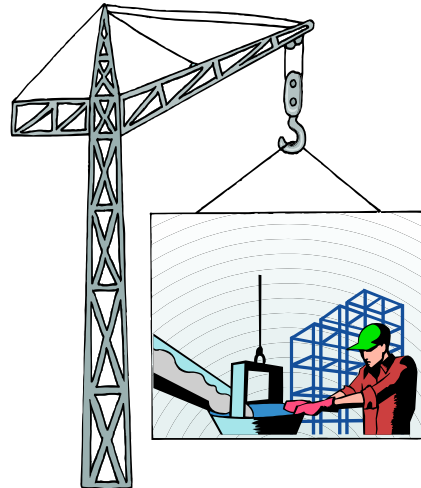


# HKAS 11, 18 & 23 & Interpretations

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## Examples and Cases for Discussion



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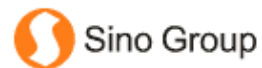
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1

## Revenue

### Case



### **Sino Land Company Limited**

2005 Annual Report stated that:

- Where properties are sold under deferred terms, the difference between the sales prices with and without such terms
  - is treated as deferred interest income and
  - is released to the income statement on a straight line basis over the repayment period commencing from the completion of the relevant sales agreements.

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2

## Revenue

### Example

- Sale and repurchase agreements (other than swap transactions)
  - under which the seller concurrently agrees to repurchase the same goods at a later date, or
  - when the seller has a call option to repurchase, or
  - the buyer has a put option to require the repurchase, by the seller, of the goods
- Any difference if the goods involved are financial assets.

## Revenue

### Example

"Bill and hold" sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.

# Revenue

## Example

### Amortised Cost on Low Interest Loan

- Entity A grants a 3-year loan of HK\$50,000 to an important new customer in 1 Jan. 2005
  - The interest rate on the loan is 4%
  - The current market lending rates for similar loans is 6%
- Entity A believes that the future business to be generated with this new customer will lead to a profitable lending relationship.
- On initial recognition, Entity A recognised \$47,327 (as calculated below):

|            | Cash inflow               | Discount factor                          | Present value    |
|------------|---------------------------|--|------------------|
| 31.12.2005 | \$ 50,000 x 4% = \$ 2,000 | $1 / (1 + 6\%)^1$                        | \$ 1,887         |
| 31.12.2006 | \$ 2,000                  | $1 / (1 + 6\%)^2$                        | \$ 1,780         |
| 31.12.2007 | \$ 52,000                 | $1 / (1 + 6\%)^3$                        | <u>\$ 43,660</u> |
|            |                           | <i>Fair value at initial recognition</i> | <i>\$ 47,327</i> |

- Calculate the amortised cost each year end.

# Construction Contracts

## Example

- On 1 Jan. 2001, Vision Corp. signed a construction contract with a customer for 3 years with an agreed contract consideration of HK\$200 million.
- The cost of the contract was estimated at HK\$150 million.
- The percentage of completion of the contract is based on the work certified by an independent surveyor appointed by the customer.
- During the year to 31 Dec. 2001, Vision Corp. incurred contract cost of HK\$70 million.
- The surveyor certified that 40% of the contract work had been completed on 31 Dec. 2001.
- On 31 Dec. 2001, Vision Corp. received a progress payment of HK\$100 million.
- Prepare the journal entries and extract of financial statements of Vision Corp. for the year ended 31 Dec. 2001.

## Borrowing Costs

### Example

- Entity A constructs a scientific medical equipment for its own use, with a cost of HK\$50 million and consider it as a qualified asset.
- Borrowing costs capitalised under HKAS 23 amounts to HK\$6 million.
- It also receives a government grant of HK\$5 million on that asset.
- Can the government grant received be recognised as part of the expenditure on qualified asset?

## Borrowing Costs

### Example

- Before the construction of a property in a land, Entity GV has to prepare the construction plan and get the government approval.
- Borrowing costs have been incurred during the above period.
- Are these borrowing costs eligible for capitalisation under HKAS 23?

## Borrowing Costs

### Example

- Entity A has finished the physical construction of a building for Miss Lee, subject to certain modification according to her specification after her inspection.
- Borrowing costs are incurred during the modification period
- Can these borrowing costs be capitalised?

## Borrowing Costs

### Example

- On 1 January 20x6 Rechno Co borrowed \$15m to finance the production of two assets, both of which were expected to take a year to build.
- Production started during 2008.
- The loan facility was drawn down on 1 January 2008, and was utilised as follows, with the remaining funds invested temporarily.

|                | <u>Asset X</u> | <u>Asset Y</u> |
|----------------|----------------|----------------|
|                | \$m            | \$m            |
| 1 January 2008 | 2.5            | 5.0            |
| 1 July 2008    | 2.5            | 5.0            |

- The loan interest rate is 10% and Rechno Co can invest surplus funds at 8%.
- Ignoring compound interest, calculate the borrowing costs which may be capitalised for each of the asset and consequently the cost of each asset at 31 Dec. 2008.

*Source from ACCA 3.6 Revision Pack of BPP*

# Borrowing Costs

## Example

- Zenzi Co had the following loans in place in 2008

|                               | 1 Jan 2008 | 31 Dec 2008 |
|-------------------------------|------------|-------------|
|                               | \$m        | \$m         |
| 10% bank loan repayable 2013  | 120        | 120         |
| 9.5% bank loan repayable 2011 | 80         | 80          |
| 8.9% debenture repayable 2018 | --         | 150         |

- The 8.9% debenture was issued to fund the construction of a qualifying asset (a piece of mining equipment), construction of which began on 1 July 2008.
- On 1 Jan 2008, Zenzi Co began construction of a qualifying asset, a piece of machinery for a hydro-electric plant, using existing borrowings.
- Expenditure drawn down for the construction was:
  - \$30m on 1 Jan 2008 and \$20m on 1 Oct 2008.
- Calculate the borrowing costs to be capitalised for the hydro-electric plant machine.

Source from ACCA 3.6 Revision Pack of BPP

# HK Interpretation 1 – Sinking Fund

## Example

- A machine costs HK\$600,000 with an estimated useful life of 3 years?
- Calculate depreciation for the years under different depreciation methods.

|                                       | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
|---------------------------------------|---------------|---------------|---------------|--------------|
| Straight-line basis                   |               |               |               |              |
| Reducing balance (at 70%)             |               |               |               |              |
| Sum-of-year-digit                     |               |               |               |              |
| Sinking fund<br>(compounded at 23.2%) |               |               |               |              |

## HK Interpretation 1 – Sinking Fund

### Case

2002 Annual Report of Anhui Expressway Co. Ltd. stated that:

- **Depreciation** of toll roads and amortisation of land use rights in relation to toll roads are calculated to write off their cost on the basis of a **sinking fund calculation** whereby
  - annual depreciation amounts compounded
    - at an average rate of 7%, 6%, 3% and 4% per annum for Hening Expressway, 205 Tian Chang Section, Xuan Guang Expressway and Gao Jie Expressway respectively
  - will approximate the total carrying value of the toll roads and the land use rights
    - in relation to toll roads at the end of operating periods of respective toll roads.
- Please comment.



## HK Interpretation 1 – Sinking Fund

### Case



GZI Transport Ltd. stated in 2002 Annual Report:

- **Goodwill** on acquisition of subsidiary / associated company / jointly controlled entity engaged in the operation of toll highways or bridges occurring on or after 1 January 2001
  - is amortised on the basis of a **sinking fund calculation** over the period .....
  - for which the Group is granted the rights to operate the highways or bridges.
- Please comment.

## HK Interpretation 3 – Revenue

### Case



Annual Report 2003/04 stated that:

- Profit on pre-sale of properties under development for sale
  - is recognised over the course of the development and
  - is calculated each year as a proportion of the total estimated profit to completion, the proportion used being the lower of
    - the proportion of construction costs incurred at the balance sheet date to estimated total construction costs and
    - the proportion of sales proceeds received and receivable at the balance sheet date to total sales proceeds in respect of the units sold.

### Stage of Completion

## HK Interpretation 3 – Revenue

### Case



2004 Annual Report set out that:

- When properties under development are sold, income is recognised when the property is completed and the relevant occupation permit is issued by the Authorities.
- Payments received from the purchasers prior to this stage
  - are recorded as customers' deposits received and
  - are deducted from the value of stock of properties.

### Full Completion