DECEMBER 2019 AND JUNE 2020 SUPPLEMENT

Qualification Programme

Module A
Financial Reporting

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Introduction

This Supplement is to be used in conjunction with the sixth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack and 31 May 2019, the cut-off date for examinable standards and legislation for the December 2019 and June 2020 examinations. You will find a list of the standards that are examinable in your examination session by logging onto the HKICPA online QP Learning Centre.

The Supplement comprises a technical update on developments that will be examinable in December 2019 and June 2020 examination session that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

Errata – Learning Pack

Chapter 6	Investment property
Answer to self-test question Answer 1(a) 1 **Page 159**	**The final bullet point is amended to read:** • Therefore Tennant House is outside the scope of HKAS 40.

Chapter 9	Leases
Section 4.3.1 **Page 245**	The following text is added underneath the diagram: Note that practically a residual value guarantee and purchase option are mutually exclusive. If a purchase option is exercised, then a residual value guarantee is not relevant and if a purchase option is not exercised then a residual value guarantee is relevant. If the measurement of the net investment in the lease includes a purchase option because it is reasonably certain to be exercised, then any residual value guarantee is not included in the measurement.
Answers to self-test questions Answer 5 **Page 255**	**The workings under the lease liability amortisation table are amended as follows:** The right-of-use asset is initially measured at: Lease liability — $216,473 Initial deposit — $30,000 Estimated dismantling costs ($20,000 × 1/1.05^5) — $15,671 Total — $262,144 It is subsequently depreciated over the lease term resulting in an annual depreciation charge of $52,429 ($262,144/5). **Extracts from the financial statements** **Statement of financial position at 30 June 20X8** Right-of-use asset (262,144 – 52,429) — $209,715 *Non-current liabilities* Lease liability — $136,162 *Current liabilities* Lease liability (50,000 – 8,865) — $41,135 **Statement of profit or loss for the year ended 30 June 20X8** Depreciation expense — $52,429 Finance cost — $10,824

Chapter 16	Borrowing costs
Answer to self-test question Answer 1 **Page 482**	**The first line of the calculation is amended to read:** Initial loan: $1.5 million × 8% × 10/12 = $100,000

Chapter 17	Financial instruments
Solution to example: Financial asset measured at amortised cost **Page 509**	**The last sentence of the solution 'Investments whose fair value cannot be reliably measured should be measured at cost' should be deleted.**

Chapter 29	Changes in group structures
Section 2.2 **Page 875**	**The second sentence is amended to read:** Any gain or loss arising from the remeasurement will be recognised in profit or loss or other comprehensive income, as appropriate.
Section 2.2 Example **Page 876**	**The first sentence of the solution is amended to read:** In 20X8, a gain of $500 arises on remeasurement of the 15% equity interest to fair value. As the investment was classified as a financial asset at fair value through other comprehensive income, this is recognised in other comprehensive income.

Technical Update – Learning Pack

Chapter 1	Legal environment
Section 1.2 **Page 8**	**The sentence at the top of the page immediately before the bullet points is amended to be:** The AA of companies incorporated under the CO may be in electronic form and must contain the following mandatory clauses (the Mandatory Articles'):
Section 2.2 **Page 14**	**The first sentence is amended to be:** The term 'officer' is a generic one that can be applied to directors, the secretary and some other senior managers; in a subsidiary undertaking an officer is a member of the governing body of the undertaking or any other person involved in its management.
Section 3.6 **Page 20**	**The following bullet points are added at the start of the list of bullet points within this section:** • S.369 – a company prepares financial statements to its accounting reference date. For a new company, the primary accounting reference date must be on or before the last day of the month of the anniversary of the company's incorporation. • S.370 – subsequently the accounting reference date is the anniversary of the primary accounting reference date. • S.371 – the accounting reference date may be changed for the current year and subsequent years or for the previous year and subsequent years. This change will result in an accounting reference period that is either shorter or longer than 12 months. A longer period may not be more than 18 months.

Chapter 2	Financial reporting framework

Section 6

Page 43

The following replaces the existing section 6

Topic highlights

Members of the HKICPA are bound by its Code of Ethics.

Certified public accountants in business owe certain legal duties towards their employers. Additionally, they have ethical duties towards the HKICPA. The Council of HKICPA requires members of the Institute (and therefore certified public accountants) to comply with the *Code of Ethics for Professional Accountants* (the Code). Apparent failures by certified public accountants to comply with the Code are liable to be enquired into by the appropriate committee established under the authority of the Institute, and disciplinary action may result. Disciplinary action may include an order that the name of the certified public accountant be removed from the Institute's membership register.

The Code of Ethics is likely to be taken into account when the work of a certified public accountant is being considered in a court of law or in other contested situations.

The *Code* was revised in November 2018. It brings together key ethics advances over the past four years.

6.1 Ethics in accounting

Ethics in accounting is of utmost importance to accounting professionals and those who rely on their services. Accounting professionals know that people who use their services, especially decision makers using financial statements, expect them to be highly competent, reliable and objective. Those who work in the field of accounting must not only be well qualified, but must also possess a high degree of professional integrity. A professional's good reputation is one of his or her most important assets. Compliance with the *Code's* fundamental principles ensures that professional standards are maintained.

There is a very fine line between acceptable accounting practice and management's deliberate misrepresentation in the financial statements.

The financial statements must meet the following criteria:

(a) **Technical compliance:** a transaction must be recorded in accordance with generally accepted accounting principles (GAAP).

(b) **Economic substance:** the resulting financial statements must represent the economic substance of the event that has occurred.

(c) **Full disclosure and transparency:** sufficient disclosure must be made so that the effects of transactions are transparent to the reader of the financial statements.

Accounting plays a critical function in society. It affects human behaviour especially when pay or compensation is impacted, and to deliberately mask the nature of accounting transactions could be deemed as unethical behaviour.

6.2 Fundamental principles

All professional accountants, whether in business or public practice, are required to comply with the following fundamental principles:

(a) **Integrity:** a professional accountant should be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

In particular, paragraph R111.2 of the *Code* requires that a professional accountant should not knowingly be associated with reports, returns, communications or other information where they believe that the information:

(i) contains a materially false or misleading statement;

(ii) contains statements or information provided recklessly; or

(iii) omits or obscures required information where such omission or obscurity would be misleading.

If a professional accountant provides a modified report in respect of such a report, return, communication or other information, the accountant is not in breach of paragraph R111.2.

If a professional accountant becomes aware of having been associated with such information, they should take steps to be disassociated from the information.

(b) **Objectivity:** A professional accountant should not compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

Subsection 112 requires that a professional accountant does not undertake a professional activity if a circumstance or relationship unduly influences their professional judgment regarding that activity.

(c) **Professional competence and due care:** A professional accountant must:

(i) Attain and maintain professional knowledge and skill at the required level to provide professional service; and

(ii) Act diligently and in accordance with technical and professional standards.

Accountants must also exercise sound judgment in applying professional knowledge and skill when undertaking professional activities. They should maintain an awareness and understanding of relevant technical, professional and business developments and should act in line with the requirements of an assignment. A professional accountant should provide reasonable training and supervision to those under their authority and, if necessary, make relevant parties aware of the limitations inherent in the services or activities provided.

(d) **Confidentiality:** A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships. They should:

(i) Be alert to the possibility of inadvertent disclosure;

(ii) Maintain confidentiality of information within the employing organisation;

(iii) Maintain confidentiality of information disclosed by a prospective client or employing organisation;

(iv) Not disclose confidential information outside the firm without proper and specific authority unless there is a legal or professional right or duty to disclose;

(v) Not use confidential information for personal advantage or the advantage of a third party;

(vi) Not use or disclose confidential information after a professional or business relationship has ended; and

(vii) Take reasonable steps to ensure that other personnel under the accountant's control respect the duty of confidentiality.

Subsection 114 provides examples of instances when there may be a legal or professional right or duty to disclose confidential information e.g. in the course of legal proceedings.

(e) **Professional behaviour:** A professional accountant should comply with relevant laws and regulations and avoid any conduct that they know or should know might discredit the profession. When undertaking marketing or promotional activities, a professional accountant should not make exaggerated claims for services offered, qualification or experience, nor should they make disparaging references or unsubstantiated comparisons to the work of others.

Example: Shepherd Co.

The finance director of Shepherd Co., a member of HKICPA, has carried out the following actions in June 20X9:

(a) Employed his brother's cleaning company to clean Shepherd Co.'s offices every week

(b) Used information that he acquired while at work to recommend to his sister that she buys shares in Shepherd Co.'s parent company

(c) Approved the monthly management accounts of the company by signing his name, even though he had not looked at them

Has the finance director contravened any of the fundamental principles of the *Code of Ethics for Professional Accountants*?

Solution

(a) Contravenes the principle of objectivity
(b) Contravenes the principle of confidentiality
(c) Contravenes the principle of integrity

6.3 Conceptual framework

Section 120 of the *Code* is a conceptual framework. This sets out requirements and application material to help accountants to comply with the fundamental principles and meet their responsibility to act in the public interest. It specifies an approach to:

(a) Identify threats to compliance with the fundamental principles;
(b) Evaluate the threats identified; and
(c) Address the threats by eliminating or reducing them to an acceptable level.

6.4 Threats to compliance

Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances and as such every situation that creates threats cannot be defined. Furthermore, the differing nature of engagements and work assignments might create different types of threats.

Threats to compliance with the fundamental principles fall into one or more of the following categories.

6.4.1 Self-interest threat

- Holding a financial interest in, or receiving a loan or guarantee from the employing organisation
- Participation in incentive compensation arrangements offered by the employing organisation
- Inappropriate personal use of corporate assets
- Consideration of employment security
- Commercial pressure from outside the employing organisation

6.4.2 Self-review threat

Consideration of appropriate accounting treatment for a business combination after performing the research study that supported the acquisition decision.

6.4.3 Familiarity threat

- Where the professional accountant in business is responsible for the selection of the employing organisation's financial reporting when an immediate or close family member employed by the entity makes decisions that would affect the entity's financial reporting.
- Long association with business contracts affecting the business decisions.
- A professional accountant in business accepts a material gift or hospitality, unless the value is trivial and inconsequential.

6.4.4 Intimidation threat

- Threat of dismissal or replacement of the professional accountant in business or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported.
- The professional accountant in business with a dominant personality attempting to influence the decision-making process.

6.4.5 Advocacy threat

When achieving the legitimate goals and objectives of their employing organisations, professional accountants in business may promote the organisation's goals. If the statements made are neither false nor misleading, the actions would not create an advocacy threat.

6.5 Evaluating threats

When a professional accountant identifies a threat to compliance with the fundamental principles they must evaluate whether the threat is at an acceptable level, i.e. a level at which it could be concluded that there is no breach of the fundamental principles.

Both qualitative and quantitative factors should be considered in the evaluation of threats and the following may be relevant to the assessment:

– Corporate governance requirements;
– Educational, training and experience requirements for the profession;
– Effective complaint systems;
– An explicitly stated duty to report breaches of ethics requirements; and
– Professional or regulatory monitoring and disciplinary procedures.

A professional accountant should be aware of new information that becomes available that may impact an assessment of a threat.

6.6 Eliminate or reduce threats

Where identified threats to compliance are not at an acceptable level the professional accountant should eliminate the threats or reduce them to an acceptable level. This may be achieved by:

– Eliminating the circumstances that create the threats;
– Applying safeguards, or
– Declining or ending the professional activity.

Safeguards are actions that the professional accountant takes that effectively reduce threats to compliance to an acceptable level. They may be created by the profession, legislation or regulation or may be safeguards in the working environment. These include:

- The employing organisation's systems of corporate oversight or other oversight structures
- The employing organisation's ethics and conduct programmes
- Recruitment procedures in the employing organisation emphasising the importance of employing highly competent staff
- Implementing strong internal controls
- Appropriate disciplinary processes
- Strong leadership to emphasise the importance of ethical behaviour and expecting employees to act ethically at all times
- Set policies and procedures to implement and monitor quality of employee
- Update employees with any changes in policies and procedures
- Appropriate training education in implementing such policies
- Set policies and procedures to encourage each employee to communicate to senior levels within the employing organisation
- Consult another professional accountant

6.7 Convergence with the IESBA *Code of Ethics*

The revised *Code of Ethics for Professional Accountants* as issued in November 2018 maintains convergence with the *Code of Ethics for Professional Accountants* issued by the IESBA in April 2018.

In addition to the IESBA Code, the Hong Kong *Code* contains additional local requirements in Part C, such as guidance on the change of auditors of a listed issuer on the stock exchange of Hong Kong. These form an integral part of the *Code* and members should ensure that they are aware of the additional requirements and comply with them.

Links to other modules

Ethics is also part of the syllabus for Module B *Corporate Financing* and Module C *Business Assurance.*

Section 7.3.2 | **The final sentence of the first paragraph is replaced by the following:**

Page 49 | The SME-FRF and FRS were updated in December 2015 and again in February 2019.

Section 8
Page 49

This section is replaced by the following:

8 The HKICPA's *Conceptual Framework*

Topic highlights

The *Conceptual Framework* provides the basis for the development of HKFRS/HKAS.

In June 1997, the HKICPA produced a document, *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*). This is, in effect the **conceptual framework** upon which all HKFRS are based and hence it determines how financial statements are prepared and the information they contain.

A new *Conceptual Framework* was issued in 2018 which improves the previous *Framework* by:

- 'Filling the gaps' by providing guidance on presentation and disclosure;
- Updating the content; and
- Clarifying certain areas.

The chapters of the new *Conceptual Framework* are:

(1) The objective of general purpose financial reporting
(2) Qualitative characteristics of useful financial information
(3) Financial statements and the reporting entity
(4) The elements of financial statements
(5) Recognition and derecognition
(6) Measurement
(7) Presentation and disclosure
(8) Concepts of capital and capital maintenance

8.1 Introduction

The introduction to the *Conceptual Framework* deals with its status and purpose.

The *Conceptual Framework* is not a Standard and nothing within it overrides any Standard or requirement within a standard.

Its purpose is to:

(a) Assist the HKICPA to develop HKFRS and Accounting Guidelines that are based on consistent concepts;

(b) Assist preparers to develop consistent accounting policies when no HKFRS or Accounting Guideline applies to a particular transaction or event, or where there is a choice of accounting policy; and

(c) Assist all parties to understand and interpret HKFRS and Accounting Guidelines.

8.2 The objective of general purpose financial reporting

The objective of general purpose financial reporting is to provide financial information about a reporting entity that is useful to existing and potential future investors), lenders and other creditors in making decisions relating to providing resources to the entity. Other users of the financial statements are secondary to these main users.

Relevant decisions may be about:

(a) Buying, selling or holding debt or equity instruments

(b) Providing or settling loans or other forms of credit

(c) Exercising rights to vote on management's actions that affect the use of an entity's economic resources.

	To make such decisions, primary users require information about: • the economic resources of the entity; • the claims against the entity; • changes in the entity's economic resources and claims; and • how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's economic resources. Most investors, creditors and lenders cannot require entities to provide information directly to them, and therefore rely on general purpose financial statements. Although such financial statements do include a large amount of information, the *Conceptual Framework* states that general purpose financial statements do not and cannot provide all of the information that investors, lenders and other creditors need. Therefore, these users must also consider information from other sources, such as general economic conditions and expectations, political events and political climate, and industry and company outlooks. **8.2.1 Information about economic resources and claims** Information about resources and claims helps users to assess an entity's liquidity and solvency and its needs for additional financing. Such information can also help users to assess management's stewardship of the entity's economic resources. This information is found in the statement of financial position. **8.2.2 Information about changes in economic resources and claims** Information about changes in resources and claims helps users to assess the return that an entity has produced using the economic resources available to it. This in turn provides an indication of the performance of management. This information is found in the statement of profit or loss and other comprehensive income, the statement of cash flows and the statement of changes in equity. Financial performance information, other than cash flow information, must be prepared on the accrual basis. **8.2.3 Stewardship of management** The 2018 *Conceptual Framework* emphasises the use of financial information to assess the stewardship of management. Management has a responsibility to use an entity's economic resources efficiently and effectively, e.g. by protecting those resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws and regulations.
Section 9 **Page 53**	**The first paragraph of the introductory section, immediately after topic highlights is deleted.**
Section 9.1 **Page 53**	**The reference next to the section heading is changed to be CF 2.6-2.11**
Section 9.1.1 **Page 53**	**The paragraph under the subheading 'Materiality' is replaced by the following:** Materiality is related to relevance. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those financial reports. Materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. It is impossible to specify a quantitative threshold for materiality or predetermine what could be material in a particular situation as it depends on the individual entity.

Section 9.1.2 **Page 53**	**The text in this section is replaced by the following:** Financial information (both words and numbers) must faithfully represent the substance of the phenomena that it purports to represent. Often the substance of an economic phenomenon and its legal form are the same, however if they are not, providing information only about the legal form would not result in a faithful representation. To be a perfectly faithful representation, a depiction would have three characteristics – it would be complete, neutral and free from error. • Information that is complete means all necessary information is included for the user to understand the item being depicted. • Neutral information is prepared without bias in the selection or presentation of the information. Neutrality is supported by the exercise of prudence, i.e. the exercise of caution when making judgments under conditions of uncertainty so that assets and income are not overstated and liabilities and income are not understated. • Free from error means there are no errors or omissions in the description of the item, and the process used to produce the reported information has been selected and applied with no errors in the process. Faithful representation does not, however, mean accurate in all respects e.g. an estimate of an unobservable fair value cannot be determined to be accurate or inaccurate.
Section 9.1.3 **Page 54**	**The reference next to the section heading is changed to be CF 2.20-2.21 and point (b) is amended to be:** (b) Identify the type of information about that phenomenon that would be most relevant.
Section 9.2 **Page 54**	**The reference next to the section heading is changed to be CF 2.23 – 2.36**
Section 9.2.5 **Page 55**	**The reference next to the section heading is changed to be CF 2.37 – 2.38**
Section 9.3 **Page 55**	**The reference next to the section heading is changed to be CF 2.39 – 2.41**
Section 9.4 **Page 55**	**This section is deleted, however self-test question 2 is retained.**
Section 10 **Page 56**	**The current section 10 is deleted and a new section 10 is inserted as follows:** **10 Financial statements and the reporting entity** The objective of financial statements is to provide financial information that is useful to users to assess prospects for future cash flows to a reporting entity and in assessing management's stewardship of the reporting entity. This is provided: (a) In the **statement of financial position** by recognising assets, liabilities and equity (b) In the **statement of financial performance** (statement of profit or loss and other comprehensive income) by recognising income and expenses

(c) In **other statements and notes** by presenting/disclosing information about:

- The nature of recognised items and associated risks
- The nature of unrecognised items and associated risks
- Cash flows
- Contributions from and distributions to equity holders
- Methods, assumptions and judgments used in estimating amounts presented or disclosed.

10.1 Reporting period

Financial statements are prepared for a specified period of time and should also include comparative amounts for at least one preceding period. They should only include forward-looking information if:

(a) It relates to recognised or unrecognised assets or liabilities that existed at the end of (or during) the reporting period or to income and expenses for the reporting period, and

(b) It is useful to users.

10.2 Going concern assumption

Financial statements are usually prepared on the going concern assumption i.e. it is assumed that the business will continue in operation for the foreseeable future and will not cease trading or enter liquidation. If that is not the case and the company is expected to cease trading or enter liquidation, the financial statements may have to be prepared on a different basis and that basis should be disclosed in the financial statements.

10.3 The reporting entity

A **reporting entity** is an entity that is required, or chooses, to prepare financial statements. It can be a single entity or a proportion of an entity, or can comprise more than one entity. It is not necessarily a legal entity.

Different types of financial statements are relevant to different types of reporting entity:

- A single entity prepares unconsolidated financial statements;
- Two or more entities with no control relationship prepare combined financial statements;
- An entity that controls other entities prepares consolidated financial statements.

In some cases it is difficult to determine the boundary of a reporting entity, e.g. if it is not a legal entity. In that case determining the reporting entity is driven by the information needs of the primary users of the entity's financial statements with consideration given to the fundamental qualitative characteristics of relevance and faithful representation.

Section 11

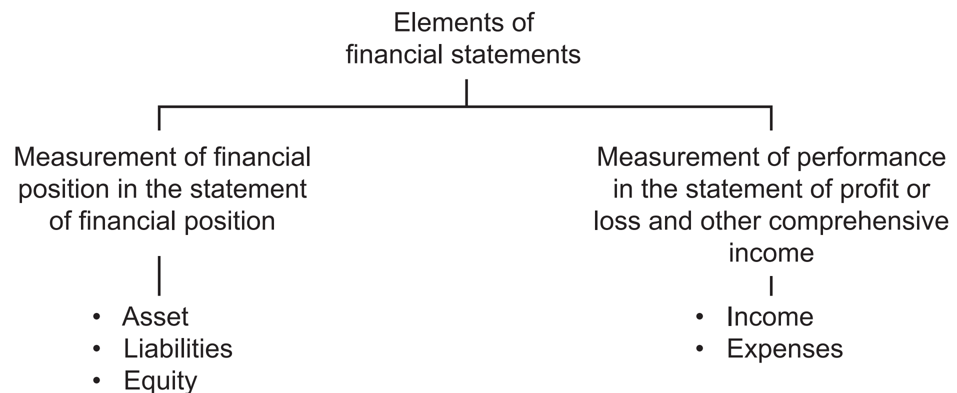
Page 60

The current section 11 is deleted and a new section 11 is inserted as follows:

Topic highlights

Transactions and other events are grouped together in broad classes according to their economic characteristics. These broad classes are the elements of financial statements: assets, liabilities, equity, income and expenses.

This chapter of the *Conceptual Framework* lays out the elements as follows:



A process of sub-classification then takes place for presentation in the financial statements, e.g. assets are classified by their nature or function in the business to show information in the best way for users to take economic decisions.

11.1 Definitions

The *Conceptual Framework* provides the following definitions:

An **asset** is a present economic resource controlled by the entity as a result of past events.

An **economic resource** is a right that has the potential to produce economic benefits.

A **liability** is a present obligation to transfer an economic resource as a result of past events.

An **obligation** is a duty or responsibility that an entity has no practical ability to avoid.

Equity is the residual interest in the assets of an entity after deducting all of its liabilities.

Income is increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.

The *Conceptual Framework* links the definitions to items discussed in Chapter 1:

- An asset is an economic resource;
- A liability or equity is a claim;
- Income or expenses are changes in economic resources and claims.

11.2 Definition of an asset

An asset is a present economic resource controlled by an entity as a result of past events. The definition of an economic resource is a right that has the potential to produce economic benefits.

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A **right with the potential to produce economic benefits** may take many forms and may relate to the obligation of another party (e.g. a right to receive cash from another party) or may not (e.g. a right to use a property). In order to be an asset a right must meet other aspects of the definition i.e. it must:

(i) Have the potential to produce economic benefits and
(ii) It must be controlled.

An economic resource is a right that has the **potential to produce economic benefits.** This does not require economic benefits to be certain or likely; an asset may still exist if there is a low likelihood of economic benefits, however this likelihood will affect whether the asset is recognised and, if so, how it is measured.

An entity **controls** a resource if it has the present ability to direct its use, obtain resulting economic benefits and prevent others from obtaining these. Therefore only one party can control a resource.

11.3 Definition of a liability

A liability is a present obligation of an entity to transfer an economic resource as a result of past events.

An **obligation** is a duty or responsibility that an entity has no practical ability to avoid. It is always owed to another party (which may be society at large) and may be a legal or a constructive obligation. A constructive obligation is an obligation that arises from an entity's customary practices, published policies or specific statements.

A **transfer of an economic resource** need not be certain or likely; there must simply be potential for such a transfer. As with an asset, a low probability of transfer will affect whether a liability is recognised and, if so, how it is measured.

A **present obligation as a result of past events** will only exist if the entity has already obtained benefits or taken an action and as a result will or may have to transfer an economic resource that it would not otherwise have had to transfer.

Self-test question 3

Trainton Peach Co (TP) has recently acquired another company, Luton Sound (LS), in order to access specific know how. TP has incurred a high level of external consultancy fees and spent a large proportion of internal finance department time (and so cost) on the acquisition. The Managing Director of TP has asked you, the Group Finance Manager, to capitalise the external costs and a proportion of the internal costs and amortise them over the same period as goodwill on the acquisition. The Managing Director's rationale for the request is that this treatment should make the financial statements more relevant.

Required

Prepare notes in reply to the Managing Director.

(The answer is at the end of the chapter)

11.4 Unit of account

The unit of account is the individual asset or group of assets or individual liability or group of liabilities to which recognition and measurement guidance applies. For example, an equity share investment is made up of several assets, but is recognised and measured as a single unit. In some cases items are recognised separately but measured on a portfolio basis. A unit of account should be selected to provide useful information i.e. the information provided must be relevant and must faithfully represent the substance of the transaction or event from which the items have arisen.

11.5 Definition of equity

Equity is the residual interest in the assets of an entity after deducting all liabilities. Equity claims are claims against the entity that do not meet the definition of a liability. They may be sub-classified in the statement of financial position. This is relevant to the decision-making needs of the users as it will indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. Some reserves are required by statute or other law, e.g. for the future protection of creditors. The amount shown for equity depends on the measurement of assets and liabilities. It has nothing to do with the market value of the entity's shares.

11.6 Definitions of income and expenses

Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity.

Income and expenses are the elements of financial statements that relate to an entity's financial performance. Different transactions and other events generate income and expenses with different characteristics. Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance.

Section 12

Page 61

The current section 12 is deleted and a new section 12 is added:

12 Recognition and derecognition

The *Conceptual Framework* issued in 2018 provides guidance on derecognition in addition to guidance on recognition.

Recognition is the process of incorporating an item that meets the definition of an element into the financial statements. Derecognition is the removal of an element (or part of an element) from the financial statements.

Recognition and derecognition links the financial statements:

- Income is recognised at the same time as the recognition of (or increase in carrying amount of) an asset or the derecognition of (or decrease in the carrying amount of) a liability.
- An expense is recognised at the same time as the derecognition of (or decrease in carrying amount of) an asset or the recognition of (or increase in the carrying amount of) a liability.

12.1 Recognition

An item is recognised in the financial statements if:

(a) It meets the definition of an element; and
(b) It provides users with information that is relevant; and
(c) It results in a faithful representation.

Recognition may not provide information that is relevant if it is uncertain that an item exists ('existence uncertainty') or the probability of a transfer of economic benefits is low.

If the level of uncertainty involved in measuring an item is high ('measurement uncertainty'), then recognition may not result in a faithful representation.

These recognition criteria are not currently reflected in the specific recognition criteria within certain standards, such as:

HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

HKAS 38 *Intangible Assets*

This is because these standards have not been updated since the issue of the *Conceptual Framework* in 2018.

12.2 Derecognition

Derecognition normally occurs when the definition of an asset or liability is no longer met:

- An **asset** is normally derecognised when control is lost.
- A **liability** is normally derecognised when there is no longer a present obligation.

Derecognition should faithfully represent any assets and liabilities retained after the event or transaction that led to derecognition and the change in assets and liabilities as a result of the transaction.

In some cases an entity may appear to transfer an asset or liability but derecognition is not appropriate. For example, exposure to variations in the amount of economic benefits that may be produced by an asset indicates that it is still controlled.

Section 13

Page 61

The current section 13 is deleted and new sections 13 – 15 are added:

13 Measurement

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the financial statements

The *Conceptual Framework* refers to two main measurement bases:

- Historical cost
- Current value

Historical cost is the most commonly used measurement basis, however this is normally combined with other bases e.g. inventory is carried at the lower of cost and net realisable value.

13.1 Historical cost

Historical cost is based on the transaction price when an asset was acquired/created or a liability was incurred/taken on. This measurement basis does not generally reflect changes in values unless the change relates to the impairment of an asset or a provision becoming onerous.

Where an item is recognised as a result of a transaction that is not on market terms, a current value may be used as a deemed cost on initial recognition and as a starting point for subsequent accounting.

Historical cost may be updated over time to depict, for example:

- Depreciation or amortisation of assets
- Payments that extinguish part of an asset or liability
- The accrual of interest to reflect a financing component of an asset or liability

Measurement of financial instruments at amortised cost is an application of the historical cost measurement basis.

13.2 Current value

Current value reflects changes in value. The *Conceptual Framework* refers to three forms of current value:

(a) Fair value, being the price received to sell an asset or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

(b) Value in use, being the present value of cash flows from the use/disposal of an asset, or fulfilment value, being the present value of resources transferred to fulfil a liability.

(c) Current cost, being the cost of an equivalent asset at the measurement date, or consideration received for an equivalent liability at the measurement date.

13.3 Selection of measurement basis

The qualitative characteristics, particularly the fundamental characteristics, should be considered when selecting a measurement basis:

(a) Historical cost may provide less relevant information because it does not reflect changes in value.

(b) Assets and liabilities may be related but not measured consistently. In this case faithful representation is compromised.

(c) Comparability is achieved where the same measurement basis is used consistently.

(d) Changes in measurement basis may affect understandability.

(e) Historical cost is generally verifiable.

The cost constraint should also be considered, i.e. the costs of using a certain measurement basis should not exceed the benefits of doing so. This may be particularly true in the case of fair value measurement.

14 Presentation and disclosure

Guidance on presentation and disclosure is new in the 2018 version of the *Conceptual Framework.*

Effective presentation and disclosure makes information more relevant, contributes to a faithful representation and enhances understandability and comparability.

Effective presentation and disclosure requires:

- Focus on presentation and disclosure objectives and principles:
  - a balance is needed between flexibility to provide relevant information that faithfully represents elements in the financial statements and requiring information that is comparable;
  - entity-specific information is more useful than standardised 'boilerplate' descriptions;
  - duplication of information in the financial statements is usually unnecessary and impacts understandability.
- The classification of assets, liabilities, equity, income and expenses (the grouping of similar items, separation of dissimilar items and in general no offsetting of assets and liabilities);
- Effective aggregation of information (there should be a balance between summarising a large volume of detail and concealing detail).

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14.1 Profit and other comprehensive income

The *Conceptual Framework* includes two principles which should be adhered to unless an HKFRS requires alternative treatment:

(a) In principle all income and expenses are included in profit or loss rather than recognised as other comprehensive income; and

(b) In principle all other comprehensive income is reclassified to profit or loss in a future period.

In exceptional circumstances HKFRS may require that:

– Income or expenses arising from a change in value of an asset or liability is recognised as OCI because this results in more relevant information or a more faithful representation

– OCI is not reclassified to profit or loss because there is no clear basis for identifying the period in which reclassification should take place or the amount that should be reclassified.

15 Concepts of capital and capital maintenance

The *Conceptual Framework* refers to two concepts of capital and capital maintenance:

(a) **Financial capital maintenance** under which a profit is earned only if the financial amount of net assets at the end of the period exceeds the financial amount of net assets at the start of the period (after excluding distributions to and contributions from owners). Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) **Physical capital maintenance** under which a profit is earned only if the physical productive capacity at the end of the period exceeds that at the start of the period (after excluding distributions to and contributions from owners). This requires the current cost basis of measurement.

Section 14

Page 64

The current section 14 is renumbered to be section 16.

Section 15

Page 66

The following is inserted as new section 17 (immediately before the current section 15); subsequent sections are renumbered:

17 Materiality

The IASB issued Practice Statement 2: *Making Materiality Judgements* in September 2017. This is a tool to aid management in using judgment to decide what information is material and what is not; it is a non-mandatory document and does not have the status of an IFRS (HKFRS); it may be applied with immediate effect.

17.1 General characteristics of materiality

The Statement refers to the definition of materiality contained within the *Conceptual Framework:*

'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.'

(*Conceptual Framework for Financial Reporting*: para. QC11)

Materiality is pervasive to the preparation of financial statements and affects recognition, measurement, presentation and disclosure.

When considering whether information is material, a company should consider its own circumstances and the needs of primary users of its financial statements, i.e. investors, lenders and other creditors.

17.2 Interaction with local laws and regulations

The Practice Statement clarifies that:

- A company's financial statements must comply with requirements of IFRS (HKFRS), including those relating to materiality.
- Providing additional information to meet local legal or regulatory requirements is allowed by IFRS (HKFRS), even if that information is not material, provided that it does not obscure material information.

17.3 Making materiality judgments

The practice statement includes a four-step process that entities may find useful in making materiality judgments:

Step 1

Identify information that has the potential to be material. This step requires consideration of IFRS (HKFRS) requirements and the common information needs of primary users.

Step 2

Assess whether the information identified is material. Both quantitative and qualitative factors should be considered.

Step 3

Organise the information within the draft financial statements so that it supports clear and concise communication.

Step 4

Review the information provided as a whole, considering whether it is material individually and in combination with other information. At this stage information may need to be added or removed.

17.4 Specific topics

Specific guidance is provided on how to make materiality judgments on prior period information, errors, covenants and in interim reporting.

Prior period information

An assessment of whether prior period information is material to current period financial statements may result in a company providing either more or less prior period information than was provided in the prior year financial statements, depending on what level of information is necessary to understand current period financial statements.

Errors

In order to assess whether an error is material, the Practice Statement clarifies that the materiality process described in section 17.3 should be applied.

	Covenants When considering the materiality of information related to covenants, a company should consider: • The consequences of a breach in covenant; and • The likelihood of such a breach occurring. **Interim reporting** When preparing interim financial statements, a company should consider the same materiality factors that it considers when preparing its annual financial statements, however it should also take into consideration that the purpose of an interim report differs from the purpose of an annual financial report.
Section 15.1 **Page 67**	**This section is renumbered as section 18. A new section 18.1.3 is added:** **18.1.3 Current developments** The IASB has added a project to its work plan to update the *Management Commentary* practice statement. The update process will consider; • Developments from other narrative reporting initiatives, e.g. focusing on business-critical resources and long-term value creation; and • Acknowledged gaps in narrative reporting practice, such as reporting forward-looking information, short-term reporting on strategies and inconsistent reporting on business models. An exposure draft of amendments to the *Management Commentary Practice Statement* is expected in the first half of 2020.
Section 17 **Page 71**	**The following replaces this section:** **20 Current developments** The IASB is continually working to develop new accounting standards and interpretations and amend and improve existing ones. The HKICPA consults on these developments, and generally adopts new and amended guidance within its own HKFRS framework. Specific projects that are relevant to the Module A syllabus are explained in the relevant chapters of the Learning Pack. After a new or revised standard has been applied for two years internationally, the IASB usually conducts a post-implementation review (PIR). When undertaking such a review, the IASB: • Considers any contentious matters in the development of the standard; • Considers any issues that have been highlighted since the issue of the standard; and • Identifies areas where implementation problems have been encountered. On concluding a PIR, the IASB publishes its findings and decides whether improvements should be made to the standard. A PIR of IFRS 3 (HKFRS 3) *Business Combinations* was concluded in 2015, and as a result of the review, amendments to clarify the definition of a business were made to the standard. These amendments are included in Chapter 26. A PIR of IFRS 13 (HKFRS 13) *Fair Value Measurement* was completed in 2018. This concluded that the standard is working as intended and that no amendments were necessary.

	The IASB is intending to start PIRs of IFRS 10-12 (HKFRS 10-12) (financial standards relating to consolidation) and IFRS 5 (HKFRS 5) *Non-current Assets Held for Sale and Discontinued Operations* during 2019 or 2020. A PIR of IFRS 5 (HKFRS 5) is not required; however, the IASB has decided that this is the most effective way to address issues identified by the IFRS Interpretations Committee.
Topic recap **Page 74**	**The diagram related to the *Conceptual Framework* is replaced with that provided in the appendix to this Supplement.**
Answers to self-test questions **Page 76**	**The answer to self-test question 3 is replaced with the following:** Although relevance is a fundamental characteristic of the *Conceptual Framework,* and must be considered when preparing financial statements, the issue here is whether the costs meet the definition of an asset and whether recognition is appropriate. An asset is 'a present economic resource controlled by the entity as a result of past events'. An economic resource has the potential to produce economic benefits. The *Conceptual Framework* states that an asset should be recognised only if it results in information that: – Is relevant, and – Results in a faithful representation. It may be argued that the costs incurred resulted in TP gaining knowledge, which is a resource that it controls as the result of a past event and which has the potential to produce economic benefits. Alternatively it can be argued that this benefit arose from the consideration paid to acquire LS and that the fees incurred were consideration for consultancy services, the benefit of which has already been felt. It is therefore questionable whether the definition of an asset is met. Assuming that the fees were considered an asset, the next question is therefore whether recognition would result in relevant information that results in a faithful representation. Relevance is a fundamental characteristic of the *Conceptual Framework.* Information is relevant when it is capable of making a difference in the decisions made by users because it has either a predictive or a confirmatory value or both. The capitalisation of costs incurred prior to an acquisition does not have either a predictive or confirmatory value. Therefore capitalising such costs will not increase relevance. Equally it is questionable whether capitalisation would result in a faithful representation. In order for this to be the case it would have to provide complete and neutral information that is free from error. Prudence is an element of neutrality, i.e. the exercise of caution when making judgments under conditions of uncertainty so that assets are not overstated. Presumably the value of the knowledge acquired on the acquisition of LS was built into the purchase price and as such that knowledge has already been recognised as an asset (either as an intangible on acquisition or within goodwill). Therefore to recognise fees as an asset would be to double count the acquired benefit.

Chapter 3	Small company reporting

Section 3.1.1

Page 82

The final row of the table is amended and an additional row added as follows:

Group of eligible companies	Each company in the group must qualify as a small private company or eligible larger company and the aggregate amounts for the group must not exceed two of three of the size tests for larger eligible private companies.	At least 75% of the members of the holding company of the group must approve and none of the members holding the remaining voting rights vote against the resolution.
Mixed group (a group comprising a mix of one or more small/eligible private companies and one or more small companies limited by guarantee	If the holding company is a small private company the aggregate amounts for the group must not exceed two of three of the size tests for a group of small private companies.	No member approval is required.
	If the holding company is an eligible private company, the aggregate amounts for the group must not exceed two of three of the size tests for a group of larger eligible companies.	At least 75% of the members of the holding company of the group must approve and none of the members holding the remaining voting rights vote against the resolution.
	If the holding company is a small company limited by guarantee, the aggregate annual revenue of the mixed group must not exceed $25m.	No member approval is required.

Section 3.1.2

Page 85

The following sentence is added at the end of the paragraph:

Groups that are eligible to use the SME-FRF and SME-FRS in accordance with Companies Ordinance (see section 3.1.1) may include non-Hong Kong corporates.

Section 3.3.2 **Page 86**	**The text in the first part of this section is amended as follows:** Under the SME-FRS (19.1), an entity that is a parent at the end of the financial year is required to present consolidated financial statements except when: (a) It is a wholly-owned subsidiary of another entity at the end of the financial year; or (b) It is a partially owned subsidiary of another entity at the end of the financial year and it meets either of the following conditions: (i) At least 6 months before the end of the financial year the directors notify the members in writing of their intention not to prepare consolidated financial statements for the financial year, the notification does not relate to any other financial year, and as at a date falling 3 months before the end of the financial year, no member has responded to the notification by giving the directors a written request for the preparation of consolidated financial statements for the financial year; or (ii) All members agree in writing before the end of the financial year that consolidated financial statements will not be prepared for the financial year and the agreement does not relate to any other financial year.
Section 4.1.2 **Page 87**	**The section is retitled 'Comprehensive reviews of the *IFRS for SMEs*' and the following paragraph is added to the end of the section:** The second comprehensive review of the *IFRS for SMEs* commenced in 2019 with the issue of a Request for Information. The IASB uses this to gather views on whether, and if so how, the *IFRS for SMEs* should be updated to take account of amendments to full IFRS Standards since the last comprehensive review.

Chapter 5	**Property, plant and equipment**
Section 1.4 **Page 125**	**A new section 1.4.4 is added:** **1.4.4 Current developments** In 2017 the IASB issued an exposure draft proposing to amend guidance contained within IAS 16 (HKAS 16) relating to elements of the cost of an asset. It is proposed that the standard is amended to require that proceeds from the sale of items produced while bringing an asset to the location and condition necessary for it to be capable of operating as intended by management, together with the costs of producing the items, are recognised in profit or loss; these cannot be deducted from the cost of the asset. An amendment to IAS 16 is the next stage in the project.

Chapter 11	**Provisions, contingent liabilities and contingent assets**
Section 2.8 **Page 285**	**The current section 2.8 is renumbered section 2.9 and a new section 2.8 is added:** **2.8 Current developments** Now that the *Conceptual Framework* project has been completed and new guidance issued, the IASB is considering whether to start a project to amend aspects of IAS 37 (HKAS 37), and if so which aspects to amend. It is currently gathering evidence and a decision is expected in the second half of 2019. Clarification guidance on onerous contracts is, however, considered more urgent due to the IFRS 15 (HKFRS 15) *Revenue from Contracts with Customers* requirement to apply IAS 37 (HKAS 37) to loss-making contracts. This is therefore the subject of a separate, fast-tracked project.

The definition of an onerous contract (section 2.6.2) specifies that the unavoidable costs under a contract reflect the least net cost of exiting the contract, which is the lower of the cost of fulfilling it or penalties arising from failure to fulfil it. IAS 37 (HKAS 37) does not, however, define the cost of fulfilling a contract. The IASB published an exposure draft of amendments to IAS 37 (HKAS 37) in 2018, which proposes that the cost of fulfilling a contract is equal to costs that relate directly to the contract. Examples of such costs are expected to be added to IAS 37 (HKAS 37) including direct labour and materials, an allocation of other costs that relate directly to the contract (e.g. supervision and insurance) and costs explicitly chargeable to the counterparty under the contract.

Chapter 12 Share-based payment

Example at the end of section 3.1.1

Page 318

The example is replaced with the following:

Example: Group equity-settled share-based transaction

On 1 January 20X1, Principal Co. implemented a share incentive scheme for the five members of senior management at its subsidiary Sublime Co.

Principal granted ten share options to each senior manager on this date, each with a fair value of $80. The fair value of each option at 31 December 20X1 is $70 and at 31 December 20X2 is $90.

All five senior managers are expected to remain in employment until the settlement date.

Required

What entries are required to record this transaction in the financial statements of Principal, Sublime and the Group?

Solution

Principal

Principal is the entity responsible for settling the transaction. As the transaction will be settled in Principal's own equity instruments it must be recognised as an equity-settled share-based payment transaction.

On initial recognition of the liability, a debit is made to the cost of investment in Sublime. The amount is measured in the same way as we have seen for an equity-settled payment previously i.e. at the fair value of the award at the grant date.

			$	$
20X1	DEBIT	Cost of investment in Sublime (5×10 options $\times$ \$80)/2 years	2,000	
	CREDIT	Equity – share-based payment reserve		2,000

To record the share-based payment after one year's service based.

			$	$
20X2	DEBIT	Cost of investment in Sublime (5×10 options $\times$ \$80) – 2,000	2,000	
	CREDIT	Equity – share-based payment reserve		2,000

To record the share-based payment after the second year's service.

Sublime

Sublime is the entity receiving the services of the five senior managers. It has no obligation to settle the transaction itself and therefore it must be recognised as an equity-settled share-based payment transaction:

			$	$
20X1	DEBIT	Remuneration expense (5 × 10 SARs × $80)/2 years	2,000	
	CREDIT	Equity – share-based payment reserve		2,000

To record the first year's service expense and corresponding increase in equity.

			$	$
20X2	DEBIT	Remuneration expense (5 × 10 SARs × $80)/2 years	2,000	
	CREDIT	Equity – share-based payment reserve		2,000

To record the second year's service expense and corresponding increase in equity.

Group

In the consolidated accounts the transaction is accounted for as equity-settled:

In 20X1 it records:

(i) A remuneration expense of $2,000
(ii) A share-based payment reserve of $2,000

This is achieved by posting the following consolidation journal:

			$	$
20X1	DEBIT	Equity – share-based payment reserve	2,000	
	CREDIT	Cost of investment in Sublime		2,000

To eliminate the cost of investment in Sublime against equity in that company.

In 20X2 The Principal Group again records:

(i) A remuneration expense of $2,000
(ii) An increase in the share-based payment reserve of $2,000 to $4,000

This is achieved by posting the following consolidation journal:

			$	$
20X1	DEBIT	Equity – share-based payment reserve (2,000 + 2,000)	4,000	
	CREDIT	Cost of investment in Sublime (2,000 + 2,000)		4,000

To eliminate the cost of investment in Sublime against equity in that company.

Chapter 14	Income taxes
Section 6.1 Page 411 HKAS 12.57A	**This section should be retitled and the text replaced with the following:** **6.1 Income tax consequences of dividends** An entity should recognise the income tax consequences of dividends when it recognises a liability to pay a dividend. As a dividend is a distribution of profits resulting from past transactions and events, the related tax effect should be recognised in the same manner as the underlying transaction or event, in profit or loss, other comprehensive income or equity.
Section 11.3 Page 428	**The section is replaced with the following:** **HK(IFRIC) Int-23 *Uncertainty over Income Tax Treatments*** The Interpretation provides guidance on accounting for current and deferred tax liabilities and assets where there is uncertainty as to the application of tax law to a transaction or circumstance. In this situation: • If it is probable that tax authorities will accept an uncertain tax treatment, tax amounts are determined based on that treatment. • If it is not probable that tax authorities will accept an uncertain tax treatment, the effect of uncertainties must be reflected in the determination of tax amounts. Tax uncertainties should be reflected using one of two approaches: – The most likely amount (the single most likely amount in a range of possible outcomes); or – The expected value (the sum of probability-weighted amounts in a range of possible amounts). If uncertain treatment affects both current and deferred tax amounts, consistent judgments and estimates should be applied.

Chapter 15	Employee benefits
Section 5.7.1 Page 459 HKAS 19.99,101A	**The fourth sentence is amended to be:** In either case the past service cost is the resulting change in the present value of the defined benefit plan. The past service cost may be positive where new benefits are introduced or negative where existing benefits are withdrawn. The amount is advised by an actuary who must calculate the amount by measuring the defined benefit plan liability (or asset) using updated assumptions, but ignoring the effect of the asset ceiling if the plan is in surplus (see section 5.8).
Section 5.7.2 Page 459	**Point (a) is amended to be:** (a) The **present value of the defined benefit obligation** being settled, as valued on the date of the settlement, using updated assumptions; and
Section 5.7 Page 459 HKAS 19.122A, 123A	**A new section 5.7.3 is added before Self-test question 2** **5.7.3 Current service cost and net interest after curtailment, amendment or settlement** When a defined benefit plan has been amended, curtailed or settled, updated assumptions from the remeasurement of the plan are used to determine current service cost and interest for the remainder of the reporting period after the change to the plan. Therefore, after the amendment, net interest is calculated by multiplying the net defined benefit liability (or asset) as remeasured with the discount rate used in the remeasurement.

Section 5.12 **Page 465**	**This section should be deleted.**

Chapter 16	Borrowing costs
Section 1.2.1 **Page 476**	**The following is added immediately after self-test question 1:** If specific borrowings remain outstanding after the qualifying asset to which they relate is ready for use or sale, the borrowings are transferred to be part of general funds for the purposes of calculating a capitalisation rate, as described below.
Section 1.2.1 **Page 476** HKAS 23.14	**The final paragraph on the page is amended to be:** The **capitalisation rate** is computed as the weighted average of the borrowing costs applicable to the entity's outstanding borrowings during the period, excluding borrowing costs related to borrowings made specifically for the purpose of obtaining a qualifying asset before it is ready for use or sale. The amount of borrowing costs calculated as eligible for capitalisation must not exceed actual borrowing costs incurred.
Section 1.3 **Page 480**	**This section should be deleted.**

Chapter 17	Financial instruments
Section 1.2 **Page 492** HKFRS 9 Appendix A	**A new section 1.2.3 is added as follows:** **1.2.3 Financial guarantee contracts** A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. For example, if a parent company guarantees a subsidiary's bank loan and reimburses the bank for losses incurred if the subsidiary fails to make payments, the parent company has issued a financial guarantee contract. A guarantee over the general obligations of another entity is not a financial guarantee contract because it does not relate to specified payments or a specified debtor. Financial guarantee contracts may be viewed as insurance contracts, and if the issuer of such a contract has explicitly asserted this previously, it may choose to apply HKFRS 17 *Insurance Contracts* to the contract. In all other cases the issuer must treat a financial guarantee contract as a **financial liability** within the scope of HKAS 32, HKFRS 9 and HKFRS 7. Financial guarantee contracts and the applicable accounting is explained in more detail in section 6.

Section 2.7

Page 500

The current section 2.7 is renumbered as section 2.8 and the following new section is inserted:

2.7 Current developments

The IASB issued a discussion paper on Financial Instruments with Characteristics of Equity in 2018. This considers how the requirements of IAS 32 (HKAS 32) could be improved to make application in practice less problematic. It proposes new principles for classifying financial instruments as liabilities or equity, with a preferred approach that classifies an item as a liability if it has either:

(i) An unavoidable contractual obligation to transfer cash at a specified time other than on liquidation (a 'timing' feature) or

(ii) An unavoidable contractual obligation for an amount that is independent of the entity's available economic resources (an 'amount' feature).

For example, a term loan results in a contractual obligation to transfer cash at maturity and the full amount is due regardless of the borrower's available economic resources.

Section 3.2

Page 501

The following sentence is added to the end of the second paragraph:

The *Conceptual Framework* requires that items are recognised when recognition would result in relevant information and a faithful representation.

Section 3.2.4

Page 503

HKFRS 9.B4.1.10-B4.1.12A

The section is replaced with the following:

Prepayment features with negative compensation

Some financial asset debt instruments have a prepayment feature with negative compensation:

- A prepayment feature is the option to terminate the instrument before maturity;
- Negative compensation arises where the party exercising the early termination option receives compensation from the other party rather than paying it to the other party.

HKFRS 9 was amended in 2017 to clarify that where a debt instrument has a prepayment feature with negative compensation, its contractual terms can still give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. Therefore a financial asset with such a feature is not necessarily measured at fair value through profit or loss.

Section 3.4.2

Page 504

The following sentence is added immediately before the example:

Where a financial liability is modified or exchanged but this does not lead to derecognition, if the carrying amount of the instrument is changed, this leads to an immediate gain or loss in profit or loss.

Section 3.5

Page 506

The current section 3.5 is renumbered as section 3.6 and the following new section is inserted:

3.5 Current developments

As explained in section 3.4.2, when a financial liability is modified, a 10% test is applied in order to determine whether the modification is substantial and so the original liability should be derecognised. IFRS 9 (HKFRS 9) does not specify which fees and costs incurred by a company should be included in cash flows for the purpose of the 10% test. An exposure draft of clarification amendments to IFRS 9 (HKFRS 9) is expected in the first half of 2019.

Section 5 **Page 515**	**The final bullet point within the introduction to section 5 is amended to be:** • Financial guarantee contracts not measured at FVTPL (see section 6).
Section 6 **Page 521**	**A new section 6 is inserted and the remaining sections of the chapter are renumbered 7–9.**

6 Financial guarantee contracts

Topic highlights

A financial guarantee contract is initially measured at fair value and subsequently measured at the higher of the HKFSR 9 expected credit loss allowance and the initial measurement less any cumulative income or amortisation recognised.

HKFRS 9.Appendix A

As explained in section 1.2.3, a financial guarantee contract (FGC) is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due.

HKFRS 9 provides specific guidance for accounting for financial guarantee contracts.

6.1. Initial recognition

HKFRS 9.B2.5

An FGC is recognised by the issuer as a **financial liability** when the guarantee is issued, and initially measured at **fair value**.

The issuer may receive a premium in consideration for the issue of the FGC. This is likely to be the case where FGC was issued to an unrelated party in a standalone, arm's-length transaction. The issuer is less likely to receive a premium where the debtor is a member of the same group as the issuer.

- Where the issuer receives a premium this premium is equal to the fair value of the instrument on the date of initial recognition, unless there is evidence to the contrary.
- Where no premium is received by the issuer, the fair value must be measured using a different method. This method should quantify the economic benefit of the FGC to the debtor. For example, if a guaranteed loan carries an interest rate of 6% and the same loan without a guarantee carried an interest rate of 10%, then fair value is determined as the present value of the difference in interest amounts over the loan term.

6.2 Subsequent measurement

In accordance with HKFRS 9, an FGC may be designated at fair value through profit or loss if:

- There is an accounting mismatch; or
- If it is part of a portfolio that is managed and has its performance evaluated on a fair value basis.

HKFRS 9.4.2.1

Where this designation is not made, an FGC is subsequently measured at the higher of:

(a) The HKFRS 9 expected credit loss allowance; and

(b) The amount initially recognised less any cumulative income recognised in accordance with the principles of HKFRS 15.

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HKFRS 9.B5.5.8, B5.5.32

6.2.1 Expected credit loss allowance

As explained in section 5, credit losses are measured at the present value of cash shortfalls. In the case of FGC, cash shortfalls are the difference between:

- Expected payments to reimburse the holder for a credit loss that it incurs; and
- Any amounts that the entity expects to receive from the holder, the debtor or any other party.

When considering whether lifetime expected credit losses should be recognised due to a significant increase in the risk of default, the reporting entity should consider changes in the risk that the **specified debtor** will default on the contract.

Example

On 1 January 20X7, Eastern Bank provided a $10 million loan to Hartley Holt Company (HHC). The loan carried an annual interest rate of 6%. HHC's parent company, Whitaker Smee Company (WSC) provided a guarantee to Eastern Bank for any losses incurred if HHC defaulted on payments due over the three-year term of the loan. If the guarantee had not been provided, the annual interest rate attached to the loan would have been 9%.

At 31 December 20X7 there is a 2% probability that HHC will default on the loan in the next 12 months and WSC will be required to reimburse Eastern Bank with $10 million; at 31 December 20X8 there is a significant increase in the risk of default and the probability of default within the remaining term of the loan is 70%, again with the result that WSC would have to reimburse Eastern Bank with $10 million. In the case of a default, WSC does not anticipate receiving any amounts in respect of the guarantee.

An appropriate discount rate to use throughout is 9%.

Required

How should WSC account for the guarantee provided over the two years to 31 December 20X8?

Solution

The guarantee is a financial guarantee contract because WSC guarantees specified amounts to Eastern Bank in relation to a specified debtor, HHC.

1 January 20X7

WSC recognises the FGC on 1 January 20X7 at fair value. As no premium is received, fair value is calculated as the present value of the difference between contractual interest and interest if there were no guarantee.

	Without guarantee	*With guarantee*	*Difference*	*Discount factor*	*Present value*
	$	$	$		$
31.12.X7	900,000	600,000	300,000	1/1.09	275,229
31.12.X8	900,000	600,000	300,000	$1/1.09^2$	252,504
31.12.X9	10,900,000	10,600,000	300,000	$1/1.09^3$	231,655
					759,388

The FGC is initially recognised by WSC by:

		$'000	$'000
DEBIT	Investment in subsidiary	759	
CREDIT	Financial liability		759

To recognise the FGC at fair value.

The debit entry is not to WSC's profit or loss as the transaction does not represent an expense of that company. Instead WSC is providing a form of capital to its subsidiary and so recognises the transaction as an investment in its subsidiary.

31 December 20X7

The FGC is measured at the higher of:

- The initial fair value less cumulative income (i.e. the present value of remaining cash flows):

	$'000
Initial fair value	759
Amortisation ($300,000/1.09^3)	(232)
	527

- The expected credit loss allowance:

  $10,000,000 × 2% = $200,000

Therefore the FGC is measured at fair value less cumulative income. The change in carrying amount is recognised by:

		$'000	$'000
DEBIT	Financial liability	232	
CREDIT	Finance income		232

To recognise the amortisation of the liability for the FGC.

31 December 20X8

The FGC is measured at the higher of:

- The initial fair value less cumulative income (i.e. the present value of remaining cash flows):

	$'000
Initial fair value	759
Amortisation in 20X7 ($300,000/1.09^3)	(232)
Amortisation in 20X8 ($300,000/1.09^2)	(253)
	274

- The expected credit loss allowance:

  $10,000,000 × 70% = $7,000,000

Therefore the FGC is measured at the expected credit loss allowance. The change in carrying amount of $6,473,000 ($7,000,000 – $527,000) is recognised by:

		$'000	$'000
DEBIT	Profit or loss	6,726	
CREDIT	Financial liability		6,473
CREDIT	Finance income		253

To recognise amortisation of the liability for the FGC and adjust carrying amount to be the amount of the loss allowance.

Note. In this example the amortisation of the FGC is equal to the present value of cash flows that no longer form part of the fair value of the instrument. As an approximation amortisation may be calculated on a straight-line basis (i.e. $253,000 per annum).

Chapter 21	Accounting policies, changes in accounting estimates and errors; events after the reporting period
Section 1.2 **Page 625**	**The definition of material is amended to be:** **Material.** Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements which provide financial information about specific reporting entity.
Section 1.2 **Page 625**	**A new subsection 1.2.1 is added:** **1.2.1 Definition of material** HKAS 8 refers to the HKAS 1 detailed definition of materiality. When assessing materiality both the nature and magnitude of information should be considered. Information should be considered in the context of the financial statements taken as a whole. The characteristics of users should also be considered when determining whether information could reasonably be expected to influence their decisions. The definition of materiality was amended in 2018 to include reference to 'obscuring' information. Further guidance added to HKAS 1 clarifies that information is obscured if it is communicated in a way that would have a similar effect on users as omitting or misstating information, for example: (a) Information regarding a material item, transaction or event is disclosed but the language used is vague and unclear; (b) Such information is scattered throughout the financial statements; (c) Dissimilar items, transactions or events are inappropriately aggregated; (d) Similar items, transactions or events are inappropriately disaggregated; (e) Material information is hidden by immaterial information so reducing understandability.
Section 5 **Page 634**	**A new section 5 is added and the existing section 5 is renumbered to be section 6.** **5 Current developments** The IASB has two projects relating to IAS 8 (HKAS 8) within its work plan. If and when amendments are complete, it is likely that they will be adopted by the HKICPA. **Accounting Policy Changes – proposed amendments to IAS 8** This project addresses the issue of changes in accounting policy made by reporting entities as a result of agenda decisions issued by the IFRS Interpretations Committee. As agenda decisions are not mandatory, such a change in policy is voluntary and so IAS 8 (HKAS 8) requires it to be applied retrospectively. In order not to discourage accounting policy changes in these circumstances, the proposed amendments would allow relief from full retrospective application if the costs of determining the effects of the change in policy exceed the expected benefits of applying it retrospectively. A tentative decision was made in December 2018 not to amend IAS 8 (HKAS 8) and the direction of the project is currently under review.

	Accounting Policies and Accounting estimates – proposed amendments to IAS 8 This project was the result of inconsistency in practice in the way in which entities distinguish between accounting policies and accounting estimates. As a result the IASB is proposing to amend the definition of accounting policies within IAS 8 (HKAS 8) and add a definition of accounting estimates. The proposed definition of accounting policies is 'the specific principles, measurement bases and practices applied by an entity in preparing and presenting financial statements' (ED/2017/5, p. 6). This definition is more concise than the existing definition and more consistent with the wording used in other standards. The proposed definition of accounting estimates is 'judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision' (ED/2017/5, p. 6). It is also proposed that a paragraph is added to IAS 8 (HKAS 8) to clarify that the cost formula used for inventories (either first-in, first-out or weighted average cost) is an accounting policy rather than an accounting estimate.

Chapter 23	Operating segments
Section 1.7.1 **Page 679**	**This section is to be deleted as the IASB has decided not to proceed with the proposed amendments to IFRS 8 (HKFRS 8) on the basis that the costs of implementation would exceed the expected benefits.**

Chapter 25	Presentation of financial statements
Section 1.5.3 **Page 719**	**The definition of material is amended and a sentence added after the definition as follows:** **Material.** Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements which provide financial information about specific reporting entity. Further detail on the definition of material is provided in Chapter 21, section 1.2.1.
Section 1.6 **Page 721**	**A subtitle '1.6.1 Classification of liabilities as current or non-current' is added to the existing text and the following sentence is added at the end.** When issued, expected in 2019, the amendments are likely to be adopted by the HKICPA.
Section 1.6 **Page 721**	**New subsections are added within section 1.6** **1.6.2 Disclosure Initiative – accounting policies** In 2017, the IASB issued a discussion paper on Principles of Disclosure. This identified that in general disclosures provide too much irrelevant information, and too little relevant information and are also ineffective at communicating information. In response it is expected that IAS 1 will be amended so that reporting entities have to disclose their material accounting policies rather than significant accounting policies. The Materiality Practice Statement will be amended to provide examples of the application of materiality within accounting policy disclosures. An exposure draft is expected in 2019.

1.6.3 Primary financial statements

This project is in its early stages; the IASB is considering changes to the structure and content of all primary financial statements, in part due to the impact of digital reporting, and is examining the use of additional performance measures in the statement of performance by reporters. As a result of the use of these measures (such as EBIT), companies' reporting is inconsistent and may result in investors making poor decisions. A discussion paper or exposure draft is expected in 2019.

Chapter 26	Principles of consolidation
Section 4.2 **Page 756**	**The following definition is added to the list of key terms:** **Business.** An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investing income (such as dividends or interest) or generating other income from ordinary activities.
Section 4.3 **Page 756**	**A new section 4.3 is added to replace the existing section 4.3, which is renumbered to be section 4.4:**

4.3 Definition of a business

A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are defined as follows:

(a) **Input:** Any economic resource that creates outputs or has the ability to contribute to the creation of outputs, when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

(b) **Process:** Any system, standard, protocol, convention or rule that, when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity or an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) **Outputs:** The result of inputs ad processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

4.3.1 Optional test

An amendment to HKFRS 3 (Revised) in 2018 introduced an optional test ('the concentration test') to assess whether an acquired set of activities and assets is a business. The choice to apply the test can be made on a transaction-by-transaction basis. If the test is met, the set of activities and assets is determined not to be a business and no further assessment is required. The test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

4.3.2 Elements of a business

If the optional test is not applied the elements of a business (input, process and output) must be considered.

Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business. As a minimum, to be considered a business, an integrated set of activities and assets must include an input and a substantive process that together significantly contribute to the ability to create output.

If an acquired set of activities and assets has outputs, continuation of revenue is not, on its own, sufficient to indicate that both an input and a substantive process have been acquired.

The nature of the elements of a business varies by industry, structure of operations and stage of development. Established businesses often have several inputs, processes and outputs, whereas new businesses generally have few inputs and processes and may have a single output. Most businesses have liabilities but the existence of liabilities does not necessarily indicate that acquired activities and assets are a business; equally a business may not have liabilities.

4.3.3 Substantive process

An acquired process must be substantive in order to conclude that a set of activities and assets are a business. An acquired process may or may not have outputs at the acquisition date.

An acquired process without outputs at the acquisition date is only substantive if:

(a) It is critical to the ability to develop or convert inputs into outputs, and

(b) The inputs acquired include both an organised workforce with the ability to perform the process and other inputs that the workforce could convert into outputs (e.g. intellectual property).

An acquired process with outputs at the acquisition date is substantive if:

(a) It is critical to the ability to continue producing outputs and the inputs acquired include an organised workforce with the ability to perform the process, and

(b) It significantly contributes to the ability to continue producing outputs and is unique or scarce and cannot be replaced without significant cost, effort or delay to the production of outputs.

Section 4.3

Page 756

This section is renumbered section 4.4 and the subsections are renumbered accordingly. The text in the introduction to this section is replaced by the following:

A transaction or other event is a business combination only if the assets acquired and liabilities assumed constitute a business as defined above. If the assets acquired are not a business, the reporting entity must account for the transaction or other event as an asset acquisition.

HKFRS 3 (revised) requires that business combinations are accounted for by applying the acquisition method. This involves:

(a) Identifying the acquirer

(b) Determining the acquisition date

(c) Recognising and measuring the identifiable assets acquired, liabilities assumed and non-controlling interests in the acquire

(d) Recognising and measuring goodwill.

Section 4.3.3 **Page 757**	**The first sentence after the bullet points is amended to be:** In doing so, the acquirer should apply the recognition criteria of the *Conceptual Framework* (2010). In other words, items should result in probable transfer of economic benefit and be capable of reliable measurement.
Section 6 **Page 774**	**This section is deleted as the definition of a business project is now complete, resulting in amendments to HKFRS 3 that are reflected in the chapter.**

Chapter 28	Consolidated accounts: accounting for associates and joint arrangements
Section 1.6 **Page 840**	**The third bullet point is amended to be:** • Other long-term interests such as long-term loans or preference shares (see section 1.8)
Section 1.8 **Page 842** HKAS 28.14A, 38	**The current section 1.8 is renumbered to be section 1.9 and the following new section 1.8 is inserted:** **1.8 Other long-term interests in associates** An associate interest is usually determined by reference to equity (voting) shares, and it is this investment to which equity accounting is applied. An investor may have other long-term interests in an entity that is classified as an associate, for example, long-term loans to the associate or an investment in its preference shares or other non-voting shares. The accounting treatment applied to these other long-term interests is as follows: (a) HKFRS 9 is applied to recognise and measure other long-term interests (including the impairment requirements of HKFRS 9). (b) These other long-term interests are aggregated with the equity investment to form a total, being the net investment in the associate. (c) HKAS 28 requirements regarding recognition of losses (section 1.6) and impairment losses (section 1.7) are applied to the net investment in the associate, meaning that the recognition of trading/impairment losses may reduce the individual carrying amount of other long-term interests within the scope of HKFRS 9 as well as the carrying amount of the equity investment in the associate. Losses are applied first to the equity investment in the associate and then to the other investments in the reverse order of their priority in liquidation. When applying HKFRS 9 requirements to other long-term interests, an entity should not take into account any adjustments to their carrying amounts due to the allocation of losses required by HKAS 28.
Section 1.9 **Page 842**	**This section is to be deleted.**

Chapter 29	Changes in group structures
Section 2.5	**This section is renamed and the text amended as follows:**
Page 887	**1.5 Acquisition of additional shares in a joint operation**
HKFRS 3.42A HKFRS 11.B33CA	HKFRS 3 and HKFRS 11 address two situations involving an increase in shares held in a joint operation: (a) Where a joint operator gains control of a joint operation that is a business, the acquirer should apply the HKFRS 3 requirements for a business combination achieved in stages. It should therefore remeasure the previously held interest in the joint operation to fair value at the acquisition date. (b) Where a party that participates in a joint operation gains joint control of that joint operation, it should not remeasure previously held interest upon gaining joint control.

Chapter 30	Consolidation of foreign operations
Section 2.5 **Page 916**	**This section is renamed 'HK(IFRIC) Int-22 *Foreign Currency Transactions and Advance Consideration'***
Section 2.5 **Page 916**	**The first sentence is deleted and the second sentence amended to be:** HK(IFRIC) Int-22 deals with the issue of non-refundable consideration received or paid in advance of a foreign currency transaction.

Answers to exam practice questions

Chapter 1, Question 1 **Page 935**	**The eighth and ninth paragraphs are replaced by the following:** Paragraph R220.4 of the *Code* states that, when preparing or presenting information, a professional accountant in business should: (a) Prepare or present the information in accordance with a relevant reporting framework, in this case in accordance with HKFRS; (b) Prepare or present the information in a manner that is intended neither to mislead nor to influence outcomes inappropriately; (c) Exercise professional judgment to represent the facts accurately and completely in all material respects, describe clearly the true nature of business transactions or activities and classify and record information in a timely and proper manner; (d) Not omit anything with the intention of rendering the information misleading or of influencing outcomes inappropriately. **In the final paragraph:** The reference to section 320.6 of the *Code* is replaced by reference to paragraph R220.9.
Chapter 2, Question 1 **Page 936**	**The second paragraph is amended to be:** Paragraph 3.9 of the *Conceptual Framework* states that financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations.
Chapter 2, Question 2 **Page 937**	**References to the *Code of Ethics for Professional Accountants* are amended as follows:** In paragraph 2, section 100.5 becomes paragraph 100.1 A1 In paragraph 3, section 300.5 becomes paragraph 200.5 A3 In paragraph 4, section 300.6 becomes paragraph R115.1 In the final paragraph, section 300.15 becomes paragraph 200.8 A2
Chapter 2, Question 3 **Page 937**	**References to the *Code of Ethics for Professional Accountants* are amended as follows:** In paragraph 2, section 100.5 becomes paragraph 100.1 A1 In paragraph 3, section 300.5 becomes paragraph 200.5 A3 In paragraph 4, section 300.6 becomes paragraph R115.1 In the final paragraph, section 300.15 becomes paragraph 200.8 A2 **Paragraph 6 is replaced by the following:** Safeguards should be applied to eliminate or reduce threats to compliance with the fundamental principles to an acceptable level (120.10 A2 of the *Code)*. These may include policies and procedures to empower employees to communicate with senior management within the entity, the audit committee, those charged with governance of the organisation or another appropriate professional accountant.

Question bank – answers	
Section A **Answer 1** **Page 1030**	**The first bullet point on the page is amended to be:** • To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the 2010 *Conceptual Framework for Financial Reporting* at the acquisition date.
Section B **Answer 23** **Page 1094**	**References to the *Code of Ethics for Professional Accountants* in Answer 6(c) are amended as follows:** In paragraph 2, section 100.5 becomes paragraph 100.1 A1 In the final paragraph, section 300.15 becomes paragraph 200.8 A2

Errata – Flashcards

Chapter 29	Changes in group structures
Page 197	**The final sentence in the 'Goodwill' box is amended to read:** The gain or loss on remeasurement of the previously held interest to fair value is recognised in profit or loss or OCI as appropriate.

Technical Update – Flashcards

Chapter 2	Financial reporting framework
Page 9	**In the HKFRSs box the third bullet point is amended to be:** • HKFRS 1 – 17
Page 10	**The middle box on the right hand side is amended to read:** (a) Identify and threats to compliance: – Self-interest threat – Self-review threat – Familiarity threat – Intimidation threat – Advocacy threat **A new box is added beneath this:** (b) Evaluate whether threats are at an acceptable level. **The bottom box on the right hand side is amended to read:** (c) Eliminate or reduce threats by: – Eliminating the circumstances that cause the threats – Applying safeguards, or – Declining or ending the professional activity.
Page 13	**A sentence is added to the bottom of the page:** Management has a responsibility to use an entity's economic resources efficiently and effectively; financial information helps users to assess the stewardship of management.
Page 14	**On the left hand side of the diagram the second sub-bullet under Faithful representation is amended to read:** – Neutral (supported by prudence)
Page 14	**A new page is added after existing page 14:** **Financial statements and the reporting entity** Financial statements are prepared (usually on the going concern assumption) for a reporting period and include: – Statement of financial position – Statement(s) of financial performance – Other statements and notes

	Comparative amounts are also provided. A reporting entity may be: – A single entity which prepares unconsolidated financial statements – Two or more entities with no control relationship, which prepare combined financial statements – An entity that controls other entities that prepares consolidated financial statements.
Page 15	**This page is replaced by the following two pages:**

Elements:

Asset – present economic resource controlled by the entity as a result of past events **Economic resource** – right that has the potential to produce economic benefits.	**Liability –** a present obligation to transfer an economic resource as a result of past events. **Obligation** – a duty or responsibility that an entity has no practical ability to avoid.
• **Equity** • **Income** • **Expenses**	

Recognition and derecognition

An item is **recognised** if: • It meets the definition of an element • It provides relevant information • It results in a faithful representation Affected by existence uncertainty and measurement uncertainty	An **asset is normally derecognised** when control is lost. A **liability is normally derecognised** when there is no longer a present obligation.

Page 16 — **The existing page 16 is replaced by the following:**

Measurement

Two main bases:

- Historical cost
- Current value

– Fair value
– Value in use or fulfilment value
– Current cost

Qualitative characteristics of financial information should be considered when selecting a measurement basis.

Page 16 **A new page is added after the existing page 16:**

Presentation and disclosure

- Effective presentation and disclosure requires:
  - Focus on presentation and disclosure objectives and principles
  - The grouping of similar items, separation of dissimilar items and in general no offsetting of assets and liabilities
  - Effective aggregation of information
- In principle all income and expenses are included in profit or loss rather than recognised as other comprehensive income, and
- In principle all other comprehensive income is reclassified to profit or loss in a future period.

Page 18 **An additional section is added to existing page 18:**

Making materiality judgments

- Materiality is pervasive to the preparation of financial statements; when considering whether information is material, a company should consider the needs of primary users of its financial statements.
- A four-step process is suggested to assess materiality:
  - Identify information that has the potential to be material.
  - Assess whether information identified is material.
  - Organise the information within the draft financial statements.
  - Review and consider whether to add/remove information.

Page 19 **This page is deleted.**

Chapter 3 Small company reporting

Page 23 **The final row in the table is amended and a new row added as follows:**

Group of eligible companies	• Each company qualifies as a small private company or eligible larger company • Aggregate amounts for the group must not exceed two of three of the size tests for larger eligible private companies	At least 75% of the members of the holding company of the group must approve and none of the members holding the remaining voting rights vote against the resolution.

Mixed group (a group comprising a mix of one or more small/eligible private companies and one or more small companies limited by guarantee)	If holding company is a small private company the aggregate amounts for the group must not exceed two of three of the size tests for a group of small private companies.	No member approval is required
	If holding company is an eligible private company, the aggregate amounts for the group must not exceed two of three of the size tests for a group of larger eligible companies	At least 75% of the members of the holding company of the group must approve and none of the members holding the remaining voting rights vote against the resolution.
	If holding company is a small company limited by guarantee, the aggregate annual revenue of the mixed group must not exceed $25m	No member approval is required

Chapter 17	Financial instruments

Page 115

New text is inserted below the two existing text boxes:

Financial guarantee contracts [HKFRS 9]

- A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due.
- Recognised by the issuer as a **financial liability** and initially measured at **fair value (**= premium, if received)
- Subsequently measured at:
  - FVTPL if designation made;
  - Higher of HKFRS 9 expected credit loss or initial fair value less cumulative income.

Chapter 28	Consolidated accounts: accounting for associates and joint arrangements

Page 188

New text is added as follows:

Other long-term interests in associate

E.g. Long-term loans to associates or preference shares held

- Measure in accordance with HKFRS 9
- Form part of the net investment in associate and are allocated trading and impairment losses

Appendix