

# Let's get

*This column is dedicated to answering questions submitted by members regarding Institute standards. You can submit questions on technical issues by sending an email to [hkipca@hkicpa.org.hk](mailto:hkipca@hkicpa.org.hk). The standard setting team will answer these questions in accordance with the policy on handling members' technical questions on our website.*

**Q.** When a bank makes an instalment loan to a borrower and allows the borrower to repay the loan before the end of the loan's term, is there a need to account for the early repayment clause separately as an embedded derivative under HKAS 39 *Financial Instruments: Recognition and Measurement*?

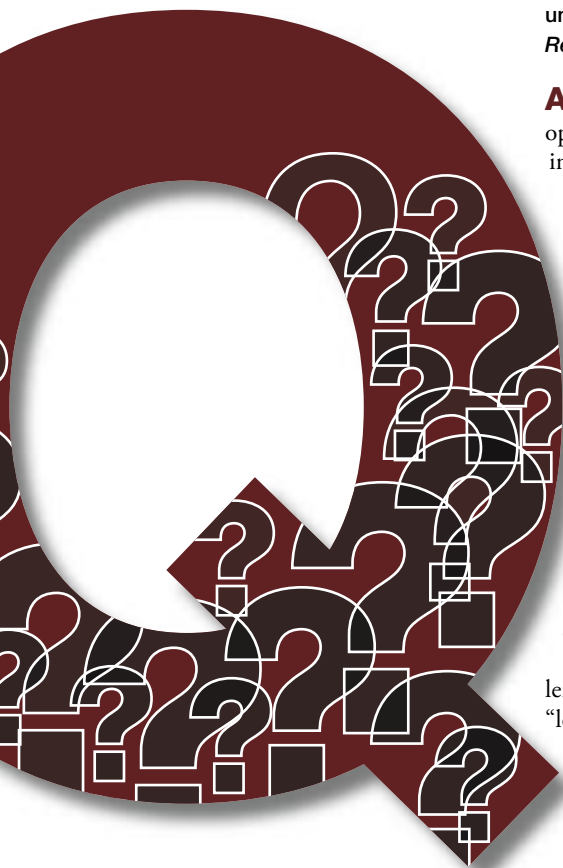
**A.** The early repayment clause is an option (a derivative) embedded in the instalment loan contract that modifies some of the terms of the instalment loan. Separation of the embedded derivative from the loan is covered by paragraph 11 of HKAS 39 and is only permitted under certain circumstances. The following discussion assumes that the economic characteristics of the early repayment clause are closely related to the economic characteristics and risks of the loan without the early repayment clause. The applicability of this assumption to particular loans will depend on the specific terms of the early repayment clause.

From the point of view of the lender, the loan meets the definition of "loans and receivables" unless the bank intends to sell the loan immediately or in the near term, in which

case the loan would be classified as a financial asset "held for trading," or the bank upon initial recognition appropriately designates the loan as "available for sale."

When the instalment loan is classified as "loans and receivables," it should be measured at amortised cost using the effective interest method. The amortised cost of a financial asset is defined in HKAS 39 as the amount at which the financial asset is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount, and minus any reduction for impairment or uncollectibility. In applying the effective interest method, the lender estimates cash flows by considering all the contractual terms of the instalment loan, including the prepayment option. Accordingly, in arriving at the fair value of the instalment loan on initial recognition and its amortised cost subsequently, the bank should have taken into account the probability that the borrower might repay the loan before the end of the term of the loan.

Similarly, if the instalment loan is designated as "available for sale" upon

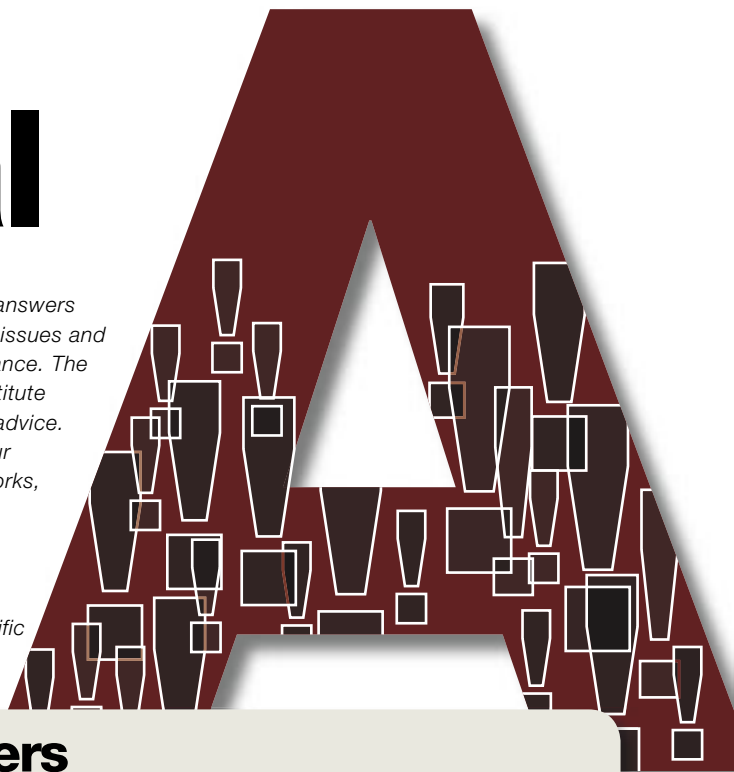


# technical

initial recognition, the bank would also have to take into account the early repayment clause in determining the fair value of the loan.

If the instalment loan is classified as “held for trading” with changes in fair value being recognised in profit or loss, separation of the early repayment clause for accounting purposes is not permitted. Accordingly, the bank would have to take into account the early repayment clause in arriving at the fair value of the loan.

*Please note that the answers only address general issues and provide general guidance. The answers do not constitute professional or legal advice. You need to base your decisions on frameworks, standards and other documents approved by the Council of the Institute, after taking account of your specific circumstances.*



## Members helping members

*Do you want to help your fellow members? Try answering this question from a member and send an email to [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk). Answers received by 20 September will be considered for inclusion in the November issue of A Plus.*

This month's question:

**Q.** My firm has been engaged to conduct an internal control review for the purpose of Chapter 3A of the Main Board Listing Rules for a company that is seeking a listing on the Hong Kong stock exchange. Which standard or practice note should I refer to?

Here is the answer to the question we asked members to help with in the July edition of *A Plus*.

**Q.** I am a practising accountant and have recently been asked by a listed company client as to whether in their preliminary announcement of results, they can refer to the draft financial statements as “audited?” If they cannot refer to their financial statements as audited in the preliminary announcement, when will they be allowed to do so?

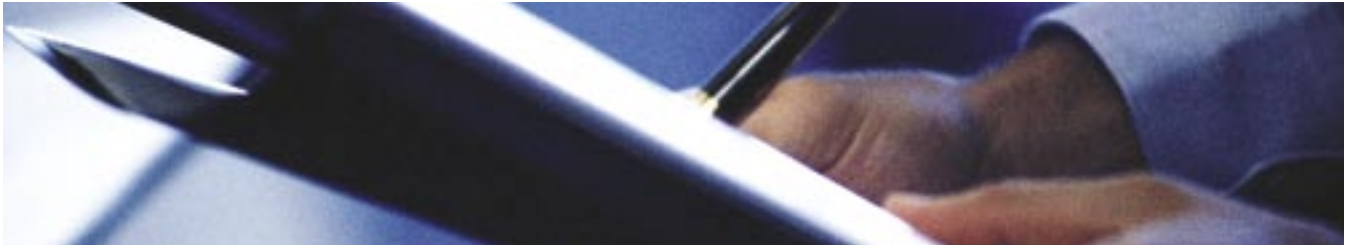
**A.** Directors of a listed issuer are required by Main Board Listing Rule 13.49(2) or GEM Listing Rule 18.49 to

publish a preliminary announcement of results for the financial year. The listing rules also require a preliminary announcement to “have been agreed with the auditors” before it is published.

The Institute has issued Practice Note 730 “Guidance for Auditors Regarding Preliminary Announcements of Annual Results” to assist auditors with their responsibilities in regard to preliminary announcements of results for the financial year. Although Practice Note 730 allows draft financial statements to form the basis of the preliminary announcements, it expects the draft financial statements to be in very final form and the audit to be more or less completed subject only to minor outstanding matters.

Financial statements are described as “audited” once the audit report is signed. If the preliminary announcement is prepared on the basis of draft financial statements, it should not state that the financial statements are “audited.” If the preliminary announcement is based on completed financial statements with a signed audit report, the preliminary announcement can refer to “audited” financial statements.

Practice Note 730 is contained in volume III of the Institute’s Members’ Handbook at [www.hkicpa.org.hk/ebook/main.php](http://www.hkicpa.org.hk/ebook/main.php).



## TechWatch 45

The latest standards  
and regulatory  
announcements

### ▶ CPD & events

#### Annual auditing update conference

The annual auditing update conference has been scheduled for Saturday, **21 October 2006**. Proposed topics to be covered during the conference include:

- Fraud consideration – HKSA 240
- Improving audit documentation – HKSA 230
- The new audit report standards – proposed HKSA 700 and HKSA 701
- Draft discussion paper “Requests for special purpose reports”
- Investment circular reporting engagements

### ▶ Financial reporting

#### The Institute invites comments on IASB ED of proposed amendments to IAS 23

The Institute has issued an invitation to comment on IASB exposure draft (ED) of proposed amendments to IAS 23 *Borrowing Costs*, with comments requested by **13 September 2006**.

The ED proposes to require an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The option of immediately recognising borrowing costs as an expense would be removed.

The IASB believes that elimination of one of the two options in accounting for borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset would improve financial reporting and result in information that is more comparable between entities.

#### The Institute comments on international pronouncements

(a) IASB exposure draft of proposed amendments to IFRS 2 *Share-based Payment – Vesting Conditions and Cancellations*

The IASB exposure draft deals with two matters. It proposes that vesting conditions (i.e. conditions that an individual or an organisation must satisfy to receive an entity’s shares under a share-based payment arrangement) should be restricted to service conditions and performance conditions. It also proposes that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

The Institute’s submission to the IASB raised concern about the proposed amendments to IFRS 2 as they are rule-based and fail to take into account the substance of the transactions.

(b) Proposed UITF abstract “The interpretation of equivalence for the purposes for section 228A of the Companies Act 1985”

With effect for accounting periods commencing on or after 1 January 2005, section 228A of the U.K. Companies Act 1985 exempts, subject to certain conditions, an intermediate parent undertaking from the requirement to prepare consolidated accounts where its parent entity is not established under the law of a European Economic Area state. The exemption conditions include the condition that the intermediate parent and all of its subsidiaries are included in consolidated accounts for a larger group drawn up in accordance with the provisions of the seventh directive or in a manner equivalent to consolidated accounts so drawn up. The proposed UITF abstract “The interpretation of equivalence for the purposes for section 228A of the Companies Act 1985” issued by the U.K. Accounting Standards Board (ASB) aims to give interpretation of equivalence for the purposes of section 228A of the U.K. Companies Act 1985.

The proposed UITF abstract refers Hong Kong GAAP as being a GAAP that is based on IFRS, but does not correspond with IFRS in all respects. The Institute’s submission to the ASB requested that reference be removed or updated for the recent achievement of convergence of HKFRSs with IFRSs.

### Consequential amendments to HK Interpretations

The Institute has issued the following revised Interpretations:

- HK Interpretation 1 *The Appropriate Accounting Policies for Infrastructure Facilities*
- HK Interpretation 3 *Revenue – Pre-completion Contracts for the Sale of Development Properties*
- HK Interpretation 4 *Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases*

The revisions in the above interpretations are consequential on the replacement of SSAPs by the relevant HKASs effective for annual periods beginning on or after 1 January 2005. Given that there are no material differences between the withdrawn SSAPs and the relevant HKASs as far as the above interpretations are concerned, these interpretations continue to apply after the changes.

## ► Banking

### HKMA disclosure rules consultation paper

The Hong Kong Monetary Authority (HKMA) issued a disclosure rules consultation paper inviting comments on the minimum disclosure standards that the HKMA expects of authorised institutions under the Banking Ordinance for the purpose of implementing the requirements of the new capital adequacy framework (often referred to as “Basel II”). Further details are set out in TechWatch 43.

The Institute’s Expert Panel on Banking has been working closely with the HKMA during the development of the consultation paper. Comments were also provided through Mrs. Patricia McBride, director of standard setting, who represented the Institute on the HKMA’s working party on financial disclosure. The Institute’s comments were primarily aimed at ensuring consistency with Hong Kong Financial Reporting Standards, and they were duly considered by the HKMA. The Institute welcomed the effort that the HKMA has been put in considering the Institute’s earlier comments and has made a submission in support of the consultation paper.

## For your information

### Revised non-statutory guidelines on directors’ duties

The Companies Registry has posted a revised “Non-statutory guidelines on directors’ duties” on its website.

*Extracts from TechWatch 45. The entire publication is available as a PDF on the Institute’s website.*

### Quick link

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