# ACCOUNTING ISSUES - FINANCIAL STATEMENTS ENDING ON OR AFTER 31 DECEMBER 2010

***Important Accounting Issues for Periods Ending on or after 31 December 2010***

- Hong Kong Interpretation 5 effective immediately requires term loans with a payment on demand clause to be classified as current liabilities
- Agreement with bankers to remove repayment on demand clauses or agree not to call for repayment for at least one year must be made before the year end
- Hong Kong leasehold land to be reclassified to property, plant and equipment in the statement of financial position
- Where reclassifications of balance sheet items are made in respect of borrowings or leasehold land, three statements of financial position are required
- Amendments to IAS 12 will remove the requirement to provide deferred tax on investment property fair value increases
- The HKICPA will likely soon adopt the same amendments regarding deferred tax on revalued investment properties

As the end of 2010 approaches, we wish to highlight some important accounting issues which we consider may have a significant impact in the preparation of financial statements for the year ending 31 December 2010 and subsequent year ends.

***Bank Loans Subject to Repayment on Demand Clauses***

On 29 November 2010, the Financial Reporting Standards Committee of the Hong Kong Institute of Certified Public Accountants issued Hong Kong Interpretation 5 “Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause”. This Interpretation requires that bank loans which include a repayment on demand clause be classified as current liabilities in the statement of financial position regardless of the likelihood of the bank exercising its right to repayment.

The following phrases in bank loans and facility letters may evidence a bank’s unconditional right to demand immediate repayment:- “the facilities are subject to the Bank’s overriding right of withdrawal and repayment on demand”; “the Lender reserves its overriding right to cancel the Facility, or to demand immediate repayment of all outstanding balances”; “notwithstanding any provisions stated in this letter, the Facilities are repayable on demand by the Bank”. We understand that it has been common practice for certain banks in Hong Kong to include such clauses in facilities letters and we recommend that companies contact their banks and explain the accounting implications of the demand clauses. Interpretation 5 is effective immediately and requires retrospective application.

Should banks not agree to either remove the repayment on demand clauses or state that they will not seek repayment of the loans for a minimum of one year from the statement of financial position date, any loans subject to these clauses must be classified as current liabilities in the current year’s financial statements as well as for prior periods. Any post balance sheet agreements to remove these clauses will be regarded as non-adjusting events so the bank’s agreement must be made before the year end.

***Amendment to HKAS 17 “Leases”***

Improvements to HKFRSs 2009 amended the accounting standard for leases so that leasehold land does not have to be classified as an operating lease (paragraph 14 of HKAS 17 has been deleted). Instead, consideration should be given as to whether substantially all the risks and rewards of ownership have passed to the leasehold property owner. For Hong Kong property, we consider that it is now a generally accepted accounting treatment to classify Hong Kong leasehold land as a finance lease and therefore any land leases prepayments which were previously included as a separate line item in the statement of financial position should be reclassified back to property, plant and equipment. Where reclassifications are made, HKAS 1 requires that three statements of financial position should be provided in the current year’s financial statements.

***Revised IAS 12 “Income Taxes”***

This month, the International Accounting Standards Board have revised IAS 12 so that deferred tax provisions in respect of investment properties carried at fair value should be based on a presumption that the carrying value of the investment property will be recovered through sale rather than through use.

Under the revised IAS 12, if Hong Kong investment properties are carried at amounts above their cost, deferred tax provisions would only be required in respect of the cumulative tax allowances received to date. Deferred tax should be provided in respect of the balancing charge which would be payable on disposal of the property but no deferred tax provision is required for the difference between the carrying value and cost since capital gains are not taxable in Hong Kong.

The revised IAS 12 is effective for accounting periods beginning on or after 1 January 2012 with early adoption permitted. The amended standard is to be applied retrospectively. The HKICPA will likely issue an equivalent amended HKAS 12 “Income Taxes” in the next few weeks and we anticipate companies wishing to early adopt the amended standard.

Should you wish to discuss these revised standards in more detail, please call or email your usual contact partner/executive or Michael Pyburn in the Technical Department.

Action should not be taken solely on the basis of the above summaries which provide only brief outlines of the revised HKFRSs.

905 Silvercord, Tower 2, 30 Canton Road, Tsimshatsui, Kowloon, Hong Kong. Tel: (852) 2375 3180 Fax: (852) 2375 3828
E-mail: ms@ms.com.hk Website: http://www.ms.com.hk