New PRC Accounting Standards – A Milestone (Part II)

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Introduction

The new PRC Accounting Standards, comprising the Basic Standard and the 38 Specific Standards as well as Application Guidance, became operative for enterprises listed in the PRC as from 1 January 2007. Part I of this article outlined the structure of the new PRC Accounting Standards. In this article, we look at the accounting practice established by the new PRC Accounting Standards in respect of assets. The next article, to be published in the coming issue of T/Dialogue, will deal with the liabilities issue.

Assets - Definition, Recognition and Measurement under the Basic Standard

An asset is defined in the Basic Standard as "a resource owned or controlled by an enterprise as a result of past transactions or events and which is expected to generate economic benefits to the enterprise".

A resource that meets the definition of an asset shall be recognised if:

(a) it is probable that the economic benefits associated with the resource will flow to the enterprise; and
(b) the resource has a cost or value that can be measured reliably.

The Basic Standard states that enterprises should generally apply the historical cost as the measurement basis in the preparation of their financial statements.

Assets – Recognition and Measurement under the Specific Standards

ASBE 30 "Presentation of Financial Statements" requires an enterprise to distinguish assets between current and non-current assets, and present them as separate classifications in its balance sheet.

An asset shall be classified as current when it meets any one of the following criteria:

(a) it is expected to be realised in, or is intended for sale or consumption in, the normal operating cycle;
(b) it is held primarily for the purpose of being traded;
(c) it is expected to be realised within one year after the balance sheet date; or
(d) it is cash or a cash equivalent unless it is restricted from being exchanged to settle a liability within one year after the balance sheet date.

All other assets shall be classified as non-current assets, and presented in accordance with their nature.
The Application Guidance to ASBE 30 provides the following asset items to be presented in the balance sheet:

Current assets:

(1) Monetary funds
(2) Trading financial assets
(3) Notes receivable
(4) Accounts receivables
(5) Payments in advance
(6) Interest receivables
(7) Dividend receivables
(8) Other receivables
(9) Inventories
(10) Non-current assets due within one year
(11) Other current assets

Non-current assets:

(12) Available-for-sale financial assets
(13) Held-to-maturity investments
(14) Long-term receivables
(15) Long-term equity investment
(16) Investment property
(17) Fixed assets
(18) Construction in progress
(19) Construction materials
(20) Fixed assets for disposal
(21) Biological assets
(22) Oil and gas assets
(23) Intangible assets
(24) Development expenditures
(25) Goodwill
(26) Long-term prepaid expenses
(27) Deferred tax assets
(28) Other non-current assets

Recognition and measurement principles for tangible, intangible and financial assets that have been introduced or significantly changed by the Specific Standards are described below.

Revised Standard - ASBE 1 "Inventories"

The existing inventory formula of last-in-first-out is no longer permitted under the revised Standard.

New Standard - ASBE 3 "Investment Property"

An investment property is defined as "property held to earn rentals or for capital appreciation or both". ASBE 3 requires that investment properties are capable of being separately measured and sold. It also specifically states that owner-occupied property and property being held as inventory are not investment properties.

An enterprise shall apply the cost model to all of its investment properties. ASBE 3, however, allows the fair value model to be chosen; in this case any gain or loss arising from the change in the fair value of the property is recognised in the income statement of the period when it arises.

New Standard - ASBE 5 "Biological Assets"

A biological asset is defined in ASBE 5 "Biological Assets" as a living animal or plant.

The biological asset shall be measured at its initial cost on acquisition. An enterprise shall apply the cost model to the subsequent measurement for all of its biological assets, except when the fair value model is chosen. The fair value model can only be applied when there is demonstrable evidence that the fair value of the biological asset can be measured reliably on a continuing basis.

Revised Standard - ASBE 6 "Intangible Assets"

ASBE 6 requires that an intangible asset with an indefinite useful life shall not be amortised. Instead, it shall be tested for impairment annually and whenever there is an indication that the asset may be impaired.

Unlike existing accounting practice, which requires charging research and development expenditure as expenses, expenditure incurred during the development phase of an internal research and development project is to be recognised as an intangible asset if certain criteria are satisfied. An enterprise is required to demonstrate the technical feasibility of the intangible asset; the intention to complete and use or sell the intangible asset; the probable future economic benefits of the intangible asset; and the availability of adequate technical, financial and other resources before it can be recognised. Furthermore, the value of the intangible asset must be capable of reliable measurement. The expenditure recognised as intangible asset shall also be subject to impairment test under ASBE 8 "Impairment of Assets".

New Standard - ASBE 8 "Impairment of Assets"

When an asset may be impaired, ASBE 8 requires its recoverable amount to be estimated; if the carrying amount of the asset exceeds its recoverable amount, an impairment loss shall be recognised. Therefore, assets will not be carried in the balance sheet at amounts higher than their recoverable amounts.

Under the new requirements of ASBE 8, the reversal of impairment losses on fixed assets, intangible assets and goodwill is prohibited.

Revised Standard - ASBE 17 "Borrowing Costs"

Under ASBE 17 "Borrowing Costs", borrowing costs incurred on funds borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of the asset. Other borrowing costs are to be recognised in the income statement as an expense in the period in which they are incurred.

New Standard - ASBE 18 "Income Taxes"

ASBE 18 "Income Taxes" prohibits the use of the tax payable method. The tax effect accounting method shall be applied to account for the effect of temporary differences. The tax effect of temporary differences between the carrying amount of assets or liabilities and their tax bases shall be recognised as a deferred tax liability or asset.

Temporary differences may be either taxable temporary differences or deductible temporary differences. Under ASBE 18, a deferred tax asset shall be recognised for deductible temporary differences to the extent that it is probable that future taxable profit will be available against which the deductible temporary difference can be utilised. Deferred tax assets shall be measured at the tax rates that are expected to apply to the period when the asset is recovered.

Goodwill under New Standard - ASBE 20 "Business Combinations"

Goodwill acquired in a business combination not involving enterprises under common control (or goodwill) is the difference between the cost of the combination and the acquirer's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree.

Under the new requirements of ASBE 20 "Business Combinations", goodwill is no longer amortized. Instead, the acquirer shall test the goodwill for impairment annually in accordance with ASBE 8 "Impairment of Assets".

Revised Standard - ASBE 21 "Leases"

Assets held under finance leases are recognised by the lessee at the lower of the fair value of the leased asset at the commencement of the lease term and the present value of the minimum lease payments. (The superseded standard, "Leases" provides that the recognised amount is the carrying amount of the leased asset originally recorded in the books of the lessor.)

Any initial direct costs that can be identified as attributable to the process of negotiating and securing the leasing agreement for a finance lease shall be added to the amount recognised as an asset. (The superseded standard, "Leases" requires the initial direct costs to be recognised as an expense in the period when they are incurred.)

New Standard - ASBE 22 "Recognition and Measurement of Financial Instruments"

A financial instrument is defined in ASBE 22 "Recognition and Measurement of Financial Instruments" as any contract that gives rise to a financial asset of one enterprise and a financial liability or equity instrument of another entity.

A "financial asset" is any asset that is:

(a) cash;
(b) an equity instrument of another entity;
(c) a contractual right to receive cash or another financial assets from another entity;
(d) a contractual right to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
(e) a contractual right to a non-derivative or a derivative that will or may be settled in the enterprise's own equity instruments.

Under the new requirements of ASBE 22, financial assets are classified into four new categories:

(a) financial assets at fair value through profit or loss;
(b) held-to-maturity investments;
(c) loans and receivables; and
(d) available-for-sale financial assets.

"Financial assets at fair value through profit or loss" has two sub-categories:

(i) financial assets classified as "held for trading"; and
(ii) financial assets designated as "at fair value through profit or loss".

A financial asset is classified as "held for trading" if it is acquired principally for the purpose of selling it in the near term; or if it is a derivative.

"Held-to-maturity investments" are non-derivative financial assets with fixed or determinable payments and fixed maturity that an enterprise has the positive intention and ability to hold to maturity.

"Loans and receivables" are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the enterprise intends to sell in the near term; (b) those that the enterprise designates as "at fair value through profit or loss"; (c) those that the enterprise designates as "available-for-sale"; or (d) those for which the holder may not recover substantially all of its initial investment.

"Available-for-sale financial assets" are non-derivative financial assets that are designated as available-for-sale or that are not classified in any of the three categories above.

Subsequent measurement of financial assets depends on the classification. The following summarises the position:

Financial Assets	**Measurement**
Financial assets at fair value through profit or loss	Fair value
Loans and receivables	Amortised cost
Held-to-maturity investments	Amortised cost
Available-for-sale financial assets	Fair value

Any gain or loss arising from a change in fair value of "financial assets at fair value through profit or loss" shall be recognised in the income statement.

Any gain or loss arising from change in fair value of "available-for-sale financial assets" shall be recognised directly in owners' equity.

The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any impairment loss.