**Hong Kong Financial Reporting Standards: HKAS 37 and HKAS 10 (Part II)**
(Relevant to AAT Examination Paper 7: Financial Accounting)
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In Part I of this article, we covered HKAS 37. Now in Part II we introduce and explain HKAS 10 ''Events after the Reporting Period'' with further examples to illustrate how to judge whether a given situation should fall under HKAS 37 or HKAS 10.

## [A] HKAS 10 Events after the Reporting Period

### [B] Objectives

1. To prescribe when an entity should adjust its financial statement for events after the reporting period; and
2. To prescribe disclosures that an entity should give about the date when the financial statements were authorised for issue and about events after the reporting period.

In studying this accounting standard, students must understand what an event after the reporting period is, the meaning of an adjusting event and a non-adjusting event, and the accounting treatments for these different events.

### [B] Events after the Reporting Period

Events after the reporting period refer to those events, favourable and unfavourable, that occur between the end of the reporting period and the date on which the financial statements are authorised for issue.

Further, these events can be favourable or unfavourable. Generally, favourable events means events that will ultimately bring in more profits, revenue and assets to the company, whereas unfavourable events will create a loss. An example of a favourable event is a successful lawsuit in which the company is being compensated for damages that it has suffered. In comparison, an unfavourable event could be the bankruptcy of a customer, requiring full provision for the debt owing.

According to HKAS 10, when we prepare financial statements, we need to consider events that occur after the end of the reporting period until a certain cut-off date. This cut-off date is the date on which the management authorises the financial statements for issue.

#### [C] Adjusting events after the reporting period

Adjusting events refer to situations where the events after reporting period provide new evidence of conditions that exist at the end of the reporting period, and this piece of evidence warrants adjustments to be put through to the financial statements.

#### [C] Example VII

The accountant of ABC Ltd prepared the company's financial statements for the year ended 31 March 2011. A liquidator's notice indicating that the amount of $15m due from a major customer would be irrecoverable was received in May 2011. The financial statements were authorised for issue in June 2011.

The receipt of the liquidator's notice in May 2011 represents an event after the reporting period. The irrecoverable debt was in existence at period end, despite the fact that the problem of its collection was not yet known to ABC Ltd. The liquidator's notice has served to provide additional information to the company on the status of the debt at the end of the reporting period.

This is an adjusting event and the accountant has to make full allowance for the debt. As a result of the adjustment, the financial statements will reflect the most up-to-date status of the debt. Therefore, the adjustments will enhance the true and fairness of the financial statements in reflecting the financial position of a company at the end of the reporting period.

**[C] Example VIII**
Using the background information in Example VII above, ABC Ltd has a substantial investment in a Latin American company, Star Ltd. In May 2011, ABC Ltd received a financial report from Star Ltd indicating that the investment value of ABC Ltd has declined by around $10m on a permanent basis due to the write-off of a major infrastructure project in March 2011.

This is another example of adjusting event. The financial report from Star Ltd provides new information regarding the status of ABC's investment at the end of the reporting period. As evidence shows that the investment has impaired at the end of the reporting period, ABC Ltd needs to incorporate the impairment loss of investment of $10m in its financial statements.

**[C] Non-adjusting events after the reporting period**
Non-adjusting events represent events that are indicative of conditions that arose after the reporting period. As a result, they should be reflected in the financial statements of the following accounting period, but not adjusted for in the financial statements of the current accounting period. In other words, since the event belongs to the next accounting period, it should be recognised in that period's financial statements.

However, if it is considered that these events are relevant and material and the users of the financial statements need the information for making economic decisions, these events can be disclosed in notes to the accounts. Otherwise users of financial statements would be deprived of material information. Details to be disclosed include the nature of the events together with an estimate of their financial effect, or a statement that such an estimate cannot be made.

**[C] Example IX**
Use the background information from Example VII. This time, ABC has a substantial investment in Cambodia. In May 2011, the investment was confiscated by the local government due to an allegation of a breach of foreign investment laws. The carrying value of the investment is $20m.

This is an example of non-adjusting event. Circumstances affecting the investment value are indicative of a condition that occurred after the reporting period. The loss involved should be recognised in the financial statements of the next accounting period.

If it is considered that this piece of information is significant and relevant, then ABC Ltd needs to disclose the event in the notes to its accounts. The following is a possible suggested disclosure:

*Subsequent event*
In May 2011, the company's investment in Cambodia was confiscated by the local government due to an allegation of a breach of foreign investment laws. The company is making every effort to negotiate with local government officials but the outcome is uncertain. The value of the investment that is involved is $20m.

**[B] Other items**
In addition to adjusting events and non-adjusting events, HKAS 10 also deals with two other items – dividends and going concern.

**[C] Dividends**
The accounting standard stipulates that if a company declares dividends after the reporting period, then the declared dividends should not be recognised as a liability in the financial statements. This is because the obligation to pay dividends crystallises at the point when the dividends are declared and approved. Therefore no dividend liability exists at theend of the reporting period.

However, these dividends should be disclosed in the notes to the financial statements in accordance with HKAS 1 "Presentation of Financial Statements".

**[C] Going concern**
The accounting standard stipulates that a company should not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Therefore, even if the going concern problem occurs after the reporting period, a company is required to prepare its accounts on a break-up basis for the current financial period. This is because if it is foreseen that a company is not a going concern, the going concern assumption cannot be adopted to the preparation of financial statements. Users of the financial statements will also become aware that the company is no longer a going concern.

**[C] Example X**
Plastics Manufacturing Ltd has its operating plant in Indonesia. In April 2011, a major earthquake occurred in Indonesia and the whole plant was destroyed. A natural disaster of this type is not covered by insurance policy taken out by the company. The company's management failed to raise adequate capital to re-start the business and decided to close down the whole operation. The company is preparing its accounts for the year ended 31 March 2011.

Based on the information given, the company's financial statements for the year ended 31 March 2011 should be prepared on a break-up basis. Otherwise information that is reported in the financial statements could be misleading.

**[B] Other disclosure**

A company is also required to disclose the date on which the financial statements were authorised for issue. This tells users of the financial statements cut-off point for the consideration of events after the reporting period. In other words, any events that occurred beyond this cut-off date would not have been considered in the preparation of the financial statements. Indeed, this cut-off point should synchronise with the auditors' cut-off point for their review of subsequent events.

**[B] Further cases to consider**

**[C] Example XI**

Assume that the companies below have their financial year ends on 30 June 2010, and that their accounts were authorised for issue on 30 October 2010. Students should determine the classification and accounting treatment of each of the cases.

1. Company A was sued by a customer for breach of contract in September 2010. The customer claimed that the goods supplied by Company A in January 2010 were found to be sub-standard. According to legal opinion, it was quite likely that compensation of $30m would be awarded against Company A.

2. Company B was sued by an overseas company for infringement of copyright in April 2010. In June 2010, the company's management was advised by its solicitors that the company was very likely to be found liable. However, it was impossible to estimate the amount of damages that would be awarded against Company B.

3. Based on the background information in (2) above, the company reached out-of-court settlement with the plaintiff for an amount of $50m in September 2010.

*Analysis of cases*

1. This is a non-adjusting event after the reporting period because the legal case arose after the year end date. Company A can disclose the event in the notes to its accounts.

2. This is a contingent liability because the solicitors are unable to give a reasonable estimate of the compensation that would be involved. However, the company clearly has a present obligation, and the outflow of economic resources to settle the obligation is probable. Since it is impossible to estimate the amount of financial loss that Company B may suffer, it is an unrecognized present obligation, and Company B is required to disclose the contingent liability in the notes to its accounts.

3. This is an adjusting event after the reporting period and the company is

required to make a provision of $50m in its financial statements. The out-of-court settlement subsequent to the year end provides additional evidence of the liability which is outstanding at the end of the reporting period.

The above cases have illustrate to students that questions set on HKAS 37 and HKAS 10 can be very similar. Students must learn to analyse the substance of the events and to identify the appropriate classification of the items. In many cases in which the questions involving elements of litigation are set, students tend to jump to the conclusion that the item in question must either be a provision or a contingent liability. The above analysis illustrates that this may not be the case.

**[A] Conclusion**

This article summarises and elaborates on the salient points covered by HKAS 37 and HKAS 10. Students should learn to understand and apply the concepts, as well as knowing the criteria for a provision, a contingent liability or a contingent asset.

[A] References

Hong Kong Accounting Standard 37 “”Provisions, Contingent Liabilities and Contingent Assets”

Hong Kong Accounting Standard 10 “Events after the Reporting Period”

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