

Financial Accounting Standards Committee

Meeting summary – August 2002

The Society's Financial Accounting Standards Committee (Committee) met on 14 August 2002 and discussed the following items:

- ✓ Proposed Exposure Draft on Investment Property
- ✓ Proposed SSAP on Agriculture
- ✓ Proposed Exposure Draft, Framework for the Preparation and Presentation of Financial Statements
- ✓ Proposed Exposure Draft Preface to Statements of Standard Accounting Practice

Investment Property

The Committee continued its discussion on a draft Invitation to Comment on a proposed Exposure Draft (ED) Revision of SSAP 13, Investment Property. The ED is based on – and would be converged with – IAS 40, Investment Property.

The draft Invitation to Comment focussed on the following areas:

- ✓ The difference in the accounting model between the present SSAP 13 (revaluation, with periodic changes in open market value typically taken directly to reserves) and IAS 40 (an initial accounting policy option between a cost model and fair value model, in the latter case with changes in fair value reported in the income statement as part of net profit or loss for the period).
- ✓ The present requirement under IAS 40 to report changes in fair value in the income statement is under review by the IASB. Since IAS 40 came into effect in 2001, many commentators have highlighted the apparent inequity in reporting unrealised gains and losses (such as those arising from changes in fair value) together with (generally realised and distributable) profits from current period operations.

The IASB has taken on board these concerns in giving its highest priority to the major overhaul of the income statement.

The Committee supports the IASB's work in restructuring the form and content of the income statement and believes that a full understanding of the proposals currently under consideration by the IASB (summarised below) would allay the concerns expressed by many commentators as to the current requirement under IAS 40 to report changes in fair value in the income statement.

- ✓ The involvement of a professionally qualified valuer, presently required under SSAP 13 for properties carried at open market value but not required under IAS 40.
- ✓ The accounting treatment in a subsidiary's financial statements in respect of investment property let to another enterprise in the same group.
- ✓ The proposal in the IASB's Improvements ED whereby investment property held under an operating lease could not be accounted for using the IAS 40 cost model.

The Committee noted that it is under an obligation to converge Hong Kong SSAPs with the IASB's Standards. With recent changes to IAS 17, Leases, proposed in the IASB's Improvements ED, it is now possible for SSAP 13 to be converged with IAS 40 – previously this was not the case. The Committee considered the following alternative courses of action:

1. Proceed with the ED and indicate that implementation of the revision to SSAP 13 will await conclusion of the IASB's Reporting Performance project;
2. Proceed with the ED and indicate that the status quo as regards accounting for changes in fair value (that is, typically, to reserve account such changes) will be retained until conclusion of the IASB's Reporting Performance project;
3. To defer publication of an ED until the IASB releases proposals to overhaul the form and content of the income statement.

The Committee considered that none of the above alternatives is consistent with its mandate to achieve convergence without delay and agreed to seek further guidance from the HKSA Council on the courses of action available.

The Committee discussed the draft Invitation to Comment. The Invitation to Comment highlights the significant consequences of adopting investment property accounting requirements converged with those specified in the IASB's Standards and invites comments thereon.

The Committee noted that the IASB's Reporting Performance project would have significant impact on the proposed introduction of accounting requirements converged with IAS 40. In summary, the IASB's current proposals are that:

- ✓ All items of revenue, expense, gains and losses would be reported in a single performance statement to be known as the "Statement of Comprehensive Income".

- ✓ The Statement of Comprehensive Income would consist of (at least) two columns, differentiating between items of revenue and expense arising from current period operations and those items that are revisions to expectations relevant to future periods.

The proposed disaggregation in the performance statement is a key aspect of the IASB's project. The results of current period operations would be reported separately from the effects of changes in estimates such as changes in the fair value of investment property.

As a consequence of the proposals presently under consideration at the IASB, the effect on reported profit or loss (from current period operations) from changes in the fair value of investment property would be completely eliminated. The Committee considered that a number of commentators may not have appreciated the significance of the IASB's proposals and that, in the context of a proposed revision to SSAP 13, it would be necessary for these be set out in the Invitation to Comment.

The Committee noted that an article on present and future developments in investment property accounting would be published in the August 2002 edition of The Hong Kong Accountant.

Agriculture

The FASC considered comment letters received in respect of the Exposure Draft of a Proposed SSAP on Agriculture.

Three comment letters were received, from:

- ✓ Charles Chan, Ip & Fung CPA Ltd
- ✓ Hong Kong Monetary Authority
- ✓ Chaoda Modern Agriculture (Holdings) Limited

The comment letters, which will be made available on the HKSA website, raised substantive points in relation to determining the cost of a biological asset, disclosure of valuers' information, potential overstatement of agricultural produce, the transitional provisions, and treatment of the unrealised gain or loss on agricultural produce after harvest.

The FASC considered that most of the points raised in the comment letters related to an understanding of the application of the proposed new SSAP rather than with the principles and requirements of the SSAP itself. The Committee noted that an article will be published in The Hong Kong Accountant following promulgation of the new SSAP and this should assist in addressing the points and clarifying on any misunderstandings apparent in the comment letters.

One comment letter raised an issue in relation to the SSAP's transitional provision and correctly noted that information on fair value would be required one year prior to the introduction of the new SSAP, for comparative information purposes.

The Committee agreed to recommend that the proposed SSAP be issued as "SSAP 36", unchanged from the ED, to become effective for financial statements covering periods beginning on or after 1 January 2004.

Framework for the Preparation and Presentation of Financial Statements

At its previous meeting, the Committee had briefly considered the convergence of those SSAPs not covered by the IASB's exposure draft on Proposed Improvements to the International Accounting Standards. The release of a convergence ED was deferred pending finalisation of the IASB's improvements, but the Committee did agree to consider a draft revision to the Framework and the Foreword for the purpose of achieving convergence with the IASB's equivalent documents.

Committee members noted the main differences between the ED/Framework and the existing Framework and the concerns previously expressed about the following possible consequences of adopting the provisions in the IASB Framework to recognise a wide range of users would place reliance on financial statements for making economic decisions:

- ✓ Widening of the expectation gap of users
- ✓ Increasing the risk and potential liability of auditors
- ✓ Removal of some of the protection given to auditors by the Caparo case

These concerns gave rise to most of the changes made to the IASB Framework when it was adopted in Hong Kong in 1997.

In light of recent developments in case law, and the scope of the Framework in describing the purpose and use for financial statements, the Committee was less concerned about the potential impact from adopting the wording contained in the IASB Framework. Accordingly, the Committee approved the release of the ED and the related Invitation to Comment for a two-month consultation period.

Preface to Statements of Standard Accounting Practice

The Committee considered a draft ED/Preface to the SSAPs and the related Invitation to Comment. This ED proposes to revise the existing Foreword and is based on the IASB's recently revised Preface to IFRS. As compared to the IASB Preface, the ED includes additional provisions concerning:

- ✓ Obligation for HKSA members to comply with SSAPs and to justify departures
- ✓ Close coordination between HK and IASB due processes

- ✓ Relationship between SSAPs and IFRS
- ✓ Status and Authority of Accounting Guidelines (AG)
- ✓ Status and Authority of Accounting Bulletins (AB)

The Committee discussed whether it should discontinue development of AG and AB documents given that the IASB does not publish similar pronouncements. After consideration, the Committee agreed there might be a continuing use for AG and AB documents.

The Committee also considered whether the Preface should establish the status and authority of discussion documents, appendices and Implementation Guidance in the ED given that, unlike the IASB, the HKSA Council has enforcement power in respect of its pronouncement and the status and authority of AG and AB are set out in the ED. Members generally considered that the status and authority of the related IASB pronouncements have been adequately dealt with in the IASB Improvements ED which the Committee intends to adopt and therefore, similar to the IASB Preface, there is no need to cover this in the proposed new Preface.

Date of Next Meeting

The Committee's next meeting will be held on 11 September 2002.

This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. All conclusions reported are tentative and may be changed at future meetings.

The IASB publishes summaries of its meetings and these can be found on the IASB's website at <http://www.iasb.org.uk>.

The Committee welcomes comments on its technical agenda. Please e-mail us at commentletters@hksa.org.hk.