



Amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKAS 27 *Consolidated and Separate Financial Statements* – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

HKICPA Standard Setting Department Staff Summary (November 2008)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk

Introduction

1. The amendments set out the changes to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and HKAS 27 *Consolidated and Separate Financial Statements* (as amended by *Improvements to HKFRSs* in October 2008) and consequential amendments to HKAS 18 *Revenue*, HKAS 21 *The Effects of Changes in Foreign Exchange Rates* and HKAS 36 *Impairment of Assets*.
2. The amendments result from consideration of responses to proposals of the International Accounting Standards Board (IASB) that were contained in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, an exposure draft of proposed amendments to IFRS 1 and IAS 27 (published in December 2007) and in *Cost of an Investment in a Subsidiary*, an exposure draft of proposed amendments to IFRS 1 (published in January 2007).
3. Entities shall apply these amendments for annual periods beginning on or after 1 January 2009, the same effective dates as Amendments to IFRS 1 and IAS 27 – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate.

Reasons for issuing Amendments to HKFRS 1 and HKAS 27

4. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing Amendments to HKFRS 1 and HKAS 27 is to maintain international convergence arising from the issuance of Amendments to IFRS 1 and IAS 27 by IASB.

The amendments to HKFRS 1 and HKAS 27 respond to concerns that retrospectively determining cost and applying the cost method in accordance with HKAS 27 on first-time adoption of HKFRSs cannot, in some circumstances, be achieved without undue cost or effort. The amendments address that issue:

- (a) by allowing first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements; and
- (b) by removing the definition of the cost method from HKAS 27 and replacing it with a requirement to present dividends as income in the separate financial statements of the investor.

The amendments to HKAS 27 also deal with the initial measurement of cost in the separate financial statements of a new parent formed as the result of a specific type of reorganisation. The amendments require the new parent to measure the cost of its investment in the previous parent at the carrying amount of its share of the equity items of the previous parent at the date of the reorganisation.

Main changes from previous requirements

Deemed cost approach

- 5. The amendment to HKFRS 1 permits a first-time adopter to use a deemed cost to account for an investment in a subsidiary, jointly controlled entity or associate. This deemed cost can be determined as either:
 - (a) fair value (determined in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*) at the entity's date of transition to HKFRSs in its separate financial statements; or
 - (b) previous GAAP carrying amount at that date

A first-time adopter may choose either of the above to measure its investment in each subsidiary, jointly controlled entity or associate that it elects to measure using a deemed cost (that is, election can be made on an investment-by-investment basis)

- 6. An entity that uses a deemed cost in its opening HKFRS statement of financial position is required to disclose:
 - (a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
 - (b) the aggregate deemed cost of those investments for which deemed cost is fair value; and
 - (c) the aggregate adjustment to the carrying amounts reported under previous GAAP.



Dividends received from a subsidiary, jointly controlled entity or associate

7. The amendments remove the definition of “cost method” and the requirement to distinguish between pre- and post-acquisition dividends. Dividends received from subsidiaries, jointly controlled entities or associates shall be recognised as income in the separate financial statements when the entity’s right to receive the dividend is established.
8. The amendments bring in an additional requirement in HKAS 36 that the receipt of dividend income is deemed to be an indicator of impairment when:
 - (a) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee’s net assets, including associated goodwill; or
 - (b) the dividend exceeds the total comprehensive income of the subsidiary, jointly controlled entity or associate in the period the dividend is declared.

Reorganisation by establishing a new parent

9. When a newly formed entity becomes the new parent entity of another entity in a group and adopts the cost model in accordance with paragraph 38(a) of HKAS 27 to account for the investment in the original parent, it measures the cost of its investment in the previous parent at the carrying amount of its share of the net assets of the existing parent in separate financial statements if the following criteria are satisfied:
 - (a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
 - (b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and
 - (c) the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganization.

Effective date and transition

10. The amendments to HKFRS 1 are effective for annual periods beginning on or after 1 January 2009, with earlier application permitted.
11. The amendments to HKAS 27 regarding the recognition of dividends from subsidiaries, jointly controlled entities and associates are also to be applied prospectively for annual periods beginning on or after 1 January 2009, with early application permitted. Where these amendments are applied for an earlier period, the related amendments to HKAS 18 *Revenue*, HKAS 21 *The Effects of Changes in Foreign Exchange Rates* and HKAS 36 *Impairment of Assets* are applied at the same time.
12. The amendments to HKAS 27 on reorganisation are applied prospectively to reorganisations occurring in annual periods beginning on or after 1 January 2009,



with earlier application permitted. If these amendments are applied retrospectively to past reorganisations, all later reorganisations shall be restated.

Other references on Amendments to IFRS 1 and IAS 27

1. Deloitte IAS Plus on Measuring investments in subsidiaries, jointly controlled entities and associates on first-time adoption
<http://www.iasplus.com/iasplus/0805ifrs1ias27.pdf>
2. KPMG IFRS Briefing Sheet on Amendments to IFRS 1 and IAS 27 – *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
http://www.kpmg.com.hk/en/virtual_library/Audit/IFRS_briefingsheet/IFRSBS0892.pdf
3. PricewaterhouseCoopers HKFRS News on Amendments to IFRS 1 and IAS 27
http://www.pwchk.com/webmedia/doc/633518168258959822_hkfrs_news_jul2008.pdf

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