How to Prepare the Statement of Changes in Equity
(Relevant to PBE Paper I – Financial Accounting)

HKAS 1 (Revised) *Presentation of Financial Statements* sets out the rules for a complete set of financial statements. It states that a complete set of financial statements shall include a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity, and a statement of cash flows and notes, comprising significant accounting policies and other explanatory information. Students should be quite familiar with the preparation of the statement of financial position, the statement of profit or loss and other comprehensive income and even the statement of cash flows. Yet, quite a number of students are unaware of how the statement of changes in equity is to be prepared, which was demonstrated by the poor performance in the December 2016 examination. This article discusses some of the techniques in preparing the statement of changes in equity, which students taking the PBE Paper I should master.

The statement of changes in equity is a columnar statement which, as its name implies, reconciles the movements (or changes) during the period for all of the components under the equity section of the statement of financial position. Such components include share capital, retained earnings and a number of reserves arising from other comprehensive income, for example, revaluation reserve. In reconciling each of the relevant components, an entity needs to explain the changes from the beginning balance to the balance as at the end of the period. The ending balances of these accounts presented in the statement of changes in equity are then connected to the statement of financial position. The skeleton of such a statement is presented below:

[Company name]
Statement of changes in equity for the year ended [year-end date]

	Share capital HK$'000	Retained earnings HK$'000	Other reserves (e.g. Revaluation reserve) HK$'000	Other reserves HK$'000	Total HK$'000
Beginning balance					
Reconciliations					
Ending balance					

Ending balances tie to statement of financial position

To demonstrate how the statement of changes in equity is prepared, let's consider the following scenario, which has been modified from the December 2016 PBE Paper I examination:

Background
Silver Trading Limited ("STL") is a company incorporated in Hong Kong. STL recorded HK$100,000,000 share capital (representing an outstanding 10,000,000 ordinary shares) and HK$40,000,000 retained earnings as at 31 March 2015. There was no other reserve on 31 March 2015. The year-end date for STL is 31 March.

The above information shows the beginning balances of the share capital (HK$100,000,000) and retained earnings (HK$40,000,000). The following discussion focuses on the movements in various columns in the statement of changes in equity.

Share capital

A common reason for a change in share capital is that an entity issues additional shares.

Consider the following situations:

Situation 1:

On 1 January 2016, STL issued 1,000,000 ordinary shares at HK$13 each to an unrelated investor.

To record the transaction, the following pair of journal entries was prepared:

Dr. Cash ($13 × 1,000,000)	HK$13,000,000	
Cr. Share capital		HK$13,000,000

Scenario 2:

Following Situation 1, STL paid HK$80,000 as share issue cost for the fund-raising exercise.

In accordance with HKAS 32 *Financial Instruments: Presentation*, share issue cost should be accounted for as a deduction from equity, i.e. from share capital. To record the share issue cost, the following pair of journal entries was prepared:

Dr. Share capital	HK$80,000	
Cr. Cash		HK$80,000

Combining the two situations, STL effectively raised a total of HK$12,920,000 from this exercise. The balance of share capital increased by HK$12,920,000 during the year, which was then reflected in the statement of changes in equity as follows:

	Share capital HK$'000				Total HK$'000
Beginning balance	100,000				
Issue of shares	**12,920**				
Ending balance	112,920				

Retained earnings

The balance of retained earnings is often changed by the following two circumstances:

(i) Profit/loss for the period that has been closed to the retained earnings at the end of the reporting period; and

(ii) Distribution of dividends, which is directly deducted from the retained earnings.

Now consider the following situation:

Situation 3:

STL reported a profit after tax of HK$4,000,000 for the year ended 31 March 2016. STL declared and distributed dividends of HK$200,000 on 1 January 2016.

The statement of changes in equity was then further updated as follows:

	Share capital HK$'000	Retained earnings HK$'000			Total HK$'000
Beginning balance	100,000	40,000			
Issue of shares	12,920	-			
Profit for the year	-	**4,000**			
Dividends declared	-	**(200)**			
Ending balance	112,920	43,800			

Other comprehensive income

The most difficult part to deal with in the statement of changes in equity is other comprehensive income. Students are expected to understand that other comprehensive income items are referred to gains or losses recognised outside of profit or loss. In other words, these items are excluded from the determination of the net profit of an entity. The *balance* of each of the other comprehensive income items, based on their different natures, will be reflected on the statement of financial position under the equity section, while their *movements during the period* will be summarised in the statement of changes in equity.

Revaluation surplus

One of the most common items under other comprehensive income is revaluation surplus. HKAS 16 *Property, Plant and Equipment* allows two methods for measuring an item of property, plant and equipment after recognition, namely, the cost model and the revaluation model. If an entity adopts the revaluation model and there is a revaluation upwards, the surplus is recognised in other comprehensive income. Such positive movement will then be reflected in the statement of changes in equity.

Consider the following situation:

Situation 4:

STL purchased its first property ("Property Z") at a cost of HK$5,000,000 on 1 April 2015. The estimated useful life of Property Z was 10 years with no residual value. STL conducted a revaluation exercise for Property Z on 1 October 2015 and determined that its fair value was HK$4,845,000. The carrying amount of Property Z prior to such revaluation was HK$4,750,000. STL adopts the revaluation model for its property.

To record the revaluation, the following pair of journal entries was prepared:

Dr. PPE (net)	HK$95,000	
Cr. Revaluation surplus (OCI) (HK$4,845,000 − HK$4,750,000)		HK$95,000

The above revaluation increased the revaluation surplus by HK$95,000, which should be reflected in the statement of changes in equity. HKAS 16 allows some of the revaluation surplus to be transferred to retained earnings, as the asset is used by the entity. In such cases, the amount of surplus transferred will be the difference between:

(i) depreciation based on the revalued amount of the asset; and
(ii) depreciation based on the asset's original cost.

It should be emphasised that such transfers are not made through profit or loss (i.e. there is no "recycling"). In other words, such revaluation surplus is not reclassifiable to profit or loss in accordance with HKAS 1 (Revised).

Assume that STL chose to make such transfer, as Property Z is used by the entity. The following pair of journal entries was prepared after the revaluation at 31 March 2016:

Dr. Revaluation surplus (OCI)	HK$5,000	
Cr. Retained earnings		HK$5,000

Calculations:

Depreciation based on the revalued amount of Property Z for the six months ended 31 March 2016	HK$4,845,000 / 9.5 years × 6/12	HK$255,000
Depreciation based on the original cost of Property Z for the six months ended 31 March 2016	HK$4,750,000 / 9.5 years × 6/12	HK$250,000
	Difference	HK$5,000

This triggered two other effects to the statement of changes in equity: (i) a decrease in the revaluation surplus by HK$5,000; and (ii) an increase in retained earnings by HK$5,000. The statement of changes in equity was then updated as follows:

	Share capital HK$'000	Retained earnings HK$'000	Revaluation reserve HK$'000		Total HK$'000
Beginning balance	100,000	40,000	-		
Issue of shares	12,920	-	-		
Profit for the year	-	4,000	-		
Dividends declared	-	(200)	-		
Revaluation of property	-	**5**	**(95 − 5) = 90**		
Ending balance	112,920	43,805	90		

Equity Investments

HKFRS 9 (2014) *Financial Instruments* allows equity investments to be measured under either of two options:

(i) fair value through profit or loss (FVTPL); or
(ii) fair value through other comprehensive income (FVTOCI), if the investments are not for trading.

HKFRS 9 (2014) further stipulates that if the equity investments are to be measured at fair value through profit or loss, the transaction cost involved will be expensed as incurred. If the entity makes an irrevocable option to measure the equity investments at fair value through other comprehensive income, the investments are initially recognised at the consideration plus transaction cost.

Based on the above discussion, if the equity investments are measured at fair value through profit or loss, the fair value movement of the investment, as well as the transaction cost, are recognised in the profit or loss, which will be closed to the retained earnings at the end of the period. In other words, this decision affects the movement of the retained earnings in the statement of changes in equity.

If, however, the entity chooses to measure the investments at fair value through other comprehensive income, the fair value movements of the investment are recognised in other comprehensive income. The effects to the statement of changes in equity are illustrated in the following situation.

Situation 5:

On 1 June 2015, STL purchased an investment in shares for the first time by acquiring 5,000 shares of Columbia Trading Limited ("CTL") at its quoted market price of HK$36 per share. Transaction costs amounted to a total of HK$10,000. STL designates the investment in CTL to be measured under fair value through other comprehensive income. On 31 March 2016, the share price of CTL dropped to HK$32 each.

Upon initial recognition, the following pair of journal entries was prepared:

Dr. Investments (FVTOCI)	HK$190,000	
Cr. Cash		HK$190,000
(HK$36 × 5,000 shares + HK$10,000)		

At the end of the year, the following pair of journal entries was prepared to account for the fair value movement:

Dr. Unrealised change in fair value of investment	HK$30,000	
Cr. Investments (FVTOCI)		HK$30,000
(HK$32 × 5,000 shares − HK$190,000)		

The statement of changes in equity was then updated as follows:

	Share capital HK$'000	Retained earnings HK$'000	Revaluation reserve HK$'000	Unrealised change in FV of investment HK$'000	Total HK$'000
Beginning balance	100,000	40,000	-	-	140,000
Issue of shares	12,920	-	-	-	12,920
Profit for the year	-	4,000	-	-	4,000
Dividends declared	-	(200)	-	-	(200)
Revaluation of property	-	5	90	-	95
Fair value of equity investments	-	-	-	**(30)**	(30)
Ending balance	112,920	43,805	90	(30)	156,785

The last two reconciling items (revaluation of property and fair value of equity investments) may sometimes be combined to show the net effects of other comprehensive income items in the statement of changes in equity.

Students are advised to master the techniques in preparing the statement of changes in equity, as it forms part of the complete set of financial statements. The key technique is to consider the financial impact of the transaction through the journal entries. If the transaction affects share capital, profit or loss, or other comprehensive income, such effect will contribute to the movement (or change) in the balance(s) of one (or more than one) equity component(s) in the statement of changes in equity.

(Note: The scenario used in this article was modified from HKIAAT's Professional Bridging Examination Paper I, December 2016, Question 4)