New PRC Accounting Standards – A Milestone (Part III)

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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 our article outlined the structure of the new PRC Accounting Standards and Part II introduced the new accounting practices established by the new PRC Accounting Standards in respect of assets. In this article we look at the new accounting practices established by the new PRC Accounting Standards in respect of liabilities.

Liabilities - Definition, Recognition and Measurement under the Basic Standard

Liability is defined in the Basic Standard as "a present obligation of an enterprise as a result of past transactions or events and is expected to result in an outflow of economic benefits from the enterprise".

An obligation that meets the definition of a liability shall be recognised if:
(a) it is probable that the economic benefits associated with the obligation will flow from the enterprise; and
(b) the amount of outflow of economic benefits in the future can be measured reliably.

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

Liabilities - Recognition and Measurement under the Specific Standards

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

A liability shall be classified as current when it meets any one of the following criteria:
(a) it is expected to be settled in the normal operating cycle;
(b) it is held primarily for the purpose of being traded;
(c) it is due to be settled within one year after the balance sheet date; or
(d) the enterprise does not have an unconditional right to defer the settlement of the liability for at least one year after the balance sheet date.

All other liabilities shall be classified as non-current liabilities, and presented in accordance with their nature.

The Application Guidance to ASBE 30 requires the following liability items to be presented in the balance sheet:

Current liabilities:
(1) Short-term borrowings
(2) Trading financial liabilities
(3) Notes payable
(4) Accounts payable
(5) Receipts in advance
(6) Employee compensation payable
(7) Tax payable
(8) Interest payable
(9) Dividends payable
(10) Other payables
(11) Non-current liabilities due within one year
(12) Other current liabilities

Non-current liabilities:
(13) Long-term borrowings
(14) Debentures payable
(15) Long-term payables
(16) Special fund payables
(17) Provisions
(18) Deferred tax liabilities
(19) Other non-current liabilities.

Recognition and measurement principles for financial and non-financial liabilities that have been introduced or significantly been changed by the Specific Standards are described below.

(i) New Standard – ASBE 9 "Employee Compensation"

An enterprise should recognise employee compensation as a liability, except for termination compensation, when the economic benefit arising from service rendered by employees in exchange for employee compensation is consumed.

An enterprise should recognise termination compensation as a liability when, and only when:
(a) the enterprise has a detailed formal plan for the termination of the employment relationship or has raised a redundancy proposal, and the plan or proposal will be implemented;
(b) the detailed formal plan or proposal includes: (i) location, function, and estimated number of employees whose services are to be terminated; (ii) termination compensation to be paid for each job classification or function; and (iii) time at which the plan will be implemented; and
(c) the enterprise cannot unilaterally withdraw from the plan or proposal.

(ii) New Standard - ASBE 11 "Share-based Payment"

Share-based payment transactions are categorised as equity-settled or cash-settled. In cash-settled share-based payment

transactions, an enterprise incurs a liability, and its amount is determined based on the enterprise's shares or other equity instruments when acquiring services or goods. ASBE 11 requires the liability incurred to be measured and re-measured at each balance sheet date and date of settlement at the fair value.

(iii) Revised Standard - ASBE 13 "Contingencies"

In determining the best estimate of a provision, the revised Standard requires an enterprise to take into account the effect of risks and uncertainties specific to the provision and the time value of money. Where the effect of the time value of money is material, the amount of the provision is determined after discounting the relevant future cash outflows.

The revised Standard also requires an enterprise to review the amount of the provision at each balance sheet date and adjust the amount to the current best estimate.

The revised Standard further explains how the recognition and measurement requirements for provisions are applied in three specific cases: future operating losses, onerous contracts, and restructuring.

(iv) New Standard - ASBE 16 "Government Grants"

Grants related to assets are recognised as a liability in the balance sheet and amortised evenly to profit or loss as income over the useful life of related assets.

(v) New Standard - ASBE 18 "Income Taxes"

Under the tax effect accounting method, 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. A deferred tax liability shall be recognised for taxable temporary differences. Deferred tax liabilities shall be measured at the tax rates that are expected to apply to the period when the liabilities will be settled.

(vi) New Standard - ASBE 20 "Business Combination"

ASBE 20 requires an acquirer to recognise an acquiree's identifiable assets, identifiable liabilities and contingent liabilities assumed at the fair value at the acquisition date in a business combination.

(vii) Revised Standard - ASBE 21 "Leases"

An asset held under finance lease and the related liability 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" required the amount of minimum lease payments to be recognised as a liability.)

(viii) 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 enterprise.

A financial liability is any liability that is:

(a) a contractual obligation to deliver cash or another financial asset to another enterprise;
(b) a contractual obligation to exchange financial assets or financial liabilities with another enterprise under conditions that are potentially unfavourable to the enterprise; or
(c) a contractual obligation 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 liabilities are classified into the following two categories:

(a) financial liabilities at fair value through profit or loss; and
(b) other financial liabilities.

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

(a) financial liabilities classified as held for trading; and
(b) financial liabilities designated as at fair value through profit or loss.

A financial liability is classified as held for trading if it is incurred principally for the purpose of repurchasing it in the near term; or if it is a derivative. Other financial liabilities are non-derivative financial liabilities that are not classified nor designated as financial liabilities at fair value through profit or loss.

ASBE 22 requires an enterprise to initially recognise a financial liability at the fair value. Subsequent measurement of a financial liability depends on the classification. The following summarises the position:

Financial Liabilities	Measurement
Financial liabilities at fair value through profit or loss	Fair value
Other financial liabilities	Amortised cost

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

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