "Scope of HKFRS 2"	431
30 HK(IFRIC)-Int 9 "Reassessment of Embedded Derivatives"	433
31 HK(IFRIC)-Int 10 "Interim Financial Reporting and Impairment"	437
32 HK(IFRIC)-Int 11 "HKFRS 2 — Group and Treasury Share Transactions"	441
33 HK(IFRIC)-Int 12 "Service Concession Arrangements"	447
34 HK(IFRIC)-Int 13 "Customer Loyalty Programmes"	455
35 HK(IFRIC)-Int 14 "HKAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"	461
36 HK(IFRIC)-Int 15 "Agreements for the Construction of Real Estate"	465
37 HK(IFRIC)-Int 16 "Hedges of a Net Investment in a Foreign Operation"	467
38 HK(IFRIC)-Int 17 "Distributions of Non-cash Assets to Owners"	471

continued over ...

- a revision of the estimated outflows of resources embodying economic benefits (eg cash flows) required to settle the obligation;
- a revision to the current market-based discount rate as defined in para 47 of HKAS 37 (this includes changes in the time value of money and the risks specific to the liability); and
- an increase that reflects the passage of time — also referred to as the unwinding of the discount.

23-300 Consensus

Most entities account for their property, plant and equipment using the cost model. Where this is so, under HK(IFRIC)-Int 1, changes in the measurement of existing decommissioning costs arising from change in estimate and discount rate should be added to, or deducted from, the cost of the related asset in the current period and depreciated prospectively over its useful life (para 5(a) and 7), and changes in decommissioning costs arising from unwinding of the discount should be recognised in profit or loss as a finance cost as it occurs (para 8). Capitalisation under HKAS 23 "Borrowing Costs" is not permitted.

If the adjustment results in an addition to the cost of an asset, the entity shall also consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable (para 5(c)). If there is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount and account for any impairment loss, in accordance with HKAS 36 "Impairment of Assets".

Illustration 23.1

On 1 January 20x1, ABC Ltd purchases a plant for cash consideration of \$30,000,000. However, ABC Ltd is required to dismantle the plant after a 20-year period. It is estimated that the dismantlement will cost \$10,000,000. The relevant discount rate is 6%, and the present value of the dismantlement cost is therefore \$3,120,000 ($\$10,000,000 / (1 + 6\%)^{20}$).

In this case, ABC Ltd will record the plant at a cost of \$33,120,000 on 1 January 20x1 as follows:

Dr	Plant	33,120,000	
Cr	Cash		30,000,000
Cr	Provision for decommissioning		3,120,000

On 31 December 20x1, ABC Ltd has to provide depreciation on the plant, by allocating the cost of \$33,120,000 over the 20 years. Besides, ABC Ltd will also have to account for the change in the decommissioning cost due to unwinding of discount (from 20 periods to 19 periods). In this case, the present value of the

decommissioning cost has increased from \$3,120,000 to \$3,307,000 ($\$3,120,000 \times 1.06$) because of the unwinding of discount. The journal entry to record this change is as follows:

Dr	Finance costs	187,000	
Cr	Provision for decommissioning		187,000

Assume that on 31 December 20x9, it is estimated that, due to technological advancement, the dismantlement cost will be just \$8,000,000. In this case, the present value of the decommissioning cost will change from \$5,200,000 ($\$10,000,000$ discounted at 6% for 11 periods) to \$4,210,000 ($\$8,000,000$ discounted at 6% for 11 periods). The journal entry to record this change is as follows:

Dr	Provision for decommissioning	990,000	
Cr	Plant		990,000

The annual depreciation for the years 20x1 to 20x9 will be based on the cost of \$33,120,000, whereas the depreciation for years thereafter will be based on the cost of \$32,130,000 ($\$33,120,000 - \$990,000$).

It may be noted that the above principle also applies when the revaluation model under HKAS 16 "Property, Plant and Equipment" is used.

Where entities account for their property, plant and equipment using the revaluation model, a change in the liability does not in itself affect the valuation of the asset for accounting purposes. Instead, it alters the revaluation surplus or deficit on the item, which is the difference between its valuation and what would have been recognised under the cost model. The effect of the change is treated consistently with other revaluation surplus or deficit. In these cases, HK(IFRIC)-Int 1 specifically provides that (para 6(a)):

- decreases in the liability shall be recognised in other comprehensive income and increase the revaluation surplus in equity (except that it shall be recognised in profit or loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in profit or loss); and
- increases in the liability shall be recognised in profit or loss (except that it shall be recognised in other comprehensive income and reduce the revaluation surplus in equity to the extent of any credit balance existing in the revaluation surplus in respect of that asset).

- (c) take-or-pay contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (eg a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).

HK(IFRIC)-Int 4 contains guidance on determining whether arrangements such as those above that do not take the legal form of a lease may in substance be a lease, or contain a lease (as defined in HKAS 17 "Leases").

HK(IFRIC)-Int 4 becomes effective for annual periods beginning on or after 1 January 2006 with earlier application encouraged. If an entity applies HK(IFRIC)-Int 4 for a period beginning before 1 January 2006, it shall disclose that fact.

The issues addressed in HK(IFRIC)-Int 4 are (para 5):

- how to determine whether an arrangement is, or contains, a lease as defined in HKAS 17;
- when to make the assessment or a reassessment whether an arrangement is, or contains, a lease; and
- if an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

Consensus

25-310 Determining whether an arrangement contains a lease

HK(IFRIC)-Int 4 provides that determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement.

On the first issue, HK(IFRIC)-Int 4 requires an assessment of whether the following two criteria are met (para 6):

- fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
- the arrangement includes the conveyance of the right to use the asset.

Therefore, to qualify as a lease, the first condition is that a specific asset has to be identified in the arrangement and fulfilment of the arrangement is dependent upon the use of that asset, eg property, plant or equipment. If no specific asset is identified in the arrangement, it is not a lease. Even if a specific asset is identified in an arrangement, it will not qualify as a lease if fulfilment of the arrangement is not dependent on the use of the specific asset. Dependence on a specifically identified asset is a feature that distinguishes a lease from other arrangements that also convey the right to use but are not leases.

The asset may be explicitly identified by the contractual provisions of the arrangement, in which case this criterion will usually be met. The criterion will also be met if the item is implicitly identified in the arrangement and surrounding facts and circumstances. This will be the case if it is not economically feasible or practical for the supplier to perform its obligation by providing the use of alternative assets. Examples of when an asset may be implicitly identified are when the supplier owns only one suitable asset; the asset used to fulfil the contract needs to be at a particular location or specialised to the purchaser's needs; and the supplier is a special purpose entity formed for a specific purpose.

The second condition is that the arrangement must convey to the purchaser (lessee) the right to control the use of the underlying asset (para 9). The right to control the use of the underlying asset is deemed to have been conveyed if any one of the following criteria is met (para 9):

- the purchaser has the ability or right to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset;
- the purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset; and
- facts and circumstances indicate that there is only a remote possibility that parties other than the purchaser could take more than an insignificant amount of the output or other utility of that asset, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output, nor equal to the current market price per unit of output as of the time of delivery of the output.

The following two examples are taken from Appendix of HK(IFRIC)-Int 4 where one is an arrangement that contains a lease and one does not.

Illustration 25.1 (adapted from HK(IFRIC)-Int 4 — Example of an arrangement that contains a lease)

AB Ltd (the purchaser) enters into an arrangement with a third party, YZ Ltd (the supplier) to supply a minimum quantity of gas needed in its production process for 20 years. The supplier designs and builds a facility adjacent to the purchaser's plant to produce the needed gas and maintains ownership and control over all significant aspects of operating the facility. The agreement provides for the following:

- Each month, the purchaser will pay a fixed capacity charge and a variable charge based on actual production taken.
- The supplier's facility is explicitly identified in the arrangement, and the supplier has the contractual right to supply gas from other sources. However, supplying gas from other sources is not economically feasible or practicable.

- (c) The supplier has the right to provide gas to other customers. However, at inception of the arrangement, the supplier has no plans to modify or expand the facility. The facility is designed to meet only the purchaser's needs.
- (d) The supplier is responsible for repairs, maintenance, and capital expenditures of the facility.
- (e) The supplier must stand ready to deliver a minimum quantity of gas each month.
- (f) If the facility does not produce the stated minimum quantity, the supplier must return all or a portion of the fixed capacity charge.

Required:

Does the arrangement contain a lease?

Analysis:

In this case, the arrangement contains a lease within the scope of HKAS 17. This assessment is arrived at based on the following:

- (a) An asset (ie the facility) is explicitly identified in the arrangement and fulfilment of the arrangement is dependent on the facility.
- (b) The purchaser has obtained the right to use the facility, and there is a remote possibility that one or more parties other than the purchaser will take more than an insignificant amount of the facility's output and the price that the purchaser will pay is neither contractually fixed per unit of output, nor equal to the current market price per unit of output as of the time of delivery of the output.

Illustration 25.2 (adapted from HK(IFRIC)-Int 4 — Example of an arrangement that does not contain a lease)

CD Ltd, a manufacturing company (the purchaser) enters into an arrangement with a third party, WX Ltd (the supplier) to supply a specific component part of its manufactured product for 10 years. The supplier designs and constructs a plant adjacent to the purchaser's factory to produce the component part. The designed capacity of the plant exceeds the purchaser's current needs, and the supplier maintains ownership and control over all significant aspects of operating the plant. The agreement provides for the following:

- (a) The supplier's plant is explicitly identified in the arrangement, but the supplier has the right to fulfil the arrangement by shipping the component parts from another plant owned by the supplier. However, to do so for any extended period of time would be uneconomical.
- (b) The supplier is responsible for repairs, maintenance, and capital expenditures of the plant.
- (c) The supplier must stand ready to deliver a minimum quantity. The purchaser is required to pay a fixed price per unit for the actual quantity taken. Even if the purchaser's needs are such that they do not need the stated minimum quantity, they still pay only for the actual quantity taken.
- (d) The supplier has the right to sell the component parts to other customers and has a history of doing so, so it is expected that parties other than the

purchasers will take more than an insignificant amount of the component parts produced at the supplier's plant.

Required:

Does the arrangement contain a lease?

Analysis:

In this case, the arrangement does not contain a lease within the scope of HKAS 17.

This is because the purchaser has not obtained the right to use the plant because the purchaser does not have the ability or right to operate or direct others to operate the plant or control physical access to the plant, and it is likely that one or more parties other than the purchaser will take more than an insignificant amount of the component parts produced at the plant. In addition, the price that the purchaser will pay is contractually fixed per unit of output taken.

25-320 Assessing or reassessing whether an arrangement contains a lease

On the second issue, HK(IFRIC)-Int 4 provides that the assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement (para 10).

Consistent with the requirements of HKAS 17, an arrangement shall be reassessed only if there was a change in the terms of the arrangement. Specifically, HK(IFRIC)-Int 4 states that a reassessment of whether the arrangement contains a lease after the inception of the lease shall be made only if any one of the following conditions is met (para 10):

- (a) There is a change in the contractual terms, other than one that merely renews or extends the arrangement.
- (b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement.
- (c) There is a change in the determination of whether the fulfilment is dependent on a specified asset.
- (d) There is a substantial change to the asset, eg substantial physical damage to property, plant and equipment.

HK(IFRIC)-Int 4 further provides that a reassessment of arrangement shall be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (eg the estimated amount of output to be delivered to the purchaser) would not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting shall be applied (or cease to apply).

If the building were to be converted into a shopping complex, it would fetch a market price of \$200,000,000.

In this case, if the building is revalued, it should be revalued to \$150,000,000 (market value for existing use), and not \$200,000,000 (market value for alternative use).

49-910 Frequency of revaluation

HKAS 16 provides that revaluations shall be made with sufficient regularity such that "the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period" (para 31).

Therefore, under HKAS 16, an entity that decides to carry any of its property, plant and equipment at revalued amount would be required to revalue the property, plant and equipment, both upwards and downwards, with such frequency so as to ensure that the carrying amount of the asset is not materially different from its fair value at end of the reporting period.

In compliance with the above provision, items of property, plant and equipment that experience significant and volatile movements in fair values would have to be revalued annually. However, items of property, plant and equipment with only insignificant movements in fair values, annual revaluation would be unnecessary. Instead a revaluation every three or five years may be sufficient.

The above provision of HKAS 16 would help to overcome the deficiency of revaluation accounting in the 1990s under the old accounting standard, whereby many entities would revalue their property, plant and equipment upwards when their market values have gone up but would not revalue the assets downwards when there has been a downturn in the market values. It would also overcome the problem of some entities carrying their property, plant and equipment at revaluation based on some irrelevant old market values.

It should, however, be noted that HKAS 16 provides that the requirement of para 31 (to make regular revaluations) is not applicable to property, plant and equipment revalued before 30 September 1995 (para 80A), provided that:

- these entities do not revalue their property, plant and equipment subsequent to 1995; and
- disclosure of reliance of para 80A is made in the financial statements.

Illustration 49.17

If an entity acquired a piece of land in 1990 and revalued it in 1993, and did not revalue the land again, then the requirement of para 31 relating to the frequency of revaluation would not apply.

However, if the entity revalued the land again in 1997, then the land would have to be revalued thereafter with sufficient frequency so as to be in compliance with the requirement of para 31.

HKAS 16 also provides that items within a class of property, plant and equipment should be revalued simultaneously (para 38). Alternatively, a class of assets may be revalued on a rolling basis, provided that the revaluation of the class of assets is completed within a short period of time and that the individual revaluations are kept up to date (para 38). This is in order to avoid the selective revaluation of assets and the reporting of amounts in the financial statements which are a mixture of costs and values as at different dates.

49-915 Accounting for revaluation

Upon an initial revaluation, HKAS 16 provides that an increase in an asset's net carrying amount (surplus on revaluation) shall be recognised in other comprehensive income and accumulated in equity under a separate heading, "revaluation surplus" (para 39), and a decrease in an asset's net carrying amount (deficit on revaluation) shall be recognised in profit or loss (para 40).

However, upon a subsequent revaluation, a revaluation surplus shall be recognised in profit or loss to the extent that it reverses a revaluation decrease in respect of the same asset previously recognised in profit or loss (para 39). On the other hand, a deficit on revaluation shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that same asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the headings of revaluation surplus (para 40).

Illustration 49.18

To illustrate the provision of para 39, assume that ABC Ltd revalued its land from cost of \$10,000,000 to market value of \$15,000,000 in 20x4, and revalued it downwards to \$12,000,000 in 20x5.

The surplus on revaluation of \$5,000,000 in 20x4 should be recognised in other comprehensive income of 20x4 and accumulated in equity under a separate heading, "revaluation surplus" and the deficit on revaluation of \$3,000,000 in 20x5 should be recognised in other comprehensive income of 20x5 and would reduce the amount of revaluation surplus accumulated in equity, instead of the amount of profit or loss.

If the land was further revalued down to \$9,000,000 in 20x6, of the total deficit of \$3,000,000 arising therefrom, \$2,000,000 should be recognised in other comprehensive income of 20x6 and would reduce the amount of revaluation surplus accumulated in equity, and \$1,000,000 charged to the 20x6 profit or loss.

Note that after revaluation, the building will be carried in the books as if it were a new asset where the gross carrying amount is equal to the revalued amount, as shown below:

Building	\$
Less: Accumulated depreciation	12,000,000
Net carrying amount	—
	<u>12,000,000</u>

Note that, under both methods, the net carrying amount of the building is \$12,000,000, and that the revaluation surplus is \$4,000,000 which is the difference between the revalued amount of \$12,000,000 and the old net carrying amount of \$8,000,000.

49-920 Depreciation of revalued asset

As mentioned earlier, the depreciable amount of an item of property, plant and equipment for the purposes of depreciation is defined in HKAS 16 as its "cost, or other amount substituted for cost, less its residual value" (para 6). Thus, when an asset has been revalued, the revalued amount, instead of its cost, will form the basis for calculating the depreciable amount.

Also, HKAS 16 requires the residual value of the asset to be reviewed at least at the end of each reporting period (para 51).

Therefore, when an asset is revalued, the depreciable amount has to be recalculated, based on the revalued amount and the newly estimated residual value. The new depreciable amount calculated is then allocated over the remaining useful life of the asset.

Illustration 49.21

Assume that ABC Ltd acquired a building at a cost of \$50,000,000. The building was expected to have a useful life of 50 years with no residual value, and was depreciated using the straight-line method.

After 10 years, when the building was carried in the books at \$40,000,000, it was revalued to its fair market value of \$60,000,000. Assume also that at the date of revaluation, the building was estimated to have another 40 years of useful life and no residual value.

The depreciation charge for the building for each of the next 40 years would be \$1,500,000 (\$60,000,000/40). Note that before the revaluation, the annual depreciation charge for the building for each of the first 10 years had been \$1,000,000 (\$50,000,000/50).

It may be noted that HKAS 16 provides that "some of the surplus may be transferred as the asset is used by the entity" (para 41). The amount of the

surplus to be transferred periodically is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost (para 41).

HKAS 16 further provides that the gradual transfer of the revaluation surplus is to be accounted for through a direct transfer to the retained earnings, and not through profit or loss (para 41).

Illustration 49.22

To illustrate the provisions of para 41, refer to the revaluation of the building in Illustration 49.21 above.

In this case, the depreciation charge of \$1,500,000 and the gradual transfer of the revaluation surplus of \$20,000,000 for each of the years subsequent to the revaluation may be recorded as follows:

Dr	Depreciation expense	1,500,000	
Cr	Accumulated depreciation		1,500,000
	(To record depreciation for the year)		
Dr	Revaluation surplus	500,000	
Cr	Retained profit		500,000
	(To record gradual transfer of the revaluation surplus)		

Note that the surplus of \$500,000 to be transferred each year has to be done through a direct transfer to the retained earnings, and not through the profit or loss. The amount is the difference between depreciation of \$1,500,000 based on the asset's revalued carrying amount and depreciation of \$1,000,000 based on the asset's original cost.

Note also that when the building is fully depreciated in 40 years' time, the revaluation surplus of \$20,000,000 will be fully realised.

49-925 Derecognition of revalued asset

When an asset is derecognised (eg retired or disposed of), as a matter of general practice, all the related accounts should be eliminated from the financial statements. Thus, when a previously revalued asset is derecognised, not only the gross carrying amount and the accumulated depreciation have to be written off, but the related revaluation surplus should also be written off.

However, the question often arises as to how the revaluation surplus is to be treated.

HKAS 16 provides that the revaluation surplus *may* involve transferring the whole of the surplus when the asset is retired or disposed of (para 41). (The last sentence in para 41 that "Transfers ... are not made through profit or

31 December 20x5	1,000	93	907	
31 December 20x6	1,000	49	951	951
	<u>42,000</u>	<u>5,012</u>	<u>36,988</u>	nil

The journal entries to record the lease would be the same as those under the original lease in Illustration 50.5, except for changes in the accounting period and the changes in the figures.

By the end of the lease on 31 December 20x6, all the accounts relating to the lease would have been written off: the lease liability fully settled and the leased asset fully depreciated.

50-413 Residual value

As for the residual value of the leased asset, there may be three possible scenarios as far as the lessee is concerned: firstly, the lessee may be required to guarantee the residual value of the leased asset at the end of the lease; secondly, the lessee may enjoy wholly or share with the lessor the sale proceeds of the leased asset when it is disposed of at the end of the lease; and thirdly, the lessee may have nothing to do with the residual value.

(i) Guaranteed residual value

If the lease agreement requires the lessee (or a party related to the lessee, for example, its parent) to guarantee the residual value of the leased asset, the following points should be noted:

- the guaranteed residual value will form part of the minimum lease payments;
- the depreciable amount of the leased asset will be equal to the capitalised amount less the guaranteed residual value (as in the case for assets under HKAS 16);
- the lease liability will also have a balance equal to the amount of the guaranteed residual value at the end of the lease; and
- a gain or loss will arise due to the difference between the guaranteed residual value and the fair value of the leased asset at the end of the lease.

Illustration 50.8

Assume that in the lease transaction between ABC Trading Ltd and DEF Leasing Ltd in Illustration 50.5 above, ABC Trading Ltd guaranteed DEF Leasing Ltd that the leased asset would have a residual value of \$5,000 when the leased asset reverted back to the lessor at the end of the lease on 31 December 20x4.

The above lease would be classified as a finance lease because the lease term (four years) was for the "major part" (more than 75%) of the useful life (five years).

In this case, the minimum lease payments would be increased by the guaranteed residual value of \$5,000 to \$45,000. The depreciable amount of the leased equipment would be reduced by the guaranteed residual value. The related calculations would be as shown below:

- Calculation of the present value of the minimum lease payments:
Minimum lease payments:
Ordinary annuity of \$10,000 for 4 periods plus \$5,000 at the end of the 4th period = \$45,000
Discount rate: 5%
Present value: $\$10,000 \times 3.54595 + \$5,000 \times 0.8227 = \$39,572$
The leased equipment would be capitalised and the related liability recognised in ABC Trading Ltd's books at \$39,572 (as the present value of minimum lease payments of \$39,572 was lower than the fair value of \$42,000).
- The depreciable amount of the leased equipment would be \$34,572 (\$39,572 - \$5,000). The depreciation for the leased equipment would therefore be \$8,643 (\$34,572/4 years) for each of the 4 years from 20x1 to 20x4.
- Amortisation schedule for finance charges of \$5,428 (\$45,000 - \$39,572):

Date	Lease payment	Interest expense	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				39,572
31 December 20x1	10,000	1,979	8,021	31,551
31 December 20x2	10,000	1,578	8,422	23,129
31 December 20x3	10,000	1,157	8,843	14,286
31 December 20x4	10,000	714	9,286	5,000
	<u>40,000</u>	<u>5,428</u>	<u>34,572</u>	

The journal entries to record the lease would be the same as those under the original lease in Illustration 50.5, except for changes in the figures.

In addition, it may be noted that in the amortisation schedule, there would be a balance of \$5,000 in the lease liability account at the end of the lease. This is the amount the lessee had guaranteed to pay on the residual value of the leased asset.

The leased equipment account would also be carried at a book value of \$5,000 (capitalised amount of \$39,572 less accumulated depreciation of \$34,572 (\$8,643 × 4 years)). Assuming that the fair value of the equipment as at 31 December 20x4 was \$5,000, the journal entry to close the accounts relating to the lease would simply be as follows:

31 December 20x4

Dr	Receivable from lessor		
Dr	Accumulated depreciation	2,000	
Cr	Leased equipment	33,459	
	(to close the lease accounts)		35,459

January 20x5

Dr	Cash		
Cr	Receivable from lessor	2,000	
	(to record receivable from lessor)		2,000

If the leased asset were subsequently disposed of at an amount more than or less than \$5,000, the lessee would record the surplus as a gain, and the deficit as a loss, as the case may be.

(iii) Unguaranteed residual value

If the lessee (or a party related to the lessee) does not guarantee the residual value, nor is the lessee entitled to the sale proceeds of the leased asset at the end of the lease, then the residual value of the leased asset is of no relevance to the lessee and should therefore be ignored.

50-414 Use of lessee's incremental borrowing rate

In practice, the lessor may not always disclose the implicit interest rate to the lessee because the lessor may deem the implicit interest rate used in the lease agreement as part of its trade secrets.

In cases where the lessee has no knowledge of the lessor's implicit interest rate, HKAS 17 requires that the lessee uses its own incremental borrowing rate to compute the present value of the minimum lease payments (para 20).

Illustration 50.10

Assume that in the original case of the lease between ABC Trading Ltd and DEF Leasing Ltd in Illustration 50.5 above, ABC Trading Ltd had no knowledge of the implicit interest rate used in the lease, and that its incremental borrowing rate was 6% per annum.

In this case, the lease would still be classified as a finance lease (because the lease term of four years was more than 75% of the useful life of the leased equipment). However, in the computation of the minimum lease payments, the lessee's incremental borrowing rate of 6% would be used (instead of the implicit interest rate of 5%).

50-414

Calculation of the present value of the minimum lease payments:

(a) Minimum lease payments:

Ordinary annuity of \$10,000 for 4 periods = \$40,000

Discount rate: 6%

Present value: $\$10,000 \times 3.4651 = \$34,651$

Since the present value of the minimum lease payments was less than the fair value of the equipment, the leased asset would be capitalised, and the related liability recognised in ABC Trading Ltd's books at \$34,651.

- (b) The depreciation charge for the leased equipment would be \$8,662.75 ($\$34,651 / 4$ years) for each of the 4 years from 20x1 to 20x4.
- (c) Amortisation schedule for finance charges of \$5,349 ($\$40,000 - \$34,651$):

Date	Lease payment	Interest expense (6%)	Principal	Lease liability
	\$	\$	\$	\$
1 January 20x1				34,651
31 December 20x1	10,000	2,079	7,921	26,730
31 December 20x2	10,000	1,604	8,396	18,334
31 December 20x3	10,000	1,100	8,900	9,434
31 December 20x4	10,000	566	9,434	nil
	<u>40,000</u>	<u>5,349</u>	<u>34,651</u>	

The journal entries to record the lease would be the same as those under the original lease in Illustration 50.5, except for changes in the figures.

By the end of the lease on 31 December 20x4, all the accounts relating to the lease would have been written off: the lease liability fully settled, and the leased asset fully depreciated.

50-415 Annuity due

In practice, it is common for the lease agreement to provide for the first periodic lease payment to be made at the beginning of the period (annuity due) rather than at the end of the period (ordinary annuity).

Financially, the difference between an annuity due and an ordinary annuity is that in the former case the lessee is taking less financing from the lessor, and therefore the implicit interest rate charged by the lessor should be reduced correspondingly.

cost-to-cost basis. Revenue from information technology services where the services involve substantially the procurement of computer equipment and third party software for installation is recognised upon full completion of the project."

"Interest income from investments is recognised as it accrues using the effective interest method."

"Recognition of initial franchise fees and related direct expenses is deferred, if significant, until the Group's services under its franchise agreements are performed. Royalties income is recognised on a periodic basis as a percentage of the franchisees' sales in accordance with the terms as stated in the franchise agreement."

"Dividend income from investments is recognised when the shareholder's right to receive payment has been established."

"Rental income receivable under operating leases is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised in profit or loss as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned."

51-900 Comparison with International Accounting Standards

HKAS 18 is based on IAS 18 "Revenue". There are no major textual differences between the two accounting standards. Compliance with HKAS 18 will ensure compliance with IAS 18.

52 HKAS 19 (2011)

"Employee Benefits"

Introduction	52-100
Short-term employee benefits	52-200
Post-employment benefits	
Post-employment benefits	52-300
Defined contribution plans	52-310
Defined benefit plans	52-400
Termination benefits	52-500
Other long-term employee benefits	52-600
Sample disclosures	52-700
Comparison with HKAS 19 "Employee Benefits"	52-700
Comparison with International Accounting Standards	52-800

52-100 Introduction

HKAS 19 (2011) "Employee Benefits" prescribes the accounting and disclosure for employee benefits, other than those to which HKFRS 2 "Share-based Payment" applies (para 2).

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment (para 8). They include benefits provided directly either to employees or to their dependents or beneficiaries. (para 6).

HKAS 19 (2011) generally requires an entity to recognise (para 1):

- a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- an expense when the entity consumes the economic benefits arising from the service provided by an employee in exchange for employee benefits.

For purposes of accounting and disclosure, HKAS 19 (2011) has categorised employee benefits into four groupings, namely:

- short-term employee benefits;
- post-employment benefits;
- termination benefits; and
- other long-term employee benefits.

In addition to HKAS 19 (2011), HK(IFRIC)-Int 14 "HKAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" provides guidance on the effect of asset ceiling test that relates to all post-employment and other long-term employee defined benefit plans.

HKAS 19 (2011) supersedes the previous version of HKAS 19, and is applicable for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

52-200 Short-term employee benefits

Short-term employment benefits are defined in HKAS 19 (2011) as employee benefits (other than termination benefits) that are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service (para 8).

Short-term employee benefits include items such as (para 5 (a)):

- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit sharing and bonuses; and
- non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Generally, for all short-term employee benefits, HKAS 19 (2011) requires the undiscounted amount of the benefits to be recognised as expenses for the accounting period during which they are incurred, and the amount remained unpaid recognised as a liability (accrued expense) (para 11).

For short-term paid absences, HKAS 19 (2011) provides that an entity shall provide for, at the end of the reporting period, the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period (para 16).

Illustration 52.1

(This illustration is modified from the Example in para 17 of HKAS 19 (2011).)

An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one calendar year. At 31 December 20x8, the average unused entitlement is two days per employee (ie total of 200 days). The entity expects, based on past experience, that 92 employees will take no more than five days of paid sick leave in 20x9, and that the remaining eight employees will take an average of seven days each.

In this case, since the entity expects that it will pay an additional 16 days (two days each, for eight employees) of sick leave as a result of the unused entitlement that has accumulated at 31 December 20x8, it recognises a liability equal to 16 days of sick leave, even though the total unused sick leave is 200 days.

For profit sharing and bonus plans, HKAS 19 (2011) provides that an entity shall recognise the expected cost of profit sharing and bonus payments when, and only when (para 19),

- the entity has a present legal or constructive obligation to make such payments as a result of past events; and
 - a reliable estimate of the obligation can be made.
- A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

Illustration 52.2

Scenario A

The employment contracts that A Ltd (which has accounting year-ends of 31 December) entered into with its employees contain a clause which requires A Ltd to pay its employees a "13th month bonus" (or a proportionate amount thereof if an employee works for less than 12 months for a year) in January the following year.

In this case, A Ltd has a legal obligation to pay the "13th month bonus". Therefore, at each year-end, A Ltd will have to make a provision for the "13th month bonus" by:

Dr Staff costs
Cr Provision for bonus

Scenario B

The employment contracts that B Ltd (which has accounting year-ends of 31 December) entered into with its employees do not contain any clause on "bonus". However, in the past, B Ltd has been paying its employees a one-month bonus (or a proportionate amount thereof if an employee works for less than 12 months for a year) in January the following year.

In this case, B Ltd does not have a legal obligation to pay the one-month bonus. However, through its action in the past, B Ltd has created in the mind of its employees an expectation that a one-month bonus will be paid and consequently, B Ltd does have a constructive obligation to pay the one-month bonus. Thus, at each year-end, B Ltd will have to make a provision for the "one-month bonus" by:

Dr Staff costs
Cr Provision for bonus

Scenario C

In order to motivate its employees, C Ltd has informed its employees that if the profit of the company for the current year exceeds a certain amount, it may consider paying the employees an additional bonus.

In this case, C Ltd does not have an obligation to pay the additional bonus. Thus, C Ltd should not recognise the bonus at current year-end.

HKAS 19 (2011) does not require specific disclosures about short-term employee benefits. Disclosures may, however, be required by other HKFRS. For example, HKAS 24 "Related Party Disclosures" requires disclosures of