

Your gateway to industry information*

Update on HKFRS: Are you ready?

Introduction: HKFRS 7 – Financial Instruments: Disclosures

The standard requires companies to provide the financial statements readers with more information to evaluate the significance of financial instruments to an entity's financial position and performance. It requires disclosure of the nature and extent of risks arising from the use of financial instruments and how those risks have been managed.

HKFRS 7 is a comprehensive disclosure standard that applies to all companies. It is applicable for annual periods beginning on or after 1 January 2007, with prior year comparatives required.

Key disclosure requirements

Balance sheet

- Carrying amounts of each of the six categories of financial assets and financial liabilities
- Components of the fair value movement for financial assets and financial liabilities classified as fair value through profit and loss
- Reasons for any reclassification of financial assets and financial liabilities and the amounts reclassified into and/or out of each category
- Carrying amounts of financial assets transferred out but not qualified for derecognition and the associated risks and rewards
- Carrying amount and fair value of collateral held
- Reconciliation of allowance for credit losses for each class of financial assets
- Existence of compound financial instruments with multiple embedded derivatives, if any
- Details of default and breaches

Income statement

- Disclosure of certain income, expenses, gains or losses

Financial risk management

- Qualitative disclosures about each type of risks arising from financial instruments and the strategies used to manage them
- Quantitative disclosures about the potential impacts of each type of risks based on information provided to key management personnel
- Liquidity risk - maturity of financial liabilities and risk management approach
- Credit risk - maximum amount of exposure, details of collateral held, credit quality of financial assets, analysis of financial assets past due or impaired
- Market risk – sensitivity analysis

Other disclosures

- Details of valuation technique, assumptions and reference to quoted marker prices if fair value is determined based on value technique
- Accounting policies for financial instruments
- Information about hedge accounting

Note: One of the key changes brought by the new standard is the expanded quantitative disclosure of risks and the introduction of sensitivity analysis.

In this flyer...

1. Update on HKFRS
2. Tips for Tax
3. PwC Event



Market risk: Sensitivity Analysis

Paragraph 40 of HKFRS 7:

“... [I]t shall disclose: (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date; ...”

Certain financial derivatives, e.g. freight forward agreements, bunker forward contracts, interest rate swap and foreign currency forward contracts etc., are normally employed by companies in transportation and logistic industries for risk management. Below are some illustrative disclosures of a shipping company.

Illustrative disclosures

Market freight rate risk

The freight rates of the Group's shipping business are very sensitive to economic fluctuations. The revenues and cost of services of the Group will increase (decrease) if there is an increase (a decrease) in the freight rates for the vessel charter-in or charter-out transactions.

The Group uses freight forward agreements (“FFA”) transacted with shipping agents and/or brokers to manage the market freight rate risk arising from future transactions. The Group's associated risk management policy is to hedge less than xx% anticipated transactions for the subsequent 12 months.

As at 31 December 2007, the Group has derivative financial assets and liabilities in respect of FFA of \$xxx and \$xxx respectively which are all subject to market freight rate risk.

With all other variables held constant, if the average forward freight rate for vessels charterhire transactions was xx% higher/lower, the net derivative financial assets in respect of FFA will increase/decrease by approximately \$xxx and accordingly, the Group's post-tax profit and equity is estimated to be increased/decreased by approximately \$xxx and \$xxx respectively.

Other references

Recent PwC publications:

- IFRS 7 – ready or not
- IFRS 7 – potential impact of market risks
- HKFRS News: HKFRS 7 – Financial instruments for everyone (not just for banks)
- HKFRS News: HKFRS 7 – Frequently Asked Questions
- Embedding IFRS in the Transport & Logistics Industry

For enquiries on any of the publications above, please contact Annie Fong, Knowledge Manager (Tel: +852 2289 2845).

Tips for Tax

Possible Change in China Dividend Withholding Tax Policy

Effective from 1 January 2008, dividend distributed by Foreign Invested Enterprises will be subject to possibly a 10% withholding tax (could be mitigated to 5%, e.g. through interposing a Hong Kong incorporated treaty holding company).

Arrangement between the Mainland of China and Hong Kong for the Avoidance of Double Taxation

Income and profits derived by an enterprise of One Side from the international operation of ships, aircraft or land transport vehicles in shipping, air and land transport in the Other Side shall be exempt from tax (including business tax on the Mainland of China) in that Other Side.

For enquiries, Please contact: Reynold Hung, Tax Partner (Tel: +852 2289 3604)

PwC event

“Challenges in applying new China Accounting Standards” seminar was held on 29 May 2007 in Hong Kong for over 70 financial reporting personnel.

Topics covered include:

- Practical application
- Challenges towards application of fair values accounting



Contacts

Assurance
Transportation & Logistics Industry

China / Hong Kong
Alan Ng
+852 2289 2828

Beijing
Thomas Leung
+86 (10) 6533 2838

Shanghai
Jack Li
+86 (21) 6123 3736

Guangzhou
Shirley Yeung
+86 (20) 3819 2218

Shenzhen
Y K Tong
+86 (755) 8261 8021

Knowledge Manager
Annie Fong
+852 2289 2845

Tax
Transportation & Logistics Industry

Hong Kong
Reynold Hung
+852 2289 3604

pwchk.com
pwc.com/ifrs