HKFRS for Private Entities

Accounting Standard

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

CONTENTS

The *Hong Kong Financial Reporting Standard for Private Entities* (*HKFRS for Private Entities* Accounting Standard) is set out in Sections 1–35 and Appendices A–B. Terms defined in the Glossary are in **bold type** the first time they appear in each section, as appropriate. The *HKFRS for Private Entities* Accounting Standard is accompanied by a preface, a comparison with *IFRS for SMEs* Accounting Standard (Appendix C), a basis for conclusions and illustrative financial statements.

HKFRS for Private Entities Accounting Standard

Introduction

Overview of the amendments in the revised Standard

Table 1 lists the amendments by section of the *HKFRS for Private Entities* Accounting Standard. Editorial and minor consequential amendments are only listed for sections with no substantive amendments.

Table 1—Overview of the amendments in the revised Standard

Section	Subject of amendment
Preface to the *HKFRS for Private Entities* Accounting Standard	1. Section revised to reflect updates to the *Preface to the HKFRS Accounting Standards*, revised in 2025. 2. Clarification of the authority of appendices in the Standard.
Section 1 *Private Entities*	3. Clarification of the definition of 'public accountability' (see paragraph 1.3(b)).
Section 2 *Concepts and Pervasive Principles*	4. Section revised to align with the 2018 *Conceptual Framework*.
Section 3 *Financial Statement Presentation*	5. Clarification of the requirements relating to materiality, order of the notes, subtotals, accounting policies and disaggregation (see paragraph 3.15A). 6. Clarification of the definition of 'material' and its application (see paragraph 3.16). 7. Relocation of the description of the accrual basis of accounting from Section 2 *Concepts and Pervasive Principles* to this section (see paragraph 3.16A). 8. Amendment to require entities to disclose 'material accounting policy information' instead of 'significant accounting policies' (see paragraph 3.17(e)).
Section 4 *Statement of Financial Position*	9. Amendment to require the disaggregation of line items in the statement of financial position when such presentation is relevant to an understanding of an entity's financial position (see paragraph 4.3). 10. Removal of the requirement to disaggregate trade and other receivables to separately show receivables arising from accrued income not yet billed as a consequence of the revised Section 23 *Revenue from Contracts with Customers* (see paragraph 4.11(b)).
Section 5 *Statement of Comprehensive Income and Income Statement*	11. Editorial amendments only.

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Section	Subject of amendment
Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*	12. Addition of a requirement to disclose the amount of dividends proposed (or declared) before the financial statements were authorised for issue but not recognised as a distribution to owners during the period, and the amount per share; and the amount of any cumulative preference dividends not recognised (see paragraph 6.6).
Section 7 *Statement of Cash Flows*	13. Addition of a requirement to disclose a reconciliation of changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash flows (see paragraph 7.19A). 14. Addition of requirements to disclose information about supplier finance arrangements (see paragraphs 7.19B–7.19C).
Section 8 *Notes to the Financial Statements*	15. Amendments to require entities to disclose 'material accounting policy information' instead of 'significant accounting policies' (see paragraphs 8.4–8.6). 16. Addition of examples of the types of judgements management might make in the process of applying the private entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements (see paragraph 8.6).
Section 9 *Consolidated and Separate Financial Statements*	17. Amendment to the definition of 'control' and clarification of the application of the rebuttable presumption (see paragraphs 9.4–9.12). 18. Amendments to set out requirements when a parent loses control of a subsidiary and to require entities to measure any retained interest in a former subsidiary at its fair value at the date control is lost (see paragraphs 9.18–9.19). 19. Relocation of requirements on changes in a parent's controlling interest in a subsidiary from Section 22 *Liabilities and Equity* to this section (see paragraph 9.20A). 20. Removal of the requirement to disclose the basis for concluding that control exists when the parent does not own more than half of the voting power in the other entity (see paragraph 9.23(b)). 21. Addition of a requirement to disclose information on losing control of a subsidiary if the entity retains an interest in the former subsidiary (see paragraph 9.23B). 22. Amendment to specify that a parent that is exempt in accordance with paragraph 9.3 from preparing consolidated financial statements is permitted to present separate financial statements as its only financial statements (see paragraph 9.25A). 23. Amendment to require additional information for an entity that prepares separate financial statements (see paragraph 9.27(c)).

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Section	Subject of amendment
Section 10 *Accounting Policies, Estimates and Errors*	24. Consequential amendments arising from the removal of the option to apply the recognition and measurement requirements of HKAS 39 *Financial Instruments: Recognition and Measurement* that was previously in Sections 11 and 12 (see paragraph 10.11). 25. Amendment to introduce the definition of 'accounting estimate' to help entities distinguish changes in accounting estimates from changes in accounting policies (see paragraphs 10.14A–10.15).
Section 11 *Financial Instruments*	26. Removal of the option for an entity to apply the recognition and measurement requirements of HKAS 39 (see paragraph 11.2). 27. Amendment to exclude from the scope of this section financial guarantee contracts issued at nil consideration when the specified debtor is another entity within the group, and also clarify that other issued financial guarantee contracts are in the scope of this section (see paragraphs 11.6(g) and 11.49(k)). 28. Clarification that debt instruments that have prepayment features with negative compensation payments can still meet the criteria to be measured at amortised cost (see paragraph 11.9(b)). 29. Addition of a supplementary principle for classifying debt instruments based on their contractual cash flow characteristics (see paragraph 11.9ZA). 30. Clarification of the reclassification requirements for financial instruments (see paragraph 11.11A). 31. Consequential amendments to initial measurement requirements in this section arising from the revised Section 23 (see paragraph 11.13–11.13A). 32. Relocation to this section of the requirements in the previous Section 23 *Revenue* on the recognition of revenue from dividends (see paragraphs 11.14A and 11.55). 33. Relocation to the new Section 12 *Fair Value Measurement* of the requirements for estimating fair value and disclosing information about fair value measurements (see paragraphs 11.27–11.32). 34. Addition of requirements to disclose an analysis of the age of financial assets and a maturity analysis of financial liabilities (see paragraphs 11.43–11.43B). 35. Relocation of the requirements in the previous Section 12 *Other Financial Instrument Issues* to a separate part of this section (Part II *Other Financial Instrument Issues*). 36. Consequential amendment to the scope of this section for contracts for contingent consideration in a business combination arising from the revised Section 19 *Business Combinations and Goodwill* (see paragraph 11.49(g)).
Section 12 *Fair Value Measurement*	37. A new section that sets out the requirements for measuring fair value and disclosing information about fair value measurements.

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Section	Subject of amendment
Section 13 *Inventories*	38. Consequential amendments to this section arising from the revised Section 23 (see paragraphs 13.2(a), 13.2A and 13.14).
Section 14 *Investments in Associates*	39. Clarification of the treatment of long-term interests in an associate or jointly controlled entity that form part of the entity's net investment in an associate or jointly controlled entity (see paragraphs 14.8(d) and 14.8(h)).
Section 15 *Joint Arrangements*	40. Replacement of the term 'joint venture' with 'joint arrangement'. 41. Amendment of the definition of 'joint control' to align it with the definition of 'control' in Section 9 *Consolidated and Separate Financial Statements* (see paragraphs 15.2 and 15.2A). 42. Amendments to require an entity that does not have joint control of a joint arrangement to account for its interest based on the type of arrangement (see paragraphs 15.18–15.18B). 43. Removal of the requirement for entities to disclose their share of the capital commitments of joint ventures (see paragraph 15.19(d)).
Section 16 *Investment Property*	44. Clarification that determining whether a transaction meets both the definition of 'business combination' and 'investment property' requires separate application of this section and Section 19 (see paragraph 16.3A). 45. Clarification that an entity shall transfer a property to, or from, investment property only when there is evidence of a change in use (see paragraph 16.9). 46. Relocation to the new Section 12 of the requirement to disclose information about fair value measurements (see paragraph 16.10(a)).
Section 17 *Property, Plant and Equipment*	47. Amendment to include bearer plants that are separately measurable without undue cost or effort within the scope of this section (see paragraph 17.3(a)). 48. Clarification of the factors considered in determining the useful life of an asset stating that expected future reductions in the selling price of an item produced using the asset could indicate the expectation of technical or commercial obsolescence of that asset (see paragraph 17.21(c)). 49. Clarification that a depreciation method based on revenue is not appropriate (see paragraph 17.22). 50. Consequential amendments arising from the revised Section 23 (see paragraph 17.29). 51. Relocation to the new Section 12 of the requirement to disclose information about fair value measurements (see paragraph 17.33(c)).

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Section	Subject of amendment
Section 18 *Intangible Assets other than Goodwill*	52. Clarification of the definition of ‘asset’ used in this section (see footnote to paragraph 18.4). 53. Addition of a rebuttable presumption that amortisation methods based on revenue are not appropriate, with details of the limited circumstances in which the presumption may be rebutted (see paragraph 18.22A).
Section 19 *Business Combinations and Goodwill*	54. Section revised to align with HKFRS 3 (2008) *Business Combinations* and subsequent amendments, including *Definition of a Business* (2018) and *Reference to the Conceptual Framework* (2020).
Section 20 *Leases*	55. Editorial amendments only.
Section 21 *Provisions and Contingencies*	56. Clarification of the definition of ‘liability’ used in this section (see footnote to paragraph 21.1). 57. Removal of requirements relating to contingent consideration in a business combination from the scope of this section as a consequence of the revised Section 19 (see paragraph 21.1(e)). 58. Amendment to include financial guarantee contracts issued at nil consideration when the specified debtor is another entity within the group within the scope of this section and specify additional disclosures (see paragraphs 21.1A and 21.18–21.19). 59. Relocation of the guidance on restructuring costs from the Appendix to this section and the addition of examples (see paragraphs 21.6A–21.6B and 21A.3). 60. Removal of the example on customer refunds from the Appendix to this section as a consequence of the revised Section 23 (see paragraph 21A.5).
Section 22 *Liabilities and Equity*	61. Removal of contracts for contingent consideration in a business combination from the scope exclusions of this section as a consequence of the revised Section 19 (see paragraph 22.2(c)). 62. Addition of a relief from presenting the amount receivable as an offset to equity when equity instruments are issued before the receipt of cash or other resources when laws or regulations prohibit such presentation (see paragraph 22.7(a)). 63. Relocation of the requirements on transactions in shares of a consolidated subsidiary to Section 9 (see paragraph 22.19).
Section 23 *Revenue from Contracts with Customers*	64. Section revised to align with HKFRS 15 *Revenue from Contracts with Customers*.

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Section	Subject of amendment
Section 24 *Government Grants*	65. Editorial amendments only.
Section 25 *Borrowing Costs*	66. Editorial amendments only.
Section 26 *Share-based Payment*	67. Amendments to specify which transactions that occur when businesses or entities restructure their equity, or combine or form a jointly controlled entity, are included or excluded from the scope of this section (see paragraph 26.1C). 68. Clarification of the definition of ‘fair value’ used in this section (see paragraphs 26.1D–26.1E). 69. Clarification of whether requirements apply only to share based payment transactions with employees and others providing similar services (see paragraphs 26.5–26.6, 26.8 and 26.16). 70. Clarification of the definition of ‘vesting conditions’ by separately defining a ‘performance condition’ and a ‘service condition’ (see paragraph 26.9). 71. Addition of requirements on the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments (see paragraphs 26.14A–26.14B). 72. Addition of requirements on the classification of share-based payment transactions with a net settlement feature for withholding tax obligations (see paragraphs 26.15–26.15D).
Section 27 *Impairment of Assets*	73. Consequential amendments to this section arising from the new Section 12 and the revised Section 23 (see paragraphs 27.1(f) and 27.14).
Section 28 *Employee Benefits*	74. Clarification that an entity is required to assess the depth of the market for high quality corporate bonds at a currency level (see paragraph 28.17). 75. Clarification that an entity using the measurement simplification for its defined benefit obligation measures the obligation at the current termination amount, assuming all the entity’s employees terminate their employment at the reporting date (see paragraph 28.19). 76. Amendments to align the requirements on the timing of the recognition of termination benefits with the requirements on the recognition of restructuring costs in the scope of Section 21 *Provisions and Contingencies* (see paragraphs 28.31, 28.34–28.35). 77. Addition of a requirement for an entity that applies the measurement simplification for its defined benefit obligation to disclose its assumptions for measuring its obligation (see paragraph 28.41(c)). 78. Amendment to require a more detailed reconciliation of the opening and closing balances of a defined benefit obligation (see paragraph 28.41(e)).

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Section	Subject of amendment
	79. Amendment to require a more detailed reconciliation of the opening and closing balances of plan assets and any recognised reimbursement rights (see paragraph 28.41(f)). 80. Removal of the requirement to disclose the total cost related to defined benefit plans for the period (see paragraph 28.41(g)). 81. Addition of a requirement to disclose the expected contributions to the defined benefit plan for the next annual reporting period (see paragraph 28.41(l)). 82. Addition of a requirement for an entity that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group to disclose its contribution towards the group plan (see paragraph 28.41C). 83. Addition of an option for an entity that recognises and measures employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group to disclose information about the group plan by cross-reference to the financial statements of another group entity if specific criteria are met (see paragraph 28.41D). 84. Addition of a requirement to disclose information about contingent liabilities arising from post-employment benefit obligations if required by Section 21 (see paragraph 28.41E).
Section 29 *Income Tax*	85. Clarification of the requirements for when a deferred tax asset is recognised for unrealised losses (see paragraphs 29.16A, 29.19(a) and 29.19A). 86. Addition of requirements on how to reflect the effects of uncertainty in the accounting for income taxes (see paragraphs 29.34A–29.34D). 87. Amendments to the requirements for offsetting income tax assets and liabilities (see paragraphs 29.37–29.37A and 29.41).
Section 30 *Foreign Currency Translation*	88. Addition of requirements to apply a consistent approach to assessing whether a currency is exchangeable into another currency, and to determining the exchange rate to use and the disclosures to provide (see paragraphs 30.5A, 30.28–30.29 and Appendix to Section 30). 89. Addition of a requirement for determining the exchange rate to use in transactions that involve advance consideration paid or received in a foreign currency (see paragraph 30.8A).
Section 31 *Hyperinflation*	90. Editorial amendments only.
Section 32 *Events after the End of the Reporting Period*	91. Not amended.

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Section	Subject of amendment
Section 33 *Related Party Disclosures*	92. Amendment of the heading related to the disclosure of controlling party relationships (see heading above paragraph 33.5). 93. Addition of a requirement to disclose amounts incurred by an entity for the provision of key management services that are provided by a separate management entity (see paragraph 33.7A). 94. Clarification of the requirement to disclose information about commitments between an entity and its related parties (see paragraph 33.9(b)). 95. Replacement of the term 'state' with 'government' (see paragraph 33.11). 96. Addition of commitments as an example of a related party transaction (see paragraph 33.12(ha)). 97. Addition of a disclosure requirement for an entity that applies the exemption from disclosing information about the entity's relationship, and transactions, with government-related entities (see paragraph 33.15).
Section 34 *Specialised Activities*	98. Addition of a requirement to account for bearer plants that, at initial recognition, can be measured separately without undue cost or effort, in accordance with Section 17 *Property, Plant and Equipment* (see paragraphs 34.2–34.2B). 99. Removal of requirements on fair value measurement as a consequence of the new Section 12 (see paragraph 34.6). 100. Relocation to the new Section 12 of the requirement to disclose information about the fair value measurement of biological assets (see paragraph 34.7(b)). 101. Addition of a requirement to treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either Section 17 or Section 18 *Intangible Assets other than Goodwill* (see paragraph 34.11G).
Section 35 *Transition to the HKFRS for Private Entities Accounting Standard*	102. Addition of an exception to the retrospective application of the Standard on first-time adoption for contracts with customers completed before the date of transition (see paragraph 35.9(g)). 103. Addition of an option permitting first-time adopters to apply Section 23 retrospectively or prospectively, in accordance with the transitional requirements for the revised Section 23 (see paragraph 35.10(o)).
Appendix A *Effective date and transition*	104. Appendix revised to provide requirements on the transition to the revised Standard.
Appendix B *Glossary of terms*	105. Consequential amendments arising from the amendments to other sections of the Standard.

HKFRS for Private Entities Accounting Standard

Preface to the *HKFRS for Private Entities* Accounting Standard

P1 This Preface sets out the scope and authority of the *HKFRS for Private Entities* Accounting Standard and describes how the Standard is maintained.

P2 Pursuant to section 18A of the Professional Accountants Ordinance (Chapter 50), Council of HKICPA (Council) may, in relation to the practice of accountancy, issue or specify any standards of accounting practice required to be observed, maintained or otherwise applied by members of the HKICPA. Approval of HKFRS Accounting Standards and related documents, such as the *Conceptual Framework for Financial Reporting*, exposure drafts and other discussion documents, is the responsibility of Council.

P3 Council has mandated its Financial Reporting Standards Committee (FRSC) to develop financial reporting standards to achieve convergence with IFRS Accounting Standards issued by the International Accounting Standards Board (IASB). Within this remit, Council permits the FRSC to work in whatever way it considers most effective and efficient and this may include forming advisory sub-committees or other forms of specialist advisory groups to give advice in preparing new and revised HKFRS Accounting Standards.

P4 The FRSC is also responsible for providing timely guidance on newly identified financial reporting issues not specifically addressed in HKFRS Accounting Standards or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop. It thus promotes the rigorous and uniform application of HKFRS Accounting Standards.

P5 The FRSC is responsible for reviewing and advising on the HKICPA's overall strategy, policies and processes for setting financial reporting standards. One of the FRSC's main objectives is to give advice to the HKICPA on priorities and on major standard-setting projects.

P6 In 2001, Council adopted the policy of achieving convergence of HKFRS Accounting Standards with IFRS Accounting Standards. Council's objectives in this respect are:

(a) to develop, in the public interest, a single set of high quality, understandable and enforceable financial reporting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the capital markets and other users of the information to make economic decisions;

(b) to promote the use and rigorous application of those standards;

(c) to promote and support compliance with those standards by members of the HKICPA whether as preparers or auditors of financial information; and

(d) to maintain convergence of financial reporting standards with IFRS Accounting Standards.

Scope and authority of the *HKFRS for Private Entities* Accounting Standard

P7 The IASB has developed and published the *IFRS for SMEs* Accounting Standard, which is designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities that jurisdictions often refer to as small and medium-sized entities (or SMEs), private entities or non-publicly accountable entities.

P8 Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions.

P9 Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organised in corporate form or in other forms.

P10 Many jurisdictions have developed their own definitions of SMEs for a broad range of purposes, including prescribing financial reporting requirements. Definitions that are specific to a particular jurisdiction often include quantified criteria based on revenue, assets, employees or other factors.

Furthermore, the term SMEs is often used to mean or to include very small entities, without regard to whether they publish general purpose financial statements for external users.

P11 In this regard, Council considers that *IFRS for SMEs* Accounting Standard should be adopted in Hong Kong as a reporting option for eligible private entities. Accordingly, this *HKFRS for Private Entities* Accounting Standard is based on *IFRS for SMEs* Accounting Standard by replacing the term "SMEs" in *IFRS for SMEs* Accounting Standards by "Private Entities" to suit Hong Kong's circumstances. The term "SMEs" is widely used in Hong Kong and associated with the locally developed *SME-FRF & SME-FRS*. For clarity and differentiation, this Standard which is based on "*IFRS for SMEs* Accounting Standard" is to be called "*HKFRS for Private Entities* Accounting Standard".

P12 The *HKFRS for Private Entities* Accounting Standard sets out recognition, measurement, presentation and disclosure requirements for transactions and events that are important in general purpose financial statements. It also sets out such requirements for transactions and events that arise mainly in specific industries.

P13 The *HKFRS for Private Entities* Accounting Standard is based on full HKFRS Accounting Standards with modifications to reflect the needs of users of private entities' financial statements and to reflect cost–benefit considerations relevant for private entities and the users of their financial statements.

General purpose financial statements of private entities

P14 The objective of a private entities' general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

Authority of the *HKFRS for Private Entities* Accounting Standard

P15 Council approved the adoption of *HKFRS for Private Entities* Accounting Standard as a **financial reporting option** for private entities. Private entities are companies that:

(a) do not have public accountability (see Paragraph 1.3 for definition of public accountability); and

(b) publish general purpose financial statements for external users.

P16 The scope and applicability of HKFRS Accounting Standards and *SME-FRF & SME-FRS* are unchanged and preparers can continue to use HKFRS Accounting Standards or *SME-FRF & SME-FRS* to prepare their financial statements even though they are qualified to use *HKFRS for Private Entities* Accounting Standard, if they wish to do so.

Organisation of the *HKFRS for Private Entities* Accounting Standard

P17 The *HKFRS for Private Entities* Accounting Standard is organised by topic, with each topic presented in a separate numbered section. Cross-references to paragraphs are identified by section number followed by paragraph number. Paragraph numbers are in the form xx.yy, in which xx is the section number and yy is the sequential paragraph number within that section. In examples that include monetary amounts, the measuring unit is Currency Units (abbreviated as CU).

P18 All of the paragraphs in the *HKFRS for Private Entities* Accounting Standard have equal authority (except as specified in paragraph 2.2). Some sections include appendices of application guidance, which are an integral part of the section, and some sections include appendices of illustrative examples, which accompany but are not part of the section. Appendices A and B are an integral part of the Standard. The definitions in the Glossary in Appendix B are integral to the sections in which the terms appear.

Maintenance of the *HKFRS for Private Entities* Accounting Standard

P19 HKICPA expects to undertake a review of *HKFRS for Private Entities* Accounting Standard in accordance with the IASB timetable to review its *IFRS for SMEs* Accounting Standard. The IASB expects to propose amendments to the *IFRS for SMEs* Accounting Standard by publishing an exposure draft periodically, but not more frequently than approximately once every three years. In developing those exposure drafts, the IASB expects to consider new and amended full IFRS Accounting Standards as well as specific issues that have been brought to its attention regarding the application of the *IFRS for SMEs* Accounting Standard. On occasion, the IASB may identify an urgent matter for which amendment of the *IFRS for SMEs* Accounting Standard may need to be considered outside the periodic review process. However, such occasions are expected to be rare.

P20 Until the *IFRS for SMEs* Accounting Standard is amended, any changes that the IASB may make or propose with respect to full IFRS Accounting Standards do not apply to the *IFRS for SMEs* Accounting Standard. The due process of the *HKFRS for Private Entities* Accounting Standard generally follows that of the HKFRS Accounting Standards as set out in the *Preface to HKFRS Accounting Standards*. Consistent with the current due process of HKICPA, comments will be invited publicly for the IASB exposure draft. FRSC will consider revising the *HKFRS for Private Entities* Accounting Standard based on the IASB revisions to *IFRS for SMEs* Accounting Standard. The *HKFRS for Private Entities* Accounting Standard is a stand-alone document. Entities shall not anticipate or apply changes made to full HKFRS Accounting Standards before the *HKFRS for Private Entities* Accounting Standard is amended unless, in the absence of specific guidance in the *HKFRS for Private Entities* Accounting Standard, an entity chooses to apply guidance in full HKFRS Accounting Standards and those principles do not conflict with requirements in the hierarchy set out in paragraphs 10.4–10.5.

HKFRS for Private Entities Accounting Standard

Section 1
Private Entities

Intended scope of this Standard

1.1 The *HKFRS for Private Entities* Accounting Standard is intended for use by entities without **public accountability**, which are referred to as **private entities** (Private Entities) in this Standard. This section describes the characteristics of Private Entities.

Description of private entities

1.2 Private entities are entities that:

(a) do not have public accountability; and

(b) publish **general purpose financial statements** for external users.

Examples of external users include existing and potential investors, lenders and other creditors, and credit rating agencies.

1.3 An entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (for example, banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks often meet this second criterion).

1.4 Some entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, schools, charitable organisations, co-operative enterprises requiring a nominal membership deposit and sellers that receive payment in advance of delivery of the goods or services such as utility companies), that does not make them publicly accountable.

1.5 If a publicly accountable entity applies this Standard, its financial statements shall not be described as conforming to the *HKFRS for Private Entities* Accounting Standard.

1.6 A **subsidiary** whose **parent** applies **full HKFRS Accounting Standards** or **full IFRS Accounting Standards**, or that is part of a consolidated **group** that applies full HKFRS Accounting Standards or full IFRS Accounting Standards, is not prohibited from applying this Standard in its own financial statements if that subsidiary by itself does not have public accountability. If its financial statements are described as conforming to the *HKFRS for Private Entities* Accounting Standard, it must comply with all of the requirements of this Standard.

1.7 A parent entity (including the ultimate parent or any intermediate parent) assesses its eligibility to apply this Standard in its **separate financial statements** on the basis of its own status without considering whether other group entities have, or the group as a whole has, public accountability. If a parent entity by itself does not have public accountability, it may present its separate financial statements in accordance with this Standard (see Section 9 *Consolidated and Separate Financial Statements*), even if it presents its **consolidated financial statements** in accordance with full HKFRS Accounting Standards or another set of generally accepted accounting principles (GAAP), such as its national accounting standards. Any financial statements prepared in accordance with this Standard shall be clearly distinguished from financial statements prepared in accordance with other requirements.

Section 2
Concepts and Pervasive Principles

Scope of this section

2.1 This section describes the **objective of financial statements** of **private entities** (Private Entities). It also sets out the concepts and basic principles underlying the **financial statements** of Private Entities.

2.2 The concepts and principles in this section might not always align with the requirements in other sections of the Standard. In those cases, the requirements in the other sections take precedence over the concepts and principles in this section.

The objective of financial statements of private entities

Objective, usefulness and limitations of general purpose financial statements

2.3 The objective of an entity's **general purpose financial statements** is to provide financial information about the **reporting entity** that is useful to existing and potential investors, lenders and other creditors when making decisions related to providing resources to the entity.[1]

2.4 Useful information about a reporting entity includes information about:

(a) the **economic resources** of the entity, claims against the entity and changes in those resources and claims; and

(b) how efficiently and effectively the entity's management has met its responsibilities to use the entity's economic resources.

2.5 However, general purpose financial statements do not and cannot provide all the information that existing and potential investors, lenders and other creditors consider when making decisions. These users of an entity's general purpose financial statements (users) also consider pertinent information from other sources—for example, general economic conditions and expectations, political events, and industry and company outlooks.[2]

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims

2.6 General purpose financial statements provide information about an entity's financial position, specifically about the entity's economic resources and the claims against the entity. Financial statements also provide information about the effects of transactions and other events that change the entity's economic resources and claims. Users use this information to make decisions and form expectations based on their assessment of the amount, timing and uncertainty of the entity's future **cash flows**.

2.7 Financial statements also show how efficiently and effectively the reporting entity's management has met its responsibility to use the entity's economic resources. This information helps users assess management's stewardship of those resources.

Qualitative characteristics of information in financial statements

2.8 An entity uses the qualitative characteristics of useful financial information described in paragraphs 2.9–2.24 to identify the types of information likely to be most useful for users when making decisions about the entity.

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1 Throughout this section, 'financial statements' refers to general purpose financial statements unless specified otherwise.

2 Throughout this section, 'users' refers to those existing and potential investors, lenders and other creditors who must rely on general purpose financial statements for much of the financial information they need (primary users of general purpose financial statements).

2.9 Financial information is useful only if it is relevant and faithfully represents what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

2.10 The **fundamental qualitative characteristics** of financial information are relevance and faithful representation.

Relevance

2.11 Financial information is relevant if it can influence users' decisions. Information might be relevant even if some users choose not to make use of it or are already aware of it from other sources.

2.12 Financial information can affect users' decisions by having predictive value, confirmatory value or both.

Materiality

2.13 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 a specific reporting entity. 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 the entity's financial statements. Consequently, the HKICPA cannot specify a uniform quantitative threshold for materiality or predetermine what information might be material in a particular situation.

Faithful representation

2.14 Financial statements represent economic phenomena in words and numbers. Useful financial information not only represents relevant phenomena, but also faithfully represents the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, information about the legal form would not, by itself, faithfully represent the economic phenomenon.

2.15 To be a perfectly faithful representation, a depiction of an economic phenomenon would have three characteristics: completeness, neutrality and freedom from **error**. Perfection is rarely, if ever, achievable. Instead, the HKICPA's objective is to maximise those qualities to the extent possible.

2.16 To be complete, a depiction of an economic phenomenon includes all information necessary for a user to understand the phenomenon, including all necessary descriptions and explanations.

2.17 To be neutral, a depiction of an economic phenomenon is without bias in the selection or presentation of financial information. Neutrality is supported by **prudence**, which is the exercise of caution when an entity makes judgements under conditions of uncertainty. The exercise of prudence means that **assets** and **income** are not overstated and **liabilities** and **expenses** are not understated. Equally, prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses. Such misstatements can lead to the overstatement or understatement of income or expenses in future periods. Consequently, some sections of this Standard might contain asymmetric requirements if necessary to help an entity select the most relevant information that faithfully represents what it purports to represent.

2.18 Faithful representation does not mean the depiction of an economic phenomenon is accurate in all respects. To be free from error, a depiction of the phenomenon contains no errors or omissions, and an entity has selected and applied, without errors, a process to produce the information in the financial statements.

Applying the fundamental qualitative characteristics

2.19 The most efficient and effective process by which an entity applies the fundamental qualitative characteristics of financial information, subject to the effects of enhancing characteristics (see paragraph 2.20) and the cost constraint (see paragraphs 2.25–2.27), is usually:

(a) first, to identify an economic phenomenon, about which information can be useful to users.

(b) second, to identify the type of information about the phenomenon in (a) that would be most relevant.

(c) third, to assess whether the relevant information in (b) is available and whether it can provide a faithful representation of the economic phenomenon. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the entity repeats the process with the next most relevant type of information. In some cases, the entity might have to prioritise one or more of the fundamental qualitative characteristics over others to meet the objective of financial statements (see paragraph 2.32).

Enhancing qualitative characteristics

2.20 Comparability, verifiability, **timeliness** and **understandability** are qualitative characteristics that enhance the usefulness of relevant information that provides a faithful representation of what it purports to represent. These enhancing qualitative characteristics might also help an entity decide how it depicts an economic phenomenon if the entity judges that more than one way provides equally relevant information and an equally faithful representation of that phenomenon.

Comparability

2.21 Information about an entity is more useful if users can compare that information with similar information about other entities and with similar information about the same entity for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences between, items. Comparability is reduced if entities are permitted to use alternative accounting methods for the same phenomenon.

Verifiability

2.22 Verifiability helps assure users that information faithfully represents the phenomenon it purports to represent. Verifiability means that knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is faithful. Quantified information does not have to be a single point estimate to be verifiable; a range of possible amounts and the related probabilities can also be verified.

Timeliness

2.23 Timeliness means having information available to decision-makers in time for it to be able to influence their decisions. Generally, the older the information is, the less useful it is. However, some information might continue to be timely long after the end of a **reporting period** because, for example, some users will use it to identify and analyse trends.

Understandability

2.24 Classifying, characterising and presenting information clearly and concisely makes it understandable. However, understandability should not be used as a justification for omitting material information. A set of financial statements would be incomplete if an entity excluded information about phenomena because the phenomena are inherently complex and cannot be made easy to understand.

The cost constraint on useful financial reporting

2.25 Cost is a pervasive constraint on the information that an entity can provide. Reporting financial information imposes costs on an entity, so it is important that those costs are justified by the benefits of reporting that information.

2.26 Entities expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users also incur costs of analysing and interpreting the information an entity provides. If entities do not provide needed information, users incur additional costs to obtain that information elsewhere or to estimate it.

2.27 Reporting relevant financial information that faithfully represents what it purports to represent helps users to make decisions confidently. Confident decision-making results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual user also benefits by making more informed decisions. However, it is not possible for financial statements to provide all the information that every user might find relevant.

Undue cost or effort

2.28 Some requirements in this Standard are accompanied by an undue cost or effort exemption. Such exemptions do not apply to other requirements in this Standard.

2.29 Whether an entity must spend undue cost or effort to obtain or judge the information necessary to comply with a requirement depends on the entity's specific circumstances and on management's judgement of the costs and benefits of applying that requirement. To make this judgement, an entity considers how users' decision-making could be affected by not having that information. An entity would spend undue cost or effort applying a requirement if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceeds the benefits users would receive from having the information. This Standard usually requires a private entity to judge undue cost or effort using a lower threshold than other HKFRS Accounting Standards require of publicly accountable entities because private entities are not accountable to public stakeholders.

2.30 An entity judges whether a requirement would involve undue cost or effort on initial **recognition** in the financial statements—for example, at the date of the transaction—based on information about the costs and benefits of the requirement at the time of initial recognition. If the undue cost or effort exemption also applies after initial recognition—for example, to a subsequent measurement of an item—the entity makes a new judgement of undue cost or effort at that subsequent date, based on information available at that date.

2.31 If an entity applies an undue cost or effort exemption, the entity shall disclose that fact and the reasons why applying the requirement would involve undue cost or effort. This requirement does not apply to the undue cost or effort exemption in paragraph 19.16, which is covered by the disclosure requirements in paragraph 19.38.

Financial statements and the reporting entity

Objective and scope of financial statements

2.32 The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, **equity**, income and expenses that is useful to users to assess the prospects for the entity's future net cash inflows and management's stewardship of the entity's economic resources (see paragraph 2.4).

Reporting period

2.33 An entity prepares its financial statements for a specified reporting period and discloses information about:

(a) its assets and liabilities—including unrecognised assets and liabilities—and equity that existed at the end of or during the reporting period; and

(b) its income and expenses for the reporting period.

2.34 To help users identify and analyse changes and trends, an entity also discloses in its financial statements comparative information for at least one preceding reporting period, except if this Standard permits or requires otherwise.

2.35 An entity also discloses in its financial statements information about possible future transactions and events if the information:

(a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or to equity that existed at the end of or during the reporting period, or to income or expenses for the reporting period; and

(b) is useful to users.

2.36 An entity does not usually disclose in its financial statements other types of forward-looking information—for example, explanatory material about management's expectations and strategies.

Perspective adopted in financial statements

2.37 An entity discloses in its financial statements information about transactions and other events from the perspective of the entity as a whole, not that of any particular group of the entity's current or potential investors, lenders or other creditors.

Going concern assumption

2.38 An entity normally prepares its financial statements on the assumption that it is a **going concern** and will continue in operation for the foreseeable future. Users assume that the entity has neither the intention nor the need to enter liquidation or to stop trading. If the entity has such an intention or need, it might prepare the financial statements on another basis. If so, the entity describes in its financial statements the basis it has used (see paragraphs 3.8–3.9).

The reporting entity

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

2.40 If a reporting entity comprises both a **parent** and its **subsidiaries**, the reporting entity's financial statements are referred to as **consolidated financial statements**. If the reporting entity comprises two or more entities that are not linked by a parent–subsidiary relationship, the reporting entity's financial statements are referred to as **combined financial statements**.

2.41 The boundary of the reporting entity is based on users' information needs. Users need relevant information that faithfully represents what it purports to represent. Faithful representation requires that:

(a) the boundary of the reporting entity does not contain an arbitrary or incomplete set of economic activities;

(b) including that set of economic activities within the boundary of the reporting entity results in neutral information; and

(c) a description is provided of how the boundary of the reporting entity was determined and what constitutes the reporting entity.

The elements of financial statements

2.42 The elements of financial statements are:

(a) assets, liabilities and equity, which relate to a reporting entity's **financial position**; and

(b) income and expenses, which relate to a reporting entity's financial **performance**.

2.43 These elements are linked to the economic resources, claims and changes in economic resources and claims discussed in paragraphs 2.6–2.7.

Definition of an asset

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

2.45 An economic resource is a right that has the **potential to produce economic benefits**. It does not have to be certain, or even likely, that the right will produce economic benefits for the potential to exist; it is only necessary that the right exists.

2.46 Rights that have the potential to produce economic benefits take many forms, including:

(a) rights that correspond to an obligation of another party, for example:

(i) rights to receive **cash**.

(ii) rights to receive goods or services.

(iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.

(iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs.

(b) rights that do not correspond to an obligation of another party—for example, rights over physical assets, such as **property, plant and equipment** or **inventories**, or rights over some **intangible assets**.

2.47 Many rights are established by **contract**, legislation or similar means. For example, an entity might obtain rights from owning or leasing an object, from owning a debt instrument or an equity instrument, or from owning a registered patent. However, an entity might also obtain rights in other ways—for example:

(a) by acquiring or creating know-how not in the public domain; or

(b) through another party's obligation that arises because that other party has no practical ability to act in a manner inconsistent with its customary practices, published policies or specific statements.

2.48 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that might flow from it. An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that party's activities. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.

Definition of a liability

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

2.50 A liability exists only if:

(a) an entity has an obligation;

(b) the obligation is to transfer an economic resource; and

(c) the obligation is a present obligation that exists as a result of past events.

2.51 An entity has an obligation if it has a duty or responsibility that the entity has no practical ability to avoid. An obligation is always owed to another party (or parties). It is not necessary for the entity to know the identity of the party (or parties) to whom the obligation is owed. Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed. However, obligations can also arise from an entity's customary practices, published policies or specific statements if the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a **constructive obligation**.

2.52 A liability gives rise to an obligation to transfer an economic resource if the obligation has the potential to require an entity to transfer the economic resource to another party (or parties). It does not have to be certain, or even likely, that the entity will be required to transfer the economic resource for that potential to exist. It is only necessary that the obligation exists and that, in at least one circumstance, it would require the entity to transfer the economic resource.

2.53 Obligations to transfer an economic resource include:

(a) obligations to pay cash;

(b) obligations to deliver goods or provide services;

(c) obligations to exchange economic resources with another party on unfavourable terms;

(d) obligations to transfer an economic resource if a specified uncertain future event occurs; and

(e) obligations to issue a **financial instrument** if that financial instrument obliges the entity to transfer an economic resource.

2.54 Instead of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, an entity might sometimes decide, for example:

(a) to settle the obligation by negotiating a release from the obligation;

(b) to transfer the obligation to a third party; or

(c) to replace that obligation to transfer an economic resource with another obligation by entering into a new transaction.

2.55 A present obligation exists as a result of past events only if an entity:

(a) has already obtained economic benefits or taken an action giving rise to the obligation; and

(b) will or might have to transfer an economic resource that it would not otherwise have had to transfer.

2.56 The economic benefits the entity obtained could include, for example, goods or services. The action the entity has taken could include, for example, operating a particular business or operating in a particular market. If the entity has obtained economic benefits, or has taken an action, over time, the resulting present obligation might accumulate over that time.

Assets and liabilities

Unit of account

2.57 The **unit of account** is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which an entity applies recognition criteria and measurement concepts.

2.58 An entity selects a unit of account for an asset or liability when it considers how recognition criteria and measurement concepts will apply to that asset or liability and to the related income and expenses. In some circumstances, it might be appropriate for the entity to select one unit of account for recognition and another unit of account for measurement. For example, an entity might sometimes recognise contracts individually, but measure them as part of a portfolio of contracts. For presentation and disclosure, an entity might aggregate or separate assets, liabilities, income and expenses into their components.

Executory contracts

2.59 An **executory contract** is a contract, or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partly fulfilled their obligations to an equal extent.

2.60 An executory contract establishes a combined right and obligation to exchange economic resources. The right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable. Whether the entity includes such an asset or liability in its financial statements depends on both the recognition criteria and the **measurement basis** the entity selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

Definition of equity

2.61 Equity is the residual interest in an entity's assets after deducting all its liabilities.

Definitions of income and expenses

2.62 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**.

2.63 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.

2.64 Income and expenses are the elements of financial statements that relate to an entity's financial performance. Users need information about both an entity's financial position and its financial performance. Although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

2.65 Transactions and other events generate income and expenses with varied characteristics. Separating information about income and expenses that have differing characteristics can help users understand the entity's financial performance.

Recognition and derecognition

The recognition process

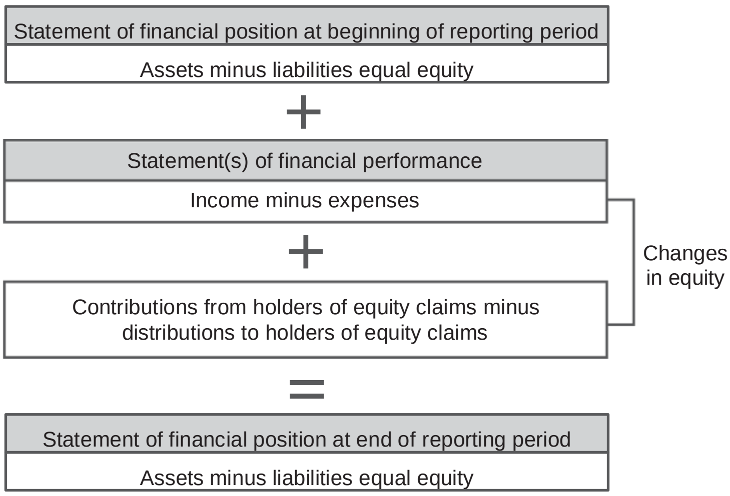
2.66 Recognition is the process of capturing assets, liabilities, equity, income and expenses in the **statement of financial position** or the statement(s) of financial performance.[3] Recognition involves depicting the item—either alone or in **aggregation** with other items—in words and by a single monetary amount in one of those statements and including that amount in one or more totals in that statement. The **carrying amount** is the amount at which an entity recognises an asset, a liability or equity in the statement of financial position.

2.67 Recognition links the elements of financial statements, the statement of financial position and the statement(s) of financial performance (see Figure 2.1). In the statement of financial position at the beginning and end of the reporting period, total assets minus total liabilities equals total equity. Recognised changes in equity during the reporting period comprise:

(a) income minus expenses recognised in the statement(s) of financial performance; plus

(b) contributions from holders of equity claims minus distributions to holders of equity claims.

Figure 2.1—How recognition links the elements of financial statements



Recognition criteria

2.68 Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.

2.69 An entity cannot correct its failure to recognise an item that satisfies the recognition criteria by disclosing the **accounting policies** it used or by providing **notes** or explanatory material.

3 The *HKFRS for Private Entities* Accounting Standard does not specify whether the statement(s) of financial performance comprise(s) a single statement or two statements. The term 'statement of profit or loss' refers to both a separate statement and a separate section within a single statement of financial performance.

Relevance

2.70 Information about assets, liabilities, equity, income and expenses is relevant to users. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity might not always provide relevant information. For example, if it is uncertain whether an asset or liability exists, or if an asset or liability exists but the probability of an inflow or outflow of economic benefits is low, information about that asset or liability might not be relevant. However, that information could be relevant in combination with other factors.

Existence uncertainty

2.71 In some cases, it might be unclear whether an asset or liability exists. That uncertainty, which might coincide with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, might mean that recognising a single asset or liability would not provide relevant information. Whether or not an entity has recognised the asset or liability, the entity might need to provide explanatory information in the financial statements about the associated uncertainties.

Faithful representation

2.72 Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether an entity can provide a faithful representation might be affected by the level of **measurement uncertainty** associated with the asset or liability or by other factors.

Measurement uncertainty

2.73 An entity measures an asset or liability in order to recognise it. In many cases, an entity estimates this measurement and it is therefore subject to measurement uncertainty. Using estimates is an essential part of preparing financial information and does not undermine the usefulness of the information if an entity clearly and accurately describes and explains the estimates.

2.74 An item that fails to meet the recognition criteria might later qualify for recognition as a result of circumstances or events.

2.75 Whether or not an entity recognises an asset or liability, the entity might need to include explanatory information to provide a faithful representation of the asset or liability. The entity could include information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome—the amount or timing of any inflow or outflow of economic benefits that will ultimately result from the asset or liability (see paragraphs 2.108–2.109).

Derecognition

2.76 **Derecognition** is the removal of all or part of a recognised asset or liability from an entity's statement of financial position. Derecognition normally occurs if that item no longer meets the definition of an asset or a liability. For example:

(a) for an asset, derecognition normally occurs if the entity loses control of all or part of the recognised asset; and

(b) for a liability, derecognition normally occurs if the entity no longer has a present obligation for all or part of the recognised liability.

2.77 Accounting requirements for derecognition in this Standard aim for an entity to faithfully represent any assets and liabilities it retained after a transaction or other event that led to derecognition and the change in the entity's assets or liabilities as a result of that transaction or other event.

2.78 To achieve the aim described in paragraph 2.77, an entity normally:

(a) derecognises any of its assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred, and recognises any resulting income and expenses; and

(b) continues to recognise any of its retained assets or liabilities.

2.79 To achieve the aim described in paragraph 2.77, an entity can:

(a) present the retained component separately in the statement of financial position;

(b) present separately in the statement(s) of financial performance any income and expenses the entity recognised as a result of the derecognition of the transferred component; or

(c) provide explanatory information.

Measurement

2.80 An entity quantifies elements recognised in financial statements in monetary terms. To quantify an element, an entity first selects a measurement basis.

2.81 A measurement basis is an identified feature—for example, historical cost, **fair value** or fulfilment value—of the item being measured. Applying a measurement basis to an asset or liability creates a **measure** for that asset or liability and for related income and expenses.

2.82 The appropriate measurement basis is specific to the item being measured.

Measurement bases

Historical cost

2.83 Historical cost measures provide monetary information about assets, liabilities and related income and expenses using information an entity derived, at least in part, from the price of the transaction or other event that gave rise to them.

2.84 The historical cost of an asset is the value of the costs incurred in acquiring or creating the asset, comprising the consideration an entity paid to acquire or create the asset plus **transaction costs**. The historical cost of a liability is the value of the consideration the entity received to incur or take on the liability minus transaction costs.

2.85 An entity updates over time the historical cost of an asset to depict, if applicable:

(a) the consumption of part or all of the economic resource that constitutes the asset (**depreciation** or **amortisation**);

(b) any payments received for part or all of the asset;

(c) the effect of events that cause part or all of the historical cost of the asset to no longer be recoverable (**impairment**); and

(d) the accrual of interest to reflect any financing component of the asset.

2.86 An entity updates over time the historical cost of a liability to depict, if applicable:

(a) the fulfilment of part or all of the liability—for example, by making payments that diminish part or all of the liability or by satisfying an obligation to deliver goods or services.

(b) the effect of events that increase the value of the obligation to transfer the economic resources needed to fulfil the liability to the extent that the liability becomes onerous. A liability is onerous if the historical cost is no longer enough to depict the obligation to fulfil the liability.

(c) the accrual of interest to reflect any financing component of the liability.

2.87 One way an entity applies a historical cost measurement basis to **financial assets** and **financial liabilities** is to measure them at amortised cost. The **amortised cost of a financial asset or financial liability** reflects estimates of future cash flows discounted at the rate the entity determined at initial recognition. For variable rate instruments, the entity updates the discount rate to reflect changes in the variable rate. Over time, the entity updates the amortised cost of a financial asset or financial liability to depict changes such as the accrual of interest, the impairment of a financial asset and receipts or payments.

Current value

2.88 Measurements based on current value provide monetary information about assets, liabilities and related income and expenses using information updated to reflect conditions at the measurement date. Current value measurement bases include:

(a) fair value;

(b) current cost;

(c) **value in use** for assets; and

(d) fulfilment value for liabilities.

2.89 Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an **orderly transaction** between **market participants** at the measurement date. Because fair value is not derived, even in part, from the price of the transaction or other event that gives rise to the asset or the liability, fair value is not increased by transaction costs an entity incurs when acquiring the asset and is not decreased by the transaction costs an entity incurs when it takes on the liability.

2.90 Current cost is the cost of an equivalent asset at the measurement date, comprising the consideration an entity would pay at the measurement date plus the transaction costs the entity would incur at that date. The current cost of a liability is the consideration an entity would receive for an equivalent liability at the measurement date minus the transaction costs the entity would incur at that date.

2.91 Value in use is the **present value** of the cash flows or other economic benefits that an entity expects to derive from the use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash or other economic resources that an entity expects to be obliged to transfer when it fulfils a liability. Because value in use and fulfilment value are based on future cash flows, they do not include transaction costs incurred when an entity acquires an asset or takes on a liability.

Information provided by particular measurement bases

2.92 When an entity selects a measurement basis, it considers the nature of the information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance.

Historical cost

2.93 If an entity measures an asset or liability at historical cost, the resulting information might be relevant to users because historical cost uses information derived, at least in part, from the price of the transaction or other event that gave rise to the asset or liability. Because an entity reduces historical cost to reflect consumption of an asset and its impairment, the amount expected to be recovered from an asset measured at historical cost is at least as great as its carrying amount. Similarly, because an entity increases the historical cost of a liability when the liability becomes onerous, the value of the obligation to transfer the economic resources needed to fulfil the liability is no more than the carrying amount of the liability.

Current value

2.94 If an entity measures an asset or liability at fair value, the resulting information might have predictive value because fair value reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows.

2.95 If an entity measures an asset using value in use, the resulting information is about the present value of the estimated cash flows from the use of the asset and from its ultimate disposal. This information might have predictive value because it can be used in assessing the prospects for future net cash inflows.

2.96 If an entity measures a liability using fulfilment value, the resulting information is about the present value of the estimated cash flows needed to fulfil the liability. This information might have predictive value, particularly if the entity expects to fulfil the liability instead of transferring it or settling it by negotiation.

2.97 If an entity provides updated estimates of value in use or fulfilment value, combined with information about estimates of the amount, timing and uncertainty of future cash flows, that information might help verify previous estimates of value in use or fulfilment value.

2.98 If an entity measures an asset or liability using current cost, the resulting information might be relevant because current cost reflects the cost at which an equivalent asset could be acquired or created at the measurement date or the consideration that would be received from incurring or taking on an equivalent liability.

Factors to consider when selecting a measurement basis

2.99 When an entity selects a measurement basis for an asset or liability and for the related income and expenses, the entity considers the nature of the information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance.

2.100 In most cases, an entity will not select a measurement basis based on a single factor. The relative importance of each factor depends on the facts and circumstances of the item being measured.

2.101 An entity selects a measurement basis that will provide useful information to users. To be useful, the information is relevant and faithfully represents what it purports to represent. In addition, the information should be comparable, verifiable, timely and understandable, to the extent possible.

Relevance

2.102 The relevance of information an entity provides using a measurement basis is affected by:

(a) the characteristics of the asset or liability, in particular the variability of cash flows and whether the value of the asset or liability is sensitive to market factors or other risks; and

(b) how that asset or liability contributes to future cash flows.

2.103 If the value of an asset or liability is sensitive to market factors or other risks, its historical cost might differ significantly from its current value. Consequently, historical cost might not provide relevant information if information about changes in value is important to users.

2.104 For assets and liabilities that produce cash flows directly, such as assets that can be sold independently and without a substantial economic penalty (for example, without substantial business disruption), the measurement basis that provides the most relevant information is likely a current value that takes into account current estimates of the amount, timing and uncertainty of the future cash flows. For assets and liabilities that do not produce cash flows directly, an entity considers the principles of relevance and faithful representation to the extent that they apply to the facts and circumstances.

2.105 If an entity's business activity involves managing financial assets and financial liabilities with the objective of collecting contractual cash flows, amortised cost might provide relevant information that can be used to derive the margin between the interest earned on the assets and the interest incurred on the liabilities.

Faithful representation

2.106 In some circumstances, an entity uses the same measurement basis for related assets and liabilities to provide users with more useful information than the information that would result from using different measurement bases—for example, if the entity's cash flows from one asset or liability are directly linked to its cash flows from another asset or liability.

2.107 As noted in paragraph 2.18, although a perfectly faithful representation is free from error, measures do not have to be perfectly accurate.

2.108 Measurement uncertainty arises if an entity estimates an item's value because it cannot measure the item by observing prices in an **active market**. The level of measurement uncertainty associated with a particular measurement basis might affect whether the information an entity provides using that measurement basis is a faithful representation of the entity's financial position and financial performance. A high level of measurement uncertainty does not necessarily prevent an entity from using a measurement basis that provides relevant information, but in some cases, the level is so high that such information might not lead to a sufficiently faithful representation. In these cases, an entity should consider selecting another measurement basis that would also result in relevant information.

2.109 Measurement uncertainty is not the same as **outcome uncertainty** and **existence uncertainty**. Outcome uncertainty arises when there is uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability. Existence uncertainty arises when an asset or a liability's existence is uncertain. Paragraphs 2.70–2.71 discuss how existence uncertainty might affect an entity's decisions to recognise an asset or liability when the entity is uncertain about whether that asset or liability exists.

Enhancing qualitative characteristics and the cost constraint

2.110 The enhancing qualitative characteristics of comparability, understandability and verifiability, and the cost constraint, affect an entity's selection of a measurement basis. The enhancing qualitative characteristic of timeliness has no specific implications for measurement.

2.111 Consistently using the same measurement bases for the same items, either from period to period within a reporting entity or in a single period across entities, can help make financial statements more comparable.

2.112 If an entity changes the measurement basis it uses, its financial statements might be less understandable. However, a change might be justified if, for example, the change results in more relevant information. If an entity changes the measurement basis it uses, users might need explanatory information to understand the effect of that change.

2.113 Understandability depends partly on how many measurement bases an entity uses and whether its use of those bases changes over time. In general, the more measurement bases an entity uses, the more complex the resulting information. Consequently, the information becomes less understandable and the totals or subtotals in the statement of financial position and the statement(s) of financial performance become less informative. However, it could be appropriate for an entity to use more measurement bases if doing so provides useful information.

2.114 Verifiability is improved when an entity uses measurement bases that result in information that can be independently corroborated, either directly (for example, by observing prices) or indirectly (for example, by checking inputs to a model). If a measure cannot be verified, an entity might provide explanatory information to enable users to understand how the entity determined the measure.

Measurement of equity

2.115 An entity does not directly measure the total carrying amount of equity (total equity). The total of the carrying amounts of all recognised assets minus the total of the carrying amounts of all recognised liabilities equals the total equity.

2.116 Although an entity does not directly measure total equity, the entity might directly measure the carrying amount of some individual classes of equity and some components of equity.

Presentation and disclosure

Presentation and disclosure as communication tools

2.117 A reporting entity communicates information about its assets, liabilities, equity, income and expenses by presenting and disclosing information in its financial statements.

2.118 An entity that effectively presents and discloses information in its financial statements makes that information more relevant, understandable and comparable. Effective presentation and disclosure also contribute to faithful representation of the entity's assets, liabilities, equity, income and expenses.

2.119 Just as cost constrains other financial reporting decisions, it also constrains an entity's decisions about presentation and disclosure. When an entity decides how to present and disclose information, it is important that the entity considers whether the benefits to users justify the costs of providing and using that information.

Classification

2.120 **Classification** is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include the nature of the item, its role (or function) within the entity's business activities and how the entity measures it.

2.121 Classifying dissimilar assets, liabilities, equity, income or expenses together can obscure relevant information, reduce understandability and comparability and might not result in a faithful representation of what the information purports to represent.

2.122 An entity applies the classification to the unit of account the entity selected for an asset or liability. However, an entity separates an asset or liability's components by characteristic and classifies those components separately if the resulting financial information is more useful.

2.123 An entity classifies income and expenses and includes them either:

(a) in the statement of **profit or loss**; or

(b) in **other comprehensive income**.

2.124 The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period. Therefore, in principle, an entity includes all income and expenses in that statement. An entity presents items of income or expense in other comprehensive income only if explicitly permitted or required by this Standard.

2.125 In principle, an entity reclassifies income and expenses it included in other comprehensive income in one period into the statement of profit or loss in a future period if doing so results in the statement of profit or loss providing more relevant information or providing a more faithful representation of the entity's financial performance, for that future period. Individual sections of this Standard might describe situations in which an entity is permitted or required to reclassify income and expenses included in other comprehensive income.

Offsetting

2.126 **Offsetting** occurs when an entity recognises and measures both an asset and a liability as separate units of account, but groups them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate unless required or permitted by a specific section of this Standard.

Classification of equity

2.127 To provide useful information, an entity might classify equity claims separately if those equity claims have differing characteristics.

2.128 Similarly, to provide useful information, an entity might classify components of equity separately if some of those components are subject to particular legal, regulatory or other requirements. For example, in some jurisdictions, an entity is permitted to make distributions to holders of equity claims only if it has enough reserves specified as distributable. Separate presentation or disclosure of those reserves might provide useful information.

Aggregation

2.129 Aggregation is the adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.

2.130 Aggregation can make information more useful by summarising a large volume of detail, but in doing so, aggregation also conceals some of that detail. An entity balances its use of aggregation so that relevant information is not obscured either by too little or too much detail.

Section 3
Financial Statement Presentation

Scope of this section

3.1 This section explains **true and fair view** of **financial statements**, what compliance with the *HKFRS for Private Entities* Accounting Standard requires and what comprises a complete set of financial statements.

True and fair view

3.2 Financial statements shall present a true and fair view of the **financial position**, financial **performance** and **cash flows** of an entity. True and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and **recognition** criteria for **assets**, **liabilities**, **income** and **expenses** set out in Section 2 *Concepts and Pervasive Principles*:

(a) the application of the *HKFRS for Private Entities* Accounting Standard, with additional disclosure when necessary, is presumed to result in financial statements that achieve a true and fair view of the financial position, financial performance and cash flows of Private Entities.

(b) the application of this Standard by an entity with **public accountability** does not result in a true and fair view in accordance with this Standard (see paragraph 1.5).

The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance.

Compliance with the *HKFRS for Private Entities* Accounting Standard

3.3 An entity whose financial statements comply with the *HKFRS for Private Entities* Accounting Standard shall make an explicit and unreserved statement of such compliance in the **notes**. Financial statements shall not be described as complying with the *HKFRS for Private Entities* Accounting Standard unless they comply with all the requirements of this Standard.

3.4 In the extremely rare circumstances when management concludes that compliance with this Standard would be so misleading that it would conflict with the **objective of financial statements** of Private Entities set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.5 unless the relevant regulatory framework prohibits such a departure.

3.5 When an entity departs from a requirement of this Standard in accordance with paragraph 3.4, it shall disclose the following:

(a) that management has concluded that the financial statements present a true and fair view of the entity's financial position, financial performance and cash flows;

(b) that it has complied with the *HKFRS for Private Entities* Accounting Standard, except that it has departed from a particular requirement to achieve a true and fair view; and

(c) the nature of the departure, including the treatment that the *HKFRS for Private Entities* Accounting Standard would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2 and the treatment adopted.

3.6 When an entity has departed from a requirement of this Standard in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.5(c).

3.7 In the extremely rare circumstances when management concludes that compliance with a requirement in this Standard would be so misleading that it would conflict with the objective of financial statements of Private Entities set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing the following:

(a) the nature of the requirement in this Standard and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2; and

(b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a true and fair view.

Going concern

3.8 When preparing financial statements, the management of an entity using this Standard shall make an assessment of the entity's ability to continue as a **going concern**. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the **reporting date**.

3.9 When management is aware, in making its assessment, of **material** uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

3.10 An entity shall present a complete set of financial statements (including comparative information– see paragraph 3.14) at least annually. When the end of an entity's **reporting period** changes and the financial statements are presented for a period longer or shorter than one year, the entity shall disclose the following:

(a) that fact;

(b) the reason for using a longer or shorter period; and

(c) the fact that comparative amounts presented in the financial statements (including the related notes) are not entirely comparable.

Consistency of presentation

3.11 An entity shall retain the presentation and **classification** of items in the financial statements from one period to the next unless:

(a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*; or

(b) this Standard requires a change in presentation.

3.12 When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is **impracticable**. When comparative amounts are reclassified, an entity shall disclose the following:

(a) the nature of the reclassification;

(b) the amount of each item or class of items that is reclassified; and

(c) the reason for the reclassification.

3.13 If it is impracticable to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable.

Comparative information

3.14 Except when this Standard permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Materiality and aggregation

3.15 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

3.15A When applying this Standard an entity shall decide, after taking into consideration all the relevant facts and circumstances, how it aggregates information in the financial statements, including the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

3.16 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 a specific **reporting entity**. Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Accrual basis

3.16A An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.

Complete set of financial statements

3.17 A complete set of financial statements of an entity shall include all of the following:

(a) a **statement of financial position** as at the reporting date;

(b) either:

(i) a single **statement of comprehensive income** for the reporting period displaying all items of income and expense recognised during the period including those items recognised in determining **profit or loss** (which is a subtotal in the statement of comprehensive income) and items of **other comprehensive income**.

(ii) a separate **income statement** and a separate statement of comprehensive income. If the entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.

(c) a **statement of changes in equity** for the reporting period;

(d) a **statement of cash flows** for the reporting period; and

(e) notes, comprising material accounting policy information and other explanatory information.

3.18 If the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **errors**, and changes in accounting policy, the entity may present a single **statement of income and retained earnings** in place of the statement of comprehensive income and statement of changes in equity (see paragraph 6.4).

3.19 If an entity has no items of other comprehensive income in any of the periods for which financial statements are presented, it may present only an income statement or it may present a statement of comprehensive income in which the 'bottom line' is labelled 'profit or loss'.

3.20 Because paragraph 3.14 requires comparative amounts in respect of the previous period for all amounts presented in the financial statements, a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.

3.21 In a complete set of financial statements, an entity shall present each financial statement with equal prominence.

3.22 An entity may use titles for the financial statements other than those used in this Standard as long as they are not misleading.

Identification of the financial statements

3.23 An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently and repeat it when necessary for an understanding of the information presented:

(a) the name of the reporting entity and any change in its name since the end of the preceding reporting period;

(b) whether the financial statements cover the individual entity or a **group** of entities;

(c) the date of the end of the reporting period and the period covered by the financial statements;

(d) the **presentation currency**, as defined in Section 30 *Foreign Currency Translation*; and

(e) the level of rounding, if any, used in presenting amounts in the financial statements.

3.24 An entity shall disclose the following in the notes:

(a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office); and

(b) a description of the nature of the entity's operations and its principal activities.

Presentation of information not required by this Standard

3.25 This Standard does not address presentation of segment information, earnings per share, or interim financial reports by a private entity. An entity making such disclosures shall describe the basis for preparing and presenting the information.

Section 4
Statement of Financial Position

Scope of this section

4.1 This section sets out the information that is to be presented in a **statement of financial position** and how to present it. The statement of financial position (sometimes called the balance sheet) presents an entity's **assets**, **liabilities** and **equity** as of a specific date—the end of the **reporting period**.

Information to be presented in the statement of financial position

4.2 The statement of financial position shall include line items that present the following amounts:

(a) **cash** and **cash equivalents**;

(b) trade and other receivables;

(c) **financial assets** (excluding amounts shown under (a), (b), (j) and (k));

(d) **inventories**;

(e) **property, plant and equipment** (including **bearer plants** in the scope of Section 17 *Property, Plant and Equipment*);

(ea) **investment property** carried at cost less accumulated **depreciation** and **impairment**;

(f) investment property carried at **fair value** through **profit or loss**;

(g) **intangible assets**;

(h) **biological assets** in the scope of Section 34 *Specialised Activities* carried at cost less accumulated depreciation and impairment;

(i) biological assets in the scope of Section 34 carried at fair value through profit or loss;

(j) investments in **associates**;

(k) investments in **jointly controlled entities**;

(l) trade and other payables;

(m) **financial liabilities** (excluding amounts shown under (l) and (p));

(n) liabilities and assets for **current tax**;

(o) **deferred tax liabilities** and **deferred tax assets** (these shall always be classified as non-current);

(p) **provisions**;

(q) **non-controlling interest**, presented within equity separately from the equity attributable to the **owners** of the **parent**; and

(r) equity attributable to the owners of the parent.

4.3 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 4.2), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's **financial position**.

Current/non-current distinction

4.4 An entity shall present current and non-current assets, and current and non-current liabilities, as separate **classifications** in its statement of financial position in accordance with paragraphs 4.5–4.8, except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity (ascending or descending).

Current assets

4.5 An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in the entity's normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the **reporting date**; or

(d) the asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

4.6 An entity shall classify all other assets as non-current. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

Current liabilities

4.7 An entity shall classify a liability as current when:

(a) it expects to settle the liability in the entity's normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting date; or

(d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after reporting date[3a].

4.8 An entity shall classify all other liabilities as non-current.

Sequencing of items and format of items in the statement of financial position

4.9 This Standard does not prescribe the sequence or format in which items are to be presented. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

(a) line items are included when the size, nature or function of an item or **aggregation** of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and

(b) the descriptions used and the sequencing of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.

4.10 The judgement on whether additional items are presented separately is based on an assessment of all of the following:

(a) the amounts, nature and liquidity of assets;

(b) the function of assets within the entity; and

(c) the amounts, nature and timing of liabilities.

[3a] The classification of a term loan as a current or non-current liability in accordance with paragraph 4.7(d) shall be determined by reference to the rights and obligations of the lender and the borrower, as contractually agreed between the two parties and in force as of the reporting date. In this regard, the probability of the lender choosing to exercise its right within the next twelve months after the reporting date is not relevant.

The classification of a term loan in accordance with paragraph 4.7(d) shall depend on whether or not the borrower has an unconditional right to defer payment for at least twelve months after the reporting period. Consequently, amounts repayable under a loan agreement which includes a clause that gives the lender the unconditional right to call the loan at any time shall be classified by the borrower as current in its statement of financial position. This is because the borrower under such an agreement does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

Information to be presented either in the statement of financial position or in the notes

4.11 An entity shall disclose, either in the statement of financial position or in the **notes**, the following subclassifications of the line items presented:

(a) property, plant and equipment in classifications appropriate to the entity;

(b) trade and other receivables showing separately amounts receivable from related parties and receivable from other parties;

(c) inventories, showing separately amounts of inventories:

(i) held for sale in the ordinary course of business;

(ii) in the process of production for such sale; and

(iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

(d) trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income and accruals;

(e) provisions for **employee benefits** and other provisions; and

(f) classes of equity, such as paid-in capital, share premium, retained earnings and items of **income** and **expense** that, as permitted or required by this Standard, are recognised in **other comprehensive income** and presented separately in equity.

4.12 An entity with share capital shall disclose the following, either in the statement of financial position or in the notes:

(a) for each class of share capital:

(i) the number of shares authorised.

(ii) the number of shares issued and fully paid, and issued but not fully paid.

(iii) par value per share or that the shares have no par value.

(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period. This reconciliation need not be presented for prior periods.

(v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital.

(vi) shares in the entity held by the entity or by its **subsidiaries** or associates.

(vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts.

(b) a description of each reserve within equity.

4.13 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.12(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.

4.14 If, at the reporting date, an entity has a binding sale agreement for a major disposal of assets, or a group of assets and liabilities, the entity shall disclose the following information:

(a) a description of the asset(s) or the group of assets and liabilities;

(b) a description of the facts and circumstances of the sale; and

(c) the **carrying amount** of the assets or, if the disposal involves a group of assets and liabilities, the carrying amounts of those assets and liabilities.

Section 5
Statement of Comprehensive Income and Income Statement

Scope of this section

5.1 This section requires an entity to present its **total comprehensive income** for a period—ie its financial **performance** for the period—in one or two **financial statements**. It sets out the information that is to be presented in those statements and how to present it.

Presentation of total comprehensive income

5.2 An entity shall present its total comprehensive income for a period either:

(a) in a **single statement of comprehensive income**, in which case the statement of comprehensive income presents all items of **income** and **expense** recognised in the period; or

(b) in two statements—an **income statement** and a statement of comprehensive income—in which case the income statement presents all items of income and expense recognised in the period except those that are recognised in total comprehensive income outside of **profit or loss** as permitted or required by this Standard.

5.3 A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy to which Section 10 *Accounting Policies, Estimates and Errors* applies.

Single-statement approach

5.4 Under the single-statement approach, the statement of comprehensive income shall include all items of income and expense recognised in a period unless this Standard requires otherwise. This Standard provides different treatment for the following circumstances:

(a) the effects of corrections of **errors** and changes in **accounting policies** are presented as retrospective adjustments of prior periods instead of as part of profit or loss in the period in which they are identified (see Section 10); and

(b) four types of **other comprehensive income** are recognised as part of total comprehensive income, outside of profit or loss, when they arise:

(i) some gains and losses arising on translating the financial statements of a **foreign operation** (see Section 30 *Foreign Currency Translation*);

(ii) some actuarial gains and losses (see Section 28 *Employee Benefits*);

(iii) some changes in **fair values** of **hedging instruments** (see Part II of Section 11 *Financial Instruments*); and

(iv) changes in the revaluation surplus for **property, plant and equipment** measured in accordance with the revaluation model (see Section 17 *Property, Plant and Equipment*).

5.5 As a minimum, an entity shall include, in the statement of comprehensive income, line items that present the following amounts for the period:

(a) **revenue**.

(b) finance costs.

(c) share of the profit or loss of investments in **associates** (see Section 14 *Investments in Associates*) and **jointly controlled entities** (see Section 15 *Joint Arrangements*) accounted for using the equity method.

(d) **tax expense** excluding tax allocated to items (e), (g) and (h) (see paragraph 29.35).

(e) a single amount comprising the total of:

(i) the post-tax profit or loss of a **discontinued operation**; and

(ii) the post-tax gain or loss attributable to an **impairment**, or reversal of an impairment, of the **assets** in the discontinued operation (see Section 27 *Impairment of Assets*), both at the time and subsequent to being classified as a discontinued operation and to the disposal of the net assets constituting the discontinued operation.

(f) profit or loss (if an entity has no items of other comprehensive income, this line need not be presented).

(g) each item of other comprehensive income (see paragraph 5.4(b)) classified by nature (excluding amounts in (h)). Such items shall be grouped into those that, in accordance with this Standard:

(i) will not be reclassified subsequently to profit or loss—ie those in paragraph 5.4(b)(i)–(ii) and (iv); and

(ii) will be reclassified subsequently to profit or loss when specific conditions are met—ie those in paragraph 5.4(b)(iii).

(h) share of the other comprehensive income of associates and jointly controlled entities accounted for using the equity method.

(i) total comprehensive income (if an entity has no items of other comprehensive income, it may use another term for this line such as profit or loss).

5.6 An entity shall disclose separately the following items in the statement of comprehensive income as allocations for the period:

(a) profit or loss for the period attributable to

(i) **non-controlling interest**; and

(ii) **owners** of the **parent**.

(b) total comprehensive income for the period attributable to

(i) non-controlling interest; and

(ii) owners of the parent.

Two-statement approach

5.7 Under the two-statement approach, the income statement shall display, as a minimum, line items that present the amounts in paragraph 5.5(a)–5.5(f) for the period, with profit or loss as the last line. The statement of comprehensive income shall begin with profit or loss as its first line and shall display, as a minimum, line items that present the amounts in paragraph 5.5(g)–5.5(i) and paragraph 5.6 for the period.

Requirements applicable to both approaches

5.8 Under this Standard, the effects of corrections of errors and changes in accounting policies are presented as retrospective adjustments of prior periods instead of as part of profit or loss in the period in which they are identified (see Section 10).

5.9 An entity shall present additional line items, headings and subtotals in the statement of comprehensive income (and in the income statement, if presented), when such presentation is relevant to an understanding of the entity's financial performance.

5.10 An entity shall not present or describe any items of income and expense as 'extraordinary items' in the statement of comprehensive income (or in the income statement, if presented) or in the **notes**.

Analysis of expenses

5.11 An entity shall present an analysis of expenses using a **classification** based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant.

Analysis by nature of expense

(a) Under this method of classification, expenses are aggregated in the statement of comprehensive income according to their nature (for example, **depreciation**, purchases of materials, transport costs, **employee benefits** and advertising costs) and are not reallocated among various functions within the entity.

Analysis by function of expense

(b) Under this method of classification, expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

Section 6
Statement of Changes in Equity and Statement of Income and Retained Earnings

Scope of this section

6.1 This section sets out requirements for presenting the changes in an entity's **equity** for a period, either in a **statement of changes in equity** or, if specified conditions are met and an entity chooses, in a **statement of income and retained earnings**.

Statement of changes in equity

Purpose

6.2 The statement of changes in equity presents an entity's **profit or loss** for a **reporting period**, **other comprehensive income** for the period, the effects of changes in **accounting policies** and corrections of **errors** recognised in the period and the amounts of investments by, and dividends and other distributions to, **owners** in their capacity as owners during the period.

Information to be presented in the statement of changes in equity

6.3 The statement of changes in equity includes the following information:

(a) **total comprehensive income** for the period, showing separately the total amounts attributable to owners of the **parent** and to **non-controlling interests**;

(b) for each component of equity, the effects of **retrospective application** or retrospective restatement recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*; and

(c) for each component of equity, a reconciliation between the **carrying amount** at the beginning and the end of the period, separately disclosing changes resulting from:

(i) profit or loss;

(ii) other comprehensive income; and

(iii) the amounts of investments by, and dividends and other distributions to, owners in their capacity as owners, showing separately issues of shares, **treasury share** transactions, dividends and other distributions to owners and changes in ownership interests in **subsidiaries** that do not result in a loss of **control**.

Statement of income and retained earnings

Purpose

6.4 The statement of income and retained earnings presents an entity's profit or loss and changes in retained earnings for a reporting period. Paragraph 3.18 permits an entity to present a statement of income and retained earnings in place of a **statement of comprehensive income** and a statement of changes in equity if the only changes to its equity during the periods for which **financial statements** are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.

Information to be presented in the statement of income and retained earnings

6.5 An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Statement of Comprehensive Income and Income Statement*:

(a) retained earnings at the beginning of the reporting period;

(b) dividends declared and paid or payable during the period;

(c) restatements of retained earnings for corrections of prior period errors;

(d) restatements of retained earnings for changes in accounting policy; and

(e) retained earnings at the end of the reporting period.

Information to be disclosed in the notes

6.6 An entity shall disclose in the **notes**:

(a) the amount of dividends proposed (or declared) before the financial statements were authorised for issue but not recognised as a distribution to owners during the reporting period, and the amount per share; and

(b) the amount of any cumulative preference dividends not recognised.

Section 7
Statement of Cash Flows

Scope of this section

7.1 This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** of an entity for a **reporting period**, showing separately changes from **operating activities**, **investing activities** and **financing activities**.

Cash equivalents

7.2 Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. They are held to meet short-term cash commitments instead of for investment or other purposes. Consequently, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Information to be presented in the statement of cash flows

7.3 An entity shall present a statement of cash flows that presents **cash flows** for a reporting period classified by operating activities, investing activities and financing activities.

Operating activities

7.4 Operating activities are the principal revenue-producing activities of the entity. Consequently, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of **profit or loss**. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other **revenue**;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash payments or refunds of income tax, unless they can be specifically identified with financing and investing activities; and

(f) cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to **inventory** acquired specifically for resale.

Some transactions, such as the sale of an item of plant by a manufacturing entity, may give rise to a gain or loss that is included in profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

Investing activities

7.5 Investing activities are the acquisition and disposal of long-term **assets** and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire **property, plant and equipment** (including self-constructed property, plant and equipment), **intangible assets** and other long-term assets;

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

(c) cash payments to acquire **equity** or debt instruments of other entities (other than payments for those instruments classified as cash equivalents or held for dealing or trading);

(d) cash receipts from sales of equity or debt instruments of other entities (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);

(e) cash advances and loans made to other parties;

(f) cash receipts from the repayment of advances and loans made to other parties;

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge (see Part II of Section 11 *Financial Instruments*), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.

Financing activities

7.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to **owners** to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding **liability** relating to a **finance lease**.

Reporting cash flows from operating activities

7.7 An entity shall present cash flows from operating activities using either:

(a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments and items of **income** or **expense** associated with investing or financing cash flows; or

(b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.

Indirect method

7.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as **depreciation**, **provisions**, **deferred tax**, accrued income (expenses) not yet received (paid) in cash, unrealised foreign currency gains and losses, and undistributed profits of **associates**; and

(c) all other items for which the cash effects relate to investing or financing.

Direct method

7.9 Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales and other items in the **statement of comprehensive income** (or the **income statement**, if presented) for:

(i) changes during the period in inventories and operating receivables and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

Reporting cash flows from investing and financing activities

7.10 An entity shall present separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of **subsidiaries** or other business units shall be presented separately and classified as investing activities.

Foreign currency cash flows

7.11 An entity shall record cash flows arising from transactions in a foreign currency in the entity's **functional currency** by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the entity's functional currency and the foreign currency at the dates of the cash flows.

7.12A Paragraph 30.19 explains when an exchange rate that approximates the actual rate can be used.

7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be presented in the statement of cash flows. Consequently, the entity shall remeasure cash and cash equivalents held during the reporting period (such as amounts of foreign currency held and foreign currency bank accounts) at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

Interest and dividends

7.14 An entity shall present separately cash flows from interest and dividends received and paid. The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.

7.15 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

7.16 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Income tax

7.17 An entity shall present separately cash flows arising from income tax and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Non-cash transactions

7.18 An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the **financial statements** in a way that provides all the relevant information about those investing and financing activities.

7.19 Many investing and financing activities do not have a direct impact on current cash flows even though they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows because these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;

(b) the acquisition of an entity by means of an equity issue; and

(c) the conversion of debt to equity.

Changes in liabilities arising from financing activities

7.19A An entity shall disclose a reconciliation between the opening and closing balances in the **statement of financial position** for liabilities arising from financing activities. Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. An entity shall include in the reconciliation:

(a) changes from financing cash flows;

(b) changes arising from obtaining or losing **control** of subsidiaries or other businesses;

(c) the effect of changes in foreign exchange rates;

(d) changes in fair values; and

(e) other changes.

Supplier finance arrangements

7.19B Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as 'supply chain finance', 'payables finance' or 'reverse factoring arrangements'. Examples of arrangements that are not supplier finance arrangements include:

(a) arrangements that are solely credit enhancements for an entity (for example, financial guarantees including letters of credit used as guarantees); and

(b) instruments used by an entity to settle directly with a supplier the amounts owed (for example, a situation in which an entity uses a credit card to settle the amount owed to a supplier and then has an obligation to pay the issuing bank instead).

7.19C An entity shall disclose in aggregate for its supplier finance arrangements:

(a) the key terms and conditions of the arrangements (for example, terms and conditions related to the interest rate, fees charged, extended payment terms and security or guarantees provided). However, an entity shall disclose separately the terms and conditions of arrangements that have dissimilar key terms and conditions.

(b) as at the beginning and end of the reporting period:

(i) the **carrying amounts**, and associated line items presented in the entity's statement of financial position, of the **financial liabilities** that are part of a supplier finance arrangement.

(ii) the carrying amounts, and associated line items, of the financial liabilities disclosed in accordance with (i) for which suppliers have already received payment from the finance providers, unless it is **impracticable** to do so. If it is impracticable to make this disclosure, the entity shall state that fact.

(iii) the range of payment due dates (for example, 30–40 days after the invoice date) for both the financial liabilities disclosed in accordance with (i) and comparable trade payables that are not part of the supplier finance arrangement. Comparable trade payables are, for example, the entity's trade payables within the same line of business or jurisdiction as the financial liabilities disclosed in accordance with (i). If ranges of payment due dates are wide, an entity shall disclose explanatory information about those ranges or divide them into narrower ranges.

(c) the type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed in accordance with (b)(i). These non-cash changes include the effect of **business combinations**, exchange differences and other transactions that do not require the use of cash or cash equivalents (see paragraph 7.18). For example, an entity that buys goods and services from suppliers would typically classify the cash outflows to settle amounts owed to its suppliers as cash outflows from operating activities. If the entity owes its suppliers an amount that becomes part of a supplier finance arrangement, the entity—having considered the terms and conditions of the arrangement—might classify the cash outflow to settle the amount owed as a cash flow from financing activities. In such circumstances, the entity might not have reported any cash inflow from financing activities, in which case the outcome would be a non-cash change in liabilities arising from financing activities.

Components of cash and cash equivalents

7.20 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in the statement of cash flows with the equivalent items reported in the statement of financial position. However, an entity is not required to present this reconciliation if the amount of cash and cash equivalents presented in the statement of cash flows is identical to the amount similarly described in the statement of financial position.

Other disclosures

7.21 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

Section 8
Notes to the Financial Statements

Scope of this section

8.1 This section sets out the principles underlying information that is to be presented in the **notes** to the **financial statements** and how to present it. Notes contain information in addition to that presented in the **statement of financial position**, the **statement of comprehensive income** (if presented), the **income statement** (if presented), the combined **statement of income and retained earnings** (if presented), the **statement of changes in equity** (if presented) and the **statement of cash flows**. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements. In addition to the requirements of this section, nearly every other section of this Standard requires disclosures that are normally presented in the notes.

Structure of the notes

8.2 The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5–8.7;

(b) disclose the information required by this Standard that is not presented elsewhere in the financial statements; and

(c) provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.

8.4 An entity normally presents the notes in the following order:

(a) a statement that the financial statements have been prepared in compliance with the *HKFRS for Private Entities* Accounting Standard (see paragraph 3.3);

(b) **material** accounting policy information (see paragraph 8.5);

(c) supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and

(d) any other disclosures.

Disclosure of accounting policies

8.5 An entity shall disclose material accounting policy information. Accounting policy information is material if, when considered together with other information included in the entity's financial statements, it can reasonably be expected to influence decisions that the **primary users** of **general purpose financial statements** make on the basis of those financial statements.

Information about judgements

8.6 An entity shall disclose, along with material accounting policy information or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Examples of judgements that an entity might be required to disclose include those made in determining:

(a) appropriate classes of assets and liabilities in accordance with paragraph 12.30 for which disclosures about fair value measurements are provided;

(b) that the entity has **control** of another entity; and

(c) that the entity has **joint control** of an arrangement or significant influence over another entity.

Information about key sources of estimation uncertainty

8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the **reporting date**, that have a significant risk of causing a **material** adjustment to the **carrying amounts** of **assets** and **liabilities** within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature; and

(b) their carrying amount as at the end of the **reporting period**.

Section 9
Consolidated and Separate Financial Statements

Scope of this section

9.1 This section defines the circumstances in which an entity applying this Standard presents **consolidated financial statements** and the procedures for preparing those statements in accordance with this Standard. It also includes guidance on **separate financial statements** and **combined financial statements** if they are prepared in accordance with this Standard. If a **parent** by itself does not have **public accountability**, it may present its separate financial statements in accordance with this Standard, even if it presents its consolidated financial statements in accordance with **full HKFRS Accounting Standards** or another set of generally accepted accounting principles (GAAP).

Requirement to present consolidated financial statements

9.2 Except as permitted or required by paragraphs 9.3 and 9.3C, a parent shall present consolidated financial statements. Consolidated financial statements shall include all **subsidiaries** of the parent, except subsidiaries to which paragraph 9.3A applies.

9.3 A parent need not present consolidated financial statements if both of the following conditions are met:

(a) the parent is itself a subsidiary; and

(b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full HKFRS Accounting Standards, full IFRS Accounting Standards, this Standard or the *IFRS for SMEs* Accounting Standard issued by the IASB.

9.3A Subject to paragraph 9.3B, a subsidiary is not consolidated if it is acquired and is held with the intention of selling or disposing of it within one year from its acquisition date (see paragraph 19.11). Such a subsidiary is accounted for in accordance with the requirements in Section 11 *Financial Instruments* for investments in paragraph 11.8(d), instead of in accordance with this section. The parent shall also provide the disclosure required in paragraph 9.23A.

9.3B If a subsidiary previously excluded from consolidation in accordance with paragraph 9.3A is not disposed of within one year from its acquisition date:

(a) the parent shall consolidate the subsidiary from the acquisition date unless it meets the condition in paragraph 9.3B(b). Consequently, if the acquisition date was in a prior period, the relevant prior periods shall be restated.

(b) if the delay is caused by events or circumstances beyond the parent's control and there is sufficient evidence at the **reporting date** that the parent remains committed to its plan to sell or dispose of the subsidiary, the parent shall continue to account for the subsidiary in accordance with paragraph 9.3A.

9.3C If a parent has no subsidiaries other than subsidiaries that are not consolidated in accordance with paragraphs 9.3A–9.3B, it shall not present consolidated financial statements. However, the parent shall provide the disclosure required in paragraph 9.23A.

9.3D A subsidiary is not excluded from consolidation because:

(a) the investor is a venture capital organisation or similar entity.

(b) its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.

(c) it operates in a jurisdiction that imposes restrictions on transferring **cash** or other **assets** out of the jurisdiction.

Control

9.4 A subsidiary is an entity (an investee) that is controlled by another entity (an investor). An investor, regardless of the nature of its involvement with an investee, shall determine whether it is a parent by assessing whether it **controls** the investee.

9.4A An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

9.4B Thus, an investor controls an investee if the investor has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

9.4C An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 9.4B.

9.5 Control is presumed to exist when the investor owns, directly or indirectly through subsidiaries, a majority of the voting rights of an investee. An investor that owns, directly or indirectly through subsidiaries, a majority of the voting rights of an investee is not required to assess whether it has the elements of control listed in paragraph 9.4B. However, the presumption can be rebutted if it can be clearly demonstrated that the investor does not have one or more of the elements of control listed in paragraph 9.4B—for example, if the investor owns a majority of the voting rights of an investee, but another entity has existing rights that give that entity the current ability to direct the **relevant activities** through contractual arrangements.

Power

9.6 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, that is, the activities that significantly affect the investee's returns. Depending on the circumstances, relevant activities can include:

(a) selling and purchasing goods or services;

(b) selecting, acquiring or disposing of assets;

(c) researching and developing new products or processes; and

(d) determining a funding structure or obtaining funding.

9.7 An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but is not, in itself, conclusive in determining whether the investor has power over an investee.

9.7A If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

9.7B An investor will typically have power when it holds a majority of the voting rights of an investee (see paragraph 9.5). However, an investor can have power even if it holds less than a majority of the voting rights of an investee, for example, through:

(a) a contractual arrangement between the investor and other vote-holders;

(b) rights arising from other contractual arrangements;

(c) the investor's voting rights;

(d) potential voting rights (see paragraph 9.8); or

(e) a combination of (a)–(d).

9.8 When determining whether it has power, an investor considers its potential voting rights as well as potential voting rights held by other parties. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the holder of the right has the practical ability to exercise that right. Usually, for the holder of the right to have the practical ability to exercise that right, the right needs to be currently exercisable.

9.9 If an investor also has voting or other decision-making rights relating to the investee's relevant activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.

Returns

9.10 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Link between power and returns

9.11 For an investor to control an investee, the investor must have not only power over the investee and exposure or rights to variable returns from its involvement with the investee, but also the ability to use its power to affect its returns from its involvement with the investee.

9.12 When an investor with decision-making rights (a decision-maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf, and for the benefit, of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision-maker is not an agent simply because other parties can benefit from the decisions that it makes.

Consolidation procedures

9.13 The consolidated financial statements present financial information about the **group** as a single economic entity. In preparing consolidated financial statements, an entity shall:

(a) combine the **financial statements** of the parent and its subsidiaries line by line by adding together like items of assets, **liabilities**, **equity**, **income** and **expenses**.

(b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.

(c) measure and present **non-controlling interest** in the **profit or loss** and **total comprehensive income** of consolidated subsidiaries for the **reporting period** separately from the interest of the **owners** of the parent.

(d) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interest in the net assets consists of:

(i) the amount of the non-controlling interest at the date of the original combination calculated in accordance with Section 19 *Business Combinations and Goodwill*; and

(ii) the non-controlling interest's share of changes in equity since the date of the combination.

9.14 The proportions of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interest are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of potential voting rights, and other options or convertible instruments.

Intragroup balances and transactions

9.15 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as **inventory** and **property, plant and equipment**, are eliminated in full. Intragroup losses may indicate an **impairment** that requires **recognition** in the consolidated financial statements (see Section 27 *Impairment of Assets*). Section 29 *Income Tax* applies to **temporary differences** that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform reporting date

9.16 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date unless it is **impracticable** to do so. If it is impracticable to prepare the financial statements of a subsidiary as of the same reporting date as the parent, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

Uniform accounting policies

9.17 Consolidated financial statements shall be prepared using uniform **accounting policies** for like transactions and other events and conditions in similar circumstances. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Acquisition and disposal of subsidiaries

9.18 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent loses control of the subsidiary.

9.18A If a parent loses control of a subsidiary, the parent:

(a) derecognises:

   (i) the assets (including any **goodwill**) and liabilities at their carrying amounts at the date control is lost in the former subsidiary; and

   (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date control is lost (including any components of **other comprehensive income** attributable to them);

(b) recognises:

   (i) the **fair value** of the consideration received, if any, from the transaction or event that resulted in the loss of control; and

   (ii) any interest retained in the former subsidiary at its fair value at the date control is lost; and

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest in profit or loss.

9.18B If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income for that subsidiary, except for the cumulative amount of any exchange differences that relate to a foreign subsidiary, on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. The cumulative amount of any exchange differences that relate to a foreign subsidiary recognised in other comprehensive income in accordance with Section 30 *Foreign Currency Translation* is not reclassified to profit or loss on disposal of the subsidiary.

9.19 If a parent loses control of a subsidiary but continues to hold an interest in the former subsidiary, that interest shall be accounted for in accordance with other sections of this Standard. If the retained interest is a **financial asset**, Section 11 *Financial Instruments* applies; if it is an **associate**, Section 14 *Investments in Associates* applies; if it is a **jointly controlled entity**, Section 15 *Joint Arrangements* applies. The fair value at the date control is lost shall be regarded as the fair value on initial recognition of a financial asset or the cost on initial recognition of an investment in an associate or jointly controlled entity, if applicable.

Non-controlling interest in subsidiaries

9.20 An entity shall present non-controlling interest in the consolidated **statement of financial position** within equity, separately from the equity of the owners of the parent, as required by paragraph 4.2(q).

9.20A An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of control as transactions with owners in their capacity as owners. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to owners of the parent. An entity shall not recognise any gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amounts of assets (including goodwill) or liabilities as a result of such transactions.

9.21 An entity shall disclose non-controlling interest in the profit or loss of the group separately in the **statement of comprehensive income**, as required by paragraph 5.6 (or in the **income statement**, if presented, as required by paragraph 5.7).

9.22 Profit or loss and each component of other comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest. Total comprehensive income shall be attributed to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interest having a deficit balance.

Disclosures in consolidated financial statements

9.23 The following disclosures shall be made in consolidated financial statements:

(a) the fact that the financial statements are consolidated financial statements;

(b) [deleted]

(c) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements; and

(d) the nature and extent of any significant restrictions (for example resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans.

9.23A In addition to the disclosure requirements in Section 11, a parent shall disclose the carrying amount of investments in subsidiaries that are not consolidated (see paragraphs 9.3A–9.3C) at the reporting date, in total, either in the statement of financial position or in the **notes**.

9.23B An entity shall disclose the gain or loss, if any, calculated in accordance with paragraphs 9.18–9.18B, and:

(a) the portion of that gain or loss attributable to measuring any interest retained in the former subsidiary at its fair value at the date control is lost; and

(b) the line items in profit or loss in which the gain or loss is recognised (if not presented separately).

Separate financial statements

Presentation of separate financial statements

9.24 This Standard does not require presentation of separate financial statements for the parent or for the individual subsidiaries.

9.25 Separate financial statements are presented by an entity in addition to any of the following:

(a) consolidated financial statements prepared by a parent;

(b) financial statements prepared by a parent exempted from preparing consolidated financial statements by paragraph 9.3C; or

(c) financial statements prepared by an entity that is not a parent but has significant influence over an associate or has joint control of a jointly controlled entity.

9.25A A parent that is exempt in accordance with paragraph 9.3 from preparing consolidated financial statements is permitted to present separate financial statements as its only financial statements.

Accounting policy election

9.26 When an entity prepares separate financial statements and describes them as conforming to the *HKFRS for Private Entities* Accounting Standard, those statements shall comply with all of the requirements of this Standard except as follows. The entity shall adopt a policy of accounting for its investments in subsidiaries, associates and jointly controlled entities in its separate financial statements either:

(a) at cost less impairment;

(b) at fair value with changes in fair value recognised in profit or loss; or

(c) using the equity method following the procedures in paragraph 14.8.

The entity shall apply the same accounting policy for all investments in a single class (subsidiaries, associates or jointly controlled entities), but it can elect different policies for different classes.

Disclosures in separate financial statements

9.27 When an entity prepares separate financial statements, those separate financial statements shall disclose:

(a) that the statements are separate financial statements;

(b) a description of the methods used to account for the investments in subsidiaries, jointly controlled entities and associates; and

(c) either:

(i) the consolidated financial statements or other financial statements to which they relate; or

(ii) the name and principal place of business (and country of incorporation, if different) of the entity whose consolidated financial statements comply with full HKFRS Accounting Standards, full IFRS Accounting Standards, this Standard or the *IFRS for SMEs* Accounting Standard issued by the IASB, if the entity has chosen not to prepare consolidated financial statements in accordance with paragraph 9.3.

Combined financial statements

9.28 Combined financial statements are the financial statements of a **reporting entity** that comprises two or more entities that are not all linked by a parent–subsidiary relationship. This Standard does not require combined financial statements to be prepared.

9.29 If the investor prepares combined financial statements and describes them as conforming to the *HKFRS for Private Entities* Accounting Standard, those statements shall comply with all of the requirements of this Standard. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and property, plant and equipment shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances.

Disclosures in combined financial statements

9.30 The combined financial statements shall disclose the following:

(a) the fact that the financial statements are combined financial statements;

(b) the reason why combined financial statements are prepared;

(c) the basis for determining which entities are included in the combined financial statements;

(d) the basis of preparation of the combined financial statements; and

(e) the **related party** disclosures required by Section 33 *Related Party Disclosures*.

Section 10
Accounting Policies, Estimates and Errors

Scope of this section

10.1 This section provides guidance for selecting and applying the **accounting policies** used in preparing **financial statements**. It also covers changes in **accounting estimates** and corrections of **errors** in prior period financial statements.

Selection and application of accounting policies

10.2 Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

10.3 If this Standard specifically addresses a transaction, other event or condition, an entity shall apply this Standard. However, the entity need not follow a requirement in this Standard if the effect of doing so would not be **material**.

10.4 If this Standard does not specifically address a transaction, other event or condition, an entity's management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) **reliable**, in that the financial statements:

(i) represent faithfully the **financial position**, financial **performance** and **cash flows** of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in this Standard dealing with similar and related issues; and

(b) the definitions, **recognition** criteria and measurement concepts for **assets**, **liabilities**, **income** and **expenses** and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in **full HKFRS Accounting Standards** dealing with similar and related issues.

Consistency of accounting policies

10.7 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless this Standard specifically requires or permits categorisation of items for which different policies may be appropriate. If this Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

10.8 An entity shall change an accounting policy only if the change:

(a) is required by changes to this Standard; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

10.9 The following are not changes in accounting policies:

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring;

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material; or

(c) a change to the cost model when a reliable **measure** of **fair value** is no longer available (or vice versa) for an asset that this Standard would otherwise require or permit to be measured at fair value.

10.10 If this Standard allows a choice of accounting treatment (including the **measurement basis**) for a specified transaction or other event or condition and an entity changes its previous choice, that is a change in accounting policy.

10.10A The initial application of a policy to revalue assets in accordance with Section 17 *Property, Plant and Equipment* is a change in an accounting policy to be dealt with as a revaluation in accordance with Section 17. Consequently, a change from the cost model to the revaluation model for a class of **property, plant and equipment** shall be accounted for prospectively, instead of in accordance with paragraphs 10.11–10.12.

Applying changes in accounting policies

10.11 An entity shall account for:

(a) a change in accounting policy resulting from a change in the requirements of this Standard in accordance with the transitional provisions, if any, specified in Appendix A of this Standard; and

(b) all other changes in accounting policy **retrospectively** (see paragraph 10.12).

Retrospective application

10.12 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, the entity shall apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied. When it is **impracticable** to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the **carrying amounts** of assets and liabilities as at the beginning of the earliest period for which **retrospective application** is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of **equity** for that period.

Disclosure of a change in accounting policy

10.13 When an amendment to this Standard has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following:

(a) the nature of the change in accounting policy;

(b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

(c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

10.14 When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:

(i) for the current period;

(ii) for each prior period presented; and

(iii) in the aggregate for periods before those presented.

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (c).

Financial statements of subsequent periods need not repeat these disclosures.

Accounting estimates

10.14A An accounting policy might require items in financial statements to be measured in a way that involves **measurement uncertainty**—that is, the accounting policy might require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such cases, the entity develops an accounting estimate to achieve the objective set out by the accounting policy. Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information.

10.14B An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques (for example, techniques used to measure **depreciation** for an item of property, plant and equipment, applying Section 17) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying Section 12 *Fair Value Measurement*).

Changes in accounting estimates

10.14C An entity may need to change an accounting estimate if changes occur in the circumstances on which the accounting estimate was based or as a result of new information, developments or more experience.

10.15 The effects on an accounting estimate of a change in an input or a change in a measurement technique are changes in accounting estimates unless they result from the correction of prior period errors. A change in the measurement basis applied is a change in an accounting policy and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

10.16 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, prospectively by including it in **profit or loss** in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Disclosure of a change in accounting estimates

10.18 An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

Corrections of prior period errors

10.19 Prior period errors are omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts and fraud.

10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

10.22 When it is impracticable to determine the effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;

(c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented; and

(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

Section 11
Financial Instruments

Scope of this section

11.1 Section 11 *Financial Instruments* deals with recognising, derecognising, measuring and disclosing **financial instruments** (**financial assets** and **financial liabilities**). Part I of Section 11 applies to basic financial instruments and is relevant to all entities. Part II of Section 11 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions, then Part II of Section 11 is not applicable. However, all entities shall consider the scope of Part II of Section 11 to ensure they are exempt.

11.2 [Deleted]

Part I of Section 11
Basic Financial Instruments

Introduction to Part I of Section 11

11.3 A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or **equity** instrument of another entity.

11.4 Part I of Section 11 requires an amortised cost model for all basic financial instruments except for investments in non-convertible preference shares and non-puttable ordinary or preference shares that are **publicly traded** or whose **fair value** can otherwise be measured reliably without undue cost or effort.

11.5 Basic financial instruments within the scope of Part I of Section 11 are those that satisfy the conditions in paragraph 11.8. Examples of financial instruments that normally satisfy those conditions include:

(a) **cash**;

(b) demand and fixed-term deposits when the entity is the depositor, for example bank accounts;

(c) commercial paper and commercial bills held;

(d) accounts, notes and loans receivable and payable;

(e) bonds and similar debt instruments;

(f) investments in non-convertible preference shares and non-puttable ordinary and preference shares; and

(g) commitments to receive a loan if the commitment cannot be net settled in cash.

11.6 Examples of financial instruments that do not normally satisfy the conditions in paragraph 11.8, and are therefore within the scope of Part II of Section 11, include:

(a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables;

(b) options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument;

(c) financial instruments that qualify and are designated as **hedging instruments** in accordance with the requirements in Part II of Section 11;

(d) commitments to make a loan to another entity;

(e) commitments to receive a loan if the commitment can be net settled in cash;

(f) **contingent consideration** recognised by an **acquirer** in a **business combination**; and

(g) issued **financial guarantee contracts**—however, financial guarantee contracts issued at nil consideration when the specified debtor is another entity within the **group** are in the scope of Section 21 *Provisions and Contingencies* (see paragraph 21.1A).

Scope of Part I of Section 11

11.7 Part I of Section 11 applies to all financial instruments meeting the conditions of paragraph 11.8 except for the following:

(a) interests in **subsidiaries** and **associates** and **joint arrangements** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Joint Arrangements*.

(b) financial instruments that meet the definition of an entity's own equity, including the equity component of **compound financial instruments** issued by the entity (see Section 22 *Liabilities and Equity*).

(c) **leases**, to which Section 20 *Leases* or paragraph 11.49(f) apply. However, the **derecognition** requirements in paragraphs 11.33–11.38 apply to the derecognition of lease receivables recognised by a lessor and lease payables recognised by a lessee, and the impairment requirements in paragraphs 11.21–11.26 apply to lease receivables recognised by a lessor.

(d) employers' rights and obligations under **employee benefit** plans, to which Section 28 *Employee Benefits* applies.

(e) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 *Share-based Payment* applies.

(f) reimbursement **assets** that are accounted for in accordance with Section 21 (see paragraph 21.9).

(g) rights and obligations within the scope of Section 23 *Revenue from Contracts with Customers* that are financial instruments, except for trade receivables that meet the conditions in paragraph 11.8(b).

11.7A The impairment requirements in paragraphs 11.21–11.26 apply to **contract assets**.

Basic financial instruments

11.8 An entity shall account for the following financial instruments as basic financial instruments in accordance with Part I of Section 11:

(a) cash;

(b) a debt instrument (such as an account, note or loan receivable or payable) that meets the conditions in paragraph 11.9 or paragraph 11.9ZA;

(c) a commitment to receive a loan that:

(i) cannot be settled net in cash; and

(ii) when the commitment is executed, is expected to meet the conditions in paragraph 11.9.

(d) an investment in non-convertible preference shares and non-puttable **ordinary shares** or preference shares.

11.9 A debt instrument that satisfies all of the conditions in (a)–(d) shall be accounted for in accordance with Part I of Section 11:

(a) returns to the holder (the lender/creditor) assessed in the currency in which the debt instrument is denominated are either:

(i) a fixed amount;

(ii) a fixed rate of return over the life of the instrument;

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as Sterling Overnight Indexed Average (SONIA)); or

(iv) some combination of such fixed and variable rates, provided that both the fixed and variable rates are positive (for example, an interest rate swap with a positive fixed rate and negative variable rate would not meet this criterion).

For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.

(b) there is no contractual provision that could, by its terms, result in the holder (the lender/creditor) losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision. A party may pay or receive reasonable compensation on early termination of a contract and still meet this condition.

(c) contractual provisions that permit or require the issuer (the borrower) to prepay a debt instrument or permit or require the holder (the lender/creditor) to put it back to the issuer (ie to demand repayment) before maturity are not contingent on future events other than to protect:

(i) the holder against a change in the credit risk of the issuer or the instrument (for example, defaults, credit downgrades or loan covenant violations) or a change in **control** of the issuer; or

(ii) the holder or issuer against changes in relevant taxation or law.

(d) there are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).

11.9ZA A debt instrument that does not meet all of the conditions in paragraph 11.9(a)–(d) shall nevertheless be accounted for in accordance with Part I of Section 11 if the contractual terms of the instrument give rise on specified dates to **cash flows** that are solely payments of principal and interest on the outstanding principal amount. A debt instrument with contractual terms that introduce exposure to unrelated risks or volatility—for example, changes in equity prices or commodity prices—is unlikely to meet this requirement. For the purpose of the requirement in this paragraph, 'interest' includes reasonable compensation for the time value of money, credit risk and other basic lending risks and costs—for example, liquidity risk, administrative costs associated with holding the instrument and lender's profit margin—consistent with a basic lending arrangement.

11.9A Examples of debt instruments that would normally satisfy the conditions in paragraph 11.9(a)(iv) include:

(a) a bank loan that has a fixed interest rate for an initial period that then reverts to a quoted or observable variable interest rate after that period; and

(b) a bank loan with interest payable at a quoted or observable variable interest rate plus a fixed rate throughout the life of the loan, for example SONIA plus 200 basis points.

11.9B An example of a debt instrument that would normally satisfy the conditions set out in paragraph 11.9(b)–(c) would be a bank loan that permits the borrower to terminate the arrangement early, even though the borrower may be required to pay a penalty to compensate the bank for its costs of the borrower terminating the arrangement early.

11.10 Other examples of financial instruments that would normally satisfy the conditions in paragraph 11.9 are:

(a) trade accounts and notes receivable and payable, and loans from banks or other third parties.

(b) accounts payable in a foreign currency. However, any change in the account payable because of a change in the exchange rate is recognised in **profit or loss** as required by paragraph 30.10.

(c) loans to or from subsidiaries or associates that are due on demand.

(d) a debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment (such a provision does not violate the conditions in paragraph 11.9).

11.11 Examples of financial instruments that do not satisfy the conditions in paragraph 11.9 or 11.9ZA (and are therefore within the scope of Part II of Section 11) include:

(a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares (see paragraph 11.8(d));

(b) an interest rate swap that returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(a);

(c) options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(a) is not met; and

(d) investments in convertible debt, because the return to the holder can vary with the price of the issuer's equity shares instead of just with market interest rates.

11.11A An entity shall not reassess the **classification** of a financial instrument after initial **recognition**.

Initial recognition of financial assets and liabilities

11.12 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

11.13 When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including **transaction costs** except in the initial measurement of financial assets and liabilities that are subsequently measured at fair value through profit or loss) unless:

(a) the financial asset is a trade receivable (see paragraph 11.13A); or

(b) the arrangement constitutes, in effect, a financing transaction for either the entity (for a financial liability) or the counterparty (for a financial asset) to the arrangement (see paragraph 11.13B).

11.13A A trade receivable shall be recognised initially at the amount determined by applying Section 23, unless the arrangement constitutes, in effect, a financing transaction and the entity does not apply the option in paragraph 23.38. For such arrangements, the entity shall measure the trade receivable in accordance with paragraph 11.13B.

11.13B An arrangement constitutes a financing transaction if payment is deferred beyond normal business terms, for example, providing interest-free credit to a buyer for the sale of goods, or is financed at a rate of interest that is not a market rate, for example, an interest-free or below market interest rate loan made to an employee. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the **present value** of the future payments discounted at a market rate of interest for a similar debt instrument as determined at initial recognition.

Examples—financial assets

1 For a long-term loan made to another entity, a receivable is recognised at the present value of cash receivable (including interest payments and repayment of principal) from that entity.

2 For goods sold to a customer on short-term credit, a receivable is recognised at the amount determined by applying Section 23, which is normally the invoice price.

3 For an item sold to a customer on two-year interest-free credit, a receivable is recognised at the present value of the cash receivable discounted using the prevailing market rate(s) of interest for a similar receivable. The current cash sale price will normally approximate the present value of the cash receivable discounted at the appropriate market rate.

4 For a cash purchase of another entity's ordinary shares, the investment is recognised at the amount of cash paid to acquire the shares.

Examples—financial liabilities

1 For a loan received from a bank, a payable is recognised initially at the present value of cash payable to the bank (for example, including interest payments and repayment of principal).

2 For goods purchased from a supplier on short-term credit, a payable is recognised at the undiscounted amount owed to the supplier, which is normally the invoice price.

Subsequent measurement

11.14 At the end of each **reporting period**, an entity shall measure financial instruments as follows, without any deduction for transaction costs the entity may incur on sale or other disposal:

(a) debt instruments that meet the conditions in paragraph 11.8(b) shall be measured at **amortised cost** using the **effective interest method**. Paragraphs 11.15–11.20 provide guidance on determining amortised cost using the effective interest method. Debt instruments that are classified as current assets or current **liabilities** shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received (ie net of impairment—see paragraphs 11.21–11.26) unless the arrangement constitutes, in effect, a financing transaction (see paragraphs 11.13 and 11.13B). Trade receivables that are classified as current assets shall be measured at the undiscounted amount of the cash or other consideration expected to be received (ie net of impairment) unless the arrangement constitutes, in effect, a financing transaction and the entity does not apply the option in paragraph 23.38.

(b) commitments to receive a loan that meet the conditions in paragraph 11.8(c) shall be measured at cost (which sometimes is nil) less impairment.

(c) investments in non-convertible preference shares and non-puttable ordinary or preference shares shall be measured as follows (Section 12 provides guidance on fair value):

(i) if the shares are publicly traded or their fair value can otherwise be measured reliably without undue cost or effort, the investment shall be measured at fair value with changes in fair value recognised in profit or loss; and

(ii) all other such investments shall be measured at cost less impairment.

Impairment or uncollectability must be assessed for financial assets in (a), (b) and (c)(ii). Paragraphs 11.21–11.26 provide guidance.

11.14A **Dividends** are recognised in profit or loss only when:

(a) the entity's right to receive payment is established;

(b) it is **probable** that the economic benefits associated with the dividend will flow to the entity; and

(c) the amount of the dividend can be measured reliably.

Amortised cost and effective interest method

11.15 The **amortised cost of a financial asset or financial liability** at each **reporting date** is the net of the following amounts:

(a) the amount at which the financial asset or financial liability is measured at initial recognition;

(b) minus any repayments of the principal;

(c) plus or minus the cumulative **amortisation** using the effective interest method of any difference between the amount at initial recognition and the maturity amount;

(d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectability.

Financial assets and financial liabilities that have no stated interest rate, that do not relate to an arrangement that constitutes a financing transaction and that are classified as current assets or current liabilities are initially measured at an undiscounted amount in accordance with paragraph 11.13. Consequently, (c) does not apply to them.

11.16 The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest **income** or interest **expense** over the relevant period. The **effective interest rate** is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the **carrying amount** of the financial asset or financial liability. The effective interest rate is determined on the basis of the carrying amount of the financial asset or liability at initial recognition. Under the effective interest method:

(a) the amortised cost of a financial asset (liability) is the present value of future cash receipts (payments) discounted at the effective interest rate; and

(b) the interest expense (income) in a period equals the carrying amount of the financial liability (asset) at the beginning of a period multiplied by the effective interest rate for the period.

11.17 When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example prepayment, call and similar options) and known credit losses that have been incurred, but it shall not consider possible future credit losses not yet incurred.

11.18 When calculating the effective interest rate, an entity shall amortise any related fees, finance charges paid or received (such as 'points'), transaction costs and other premiums or discounts over the expected life of the instrument, except as follows. The entity shall use a shorter period if that is the period to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, finance charges paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date.

11.19 For variable rate financial assets and variable rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest alters the effective interest rate. If a variable rate financial asset or variable rate financial liability is recognised initially at an amount equal to the principal receivable or payable at maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

11.20 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision.

Example of determining amortised cost for a five-year loan using the effective interest method

On 1 January 20X0, an entity acquires a bond for CU900, incurring transaction costs of CU50.[(a)] Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0–31 December 20X4).

The bond has a mandatory redemption of CU1,100 on 31 December 20X4.

Year	Carrying amount at beginning of period	Interest income at 6.9584%*	Cash inflow	Carrying amount at end of period
	CU	CU	CU	CU
20X0	950.00	66.11	(40.00)	976.11
20X1	976.11	67.92	(40.00)	1,004.03
20X2	1,004.03	69.86	(40.00)	1,033.89
20X3	1,033.89	71.94	(40.00)	1,065.83
20X4	1,065.83	74.17	(40.00)	1,100.00
			(1,100.00)	–

* The effective interest rate of 6.9584 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:

$40 \div (1.069584)^1 + 40 \div (1.069584)^2 + 40 \div (1.069584)^3 + 40 \div (1.069584)^4 + 1{,}140 \div (1.069584)^5 = 950$

(a) In this publication, monetary items are denominated in 'currency units' (CU).

Impairment of financial assets measured at cost or amortised cost

Recognition

11.21 At the end of each reporting period, an entity shall assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an impairment loss in profit or loss immediately.

11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:

(a) significant financial difficulty of the issuer or obligor;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;

(d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganisation; or

(e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the debtor or issuer operates.

11.24 An entity shall assess the following financial assets individually for impairment:

(a) all equity instruments regardless of significance; and

(b) other financial assets that are individually significant.

An entity shall assess other financial assets for impairment either individually or grouped on the basis of similar credit risk characteristics.

Measurement

11.25 An entity shall measure an impairment loss on the following financial assets measured at cost or amortised cost as follows:

(a) for a financial asset measured at amortised cost in accordance with paragraph 11.14(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

(b) for a financial asset measured at cost less impairment in accordance with paragraphs 11.14(b) and 11.14(c)(ii) the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold at the reporting date.

Reversal

11.26 If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the entity shall reverse the previously recognised impairment loss either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset (net of any allowance account) that exceeds what the carrying amount would have been had the impairment not previously been recognised. The entity shall recognise the amount of the reversal in profit or loss immediately.

11.27 [Deleted]

11.28 [Deleted]

11.29 [Deleted]

11.30 [Deleted]

11.31 [Deleted]

11.32 [Deleted]

Derecognition of a financial asset

11.33 An entity shall derecognise a financial asset only when either:

(a) the contractual rights to the cash flows from the financial asset expire or are settled;

(b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or

(c) the entity, despite having retained some significant risks and rewards of ownership, has transferred control of the asset to another party and the other party has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer—in this case, the entity shall:

(i) derecognise the asset; and

(ii) recognise separately any rights and obligations retained or created in the transfer.

The carrying amount of the transferred asset shall be allocated between the rights or obligations retained and those transferred on the basis of their relative fair values at the transfer date. Newly created rights and obligations shall be measured at their fair values at that date. Any difference between the consideration received and the amounts recognised and derecognised in accordance with this paragraph shall be recognised in profit or loss in the period of the transfer.

11.34 If a transfer does not result in derecognition because the entity has retained significant risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.

11.35 If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:

(a) if the transferee has the right by contract or custom to sell or repledge the collateral, the transferor shall reclassify that asset in its **statement of financial position** (for example, as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets;

(b) if the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral;

(c) if the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral; and

(d) except as provided in (c), the transferor shall continue to carry the collateral as its asset and the transferee shall not recognise the collateral as an asset.

Example—transfer that qualifies for derecognition

An entity sells a group of its accounts receivable to a bank at less than their face amount. The entity continues to handle collections from the debtors on behalf of the bank, including sending monthly statements, and the bank pays the entity a market-rate fee for servicing the receivables. The entity is obliged to remit promptly to the bank any and all amounts collected, but it has no obligation to the bank for slow payment or non-payment by the debtors. In this case, the entity has transferred to the bank substantially all of the risks and rewards of ownership of the receivables. Accordingly, it removes the receivables from its statement of financial position (ie derecognises them) and it shows no liability in respect of the proceeds received from the bank. The entity recognises a loss calculated as the difference between the carrying amount of the receivables at the time of sale and the proceeds received from the bank. The entity recognises a liability to the extent that it has collected funds from the debtors but has not yet remitted them to the bank.

Example—transfer that does not qualify for derecognition

The facts are the same as the preceding example except that the entity has agreed to buy back from the bank any receivables for which the debtor is in arrears as to principal or interest for more than 120 days. In this case, the entity has retained the risk of slow payment or non-payment by the debtors—a significant risk with respect to receivables. Accordingly, the entity does not treat the receivables as having been sold to the bank, and it does not derecognise them. Instead, it treats the proceeds from the bank as a loan secured by the receivables. The entity continues to recognise the receivables as an asset until they are collected or written off as uncollectable.

Derecognition of a financial liability

11.36 An entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged, is cancelled or expires.

11.37 If an existing borrower and lender exchange financial instruments with substantially different terms, the entities shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, an entity shall account for a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) as an extinguishment of the original financial liability and the recognition of a new financial liability.

11.38 The entity shall recognise in profit or loss any difference between the carrying amount of the financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed.

Disclosures

11.39 The following disclosures make reference to disclosures for financial liabilities measured at fair value through profit or loss. Entities that have only basic financial instruments (and therefore do not apply Part II of Section 11) will not have any financial liabilities measured at fair value through profit or loss and hence will not need to provide such disclosures.

Disclosure of accounting policies for financial instruments

11.40 In accordance with paragraph 8.5, an entity shall disclose **material** accounting policy information. Information about the **measurement basis** (or bases) for financial instruments used in preparing the financial statements is expected to be material accounting policy information.

Statement of financial position—categories of financial assets and financial liabilities

11.41 An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities at the reporting date, in total, either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss (paragraph 11.14(c)(i) and paragraph 11.54);

(b) financial assets that are debt instruments measured at amortised cost (paragraph 11.14(a));

(c) financial assets that are equity instruments measured at cost less impairment (paragraph 11.14(c)(ii) and paragraph 11.54);

(d) financial liabilities measured at fair value through profit or loss (paragraph 11.54);

(e) financial liabilities measured at amortised cost (paragraph 11.14(a)); and

(f) loan commitments measured at cost less impairment (paragraph 11.14(b)).

11.42 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its **financial position** and **performance**. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity).

11.43 An entity shall disclose an analysis of the age, by reference to due date, of trade receivables and other financial assets measured at amortised cost at the reporting date, showing separately:

(a) the amortised cost of the financial assets before adjusting for any reduction (directly or by using an allowance account) for impairment or uncollectability (see paragraph 11.15(d)); and

(b) any reduction (directly or by using an allowance account) for impairment or uncollectability (see paragraph 11.15(d)).

11.43A An entity shall disclose a maturity analysis for financial liabilities by category (see paragraph 11.41(d)–(e)). The maturity analysis shall include the remaining contractual maturities. The contractual amounts disclosed in the maturity analysis are the contractual undiscounted cash flows.

11.43B In preparing the disclosures in paragraphs 11.43–11.43A, an entity shall use time bands it considers to be the most useful. For example, for paragraph 11.43 the time bands might be:

(a) not later than one month;

(b) later than one month and not later than three months;

(c) later than three months and not later than one year;

(d) later than one year and not later than five years; and

(e) later than five years.

11.44 If a reliable **measure** of fair value is no longer available, or is not available without undue cost or effort when such an exemption is provided, for any financial instruments that would otherwise be required to be measured at fair value through profit or loss in accordance with this Standard, the entity shall disclose that fact, the carrying amount of those financial instruments and, if an undue cost or effort exemption has been used, the reasons why a reliable fair value measurement would involve undue cost or effort.

Transferred financial assets that do not qualify for derecognition

11.45 If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.33–11.35), the entity shall disclose the following for each class of such financial assets:

(a) the nature of the assets;

(b) the nature of the risks and rewards of ownership to which the entity remains exposed; and

(c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.46 When an entity has pledged financial assets as collateral for liabilities or **contingent liabilities**, it shall disclose the following:

(a) the carrying amount of the financial assets pledged as collateral; and

(b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

11.47 For **loans payable** recognised at the reporting date for which there is a breach of terms or a default of principal, interest, sinking fund or redemption terms that have not been remedied by the reporting date, an entity shall disclose the following:

(a) details of that breach or default;

(b) the carrying amount of the related loans payable at the reporting date; and

(c) whether the breach or default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

Items of income, expense, gains or losses

11.48 An entity shall disclose the following items of income, expense, gains or losses:

(a) income, expense, gains or losses, including changes in fair value, recognised on:

(i) financial assets measured at fair value through profit or loss;

(ii) financial liabilities measured at fair value through profit or loss;

(iii) financial assets measured at amortised cost; and

(iv) financial liabilities measured at amortised cost.

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not measured at fair value through profit or loss; and

(c) the amount of any impairment loss for each class of financial asset.

Part II of Section 11
Other Financial Instrument Issues

Scope of Part II of Section 11

11.49 Part II of Section 11 applies to all financial instruments except the following:

(a) those covered by Part I of Section 11.

(b) investments in **subsidiaries** and **associates** and **joint arrangements** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Joint Arrangements*.

(c) employers' rights and obligations under **employee benefit** plans (see Section 28 *Employee Benefits*).

(d) rights under **insurance contracts** unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:

(i) changes in the insured risk;

(ii) changes in foreign exchange rates; or

(iii) a default by one of the counterparties.

(e) financial instruments that meet the definition of an entity's own equity, including the equity component of **compound financial instruments** issued by the entity (see Section 22 *Liabilities and Equity*).

(f) **leases** within the scope of Section 20 *Leases*. Consequently, Part II of Section 11 applies to leases that could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:

(i) changes in the price of the leased **asset**;

(ii) changes in foreign exchange rates;

(iii) changes in lease payments based on variable market interest rates; or

(iv) a default by one of the counterparties.

(g) the measurement requirements do not apply to contracts for contingent consideration in a **business combination** (see Section 19 *Business Combinations and Goodwill*) whose fair value cannot be measured reliably without undue cost or effort at the acquisition date (see paragraph 19.27).

(h) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 *Share-based Payment* applies.

(i) reimbursement assets that are accounted for in accordance with Section 21 *Provisions and Contingencies* (see paragraph 21.9).

(j) rights and obligations within the scope of Section 23 *Revenue from Contracts with Customers* that are financial instruments, except for trade receivables that are not accounted for in accordance with Part I of Section 11.

(k) **financial guarantee contracts** issued at nil consideration when the specified debtor is another entity within the **group** (see paragraph 21.1A). Part II of Section 11 applies to other issued financial guarantee contracts.

11.50 Most contracts to buy or sell a non-financial item such as a commodity, **inventory** or **property, plant and equipment** are excluded from this section because they are not financial instruments. However, Part II of Section 11 applies to all contracts that impose risks on the buyer or seller that are not typical of contracts to buy or sell non-financial items. For example, Part II of Section 11 applies to contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates or a default by one of the counterparties.

11.51 In addition to the contracts described in paragraph 11.50, Part II of Section 11 applies to contracts to buy or sell non-financial items if the contract can be settled net in **cash** or another financial instrument, or by exchanging financial instruments as if the contracts were financial instruments, with the following exception: contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements are not financial instruments for the purposes of Section 11.

Initial recognition of financial assets and liabilities

11.52 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

11.53 When a financial asset or financial liability is recognised initially, an entity shall measure it at its **fair value**, which is normally the transaction price.

Subsequent measurement

11.54 At the end of each **reporting period**, an entity shall measure all financial instruments within the scope of Part II of Section 11 at fair value and recognise changes in fair value in **profit or loss**, except as follows:

(a) some changes in the fair value of **hedging instruments** in a designated hedging relationship are required to be recognised in **other comprehensive income** by paragraph 11.69; and

(b) **equity** instruments that are not **publicly traded** and whose fair value cannot otherwise be measured reliably without undue cost or effort and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment.

11.55 **Dividends** are recognised in profit or loss only when:

(a) the entity's right to receive payment is established;

(b) it is **probable** that the economic benefits associated with the dividend will flow to the entity; and

(c) the amount of the dividend can be measured reliably.

11.56 If a reliable measure of fair value is no longer available without undue cost or effort for an equity instrument, or a contract linked to such an instrument that if exercised will result in the delivery of such instruments, that is not publicly traded but is measured at fair value through profit or loss, its fair value at the last date that the instrument was reliably measurable without undue cost or effort is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until it is able to determine a reliable measure of fair value without undue cost or effort.

Fair value

11.57 An entity shall apply the guidance on fair value in Section 12 to fair value measurements in accordance with Section 11.

11.58 The fair value of a financial liability that is due on demand is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Impairment of financial assets measured at cost or amortised cost

11.59 An entity shall apply the guidance on impairment in paragraphs 11.21–11.26 to financial assets measured at cost less impairment in accordance with Part II of Section 11.

Derecognition of a financial asset or financial liability

11.60 An entity shall apply the **derecognition** requirements in paragraphs 11.33–11.38 to financial assets and financial liabilities to which Section 11 applies.

Hedge accounting

11.61 If specified criteria are met, an entity may designate a hedging relationship between a hedging instrument and a **hedged item** in such a way as to qualify for hedge accounting. Hedge accounting permits the gain or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.

11.62 To qualify for hedge accounting, an entity shall comply with all of the following conditions:

(a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.

(b) the hedged risk is one of the risks specified in paragraph 11.63.

(c) the hedging instrument is as specified in paragraph 11.64.

(d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

11.63 This Standard permits hedge accounting only for the following risks:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a **firm commitment** or a **highly probable forecast transaction**;

(c) price risk of a commodity that an entity holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; and

(d) foreign exchange risk in a net investment in a **foreign operation**.

Foreign exchange risk of a debt instrument measured at amortised cost is not in the list because hedge accounting would not have any significant effect on the **financial statements**. Basic accounts, notes and loans receivable and payable are normally measured at amortised cost (see paragraph 11.5(d)). This would include payables denominated in a foreign currency. Paragraph 30.10 requires any change in the **carrying amount** of the payable because of a change in the exchange rate to be recognised in profit or loss. Consequently, both the change in fair value of the hedging instrument (the cross-currency swap) and the change in the carrying amount of the payable relating to the change in the exchange rate would be recognised in profit or loss and should offset each other except to the extent of the difference between the spot rate (at which the **liability** is measured) and the forward rate (at which the swap is measured).

11.64 This Standard permits hedge accounting only if the hedging instrument has all of the following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 11.63 that is designated as the hedged risk;

(b) it involves a party external to the **reporting entity** (ie external to the **group** or individual entity being reported on);

(c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item;

(d) it has a specified maturity date not later than:

(i) the maturity of the financial instrument being hedged;

(ii) the expected settlement of the commodity purchase or sale commitment; or

(iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

Hedge of fixed interest rate risk of a recognised financial instrument or commodity price risk of a commodity held

11.65 If the conditions in paragraph 11.62 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:

(a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss; and

(b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.

11.66 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

11.67 The entity shall discontinue the hedge accounting specified in paragraph 11.65 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 11.62; or

(c) the entity revokes the designation.

11.68 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the **effective interest method** over the remaining life of the hedged item.

Hedge of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction or a net investment in a foreign operation

11.69 If the conditions in paragraph 11.62 are met and the hedged risk is:

(a) the variable interest rate risk in a debt instrument measured at amortised cost;

(b) the foreign exchange risk in a firm commitment or a highly probable forecast transaction;

(c) the commodity price risk in a firm commitment or highly probable forecast transaction; or

(d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise in other comprehensive income the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise in profit or loss in each period any excess (in absolute amount) of the cumulative change in the fair value of the hedging instrument over the cumulative change in the fair value of the expected cash flows of the hedged item since inception of the hedge (sometimes called hedge ineffectiveness). The hedging gain or loss recognised in other comprehensive income shall be reclassified to profit or loss when the hedged item is recognised in profit or loss, subject to the requirements in paragraph 11.71. However, the cumulative amount of any exchange differences that relate to a hedge of a net investment in a foreign operation recognised in other comprehensive income shall not be reclassified to profit or loss on disposal or partial disposal of the foreign operation.

11.70 If the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost, the entity shall subsequently recognise in profit or loss the periodic net cash settlements from the interest rate swap that is the hedging instrument in the period in which the net settlements accrue.

11.71 The entity shall discontinue prospectively the hedge accounting specified in paragraph 11.69 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the criteria for hedge accounting in paragraph 11.62;

(c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or

(d) the entity revokes the designation.

If the forecast transaction is no longer expected to take place or if the hedged debt instrument measured at amortised cost is derecognised, any gain or loss on the hedging instrument that was recognised in other comprehensive income shall be reclassified to profit or loss.

Disclosures

11.72 An entity applying Part II of Section 11 shall make all of the disclosures required in Part I of Section 11 incorporating in those disclosures financial instruments that are within the scope of Part II of Section 11 as well as those within the scope of Part I of Section 11. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 11.73–11.75.

11.73 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 11.63:

(a) a description of the hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the **reporting date**; and

(c) the nature of the risks being hedged, including a description of the hedged item.

11.74 If an entity uses hedge accounting for a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 11.65–11.68) it shall disclose the following:

(a) the amount of the change in fair value of the hedging instrument recognised in profit or loss for the period; and

(b) the amount of the change in fair value of the hedged item recognised in profit or loss for the period.

11.75 If an entity uses hedge accounting for a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction or a net investment in a foreign operation (paragraphs 11.69–11.71), it shall disclose the following:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

(c) the amount of the change in fair value of the hedging instrument that was recognised in other comprehensive income during the period (paragraph 11.69);

(d) the amount that was reclassified to profit or loss for the period (paragraphs 11.69 and 11.71); and

(e) the amount of any excess of the cumulative change in fair value of the hedging instrument over the cumulative change in the fair value of the expected cash flows that was recognised in profit or loss for the period (paragraph 11.69).

Section 12
Fair Value Measurement

Scope of this section

12.1 This section applies when another section requires or permits **fair value** measurements or disclosures about fair value measurements, except:

(a) **share-based payment transactions** within the scope of Section 26 *Share-based Payment*; and

(b) leasing transactions within the scope of Section 20 *Leases*.

12.2 The disclosures required by this section are not required for:

(a) **plan assets** measured at fair value in accordance with Section 28 *Employee Benefits*; and

(b) **assets** for which the **recoverable amount** is fair value less costs of disposal in accordance with Section 27 *Impairment of Assets*.

Measurement

Objective of fair value measurement

12.3 The objective of a fair value measurement is to estimate the price at which an **orderly transaction** (not a forced transaction) to sell an asset or to transfer a **liability** would take place between **market participants** at the measurement date under current market conditions (an exit price at the measurement date).

Measurement principles

12.4 Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Fair value is a market-based rather than entity-specific measurement. An entity shall measure fair value using the same assumptions that market participants would use when pricing the asset or liability. The entity's intention to hold the asset or settle the liability is not relevant.

12.5 An entity shall take into account the characteristics of the asset or liability when measuring fair value if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include:

(a) the condition and location of the asset; and

(b) restrictions, if any, on the sale or use of the asset.

12.6 An entity shall assume that the transaction to sell the asset or transfer the liability takes place in either:

(a) the **principal market** for the asset or liability; or

(b) in the absence of a principal market, the **most advantageous market** for the asset or liability.

12.7 The entity must have access to the principal (or most advantageous) market at the measurement date. In the absence of evidence to the contrary, an entity shall assume the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is the principal market or, in the absence of a principal market, the most advantageous market. Even if no observable market exists, the entity shall assume that a transaction takes place at the measurement date as a basis for estimating fair value.

12.8 An entity shall ignore **transaction costs** when using the price in the principal (or most advantageous) market to measure the fair value of the asset or liability. Transaction costs are not a characteristic of an asset or a liability; instead, they are specific to a transaction.

12.9 If location is a characteristic of the asset, an entity shall adjust the price in the principal (or most advantageous) market for the costs, if any, that would be incurred to transport the asset from its current location to that market.

Highest and best use for non-financial assets

12.10 When making a fair value measurement of a non-financial asset, an entity shall take into account a market participant's ability to generate economic benefits by using the asset for its **highest and best use** or by selling it to another market participant that would use the asset for its highest and best use.

12.11 The highest and best use of a non-financial asset takes into account any use of the asset that is physically possible, legally allowed and financially feasible as follows:

(a) a use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (for example, the location or size of a property);

(b) a use that is legally allowed takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (for example, the zoning regulations applicable to a property); and

(c) a use that is financially feasible takes into account whether a use generates adequate **income** or **cash flows** that market participants would require from an investment in that asset put to that use.

12.12 An entity shall assume the current use of a non-financial asset is its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

12.13 If a non-financial asset provides maximum value to market participants through its use in combination with other assets (and liabilities), an entity shall assume the asset would be used with those other assets (and liabilities) and that those other assets (and liabilities) would be available to market participants. An entity shall make consistent assumptions about the highest and best use of a non-financial asset for all the assets (for which highest and best use is relevant) with which the asset would be used.

Valuation techniques

12.14 If a price for an identical asset or liability is not observable, an entity shall measure fair value using another valuation technique. The entity shall use a valuation technique that is appropriate in the circumstances and for which sufficient data is available to measure fair value. The entity shall maximise its use of relevant **observable inputs** and minimise its use of **unobservable inputs**.

12.15 Three widely used valuation approaches are the market approach, the cost approach and the income approach. An entity shall use a valuation technique consistent with one or more of these approaches:

(a) *the market approach* uses as inputs the prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or a group of assets and liabilities, such as a **business**. For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables.

(b) *the cost approach* calculates the amount that would be required currently to replace the service capacity of an asset (often called 'current replacement cost').

(c) *the income approach* converts future amounts (for example, cash flows or income and **expenses**) to a single current (that is, discounted) amount. Valuation techniques using the income approach include:

(i) **present value** techniques;

(ii) option pricing models; and

(iii) the multi-period excess earnings method, which is used to measure the fair value of some **intangible assets**.

12.16 An entity shall account for revisions resulting from a change in the valuation technique or a change in its application as a change in **accounting estimate** in Section 10. However, an entity is not required to apply the disclosure requirements in Section 10 for a change in accounting estimate resulting from a change in a valuation technique or its application.

12.17 An asset or a liability measured at fair value might have a bid price and an ask price (for example, an input from a dealer market). If so, an entity shall measure the fair value of the asset or liability using the price within the bid–ask spread that is most representative of fair value in the circumstances. The entity shall use this price to measure fair value regardless of how the entity categorises the input within the fair value hierarchy (that is Level 1, Level 2 or Level 3; see paragraphs 12.22–12.27). The entity is permitted, but not required, to use the bid prices for asset positions and ask prices for liability positions. This section does not preclude an entity from using mid-market pricing or other pricing conventions, within a bid–ask spread, that are used by market participants as a practical expedient for fair value measurements.

Reliable measure of fair value

12.18 A valuation technique would be expected to arrive at a reliable **measure** of fair value if:

(a) the technique reasonably reflects how the market could be expected to price the asset; and

(b) the technique’s inputs reasonably represent market expectations and measures of the risk return factors inherent in the asset.

12.19 The fair value of investments in assets that do not have a quoted market price in an **active market** is reliably measurable if:

(a) the variability in the range of reasonable fair value measures is not significant for that asset; or

(b) the probabilities of the various measures within the range can be reasonably assessed and used to estimate fair value.

12.20 The variability in the range of reasonable fair value measures of assets that do not have a quoted market price is likely not to be significant in many situations. Normally an entity can estimate the fair value of an asset acquired from an outside party. However, if the range of reasonable fair value measures is significant and the probabilities of the various measures cannot be reasonably assessed, then a reliable measure of fair value is not available.

12.21 If a reliable measure of fair value is no longer available for an asset measured at fair value (or is not available without undue cost or effort when an undue cost or effort exemption is provided—for example, see paragraphs 11.14(c) and 11.54(b)), an entity shall instead use its **carrying amount** at the last date the asset was reliably measurable as its new cost. An entity shall measure the asset at this cost amount less **impairment** until a reliable measure of fair value is available (or is available without undue cost or effort when such an exemption is provided).

Fair value hierarchy

12.22 For consistency and comparability in fair value measurements and related disclosures, an entity shall apply a fair value hierarchy, categorising the inputs to valuation techniques used to measure fair value into three levels—Level 1, Level 2 and Level 3. This fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). In some cases, an entity might categorise the inputs used to measure the fair value of an asset or a liability within different levels of the fair value hierarchy. In these cases, an entity shall categorise the entire fair value measurement at the level of the lowest level input that is significant to the entire measurement.

Level 1 inputs

12.23 Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date. A quoted price in an active market provides the most reliable evidence of fair value. An entity shall use a quoted price in an active market to measure fair value whenever such a price is available.

12.24 If an entity holds a position in a single asset or liability (including a position comprising many identical assets or liabilities, such as a holding of **financial instruments**) and the asset or liability is traded in an active market, the entity shall measure the fair value of the asset or liability by multiplying the quoted price for the individual asset or liability by the quantity it holds. The fair value measurement of the asset or liability would be categorised within Level 1.

Level 2 inputs

12.25 Level 2 inputs are directly or indirectly observable inputs—other than quoted prices included within Level 1—for the asset or liability. Level 2 inputs include:

(a) quoted prices in active markets for assets or liabilities that are similar to the asset or liability.

(b) quoted prices in markets that are not active for assets or liabilities that are similar or identical to the asset or liability.

(c) observable inputs other than quoted prices for the asset or liability—for example:

(i) interest rates and yield curves observable at commonly quoted intervals;

(ii) implied volatilities; and

(iii) credit spreads.

(d) market-corroborated inputs.

12.26 If an entity adjusts a Level 2 input in a way that is significant to the entire measurement and uses significant unobservable inputs, the entity might need to categorise the fair value measurement within Level 3 of the fair value hierarchy.

Level 3 inputs

12.27 Level 3 inputs are unobservable inputs for the asset or liability. An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity is permitted to begin with its own data, but the entity shall adjust this data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (for example, an entity-specific synergy). An entity need not make exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available.

Disclosures

12.28 An entity shall disclose for each **class of assets** and liabilities measured at fair value in the **statement of financial position** after initial **recognition**:

(a) the carrying amounts at the end of the **reporting period**;

(b) the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, Level 2 or Level 3); and

(c) a description of the valuation technique(s) the entity used for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, and the inputs used in the fair value measurement.

12.29 For recurring fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall disclose total gains or losses for the period recognised in:

(a) **profit or loss**, and the line items in profit or loss in which those gains or losses are recognised; and

(b) **other comprehensive income**, and the line items in other comprehensive income in which those gains or losses are recognised.

12.30 An entity shall determine appropriate classes of assets and liabilities on the basis of:

(a) the nature, characteristics and risks of the asset or liability; and

(b) the level of the fair value hierarchy within which the fair value measurement is categorised.

12.31 A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position; however, an entity shall disclose sufficient information to permit reconciliation to the line items presented in the statement of financial position.

12.32 An entity shall present the quantitative disclosures required by paragraphs 12.28–12.31 in a table unless another format would be more useful.

Section 13
Inventories

Scope of this section

13.1 This section sets out the principles for recognising and measuring **inventories**. Inventories are **assets**:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

13.2 This section applies to all inventories, except:

(a) [deleted]

(b) **financial instruments** (see Section 11 *Financial Instruments*); and

(c) **biological assets** related to **agricultural activity** and **agricultural produce** at the point of harvest (see Section 34 *Specialised Activities*).

13.2A The disclosure requirements in this section apply to returns assets classified as inventory (see paragraph 23A.24(c)). Returns assets are recognised and measured in accordance with paragraphs 23A.23–23A.27 and not in accordance with this section.

13.3 This section does not apply to the measurement of inventories held by:

(a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at **fair value** less costs to sell through **profit or loss**; or

(b) commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

Measurement of inventories

13.4 An entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell.

Cost of inventories

13.5 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of purchase

13.6 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities) and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

13.7 An entity may purchase inventories on deferred settlement terms. In some cases, the arrangement effectively contains an unstated financing element, for example, a difference between the purchase price for normal credit terms and the deferred settlement amount. In these cases, the difference is recognised as interest **expense** over the period of the financing and is not added to the cost of the inventories.

Costs of conversion

13.8 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as **depreciation** and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Allocation of production overheads

13.9 An entity shall allocate fixed production overheads to the costs of conversion on the basis of the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Joint products and by-products

13.10 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of raw materials or conversion of each product are not separately identifiable, an entity shall allocate them between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, the entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the **carrying amount** of the main product is not **materially** different from its cost.

Other costs included in inventories

13.11 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

13.12 An entity applying paragraph 11.65(b) adjusts the carrying amount of a commodity **(hedged item)** held for the change in the **fair value** of the hedged item related to the hedged risk.

Costs excluded from inventories

13.13 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary during the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

13.14 [Deleted]

Cost of agricultural produce harvested from biological assets

13.15 Section 34 requires that inventories comprising agricultural produce that an entity has harvested from its biological assets shall be measured on initial **recognition** at their fair value less estimated costs to sell at the point of harvest. This becomes the cost of the inventories at that date for application of this section.

Techniques for measuring cost, such as standard costing, retail method and most recent purchase price

13.16 An entity may use techniques such as the standard cost method, the retail method or most recent purchase price for measuring the cost of inventories if the result approximates cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost formulas

13.17 An entity shall measure the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs.

13.18 An entity shall measure the cost of inventories, other than those dealt with in paragraph 13.17, by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this Standard.

Impairment of inventories

13.19 Paragraphs 27.2–27.4 require an entity to assess at the end of each **reporting period** whether any inventories are impaired, ie the carrying amount is not fully recoverable (for example, because of damage, obsolescence or declining selling prices). If an item (or group of items) of inventory is impaired, those paragraphs require the entity to measure the inventory at its selling price less costs to complete and sell and to recognise an **impairment loss**. Those paragraphs also require a reversal of a prior impairment in some circumstances.

Recognition as an expense

13.20 When inventories are sold, the entity shall recognise the carrying amount of those inventories as an expense in the period in which the related **revenue** is recognised.

13.21 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are accounted for subsequently in accordance with the section of this Standard relevant to that type of asset.

Disclosures

13.22 An entity shall disclose the following:

(a) the **accounting policies** adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in **classifications** appropriate to the entity;

(c) the amount of inventories recognised as an expense during the period;

(d) impairment losses recognised or reversed in profit or loss in accordance with Section 27 *Impairment of Assets*; and

(e) the total carrying amount of inventories pledged as security for **liabilities**.

Section 14
Investments in Associates

Scope of this section

14.1 This section applies to accounting for **associates** in **consolidated financial statements** and in the **financial statements** of an investor that is not a **parent** but that has an investment in one or more associates. Paragraph 9.26 establishes the requirements for accounting for associates in **separate financial statements**.

Associates defined

14.2 An associate is an entity over which the investor has significant influence.

14.3 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not **control** or **joint control** over those policies:

(a) if an investor holds, directly or indirectly (for example, through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case;

(b) conversely, if the investor holds, directly or indirectly (for example, through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated; and

(c) a substantial or majority ownership by another investor does not preclude an investor from having significant influence.

Measurement—accounting policy election

14.4 An investor shall account for all of its investments in associates using one of the following:

(a) the cost model in paragraph 14.5;

(b) the equity method in paragraph 14.8; or

(c) the **fair value** model in paragraph 14.9.

Cost model

14.5 An investor shall measure its investments in associates, other than those for which there is a published price quotation (see paragraph 14.7) at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.

14.6 The investor shall recognise dividends and other distributions received from the investment as **income** without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.

14.7 An investor shall measure its investments in associates for which there is a published price quotation using the fair value model (see paragraph 14.9).

Equity method

14.8 Under the equity method of accounting, an equity investment is initially recognised at the transaction price (including **transaction costs**) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and **other comprehensive income** of the associate:

(a) *distributions and other adjustments to carrying amount*. Distributions received from the associate reduce the **carrying amount** of the investment. Adjustments to the carrying amount may also be required as a consequence of changes in the associate's equity arising from items of other comprehensive income.

(b) *potential voting rights*. Although potential voting rights are considered in deciding whether significant influence exists, an investor shall measure its share of profit or loss and other comprehensive income of the associate and its share of changes in the associate's equity on the basis of present ownership interests. Those measurements shall not reflect the possible exercise or conversion of potential voting rights.

(c) *implicit goodwill and fair value adjustments*. On acquisition of the investment in an associate, an investor shall account for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable **assets** of the associate in accordance with paragraphs 19.22–19.24 and 19.34. An investor shall adjust its share of the associate's profits or losses after acquisition to account for additional **depreciation** or **amortisation** of the associate's depreciable or amortisable assets (including **goodwill**) on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.

(d) *impairment*. If there is an indication that an investment in an associate may be impaired, an investor shall test the entire carrying amount of the investment—including **financial instruments** that, in substance, form part of the investor's net investment in the associate—for impairment in accordance with Section 27, as a single asset. A financial instrument for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, part of the investor's net investment (for example, this may include preference shares or long-term receivables or loans). An investor shall apply Section 11 to any such financial instrument before it applies this paragraph or paragraph 14.8(h). Any goodwill included as part of the carrying amount of the investment in the associate is not tested separately for impairment but, instead, as part of the test for impairment of the investment as a whole.

(e) *investor's transactions with associates*. The investor shall eliminate unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions to the extent of the investor's ownership interest in the associate. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.

(f) *date of associate's financial statements*. In applying the equity method, the investor shall use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor shall use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.

(g) *associate's accounting policies*. If the associate uses **accounting policies** that differ from those of the investor, the investor shall adjust the associate's financial statements to reflect the investor's accounting policies for the purpose of applying the equity method unless it is impracticable to do so.

(h) *losses in excess of investment*. If an investor's share of losses of an associate equals or exceeds the carrying amount of its investment in the associate, the investor shall discontinue recognising its share of further losses. The investment in an associate is the carrying amount of the investment determined using the equity method together with any financial instruments that in substance form part of the investor's net investment in the associate (see paragraph 14.8(d)). After the investor's interest is reduced to zero, the investor shall recognise additional losses by a **provision** (see Section 21 *Provisions and Contingencies*) only to the extent that the investor has incurred legal or **constructive obligations** or has made payments on behalf of the associate. If the associate subsequently reports profits, the investor shall resume recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

(i) *discontinuing the equity method*. An investor shall cease using the equity method from the date that significant influence ceases:

   (i) if the associate becomes a **subsidiary** or a **jointly controlled entity**, the investor shall remeasure its previously held equity interest to fair value and recognise the resulting gain or loss, if any, in profit or loss.

(ii) if an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference between, on the one hand, the sum of the proceeds received plus the fair value of any retained interest and, on the other hand, the carrying amount of the investment in the associate including goodwill at the date significant influence is lost. Thereafter, the investor shall account for any retained interest using Section 11 *Financial Instruments*.

(iii) if an investor loses significant influence for reasons other than a partial disposal of its investment, the investor shall regard the carrying amount of the investment at that date as a new cost basis and shall account for the investment using Section 11.

Fair value model

14.9 When an investment in an associate is recognised initially, an investor shall measure it at the transaction price. Transaction price excludes transaction costs.

14.10 At each **reporting date**, an investor shall measure its investments in associates at fair value, with changes in fair value recognised in profit or loss, using the fair value measurement guidance in Section 12 *Fair Value Measurement*. An investor using the fair value model shall use the cost model for any investment in an associate for which fair value cannot be measured reliably without undue cost or effort.

Financial statement presentation

14.11 An investor shall classify investments in associates as non-current assets.

Disclosures

14.12 An entity shall disclose the following:

(a) its **accounting policy** for investments in associates;

(b) the carrying amount of investments in associates (see paragraph 4.2(j)); and

(c) the fair value of its investment in an associate if a market price for the investment is quoted and the entity accounts for the associate using the equity method.

14.13 For investments in associates accounted for using the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.

14.14 For investments in associates accounted for using the equity method, an investor shall disclose separately its share of the profit or loss and its share of any **discontinued operations**.

14.15 For investments in associates accounted for using the fair value model, an investor shall make the disclosures required in Section 12. If an investor applies the undue cost or effort exemption in paragraph 14.10 for any associates it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in associates accounted for under the cost model.

Section 15
Joint Arrangements

Scope of this section

15.1 This section applies to accounting for **joint arrangements** in **consolidated financial statements** and in the **financial statements** of an investor that is not a **parent** but that has one or more joint arrangements. This section also establishes requirements for a party that participates in but does not have **joint control** in a joint arrangement. Paragraph 9.26 establishes the requirements for accounting for a **jointly controlled entity** in **separate financial statements**.

Joint arrangements defined

15.2 A joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the contractually agreed sharing of **control** of an arrangement, which exists only when decisions about the **relevant activities** require the unanimous consent of the parties sharing control.

15.2A An entity that is a party to an arrangement shall assess whether the contractual arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the returns of the arrangement (that is, the relevant activities). Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.

15.3 Joint arrangements can take the form of jointly controlled operations, jointly controlled **assets** or jointly controlled entities.

Jointly controlled operations

15.4 The operation of some joint arrangements involves the use of the assets and other resources of the parties to the joint arrangement instead of the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the parties themselves. Each party uses its own **property, plant and equipment** and carries its own **inventories**. It also incurs its own **expenses** and **liabilities** and raises its own finance, which represent its own obligations. The joint arrangement activities may be carried out by the party's employees alongside the party's similar activities. The joint arrangement agreement usually provides a means by which the **revenue** from the sale of the joint product and any expenses that are common to the parties are to be shared among them.

15.5 In respect of its interests in jointly controlled operations, a party shall recognise in its financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the revenue that it earns from the sale of goods or services by the joint arrangement.

Jointly controlled assets

15.6 Some joint arrangements involve the joint control, and often the joint ownership, by the parties of one or more assets contributed to, or acquired for the purpose of, the joint arrangement and dedicated to the purposes of the joint arrangement.

15.7 In respect of its interest in a jointly controlled asset, a party shall recognise in its financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities that it has incurred;

(c) its share of any liabilities incurred jointly with the other parties in relation to the joint arrangement;

(d) any revenue from the sale or use of its share of the output of the joint arrangement, together with its share of any expenses incurred by the joint arrangement; and

(e) any expenses that it has incurred in respect of its interest in the joint arrangement.

Jointly controlled entities

15.8 A jointly controlled entity is a joint arrangement that involves the establishment of a corporation, partnership or other entity in which each party has an interest. The entity operates in the same way as other entities, except that an arrangement between the parties establishes joint control.

Measurement—accounting policy election

15.9 A party that has joint control shall account for all of its investments in jointly controlled entities using one of the following:

(a) the cost model in paragraph 15.10;

(b) the equity method in paragraph 15.13; or

(c) the **fair value** model in paragraph 15.14.

Cost model

15.10 A party that has joint control shall measure its investments in jointly controlled entities, other than those for which there is a published price quotation (see paragraph 15.12) at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.

15.11 The party that has joint control shall recognise distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the jointly controlled entity arising before or after the date of acquisition.

15.12 Applying the cost model in paragraph 15.10, a party that has joint control shall measure its investments in jointly controlled entities for which there is a published price quotation using the fair value model (see paragraph 15.14).

Equity method

15.13 A party that has joint control shall measure its investments in jointly controlled entities using the equity method following the procedures in paragraph 14.8 (substituting 'joint control' where that paragraph refers to 'significant influence').

Fair value model

15.14 When an investment in a jointly controlled entity is recognised initially, a party that has joint control shall measure it at transaction price. Transaction price excludes **transaction costs**.

15.15 At each **reporting date**, a party that has joint control shall measure its investments in jointly controlled entities at fair value, with changes in fair value recognised in **profit or loss**, using the fair value measurement guidance in Section 12 *Fair Value Measurement*. A party using the fair value model shall use the cost model for any investment in a jointly controlled entity for which fair value cannot be measured reliably without undue cost or effort.

Transactions between a party to the joint arrangement with joint control and a joint arrangement

15.16 When a party to the joint arrangement that has joint control contributes or sells assets to a joint arrangement, **recognition** of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint arrangement, and provided the party to the joint arrangement has transferred the significant risks and rewards of ownership, the party shall recognise only that portion of the gain or loss that is attributable to the interests of the other parties. The party shall recognise the full amount of any loss when the contribution or sale provides evidence of an impairment loss.

15.17 When a party to the joint arrangement that has joint control purchases assets from a joint arrangement, that party shall not recognise its share of the profits of the joint arrangement from the transaction until it resells the assets to an independent party. A party to the joint arrangement shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent an impairment loss.

If a party does not have joint control

15.18 A party that participates in, but does not have joint control of, a jointly controlled entity shall account for its interest in the arrangement in accordance with Section 11 *Financial Instruments* unless it has significant influence over the jointly controlled entity, in which case it shall account for the interest in the arrangement in accordance with Section 14 *Investments in Associates*.

15.18A A party that participates in, but does not have joint control of, a jointly controlled operation shall account for its interest in the arrangement in accordance with paragraph 15.5.

15.18B A party that participates in, but does not have joint control of, jointly controlled assets shall account for its interest in the arrangement in accordance with paragraph 15.7.

Disclosures

15.19 An entity shall disclose the following:

(a) the **accounting policy** it uses for recognising its investments in jointly controlled entities;

(b) the **carrying amount** of investments in jointly controlled entities (see paragraph 4.2(k));

(c) the fair value of its investment in a jointly controlled entity, if a market price for the investment is quoted and the entity accounts for the jointly controlled entity using the equity method; and

(d) the aggregate amount of its commitments relating to jointly controlled entities, including its share in the commitments that have been incurred jointly with other parties.

15.20 For jointly controlled entities accounted for using the equity method, a party that has joint control shall also make the disclosures required by paragraph 14.14 for equity method investments.

15.21 For jointly controlled entities accounted for using the fair value model, a party that has joint control shall make the disclosures required in Section 12. If a party applies the undue cost or effort exemption in paragraph 15.15 for any jointly controlled entity it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in jointly controlled entities accounted for under the cost model.

Section 16
Investment Property

Scope of this section

16.1 This section applies to accounting for investments in land or buildings that meet the definition of **investment property** in paragraph 16.2 and some property interests held by a lessee under an **operating lease** (see paragraph 16.3) that are treated like investment property. Only investment property whose **fair value** can be measured reliably without undue cost or effort on an ongoing basis is accounted for in accordance with this section at fair value through **profit or loss**. All other investment property is accounted for using the cost model in Section 17 *Property, Plant and Equipment* and remains within the scope of Section 17 unless a reliable **measure** of fair value becomes available and it is expected that fair value will be reliably measurable on an ongoing basis.

Definition and initial recognition of investment property

16.2 Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a **finance lease** to earn rentals or for capital appreciation or both, instead of for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

16.3 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property using this section if, and only if, the property would otherwise meet the definition of an investment property and the lessee can measure the fair value of the property interest without undue cost or effort on an ongoing basis. This classification alternative is available on a property-by-property basis.

16.3A An entity shall use its judgement to determine whether the acquisition of investment property is the acquisition of an **asset** or a group of assets, or a **business combination** within the scope of Section 19 *Business Combinations and Goodwill*. Determining whether a specific transaction meets the definition of a business combination as defined in Section 19 and includes an investment property as defined in this section requires the separate application of both sections.

16.4 Mixed use property shall be separated between investment property and **property, plant and equipment**. However, if the fair value of the investment property component cannot be measured reliably without undue cost or effort, the entire property shall be accounted for as property, plant and equipment in accordance with Section 17.

Measurement at initial recognition

16.5 An entity shall measure investment property at its cost at initial **recognition**. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other **transaction costs**. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments. An entity shall determine the cost of a self-constructed investment property in accordance with paragraphs 17.10–17.14.

16.6 The initial cost of a property interest held under a **lease** and classified as an investment property shall be as prescribed for a finance lease by paragraph 20.9, even if the lease would otherwise be classified as an operating lease if it was in the scope of Section 20 *Leases*. In other words, the asset is recognised at the lower of the fair value of the property and the present value of the **minimum lease payments**. An equivalent amount is recognised as a **liability** in accordance with paragraph 20.9.

Measurement after recognition

16.7 Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each **reporting date** with changes in fair value recognised in profit or loss. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Section 12 *Fair Value Measurement* provides guidance on determining fair value. An entity shall account for all other investment property using the cost model in Section 17.

Transfers

16.8 If a reliable measure of fair value is no longer available without undue cost or effort for an item of investment property measured using the fair value model, the entity shall thereafter account for that item in accordance with Section 17 until a reliable measure of fair value becomes available. The **carrying amount** of the investment property on that date becomes its cost under Section 17. Paragraph 16.10(e)(iii) requires disclosure of this change. It is a change of circumstances and not a change in accounting policy.

16.9 Other than as required by paragraph 16.8, an entity shall transfer a property to, or from, investment property only when there is a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use.

Disclosures

16.10 An entity shall disclose the following for all investment property accounted for at fair value through profit or loss (paragraph 16.7):

(a) [deleted]

(b) the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.

(c) the existence and amounts of restrictions on the realisability of investment property or the remittance of **income** and proceeds of disposal.

(d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

(e) a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:

(i) additions, disclosing separately those additions resulting from acquisitions through business combinations;

(ii) net gains or losses from fair value adjustments;

(iii) transfers to and from investment property carried at cost less accumulated **depreciation** and **impairment** (see paragraph 16.8);

(iv) transfers to and from **inventories** and owner-occupied property; and

(v) other changes.

This reconciliation need not be presented for prior periods.

16.11 In accordance with Section 20, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

Section 17
Property, Plant and Equipment

Scope of this section

17.1 This section applies to accounting for **property, plant and equipment** and accounting for **investment property** whose **fair value** cannot be measured reliably without undue cost or effort on an ongoing basis. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.

17.2 Property, plant and equipment are tangible **assets** that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

17.3 Property, plant and equipment does not include:

(a) **biological assets** related to **agricultural activity** (see Section 34 *Specialised Activities*). However, this section applies to **bearer plants** that, at initial **recognition**, can be measured, both initially and on an ongoing basis, separately from the produce on them without undue cost or effort. This section applies to such bearer plants but not to the produce on those bearer plants.

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

17.4 An entity shall recognise the cost of an item of property, plant and equipment as an asset if, and only if:

(a) it is **probable** that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

17.5 Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this section when they meet the definition of property, plant and equipment. Otherwise, such items are classified as **inventory**.

17.6 Parts of some items of property, plant and equipment may require replacement at regular intervals (for example, the roof of a building). An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 17.27–17.30 regardless of whether the replaced parts had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, the entity may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Paragraph 17.16 provides that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and **depreciate** each such component separately over its **useful life**.

17.7 A condition of continuing to operate an item of property, plant and equipment (for example, a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous major inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous major inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

17.8 Land and buildings are separable assets and an entity shall account for them separately, even when they are acquired together.

Measurement at recognition

17.9 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

17.10 The cost of an item of property, plant and equipment comprises all of the following:

(a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly and testing of functionality.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17.11 The following costs are not costs of an item of property, plant and equipment and an entity shall recognise them as an **expense** when they are incurred:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training);

(d) administration and other general overhead costs; and

(e) **borrowing costs** (see Section 25 *Borrowing Costs*).

17.12 The **income** and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in **profit or loss** if those operations are not necessary to bring the item to its intended location and operating condition.

Measurement of cost

17.13 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments.

Exchanges of assets

17.14 An item of property, plant or equipment may be acquired in exchange for a non-monetary asset, or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of the acquired asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the carrying amount of the asset given up.

Measurement after initial recognition

17.15 An entity shall choose either the cost model in paragraph 17.15A or the revaluation model in paragraph 17.15B as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. An entity shall apply the cost model to investment property whose fair value cannot be measured reliably without undue cost or effort. An entity shall recognise the costs of day-to-day servicing of an item of property, plant and equipment in profit or loss in the period in which the costs are incurred.

Cost-model

17.15A An entity shall measure an item of property, plant and equipment after initial recognition at cost less any accumulated **depreciation** and any accumulated **impairment losses**.

Revaluation model

17.15B An entity shall measure an item of property, plant and equipment whose fair value can be measured reliably at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ **materially** from that which would be determined using fair value at the end of the **reporting period**. Section 12 *Fair Value Measurement* provides guidance on determining fair value. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

17.15C If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in **other comprehensive income** and accumulated in **equity** under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

17.15D If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

Depreciation

17.16 If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. Other assets shall be depreciated over their useful lives as a single asset. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

17.17 The depreciation charge for each period shall be recognised in profit or loss unless another section of this Standard requires the cost to be recognised as part of the cost of an asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 13 *Inventories*).

Depreciable amount and depreciation period

17.18 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.

17.19 Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement and changes in market prices may indicate that the **residual value** or useful life of an asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The entity shall account for the change in residual value, depreciation method or useful life as a change in an **accounting estimate** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

17.20 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

17.21 An entity shall consider all the following factors in determining the useful life of an asset:

(a) the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related **leases**.

Depreciation method

17.22 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and a method based on usage such as the units of production method. A depreciation method that is based on **revenue** generated by an activity that includes the use of an asset is not appropriate.

17.23 If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset's future economic benefits, the entity shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with Section 10.

Impairment

Recognition and measurement of impairment

17.24 At each reporting date, an entity shall apply Section 27 *Impairment of Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount** of an asset, and when it recognises or reverses an impairment loss.

Compensation for impairment

17.25 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation becomes receivable.

Property, plant and equipment held for sale

17.26 Paragraph 27.9(f) states that a plan to dispose of an asset before the previously expected date is an indicator of impairment that triggers the calculation of the asset's recoverable amount for the purpose of determining whether the asset is impaired.

Derecognition

17.27 An entity shall derecognise an item of property, plant and equipment:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

17.28 An entity shall recognise the gain or loss on the **derecognition** of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.

17.29 The date of disposal of an item is the date the recipient obtains control of that item in accordance with the requirements in paragraphs 23.57–23.61 for determining when a promise is fulfilled. Section 20 applies to disposal by a sale and leaseback.

17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Disclosures

17.31 An entity shall disclose the following for each class of property, plant and equipment determined in accordance with paragraph 4.11(a) and separately for investment property carried at cost less accumulated depreciation and impairment:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the reporting period; and

(e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:

(i) additions;

(ii) disposals;

(iii) acquisitions through **business combinations**;

(iv) increases or decreases resulting from revaluations under paragraphs 17.15B–17.15D and from impairment losses recognised or reversed in other comprehensive income in accordance with Section 27;

(v) transfers to and from investment property carried at fair value through profit or loss (see paragraph 16.8);

(vi) impairment losses recognised or reversed in profit or loss in accordance with Section 27;

(vii) depreciation; and

(viii) other changes.

This reconciliation need not be presented for prior periods.

17.32 An entity shall also disclose the following:

(a) the existence and carrying amounts of property, plant and equipment to which the entity has restricted title or that is pledged as security for **liabilities**;

(b) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(c) if an entity has investment property whose fair value cannot be measured reliably without undue cost or effort it shall disclose that fact and the reasons why fair value measurement would involve undue cost or effort for those items of investment property.

17.33 If items of property, plant and equipment are stated at revalued amounts, an entity shall disclose the following:

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) [deleted]

(d) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and

(e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

Section 18
Intangible Assets other than Goodwill

Scope of this section

18.1 This section applies to accounting for all **intangible assets** other than **goodwill** (see Section 19 *Business Combinations and Goodwill*) and intangible assets held by an entity for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue from Contracts with Customers*).

18.2 An intangible asset is an identifiable non-monetary **asset** without physical substance. Such an asset is identifiable when:

(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or **liability**; or

(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

18.3 This section does not apply to the following:

(a) **financial assets**; or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

Recognition

General principle for recognising intangible assets

18.4 An entity shall recognise an intangible asset as an asset if, and only if:

(a) it is **probable** that the expected future economic benefits that are attributable to the asset will flow to the entity;

(b) the cost or value of the asset can be measured reliably; and

(c) the asset does not result from expenditure incurred internally on an intangible item.[4]

18.5 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the **useful life** of the asset.

18.6 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial **recognition**, giving greater weight to external evidence.

18.7 The probability recognition criterion in paragraph 18.4(a) is always considered satisfied for intangible assets that are separately acquired.

Acquisition as part of a business combination

18.8 An intangible asset acquired in a **business combination** shall be recognised unless its **fair value** cannot be measured reliably without undue cost or effort at the acquisition date.

Initial measurement

18.9 An entity shall measure an intangible asset initially at cost.

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[4] This section uses the term 'asset' in a way that differs in some respects from the definition in paragraph 2.44 and the Glossary. For the purpose of this section, an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Separate acquisition

18.10 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use.

Acquisition as part of a business combination

18.11 If an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date.

Acquisition by way of a government grant

18.12 If an intangible asset is acquired by way of a **government grant**, the cost of that intangible asset is its fair value at the date the grant is received or receivable in accordance with Section 24 *Government Grants*.

Exchanges of assets

18.13 An intangible asset may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. An entity shall measure the cost of such an intangible asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In that case, the asset's cost is measured at the **carrying amount** of the asset given up.

Internally generated intangible assets

18.14 An entity shall recognise expenditure incurred internally on an intangible item, including all expenditure for both **research** and **development** activities, as an **expense** when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in this Standard.

18.15 As examples of applying the preceding paragraph, an entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:

(a) internally generated brands, logos, publishing titles, customer lists and items similar in substance;

(b) start-up activities (ie start-up costs), which include establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) and expenditure for starting new operations or launching new products or processes (ie pre-operating costs);

(c) training activities;

(d) advertising and promotional activities;

(e) relocating or reorganising part or all of an entity; and

(f) internally generated goodwill.

18.16 Paragraph 18.15 does not preclude recognising a prepayment as an asset when payment for goods or services has been made in advance of the delivery of the goods or the rendering of the services.

Past expenses not to be recognised as an asset

18.17 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an asset.

Measurement after recognition

18.18 An entity shall measure intangible assets at cost less any accumulated **amortisation** and any accumulated **impairment losses**. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 27 *Impairment of Assets*.

Useful life

18.19 For the purpose of this Standard, all intangible assets shall be considered to have a finite useful life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

18.20 If the useful life of an intangible asset cannot be established reliably, the life shall be determined based on management's best estimate but shall not exceed ten years.

Amortisation period and amortisation method

18.21 An entity shall allocate the **depreciable amount** of an intangible asset on a systematic basis over its useful life. The amortisation charge for each period shall be recognised as an expense, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

18.22 Amortisation begins when the intangible asset is available for use, ie when it is in the location and condition necessary for it to be usable in the manner intended by management. Amortisation ceases when the asset is derecognised. The entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the entity cannot determine that pattern reliably, it shall use the straight-line method.

18.22A There is a presumption that an amortisation method based on the **revenue** generated by an activity that includes the use of an intangible asset is inappropriate. However, an entity can rebut this presumption and use an amortisation method based on revenue generated by an activity that includes the use of an intangible asset only in the limited circumstances:

(a) in which the intangible asset is expressed as a **measure** of revenue (that is, when rights over the use of an intangible asset are specified as a fixed total amount of revenue to be generated); or

(b) when it can be demonstrated that revenue and the consumption of the intangible asset's future economic benefits are highly correlated.

Residual value

18.23 An entity shall assume that the **residual value** of an intangible asset is zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an **active market** for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

Review of amortisation period and amortisation method

18.24 Factors such as a change in how an intangible asset is used, technological advancement and changes in market prices may indicate that the residual value or useful life of an intangible asset has changed since the most recent annual **reporting date**. If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, amortisation method or useful life. The entity shall account for the change in residual value, amortisation method or useful life as a change in **accounting estimate** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Recoverability of the carrying amount—impairment losses

18.25 To determine whether an intangible asset is impaired, an entity shall apply Section 27. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the **recoverable amount**, of an asset and when it recognises or reverses an impairment loss.

Retirements and disposals

18.26 An entity shall derecognise an intangible asset, and shall recognise a gain or loss in **profit or loss**:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

Disclosures

18.27 An entity shall disclose the following for each class of intangible assets:

(a) the useful lives or the amortisation rates used;

(b) the amortisation methods used;

(c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the **reporting period**;

(d) the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which any amortisation of intangible assets is included; and

(e) a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:

(i) additions;

(ii) disposals;

(iii) acquisitions through business combinations;

(iv) amortisation;

(v) impairment losses recognised or reversed in profit or loss in accordance with Section 27; and

(vi) other changes.

This reconciliation need not be presented for prior periods.

18.28 An entity shall also disclose:

(a) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is **material** to the entity's **financial statements**;

(b) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 18.12):

(i) the fair value initially recognised for these assets; and

(ii) their carrying amounts.

(c) the existence and carrying amounts of intangible assets to which the entity has restricted title or that are pledged as security for liabilities; and

(d) the amount of contractual commitments for the acquisition of intangible assets.

18.29 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period (ie the amount of expenditure incurred internally on research and development that has not been capitalised as part of the cost of another asset that meets the recognition criteria in this Standard).

Section 19
Business Combinations and Goodwill

Scope of this section

19.1 This section applies to a transaction or other event that meets the definition of a **business combination**. It sets out requirements for how an **acquirer** recognises and measures in its financial statements:

(a) the identifiable **assets** acquired, the **liabilities** assumed and any **non-controlling interest** in the **acquiree**; and

(b) the **goodwill** acquired or a gain from a bargain purchase.

19.2 This section does not apply to:

(a) combinations of entities or **businesses** under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

(b) formations of a **joint arrangement** in the financial statements of the joint arrangement itself.

(c) an acquisition of an asset or a group of assets that does not constitute a business.

Identifying a business combination

19.3 An entity shall determine whether a transaction or other event meets the definition of a business combination. A business combination is a transaction or other event in which an entity (the acquirer) obtains control of one or more businesses (the acquiree). Paragraphs 19A.1–19A.10 provide guidance on how to determine whether the transaction or other event is a business combination. If the assets acquired and liabilities assumed do not constitute a business, the **reporting entity** shall account for the transaction or other event as an asset acquisition.

19.4 An acquirer might obtain control of an acquiree in various ways—for example, by:

(a) transferring **cash**, **cash equivalents** or other assets (including net assets that constitute a business);

(b) incurring liabilities;

(c) issuing equity instruments; or

(d) providing more than one type of consideration.

19.5 A business combination might be structured in various ways for legal, taxation or other reasons. Examples of these structures include transactions or other events in which:

(a) one or more businesses become subsidiaries of an acquirer, or the net assets of one or more businesses are legally merged into the acquirer;

(b) one combining entity transfers its net assets, or its **owners** transfer their equity instruments, to another combining entity or its owners;

(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity; or

(d) a group of former owners of one of the combining entities obtains control of the combined entity.

Accounting for business combinations and goodwill

19.6 An entity shall account for each business combination by applying the acquisition method.

19.7 To apply the acquisition method, an entity shall:

(a) identify the acquirer;

(b) identify the acquisition date;

(c) recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

(d) recognise and measure goodwill or a gain from a bargain purchase.

Identifying the acquirer

19.8 For each business combination, one of the combining entities shall be identified as the acquirer.

19.9 Section 9 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—that is, to identify the entity that obtains control of another entity (the acquiree).

19.10 If an entity applying Section 9 is not able to clearly identify which of the combining entities is the acquirer, the entity shall consider the factors in paragraphs 19A.11–19A.15 to make that determination.

Identifying the acquisition date

19.11 The acquirer shall identify the acquisition date—that is, the date on which the acquirer obtains control of the acquiree.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

19.12 At the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree—except as specified in paragraphs 19.16–19.21. An acquirer shall recognise the identifiable assets acquired and liabilities assumed only if they:

(a) meet the definitions of assets and liabilities in Section 2 *Concepts and Pervasive Principles* at the acquisition date; and

(b) are part of what the acquirer and the acquiree (or the acquiree's former owners) exchanged in the business combination transaction rather than the result of separate transactions (see paragraph 19.32). The acquirer and the acquiree might enter into separate transactions before or during the negotiations for the business combination that are not part of what is exchanged in the business combination. These separate transactions shall be accounted for in accordance with the applicable sections of this Standard.

Measurement principle

19.13 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values—except as specified in paragraphs 19.16–19.21.

19.14 For each business combination, the acquirer shall measure at the acquisition date any non-controlling interests in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.

Exceptions to the recognition and measurement principles

19.15 Paragraphs 19.16–19.21 provide exceptions to the **recognition** and measurement principles set out in paragraphs 19.12–19.14 and specify both the items for which exceptions are provided and the nature of those exceptions.

19.16 An acquirer shall recognise an **intangible asset** acquired in a business combination if the asset meets the recognition principles set out in Section 18 *Intangible Assets other than Goodwill* and the asset's fair value can be measured reliably without undue cost or effort at the acquisition date.

19.17 If an acquirer assumes a liability or **contingent liability** in a business combination and that liability or contingent liability would have been within the scope of Section 21 *Provisions and Contingencies* had the acquirer incurred it separately, the acquirer shall apply paragraph 21.6 to determine whether a present obligation exists at the acquisition date as a result of past events.

19.18 If an acquirer determines, in accordance with paragraph 19.17, that a present obligation exists, the acquirer shall recognise a contingent liability at the acquisition date if:

(a) the present obligation meets the definition of a contingent liability in accordance with paragraph 21.12; and

(b) the fair value of the contingent liability can be measured reliably.

19.19 Therefore, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not **probable** that the acquirer will be required to transfer economic benefits to settle the present obligation. The acquirer does not apply the recognition requirements in paragraphs 21.4(b) and 21.12 to a contingent liability assumed in a business combination.

19.20 An acquirer shall recognise and measure in accordance with Section 29 *Income Tax* a **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a business combination.

19.21 An acquirer shall recognise and measure in accordance with Section 28 *Employee Benefits* a liability (or asset, if any) related to the acquiree's **employee benefit** arrangements.

Recognising and measuring goodwill or a gain from a bargain purchase

19.22 The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b):

(a) the sum of:

(i) the consideration transferred, measured in accordance with paragraph 19.25;

(ii) the amount of any non-controlling interest in the acquiree, measured in accordance with paragraph 19.14; and

(iii) the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree in the case of a business combination achieved in stages (see paragraphs 19.29–19.30).

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, measured in accordance with paragraphs 19.13–19.21.

Bargain purchases

19.23 Occasionally, an acquirer will make a bargain purchase—a business combination in which the amount in paragraph 19.22(b) exceeds the sum of the amounts specified in paragraph 19.22(a). If an excess remains after an acquirer applies paragraph 19.24, the acquirer shall recognise the resulting gain in **profit or loss** on the acquisition date. The gain shall be attributed to the acquirer.

19.24 Before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all the assets acquired and all the liabilities assumed and shall recognise any additional assets or liabilities identified in that reassessment. The acquirer shall then review the procedures used to measure the amounts required to be recognised at the acquisition date for:

(a) the identifiable assets acquired and the liabilities assumed;

(b) the acquirer's previously held equity interest in the acquiree, in the case of a business combination achieved in stages; and

(c) the consideration transferred.

Consideration transferred

19.25 An acquirer shall measure the consideration transferred in a business combination at fair value. The acquirer shall calculate the consideration transferred as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to the former owners of the acquiree and the equity instruments issued by the acquirer. Examples of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options and warrants.

Contingent consideration

19.26 The consideration an acquirer transfers in exchange for an acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 19.25). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree if the fair value of the contingent consideration can be reliably measured without undue cost or effort.

19.27 If the acquirer cannot reliably measure the fair value of contingent consideration at the acquisition date without undue cost or effort, it shall measure the contingent consideration at the acquisition date using the most likely amount of consideration. Subsequently, the acquirer shall not reassess whether measuring the fair value of contingent consideration involves undue cost or effort (see paragraph 19.37(b)).

19.28 The acquirer shall apply Section 22 *Liabilities and Equity* to classify an obligation to pay contingent consideration that is a **financial instrument** as a **financial liability** or as **equity**. An acquirer shall classify a right to the return of previously transferred consideration as an asset. Paragraphs 19.36–19.37 set out the requirements for accounting for contingent consideration.

A business combination achieved in stages

19.29 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. In such cases, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss.

19.30 If a party to a joint arrangement obtains control of a business that is a jointly controlled operation or a jointly controlled asset immediately before the acquisition date, the transaction is a business combination achieved in stages (a step acquisition). The acquirer shall apply the requirements for a business combination achieved in stages in accordance with paragraph 19.29, including remeasuring its entire previously held interest in the jointly controlled operation or the jointly controlled asset.

Measurement period

19.31 If an acquirer's initial accounting for a business combination is incomplete by the end of the **reporting period** in which the combination occurs, the acquirer shall recognise in its **financial statements** provisional amounts for the items for which its accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts it recognised as assets and liabilities, and recognise any additional assets and liabilities, to reflect new information it obtained about any relevant facts and circumstances that existed at the acquisition date. Any adjustments affect the goodwill acquired or any gain from a bargain purchase. After more than twelve months have passed since the acquisition date, the acquirer shall recognise adjustments to the initial accounting for a business combination only if correcting an **error** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Acquisition-related costs

19.32 Acquisition-related costs are costs an acquirer incurs to effect a business combination. The acquirer shall account for acquisition-related costs separately from the business combination, as expenses in the periods in which the costs are incurred and the services are received, with two exceptions: the acquirer shall recognise the cost to issue debt in accordance with Section 11 *Other Financial Instrument Issues* and the cost to issue equity securities in accordance with Section 22.

Subsequent measurement and accounting

19.33 After initial recognition, an acquirer shall apply the applicable sections of this Standard to assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination. After initial recognition, paragraphs 19.34–19.37 apply to:

(a) goodwill;

(b) contingent liabilities recognised as of the acquisition date; and

(c) contingent consideration.

Goodwill

19.34 After an acquirer initially recognises goodwill acquired in a business combination, the acquirer shall measure it at cost less accumulated **amortisation** and accumulated **impairment losses**. The acquirer shall apply:

(a) paragraphs 18.19–18.24 for amortisation of goodwill. If the acquirer cannot reliably establish the **useful life** of goodwill, it shall use its best estimate of the life, but that estimate shall not exceed ten years.

(b) Section 27 *Impairment of Assets* to recognise and measure any impairment of goodwill.

Contingent liabilities

19.35 After an acquirer initially recognises a contingent liability in a business combination and until the liability is settled, cancelled or expires, it shall measure the liability at the higher of:

(a) the amount that the acquirer would have recognised in accordance with Section 21; or

(b) the amount the acquirer initially recognised minus, if appropriate, the cumulative amount of **income** recognised in accordance with the principles of Section 23 *Revenue from Contracts with Customers*.

Contingent consideration

19.36 Changes resulting from events after the acquisition date (such as meeting an earnings target, reaching a specified share price or reaching a milestone on a **research** and **development** project) are not measurement-period adjustments—except for the changes in the amount of contingent consideration that are measurement-period adjustments in accordance with paragraph 19.31. An acquirer shall account for changes in the amount of contingent consideration that are not measurement-period adjustments in accordance with paragraph 19.37.

19.37 If the contingent consideration is:

(a) classified as equity the acquirer shall not remeasure that contingent consideration and shall account for its subsequent settlement within equity.

(b) other contingent consideration:

(i) whose fair value can be measured reliably without undue cost or effort at the acquisition date—the acquirer shall measure that contingent consideration at fair value at each **reporting date** and shall recognise in profit or loss any changes in fair value.

(ii) whose fair value cannot be measured reliably without undue cost or effort at the acquisition date (see paragraph 19.27)—the acquirer shall review that contingent consideration at each reporting date and adjust it to reflect the current estimate of the most likely amount of the contingent consideration at that reporting date. The acquirer shall recognise in profit or loss any adjustments to the amounts it previously recognised.

Disclosures

For business combination(s) during the reporting period

19.38 For each business combination that occurs during the reporting period, the acquirer shall disclose:

(a) the name and a description of the acquiree;

(b) the acquisition date;

(c) the percentage of voting-equity instruments acquired;

(d) the acquisition-date fair value of the total consideration transferred and a description of the components of that consideration (such as cash, equity instruments and debt instruments);

(e) for contingent consideration arrangements:

(i) the amount recognised as of the acquisition date;

(ii) a description of the arrangement and the basis for determining the amount of the payment; and

(iii) if applicable, the fact that the acquirer cannot reliably measure the acquisition-date fair value of contingent consideration without undue cost or effort (see paragraph 19.27) and the reasons it would involve undue cost or effort;

(f) the amounts recognised at the acquisition date for each class of the acquiree's assets and liabilities;

(g) for a bargain purchase, the amount of any gain recognised in profit or loss in accordance with paragraph 19.23 and the line item in the statement of comprehensive income (and in the **income statement**, if presented) in which the gain is recognised;

(h) a qualitative description of the factors that make up the goodwill recognised—for example, expected synergies from combining operations of the acquiree and the acquirer, or intangible assets not recognised in accordance with paragraph 19.16; and

(i) the information required by paragraph 21.15 for each contingent liability that the acquirer does not recognise in accordance with paragraph 19.18 (because its fair value cannot be measured reliably).

For all business combinations

19.39 An acquirer shall disclose the useful lives used to amortise goodwill and a reconciliation of the **carrying amount** of goodwill at the beginning and end of the reporting period. The acquirer shall disclose separately:

(a) additional goodwill it recognised during the reporting period arising from new business combinations;

(b) impairment losses it recognised during the reporting period in accordance with Section 27;

(c) goodwill relating to previously acquired businesses the acquirer derecognised during the reporting period; and

(d) other changes.

19.40 The reconciliation set out in paragraph 19.39 need not be presented for prior periods.

For reporting periods after the acquisition date

19.41 For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires, the entity shall disclose for each **material** business combination and in aggregate for business combinations that are individually immaterial but collectively material:

(a) any changes in the recognised amounts of contingent consideration, including any differences arising upon settlement; and

(b) the valuation techniques and key model inputs the acquirer used to measure contingent consideration.

Appendix to Section 19
Application guidance

This appendix is an integral part of Section 19.

Definition of a business (application of paragraph 19.3)

19A.1 A business is 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 investment income (such as dividends or interest) or generating other income from ordinary activities. A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. These are the three elements of a business and their definitions:

(a) an *input* is 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 of inputs include employees, non-current assets, intellectual property and the ability to obtain access to necessary materials or rights.

(b) a *process* is 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 of processes include strategic management processes, operational processes and resource management processes.

(c) an *output* is the result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income or generate other income from ordinary activities.

Optional test to identify concentration of fair value

19A.2 Paragraph 19A.3 sets out an optional concentration test for a simplified assessment of whether an acquired set of activities and assets is a business. An entity is permitted to choose whether to apply the test for each transaction or other event. If the concentration test is:

(a) met, the set of activities and assets is determined not to be a business and no further assessment is necessary; or

(b) not met (or if the entity chooses not to apply the test), the entity then performs the assessment set out in paragraphs 19A.4–19A.10.

19A.3 The concentration test is met, meaning an acquired set of activities and assets is determined not to be a business, 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. For the purposes of the concentration test:

(a) gross assets acquired exclude cash and cash equivalents, deferred tax assets and goodwill resulting from the effects of deferred tax liabilities;

(b) the fair value of the gross assets acquired includes any consideration transferred (plus the non-controlling interest's proportionate share in the recognised amounts of the acquiree's net identifiable assets and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired;

(c) a single identifiable asset includes any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination;

(d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset without incurring significant cost or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset; and

(e) the nature of each single identifiable asset and the risk characteristics (the risks associated with managing and creating outputs from the assets) are considered to assess whether assets are similar.

Elements of a business

19A.4 Although businesses usually have outputs, an integrated set of activities and assets can have no outputs and still qualify as a business. If an integrated set of activities and assets has two essential elements—inputs and processes applied to those inputs—it can be conducted and managed for the purposes identified in the definition of a business. A business need not include all of the inputs or processes that the seller used in operating that business. However, to be considered a business, an integrated set of activities and assets includes, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. Paragraphs 19A.7–19A.10 specify how to assess whether a process is substantive.

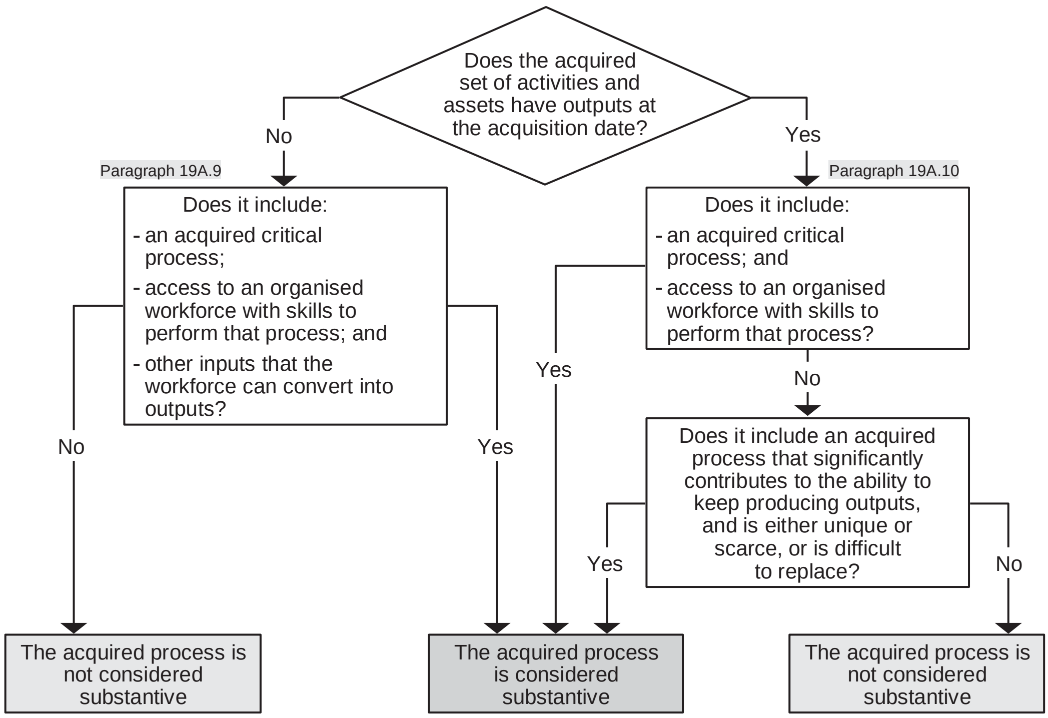
19A.5 If an acquired set of activities and assets has outputs, a continuation of **revenue** does not, on its own, show that the acquirer has acquired both an input and a substantive process.

19A.6 An acquirer determines whether a particular set of activities and assets is a business based on whether the integrated set is capable of being conducted and managed as a business by a market participant. It is not relevant whether a seller operated the set as a business or whether an acquirer intends to operate the set as a business.

Assessing whether an acquired process is substantive

19A.7 Paragraphs 19A.8–19A.10 explain how to assess whether an acquired process is substantive depending on whether the acquired set of activities and assets has no outputs (paragraph 19A.9) or has outputs (paragraph 19A.10). Figure 19.1 summarises how an entity assesses whether an acquired process is substantive.

Figure 19.1—How an entity assesses whether an acquired process is substantive



19A.8 An example of an acquired set of activities and assets that does not have outputs at the acquisition date is an early-stage entity that has not started generating revenue. If an acquired set of activities and assets generates revenue at the acquisition date, it is considered to have outputs at that date. The acquired set has outputs even if it subsequently will no longer generate revenue from external customers—for example, because it will be integrated by an acquirer.

19A.9 If a set of activities and assets does not have outputs at the acquisition date, an acquired process (or group of processes) is considered substantive only if:

(a) it is critical to the ability to develop or convert an acquired input or inputs into outputs; and

(b) the inputs acquired include both access to an organised workforce that has the necessary skills, knowledge or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:

(i) intellectual property that could be used to develop a good or service;

(ii) other economic resources—for example, technology or real estate—that could be developed to create outputs; or

(iii) rights to obtain access to necessary materials or rights that enable the creation of future outputs.

19A.10 If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) is considered substantive if, when applied to an acquired input or inputs, it:

(a) is critical to the ability to continue producing outputs, and the inputs acquired include access to an organised workforce with the necessary skills, knowledge or experience to perform that process (or group of processes); or

(b) significantly contributes to the ability to continue producing outputs and:

(i) is considered unique or scarce; or

(ii) cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

Identifying the acquirer (application of paragraphs 19.8–19.10)

19A.11 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

19A.12 In a business combination effected primarily by exchanging equity instruments, the acquirer is usually the entity that issues its equity instruments. An entity considers other pertinent facts and circumstances to identify the acquirer in a business combination effected by exchanging equity instruments. For example, the acquirer is usually the combining entity:

(a) whose owners, as a group, retain or receive after the business combination the largest portion of the voting rights in the combined entity;

(b) whose single owner or organised group of owners holds the largest minority voting interest in the combined entity, if no other owner or organised group of owners has a significant voting interest;

(c) whose owners have the ability to elect, appoint or remove a majority of the members of the governing body of the combined entity;

(d) whose (former) management dominates the senior management of the combined entity; or

(e) that pays a premium over the pre-combination fair value of the equity instruments of the other combining entity or entities.

19A.13 The acquirer is usually the combining entity whose size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

19A.14 In a business combination involving more than two entities, an entity identifies the acquirer by considering, among other things, which of the combining entities initiated the combination and the relative size of the combining entities.

19A.15 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the business combination is the acquirer, in accordance with paragraph 19.10 and the guidance in paragraphs 19A.11–19A.14. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration might be the acquirer.

Section 20
Leases

Scope of this section

20.1 This section covers accounting for all **leases** other than:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 34 *Specialised Activities*);

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*);

(c) measurement of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under **operating leases** (see Section 16 *Investment Property*);

(d) measurement of **biological assets** held by lessees under **finance leases** and biological assets provided by lessors under operating leases (see Section 34);

(e) leases that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased **asset**, changes in foreign exchange rates, changes in lease payments based on variable market interest rates, or a default by one of the counterparties (see paragraph 11.49(f)); and

(f) operating leases that are onerous.

20.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

20.3 Some arrangements, such as some outsourcing arrangements, telecommunication contracts that provide rights to capacity and take-or-pay contracts, do not take the legal form of a lease but convey rights to use assets in return for payments. Such arrangements are in substance leases of assets and they shall be accounted for under this section.

Classification of leases

20.4 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

20.5 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction instead of the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the **present value** of the **minimum lease payments** amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

20.6 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the **residual value** of the leased asset accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

20.7 The examples and indicators in paragraphs 20.5 and 20.6 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset is transferred to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.

20.8 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

Financial statements of lessees—finance leases

Initial recognition

20.9 At the commencement of the lease term, a lessee shall recognise its rights of use and obligations under finance leases as assets and **liabilities** in its **statement of financial position** at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.

20.10 The present value of the minimum lease payments shall be calculated using the **interest rate implicit in the lease**. If this cannot be determined, the **lessee's incremental borrowing rate** shall be used.

Subsequent measurement

20.11 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability using the **effective interest method** (see paragraphs 11.15–11.20). The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as **expenses** in the periods in which they are incurred.

20.12 A lessee shall depreciate an asset leased under a finance lease in accordance with the relevant section of this Standard for that type of asset, for example, Section 17 *Property, Plant and Equipment* or Section 18. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its **useful life**. A lessee shall also assess at each **reporting date** whether an asset leased under a finance lease is impaired (see Section 27 *Impairment of Assets*).

Disclosures

20.13 A lessee shall make the following disclosures for finance leases:

(a) for each **class of asset**, the net **carrying amount** at the end of the **reporting period**;

(b) the total of future minimum lease payments at the end of the reporting period, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases and restrictions imposed by lease arrangements.

20.14 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessees for assets leased under finance leases.

Financial statements of lessees—operating leases

Recognition and measurement

20.15 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense over the lease term on a straight-line basis unless either:

(a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis; or

(b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases.

If payments to the lessor vary because of factors other than general inflation, then the condition (b) is not met.

Example of applying paragraph 20.15(b):

X operates in a jurisdiction in which the consensus forecast by local banks is that the general price level index, as published by the government, will increase by an average of 10 per cent annually over the next five years. X leases some office space from Y for five years under an operating lease. The lease payments are structured to reflect the expected 10 per cent annual general inflation over the five-year term of the lease as follows

Year 1	CU100,000
Year 2	CU110,000
Year 3	CU121,000
Year 4	CU133,000
Year 5	CU146,000

X recognises annual rent expense equal to the amounts owed to the lessor. If the escalating payments are not clearly structured to compensate the lessor for expected inflationary cost increases based on published indexes or statistics, then X recognises annual rent expense on a straight-line basis: CU122,000 each year (sum of the amounts payable under the lease divided by five years).

Disclosures

20.16 A lessee shall make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) lease payments recognised as an expense; and

(c) a general description of the lessee's significant leasing arrangements including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors—finance leases

Initial recognition and measurement

20.17 A lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the **net investment in the lease**. The net investment in a lease is the lessor's **gross investment in the lease** discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance lease; and

(b) any unguaranteed residual value accruing to the lessor.

20.18 For finance leases other than those involving manufacturer or dealer lessors, initial direct costs (costs that are incremental and directly attributable to negotiating and arranging a lease) are included in the initial measurement of the finance lease receivable and reduce the amount of **income** recognised over the lease term.

Subsequent measurement

20.19 The **recognition** of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in **profit or loss**.

Manufacturer or dealer lessors

20.20 Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) finance income over the lease term.

20.21 The sales **revenue** recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity's policy for outright sales.

20.22 If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

Disclosures

20.23 A lessor shall make the following disclosures for finance leases:

(a) a reconciliation between the gross investment in the lease at the end of the reporting period and the present value of minimum lease payments receivable at the end of the reporting period. In addition, a lessor shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) unearned finance income.

(c) the unguaranteed residual values accruing to the benefit of the lessor.

(d) the accumulated allowance for uncollectable minimum lease payments receivable.

(e) contingent rents recognised as income in the period.

(f) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements.

Financial statements of lessors—operating leases

Recognition and measurement

20.24 A lessor shall present assets subject to operating leases in its **statement of financial position** according to the nature of the asset.

20.25 A lessor shall recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless either:

(a) another systematic basis is representative of the time pattern of the lessee's benefit from the leased asset, even if the receipt of payments is not on that basis; or

(b) the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases.

If payments to the lessor vary according to factors other than inflation, then condition (b) is not met.

20.26 A lessor shall recognise as an expense costs, including **depreciation**, incurred in earning the lease income. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

20.27 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.

20.28 To determine whether a leased asset has become impaired, a lessor shall apply Section 27.

20.29 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Disclosures

20.30 A lessor shall disclose the following for operating leases:

(a) the future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.

(b) total contingent rents recognised as income; and

(c) a general description of the lessor's significant leasing arrangements, including, for example, information about contingent rent, renewal or purchase options and escalation clauses and restrictions imposed by lease arrangements.

20.31 In addition, the requirements for disclosure about assets in accordance with Sections 17, 18, 27 and 34 apply to lessors for assets provided under operating leases.

Sale and leaseback transactions

20.32 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

20.33 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

20.34 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

Disclosures

20.35 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of significant leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

Section 21
Provisions and Contingencies

Scope of this section

21.1 This section applies to all **provisions** (liabilities of uncertain timing or amount), **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this Standard, which include provisions relating to:[5]

(a) **leases** (Section 20 *Leases*). However, this section deals with **operating leases** that have become onerous.

(b) **revenue** from **contracts** with **customers** (Section 23 *Revenue from Contracts with Customers*). However, this section deals with contracts with customers that have become onerous.

(c) **employee benefit** obligations (Section 28 *Employee Benefits*).

(d) **income tax** (Section 29 *Income Tax*).

(e) **contingent consideration** of an **acquirer** in a **business combination** (Section 19 *Business Combinations and Goodwill*).

21.1A This section applies to **financial guarantee contracts** issued at nil consideration when the specified debtor is another entity within the **group**. Other issued financial guarantee contracts are in the scope of Part II of Section 11 *Financial Instruments*.

21.2 The requirements in this section do not apply to **executory contracts** unless they are **onerous contracts**. Executory contracts are contracts under which neither party has fulfilled any of its obligations or both parties have partially fulfilled their obligations to an equal extent.

21.3 The word ‘provision’ is sometimes used in the context of such items as **depreciation**, impairment of **assets** and uncollectable receivables. Those are adjustments of the **carrying amounts** of assets, instead of **recognition** of liabilities, and therefore are not covered by this section.

Initial recognition

21.4 An entity shall recognise a provision only when:

(a) the entity has an obligation at the **reporting date** as a result of a past event;

(b) it is **probable** (ie more likely than not) that the entity will be required to transfer economic benefits in settlement; and

(c) the amount of the obligation can be estimated reliably.

21.5 The entity shall recognise the provision as a liability in the **statement of financial position** and shall recognise the amount of the provision as an **expense**, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

21.6 The condition in paragraph 21.4(a) (obligation at the reporting date as a result of a past event) means that the entity has no realistic alternative to settling the obligation. This can happen when the entity has a legal obligation that can be enforced by law or when the entity has a **constructive obligation** because the past event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Obligations that will arise from the entity’s future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 21.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the entity can avoid the future expenditure by its future

[5] This section uses the term ‘liability’ in a way that differs in some respects from the definition in paragraph 2.49 and the Glossary. For the purpose of this section, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

actions, for example by changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognised.

21.6A A restructuring is a programme that is planned and controlled by management and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted. Examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

(b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;

(c) changes in management structure—for example, eliminating a layer of management; and

(d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

21.6B A constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function and approximate number of employees who will be compensated for termination of their services;

(iv) the expenditures that will be undertaken; and

(v) when the plan will be implemented.

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Initial measurement

21.7 An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the **reporting period** or to transfer it to a third party at that time:

(a) when the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

(b) when the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount than the most likely outcome.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability shall be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

21.8 An entity shall exclude gains from the expected disposal of assets from the measurement of a provision.

21.9 When some or all of the amount required to settle a provision may be reimbursed by another party (for example, through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the **statement of comprehensive income**, the entity may offset any reimbursement from another party against the expense relating to the provision.

Subsequent measurement

21.10 An entity shall charge against a provision only those expenditures for which the provision was originally recognised.

21.11 An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in **profit or loss** unless the provision was originally recognised as part of the cost of an asset (see paragraph 21.5). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as a finance cost in profit or loss in the period it arises.

Contingent liabilities

21.12 A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. An entity shall not recognise a contingent liability as a liability, except for contingent liabilities assumed in a business combination applying paragraph 19.19. Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

Contingent assets

21.13 An entity shall not recognise a contingent asset as an asset. Disclosure of a contingent asset is required by paragraph 21.16 when an inflow of economic benefits is probable. However, when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

Disclosures

Disclosures about provisions

21.14 For each class of provision, an entity shall disclose all of the following:

(a) a reconciliation showing:

   (i) the carrying amount at the beginning and end of the period;

   (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;

   (iii) amounts charged against the provision during the period; and

   (iv) unused amounts reversed during the period.

(b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments;

(c) an indication of the uncertainties about the amount or timing of those outflows; and

(d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information for prior periods is not required.

Disclosures about contingent liabilities

21.15 Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable:

(a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

21.16 If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the reporting period and, unless it would involve undue cost or effort, an estimate of their financial effect, measured using the principles set out in paragraphs 21.7–21.11. If such an estimate would involve undue cost or effort, the entity shall disclose that fact and the reasons why estimating the financial effect would involve undue cost or effort.

Prejudicial disclosures

21.17 In extremely rare cases, disclosure of some or all of the information required by paragraphs 21.14–21.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Disclosures about financial guarantee contracts

21.18 An entity shall disclose for issued financial guarantee contracts in the scope of this section (see paragraph 21.1A):

(a) the nature and business purpose of these contracts;

(b) an indication of the uncertainties relating to the amount or timing of any outflow of resources; and

(c) the maximum amount the entity could be required to pay if the guarantees are called on.

21.19 An entity shall also make the disclosures required by Section 33 *Related Party Disclosures* and, if applicable, the disclosures required by paragraphs 21.14 and 21.15.

Appendix to Section 21
Illustrative examples

This appendix accompanies, but is not part of, Section 21. The examples illustrate how to apply the requirements in Section 21 when recognising and measuring provisions.

All of the entities in the examples in this appendix have 31 December as their reporting date. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets; this aspect is not dealt with in the examples. References to 'best estimate' are to the present value amount, when the effect of the time value of money is material.

Example 1 Future operating losses

21A.1 An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—there is no past event that obliges the entity to pay out resources.

Conclusion—the entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 27 *Impairment of Assets*.

Example 2 Onerous contracts

21A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, an entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—the entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion—if an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

21A.3 [Deleted]

Example 4 Warranties

21A.4 A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On the basis of experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event—the obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement—probable for the warranties as a whole.

Conclusion—the entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price. Consequently, estimated warranty costs are:

CU1,000,000 × 90% × 0	= CU0
CU1,000,000 × 6% × 30%	= CU18,000
CU1,000,000 × 4% × 70%	= CU28,000
Total	= CU46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2 and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments (CU)	Discount rate	Discount factor	Present value (CU)
1	60% × CU46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × CU46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × CU46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The entity will recognise a warranty obligation of CU41,846 at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

21A.5 [Deleted]

Example 6 Closure of a division—no implementation before end of reporting period

21A.6 On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—there has been no obligating event, and so there is no obligation.

Conclusion—the entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

21A.7 On 12 December 20X0 the board of an entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—the obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement—probable.

Conclusion—the entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division.

Example 8 Staff retraining as a result of changes in the income tax system

21A.8 The government introduces changes to the income tax system. As a result of those changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with tax regulations. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event—the tax law change does not impose an obligation on an entity to do any retraining. An obligating event for recognising a provision (the retraining itself) has not taken place.

Conclusion—the entity does not recognise a provision.

Example 9 A court case

21A.9 A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable:

(a) at 31 December 20X1

Present obligation as a result of a past obligating event—on the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion—no provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) at 31 December 20X2

Present obligation as a result of a past obligating event—on the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer.

An outflow of resources embodying economic benefits in settlement—probable.

Conclusion—a provision is recognised at the best estimate of the amount to settle the obligation, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

Section 22
Liabilities and Equity

Scope of this section

22.1 This section establishes principles for classifying **financial instruments** as either liabilities or **equity** and addresses accounting for equity instruments issued to individuals or other parties acting in their capacity as investors in equity instruments (ie in their capacity as **owners**). Section 26 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.

22.2 This section shall be applied when classifying all types of financial instruments except:

(a) those interests in **subsidiaries**, **associates** and **joint arrangements** that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Joint Arrangements*.

(b) employers' rights and obligations under **employee benefit** plans, to which Section 28 *Employee Benefits* applies.

(c) [deleted]

(d) financial instruments, contracts and obligations under **share-based payment transactions** to which Section 26 applies, except that paragraphs 22.3–22.6 shall be applied to **treasury shares** purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans and all other **share-based payment arrangements**.

Classification of a financial instrument as liability or equity

22.3 Equity is the residual interest in the **assets** of an entity after deducting all its liabilities. For the purpose of this section, a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Equity includes investments by the owners of the entity, plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.

22.3A An entity shall classify a financial instrument as a **financial liability** or as equity in accordance with the substance of the contractual arrangement, not merely its legal form, and in accordance with the definitions of a financial liability and an equity instrument. Unless an entity has an unconditional right to avoid delivering **cash** or another **financial asset** to settle a contractual obligation, the obligation meets the definition of a financial liability, and is classified as such, except for those instruments classified as equity instruments in accordance with paragraph 22.4.

22.4 Some financial instruments that meet the definition of a liability are classified as equity because they represent the residual interest in the net assets of the entity:

(a) a puttable instrument is a financial instrument that gives the holder the right to sell that instrument back to the issuer for cash or another financial asset or is automatically redeemed or repurchased by the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. A puttable instrument that has all of the following features is classified as an equity instrument:

(i) it entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets.

(ii) the instrument is in the class of instruments that is subordinate to all other classes of instruments.

(iii) all financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features.

(iv) apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments.

(v) the total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the **profit or loss**, the change in the recognised net assets or the change in the **fair value** of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

(b) instruments, or components of instruments, that are subordinate to all other classes of instruments are classified as equity if they impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

22.5 The following are examples of instruments that are classified as liabilities instead of equity:

(a) an instrument is classified as a liability if the distribution of net assets on liquidation is subject to a maximum amount (a ceiling). For example, if on liquidation the holders of the instrument receive a pro rata share of the net assets, but this amount is limited to a ceiling and the excess net assets are distributed to a charity organisation or the government, the instrument is not classified as equity.

(b) a puttable instrument is classified as equity if, when the put option is exercised, the holder receives a pro rata share of the net assets of the entity measured in accordance with this Standard. However, if the holder is entitled to an amount measured on some other basis (such as local GAAP), the instrument is classified as a liability.

(c) an instrument is classified as a liability if it obliges the entity to make payments to the holder before liquidation, such as a mandatory dividend.

(d) a puttable instrument that is classified as equity in a subsidiary's **financial statements** is classified as a liability in its parent entity's consolidated financial statements.

(e) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

22.6 Members' shares in co-operative entities and similar instruments are equity if:

(a) the entity has an unconditional right to refuse redemption of the members' shares; or

(b) redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

Original issue of shares or other equity instruments

22.7 An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the entity in exchange for the instruments:

(a) if the equity instruments are issued before the entity receives the cash or other resources, the entity shall present the amount receivable as an offset to equity in its **statement of financial position**, unless local laws or regulations prohibit such presentation (in which case the entity shall comply with the presentation requirements in the local laws or regulations);

(b) if the entity receives the cash or other resources before the equity instruments are issued, and the entity cannot be required to repay the cash or other resources received, the entity shall recognise the corresponding increase in equity to the extent of consideration received; and

(c) to the extent that the equity instruments have been subscribed for but not issued, and the entity has not yet received the cash or other resources, the entity shall not recognise an increase in equity.

22.8 An entity shall measure equity instruments, other than those issued as part of a **business combination** or those accounted for in accordance with paragraphs 22.13–22.15B, at the fair value of the cash or other resources received or receivable, net of **transaction costs**. If payment is deferred and the time value of money is **material**, the initial measurement shall be on a **present value** basis.

22.9 An entity shall account for the transaction costs of an equity transaction as a deduction from equity. **Income tax** relating to the transaction costs shall be accounted for in accordance with Section 29 *Income Tax*.

22.10 How the increase in equity arising on the issue of shares or other equity instruments is presented in the statement of financial position is determined by applicable laws. For example, the par value (or other nominal value) of shares and the amount paid in excess of par value may be required to be presented separately.

Sale of options, rights and warrants

22.11 An entity shall apply the principles in paragraphs 22.7–22.10 to equity issued by means of sales of options, rights, warrants and similar equity instruments.

Capitalisation or bonus issues of shares and share splits

22.12 A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a share split, each shareholder may receive one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

Convertible debt or similar compound financial instruments

22.13 On issuing convertible debt or similar **compound financial instruments** that contain both a liability and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.

22.14 The entity shall not revise the allocation in a subsequent period.

22.15 In periods after the instruments were issued, the entity shall account for the liability component as follows:

(a) in accordance with Part I of Section 11 *Financial Instruments* if the liability component meets the conditions in paragraph 11.9 or paragraph 11.9ZA. In these cases, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest **expense** using the **effective interest method** (see paragraphs 11.15–11.20).

(b) in accordance with Part II of Section 11 if the liability component does not meet the conditions in paragraph 11.9 or paragraph 11.9ZA.

Extinguishing financial liabilities with equity instruments

22.15A An entity may renegotiate the terms of a financial liability with a creditor of the entity with the result that the entity extinguishes the liability fully or partially by issuing equity instruments to the creditor. Issuing equity instruments constitutes consideration paid in accordance with paragraph 11.38. An entity shall measure the equity instruments issued at their fair value. However, if the fair value of the equity instruments issued cannot be measured reliably without undue cost or effort, the equity instruments shall be measured at the fair value of the financial liability extinguished. An entity shall derecognise the financial liability, or part of the financial liability, in accordance with paragraphs 11.36–11.38.

22.15B If part of the consideration paid relates to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part that remains outstanding. This allocation should be made on a reasonable basis. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the **recognition** of a new liability as required by paragraph 11.37.

22.15C An entity shall not apply paragraphs 22.15A–22.15B to transactions in situations in which:

(a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder;

(b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity; or

(c) extinguishing the financial liability by issuing equity instruments is in accordance with the original terms of the financial liability (see paragraphs 22.13–22.15).

Treasury shares

22.16 Treasury shares are the equity instruments of an entity that have been issued and subsequently reacquired by the entity. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognise a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

Distributions to owners

22.17 An entity shall reduce equity for the amount of distributions to its owners (holders of its equity instruments). Income tax relating to distributions to owners shall be accounted for in accordance with Section 29.

22.18 Sometimes an entity distributes assets other than cash to its owners ('non-cash distributions'). When an entity declares such a distribution and has an obligation to distribute non-cash assets to its owners, it shall recognise a liability. It shall measure the liability at the fair value of the assets to be distributed unless it meets the conditions in paragraph 22.18A. At the end of each **reporting period** and at the date of settlement, the entity shall review and adjust the **carrying amount** of the dividend payable to reflect changes in the fair value of the assets to be distributed, with any changes recognised in equity as adjustments to the amount of the distribution. When an entity settles the dividend payable, it shall recognise in profit or loss any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable.

22.18A If the fair value of the assets to be distributed cannot be measured reliably without undue cost or effort, the liability shall be measured at the carrying amount of the assets to be distributed. If prior to settlement the fair value of the assets to be distributed can be measured reliably without undue cost or effort, the liability is remeasured at fair value with a corresponding adjustment made to the amount of the distribution and accounted for in accordance with paragraph 22.18.

22.18B Paragraphs 22.18–22.18A do not apply to the distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. This exclusion applies to the separate, individual and **consolidated financial statements** of an entity that makes the distribution.

22.19 [Deleted]

Disclosures

22.20 If the fair value of the assets to be distributed as described in paragraphs 22.18–22.18A cannot be measured reliably without undue cost or effort, the entity shall disclose that fact and the reasons why a reliable fair value measurement would involve undue cost or effort.

Appendix to Section 22
Illustrative example of the issuer's accounting for convertible debt

This appendix accompanies, but is not part of, Section 22. It provides guidance for applying the requirements of paragraphs 22.13–22.15.

On 1 January 20X5 an entity issues 500 convertible bonds. The bonds are issued at par with a face value of CU100 per bond and are for a five-year term, with no transaction costs. The total proceeds from the issue are CU50,000. Interest is payable annually in arrears at an annual interest rate of 4 per cent. Each bond is convertible, at the holder's discretion, into 25 ordinary shares at any time up to maturity. At the time the bonds are issued, the market interest rate for similar debt that does not have the conversion option is 6 per cent.

When the instrument is issued, the liability component must be valued first, and the difference between the total proceeds on issue (which is the fair value of the instrument in its entirety) and the fair value of the liability component is assigned to the equity component. The fair value of the liability component is calculated by determining its present value using the discount rate of 6 per cent. These calculations and journal entries are illustrated:

	CU
Proceeds from the bond issue (A)	50,000
Present value of principal at the end of five years (see calculations)	37,363
Present value of interest payable annually in arrears for five years	8,425
Present value of liability, which is the fair value of liability component (B)	45,788
Residual, which is the fair value of the equity component (A) – (B)	4,212

The issuer of the bonds makes the following journal entry at issue on 1 January 20X5:

Dr Cash	CU50,000	
Cr Financial Liability – Convertible bond		CU45,788
Cr Equity		CU4,212

The CU4,212 represents a discount on issue of the bonds, so the entry could also be shown 'gross':

Dr Cash	CU50,000	
Dr Bond discount	CU4,212	
Cr Financial Liability – Convertible bond		CU50,000
Cr Equity		CU4,212

After issue, the issuer will amortise the bond discount according to the following table:

	(a) Interest payment (CU)	**(b) Total interest expense (CU) = 6% × (e)**	**(c) Amortisation of bond discount (CU) = (b) – (a)**	**(d) Bond discount (CU) = (d) – (c)**	**(e) Net liability (CU) = 50,000 – (d)**
1/1/20X5				4,212	45,788
31/12/20X5	2,000	2,747	747	3,465	46,535
31/12/20X6	2,000	2,792	792	2,673	47,327
31/12/20X7	2,000	2,840	840	1,833	48,167
31/12/20X8	2,000	2,890	890	943	49,057
31/12/20X9	2,000	2,943	943	0	50,000
Totals	10,000	14,212	4,212		

At the end of 20X5, the issuer would make the following journal entry:

Dr Interest expense	CU2,747	
Cr Bond discount		CU747
Cr Cash		CU2,000

Calculations

Present value of principal of CU50,000 at 6 per cent

CU50,000/(1.06)^5 = CU37,363

Present value of the interest annuity of CU2,000 (= CU50,000 × 4 per cent) payable at the end of each of five years

The CU2,000 annual interest payments are an annuity—a cash flow stream with a limited number (n) of periodic payments (C), receivable at dates 1 to n. To calculate the present value of this annuity, future payments are discounted by the periodic rate of interest (i) using the following formula:

$$PV = \frac{C}{i} \times [1 - \frac{1}{(1+i)^{\wedge}n}]$$

Therefore, the present value of the CU2,000 interest payments is

(CU2,000/.06) × [1 – [(1/1.06)^5] = CU8,425

This is equivalent to the sum of the present values of the five individual CU2,000 payments, as follows:

	CU
Present value of interest payment at 31 December 20X5 = 2,000/1.06	1,887
Present value of interest payment at 31 December 20X6 = 2,000/1.06^2	1,780
Present value of interest payment at 31 December 20X7 = 2,000/1.06^3	1,679
Present value of interest payment at 31 December 20X8 = 2,000/1.06^4	1,584
Present value of interest payment at 31 December 20X9 = 2,000/1.06^5	1,495
Total	8,425

Yet another way to calculate this is to use a table of present value of an ordinary annuity in arrears, five periods, interest rate of 6 per cent per period. (Such tables are easily found on the Internet.) The present value factor is 4.2124. Multiplying this by the annuity payment of CU2,000 determines the present value of CU8,425.

Section 23
Revenue from Contracts with Customers

Scope of this section

23.1 This section applies to all **contracts** with **customers**, except:

(a) **lease** contracts within the scope of Section 20 *Leases*;

(b) **insurance contracts**;

(c) **financial instruments** and other contractual rights or obligations within the scope of Section 9 *Consolidated and Separate Financial Statements*, Section 11 *Financial Instruments*, Section 14 *Investments in Associates* or Section 15 *Joint Arrangements*; and

(d) non-cash exchanges of products between entities in the same line of business to help make sales to customers.

23.2 A contract with a customer might be partially within the scope of this section and partially within the scope of other sections listed in paragraph 23.1. If one of the other sections specifies how to initially measure any parts of the contract, then an entity shall first apply the measurement requirements in that section. Otherwise, the entity shall apply this section to initially measure those parts of the contract.

Revenue recognition model

23.3 This section describes the **revenue** recognition model an entity shall apply to account for revenue from contracts with customers. Applying the model requires an entity to recognise an amount of revenue that depicts the goods or services the entity has transferred to customers and that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. An entity shall apply the model in five steps:

(a) Step 1—Identify the contract(s) with a customer (see paragraphs 23.6–23.13);

(b) Step 2—Identify the **promises** in the contract (see paragraphs 23.14–23.22);

(c) Step 3—Determine the **transaction price** (see paragraphs 23.23–23.38);

(d) Step 4—Allocate the transaction price to the promises in the contract (see paragraphs 23.39–23.48); and

(e) Step 5—Recognise revenue when (or as) the entity fulfils a promise (see paragraphs 23.49–23.67).

23.4 An entity shall apply this section consistently to contracts with similar characteristics and in similar circumstances.

23.5 This section specifies how an entity accounts for an individual contract with a customer. An entity is permitted to apply this section to a portfolio of similar contracts (or promises) if the entity reasonably expects that the result of doing so would not differ **materially** from the result of applying the section to each individual contract (or promise).

Step 1—Identify the contract(s) with a customer

23.6 A contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's usual business practices.

23.7 An entity shall apply the revenue recognition model to account for a contract with a customer that is within the scope of this section only when all of the following criteria are met:

(a) the parties to the contract have approved the contract and are committed to fulfilling their respective obligations;

(b) the entity can identify each party's rights in relation to the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance; and

(e) it is **probable** that the entity will collect the consideration that it is entitled to when the consideration is due.

23.8 If a contract with a customer meets the criteria in paragraph 23.7 at the start of the contract, an entity shall reassess whether the contract meets the criteria only if there is a significant change in relevant facts and circumstances.

23.9 If a contract with a customer does not meet the criteria in paragraph 23.7, an entity shall reassess the contract until the criteria are met.

23.10 When a contract with a customer does not meet the criteria in paragraph 23.7, an entity shall recognise any consideration received from the customer as a **liability**. If the consideration is non-refundable, the entity shall derecognise the liability and recognise the consideration as revenue when either:

(a) the contract is complete and the entity has received all, or almost all, of the consideration promised by the customer; or

(b) the contract is cancelled.

23.11 Some contracts with customers might have no fixed duration or might automatically renew periodically. An entity shall apply this section to the duration of the contract in which the parties to the contract have present enforceable rights and obligations.

23.12 If a contract is modified, an entity shall account for the contract modification by applying paragraphs 23A.2–23A.4.

Combination of contracts

23.13 An entity shall combine two or more contracts it has entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

(a) the contracts are negotiated as a package with a single commercial objective;

(b) the amount of consideration the customer will pay in one of the contracts depends on the price or performance of the other contract; or

(c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single promise in accordance with Step 2.

Step 2—Identify the promises in the contract

23.14 A promise is an obligation to transfer a distinct good or service (or a distinct bundle of goods or services). A contract with a customer might contain more than one promise. At the start of a contract, an entity shall identify the goods and services promised in the contract and determine which goods or services are distinct.

23.15 An entity might transfer distinct goods or services to a customer that are essentially the same, but at discrete instances over time (that is, transfer a series of distinct goods or services). The entity shall account for those goods or services as a single promise if:

(a) each distinct good or service in the series would meet the criteria to be a promise fulfilled over time (see paragraph 23.54); and

(b) the entity would use the same method to measure its progress in transferring control of each distinct good or service in the series to the customer (see paragraphs 23.62–23.67).

23.16 A contract with a customer usually explicitly states the goods or services that an entity promises to transfer. However, promises might be implied by an entity's usual business practices, published policies or specific statements, if these create a valid expectation of the customer that the entity will transfer a good or service to the customer.

23.17 A promise does not include activities that an entity must undertake to fulfil a contract, such as set-up activities and administrative tasks, unless those activities transfer a good or service to a customer. Non-refundable fees charged to customers at or near the start of a contract often relate to activities that do not transfer a good or service to the customer and, therefore, do not give rise to a promise. In such cases, the non-refundable upfront fee is included in the transaction price and allocated to the promises in the contract in accordance with Steps 3 and 4.

Distinct goods or services

23.18 A good or service is distinct if both of these criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources readily available to the customer. A good or service that an entity regularly sells separately is an example of a good or service that meets this criterion.

(b) the entity's obligation to transfer the good or service is separate from other obligations in the contract.

23.19 If a good or service promised to the customer is not distinct, an entity shall combine that good or service with other goods or services in the contract until it identifies a bundle of goods or services that is distinct. In some cases, the entity will account for all the goods or services in a contract as a single promise.

23.20 For the purpose of applying the criterion in paragraph 23.18(a), resources readily available to the customer are:

(a) goods or services sold separately, by the entity or another entity; or

(b) goods or services the customer has already obtained from the entity, including goods or services transferred to the customer under the contract, or from other transactions or events.

23.21 For the purpose of applying the criterion in paragraph 23.18(b), factors that suggest that the entity's obligation to transfer a good or service is not separate from other obligations in the contract include:

(a) the entity integrating the goods or services in the contract in a way that transforms them into a combined output (or outputs) for which the goods or services are inputs. For example, a construction contract in which an entity provides a contract management service that integrates various goods or services in a way that transforms them into the asset or assets to be constructed.

(b) the good or service being modified or customised by another good or service in the contract to the extent it is transformed. For example, a contract in which an entity promises to provide existing software and to customise that software, if the customisation service transforms the software.

(c) the good or service being highly dependent on, highly related to or highly affected by another good or service in the contract. For example, in some cases, two or more goods or services are highly affected by each other because an entity would not be able to fulfil its promise by transferring each of the goods or services separately.

23.22 Distinct goods or services can include:

(a) warranties (see paragraphs 23A.5–23A.7);

(b) options to acquire additional goods or services (see paragraphs 23A.8–23A.13);

(c) arranging for another party to transfer goods or services to the customer if the entity is acting as an agent (see paragraphs 23A.14–23A.20); and

(d) licences (see paragraphs 23A.28–23A.37).

Step 3—Determine the transaction price

23.23 The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring goods or services promised to a customer, excluding amounts the entity collects on behalf of third parties (for example, some sales taxes).

23.24 An entity shall determine the transaction price based on the terms of the contract and its usual business practices. When determining the transaction price, an entity shall assume the goods or services will be transferred to the customer in accordance with the contract. The entity shall also assume the contract will not be cancelled, renewed or modified.

23.25 If the consideration promised by the customer is in a form other than **cash**, an entity shall measure the non-cash consideration by applying paragraphs 23A.21–23A.22.

Variable consideration

23.26 The consideration promised by a customer might vary because of factors such as discounts, rebates, refunds, penalties or performance bonuses.

23.27 If the consideration includes a variable amount, an entity shall measure the amount of variable consideration to include in the transaction price by:

(a) estimating the amount of variable consideration (see paragraphs 23.28–23.29); and

(b) constraining that estimate (see paragraph 23.30).

23.28 An entity shall estimate an amount of variable consideration by using one of two methods:

(a) the expected value method—the sum of probability-weighted amounts in a range of possible consideration amounts. This might be an appropriate method if an entity has many contracts with similar characteristics.

(b) the most likely amount method—the most likely amount in a range of possible consideration amounts (that is, the most likely outcome of the contract). This might be an appropriate method if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

23.29 An entity shall apply one method to estimate the amount of variable consideration consistently throughout the contract.

23.30 An entity shall include in the transaction price an amount of variable consideration estimated in accordance with paragraph 23.28 only to the extent that it is **highly probable** that an entity will become entitled to this amount when the uncertainty associated with the variable consideration is later resolved.

23.31 At the end of each **reporting period**, an entity shall update the amount of variable consideration included in the transaction price to reflect any relevant changes in circumstances. An entity shall allocate any subsequent changes in the transaction price to the promises in the contract on the same basis it used at the start of the contract. An entity shall recognise amounts allocated to a fulfilled promise as revenue (or as a reduction of revenue) in the period in which the estimate changes.

23.32 An entity shall apply paragraph 23A.37 to account for consideration in the form of a royalty based on sales or use that is received in exchange for a licence of intellectual property.

Refund liabilities

23.33 If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognise a refund liability.

23.34 The entity shall measure a refund liability by first applying paragraphs 23.27–23.30 to measure the amount of variable consideration to include in the transaction price. The entity shall then recognise as a refund liability the amount of consideration received (or receivable) for goods or services transferred that is not included in the transaction price. At the end of each reporting period, an entity shall update the estimate of the refund liability to reflect consideration received (or receivable), goods or services transferred, and changes in the transaction price in accordance with paragraph 23.31.

23.35 As an exception to paragraph 23.34, an entity shall apply paragraphs 23A.23–23A.27 to account for the variable consideration and refund liability relating to a sale with a right of return.

Deferred payment

23.36 If payment is deferred and the arrangement constitutes a financing transaction (see paragraph 11.13B), an entity shall discount the promised amount of consideration at a market rate of interest for a similar debt instrument as determined at the start of the contract. An entity shall recognise the difference between the promised consideration and the discounted value of that amount as interest revenue in accordance with the **effective interest method** (see paragraphs 11.15–11.20).

23.37 An entity shall present interest revenue separately from revenue from contracts with customers.

23.38 An entity is permitted not to apply paragraphs 23.36–23.37 if, at the start of a contract, it expects a customer to pay for goods or services within one year of the entity transferring the goods or services.

Step 4—Allocate the transaction price to the promises in the contract

23.39 An entity shall allocate the transaction price to each promise it has identified in a contract in accordance with paragraphs 23.40–23.48.

23.40 Step 4 does not apply if an entity fulfils all promises in a contract:

(a) in the same reporting period as the start of the contract; or

(b) at the same point in time in accordance with paragraph 23.58.

23.41 Step 4 does not apply if a contract contains a single promise. However, an entity shall apply paragraph 23.48 if the entity accounts for a series of distinct goods or services as a single promise in accordance with paragraph 23.15 and the transaction price includes an amount of variable consideration.

Allocation based on stand-alone selling prices

23.42 At the start of a contract, an entity shall determine the stand-alone selling price of the distinct good or service (or distinct bundle of goods or services) in each promise in the contract. The entity shall allocate the transaction price in proportion to those stand-alone selling prices (that is, on a relative stand-alone selling price basis). The entity shall not reallocate the transaction price to reflect changes in the stand-alone selling prices after the start of the contract.

23.43 The 'stand-alone selling price' is the price at which an entity would separately sell a good or service. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.

23.44 If a stand-alone selling price is not directly observable, an entity shall estimate that price. An entity shall take into account all information that is reasonably available to it, including market conditions, entity-specific factors and information about the customer or class of customer. An entity shall apply estimation methods consistently in similar circumstances. Suitable estimation methods might include using the entity's competitor's prices for similar goods or services, or the expected costs of the good or service plus an appropriate margin.

23.45 As an exception to paragraph 23.42, an entity might allocate a discount or variable consideration using an alternative method (see paragraphs 23.46–23.48).

Allocation of a discount and variable consideration

23.46 In a contract:

(a) a customer receives a discount if the sum of the stand-alone selling prices of the goods or services promised in the contract is greater than the promised consideration; or

(b) the transaction price might include an amount of variable consideration (see paragraphs 23.26–23.32).

23.47 An entity shall allocate a discount or variable amount to each promise in the contract on a relative stand-alone selling price basis. However, if allocating the discount or variable amount on this basis does not represent the amount of consideration the entity expects to be entitled to in exchange for fulfilling each promise in the contract, the entity shall use another method to allocate the discount or variable amount. For example, the entity might allocate the discount or variable amount to one, or some, of the promises in the contract.

23.48 If an entity accounts for a series of distinct goods or services as a single promise in accordance with paragraph 23.15, it shall allocate a variable amount to each distinct good or service on a relative stand-alone selling price basis. However, if allocating the variable amount on this basis does not represent the amount of consideration the entity expects to be entitled to in exchange for transferring each distinct good or service in the promise, the entity shall use another method to allocate the variable amount. For example, the entity might allocate the variable amount to one, or some, of the distinct goods or services in the promise.

Step 5—Recognise revenue when (or as) the entity fulfils a promise

23.49 An entity shall recognise revenue when (or as) it fulfils a promise. An entity fulfils a promise by transferring control of the distinct good or service in the promise to the customer.

23.50 Goods and services are **assets**, even if only momentarily, when they are received and used. An entity transfers control of an asset when the customer has the present ability to direct the use of the asset and obtain the economic benefits that might flow from it.

23.51 When evaluating whether a customer obtains control of an asset, an entity shall consider any agreements to repurchase the asset. The customer does not obtain control of the asset if the entity has a right and obligation to repurchase the asset (a forward) or a right to repurchase the asset (a call option).

23.52 At the start of a contract, an entity shall determine whether it transfers control of the distinct good or service in a promise to a customer either:

(a) over time, in which case the entity fulfils the promise (and recognises revenue) over time in accordance with paragraphs 23.54–23.56; or

(b) at a point in time, in which case the entity fulfils the promise (and recognises revenue) at a point in time in accordance with paragraphs 23.57–23.61.

23.53 If a contract with a customer includes a licence that is distinct from the other goods or services in the contract, an entity shall apply paragraphs 23A.28–23A.36 to determine whether the promise to grant the licence is fulfilled over time or at a point in time.

Promises fulfilled over time

23.54 An entity transfers control of a distinct good or service over time, and therefore fulfils a promise over time, if any of these criteria is met:

(a) a customer receives and immediately uses the benefits from the entity’s performance as the entity performs (for example, a routine or recurring cleaning service);

(b) a customer controls the asset as the entity makes or improves the asset (for example, a construction contract in which the customer controls the work in progress); or

(c) the asset created by the entity's performance cannot be easily redirected to another customer (see paragraph 23.55) and the original customer is obliged to pay the entity for work done to date (see paragraph 23.56) (for example, a service contract in which an entity provides a professional opinion to a customer that is based on facts and circumstances specific to the customer, and it is obliged to pay the entity for work done to date).

23.55 An asset cannot be easily redirected to another customer if:

(a) the entity would either sell the finished asset to another customer at a significantly lower price than that paid by the original customer, or incur significant costs, compared with the cost of the asset, to rework the finished asset for sale (for example, if an asset was highly customised for a particular customer); or

(b) substantive contractual restrictions prohibit the entity from selling the asset to another customer as that asset is made or improved (for example, if the entity is legally obliged to sell work in progress to the customer).

23.56 A customer might be obliged to pay an entity for work done to date because of specific terms in the contract or laws that apply to that contract. The customer is obliged to pay the entity for work done to date if the entity has either:

(a) a present unconditional right to payment for work done to date; or

(b) an enforceable right to demand or keep payment for work done to date if the contract is cancelled before it is complete for any reason other than the entity's failure to perform as agreed.

Promises fulfilled at a point in time

23.57 If an entity does not transfer control of a distinct good or service over time, the entity transfers control of the good or service at a point in time, and therefore fulfils a promise at a point in time.

23.58 For each promise an entity fulfils at a point in time, the entity shall recognise revenue at the specific point in time a customer obtains control of the distinct good or service. To identify this point in time, an entity shall consider indicators of the transfer of control, which include:

(a) the entity having a present right to payment for the asset;

(b) the customer having legal title to the asset;

(c) the customer having physical possession of the asset;

(d) the customer having the significant risks and rewards of ownership of the asset; and

(e) the customer having accepted the asset (see paragraphs 23.60–23.61).

23.59 The indicators in paragraph 23.58 are not always conclusive. Consequently, the absence of an indicator would not preclude the customer from obtaining control of an asset. If it is clear from other features of the transaction that the customer has the present ability to direct the use of the asset and obtain the economic benefits that might flow from it, the customer has obtained control of the asset.

Customer acceptance

23.60 Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications.

23.61 If a contract includes a customer acceptance clause and the entity cannot identify whether a good or service meets the agreed-upon specifications based on the information available to the entity, it shall wait until it receives the customer's acceptance before it concludes that the customer has obtained control of the good or service.

Measuring progress towards fulfilment of a promise

23.62 For each promise fulfilled over time in accordance with paragraphs 23.54–23.56, an entity shall calculate how much revenue to recognise in each reporting period by measuring its progress towards fulfilment of that promise at the end of the period.

23.63 An entity shall choose a method of measuring progress that depicts the entity's performance in transferring control of goods or services promised to the customer. An entity shall apply one method of measuring progress for each promise fulfilled over time and shall apply that method consistently to similar promises and in similar circumstances.

23.64 At the end of each reporting period, an entity shall remeasure its progress towards fulfilment of a promise to reflect any changes in circumstances. The entity shall account for changes to the measure of progress as a change in **accounting estimate** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

23.65 When choosing which method to use to measure its progress, an entity shall consider the nature of the good or service it will transfer to a customer. Appropriate methods of measuring progress include methods that recognise revenue based on:

(a) the value to the customer of the goods or services transferred to date relative to the remaining goods or services to be transferred under the contract ('output methods'); and

(b) the entity's efforts or inputs to fulfil a promise relative to the total expected inputs to fulfil the promise ('input methods').

23.66 Common methods, and circumstances in which they might be appropriate, include:

(a) an output method based on surveys of completed work, if the surveys give an objective measure of an entity's performance to date;

(b) an output method based on units delivered, if each item transfers an equal amount of value to the customer on delivery;

(c) an output method based on time elapsed, if control of the goods or services is transferred evenly over time;

(d) an input method based on time elapsed, if an entity's efforts or inputs are spent evenly throughout the performance period;

(e) an input method based on labour hours spent, if the labour hours spent and the transfer of control of goods or services to the customer are related; and

(f) an input method based on costs incurred, excluding costs that do not contribute, or are not proportionate, to the entity's progress towards fulfilment of the promise (for example, inefficiencies and wasted or uninstalled materials).

23.67 If an entity has a right to consideration from the customer in an amount that relates directly to the value to the customer of the entity's work to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity is permitted to recognise revenue in the amount it has a right to invoice.

Contract costs

Costs to obtain a contract

23.68 An entity shall recognise the costs of obtaining a contract with a customer as an **expense** when incurred, unless another section of this Standard requires the costs to be recognised as part of the cost of an asset.

Costs to fulfil a contract

23.69 An entity shall account for the costs incurred to fulfil a contract with a customer in accordance with the relevant section of this Standard for those costs (for example, Section 13 *Inventories*, Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill*).

23.70 If the costs incurred to fulfil a contract are not within the scope of another section of this Standard, an entity shall recognise those costs as an asset if:

(a) the costs relate directly to a contract (including future contracts) that the entity can specifically identify (for example, costs relating to a specific contract that has not yet been approved) (see paragraph 23.71);

(b) the costs create or improve the entity's resources that it will use to fulfil (or continue to fulfil) promises in the future; and

(c) the entity expects to recover the costs.

23.71 Costs that relate directly to a contract include direct labour, direct materials and allocations of costs that relate directly to the contract or contract activities.

23.72 General and administrative costs do not normally satisfy the criteria in paragraph 23.70 and are therefore recognised as expenses when incurred.

23.73 An entity shall recognise costs that relate to promises that are fulfilled (or partially fulfilled) as expenses when incurred, because those costs relate to past performance.

Measurement after recognition

23.74 After initial **recognition**, an entity shall measure assets arising from the costs to fulfil a contract in accordance with paragraph 23.70 at cost less accumulated **amortisation** and any accumulated **impairment losses**:

(a) an entity shall amortise the asset based on the pattern of transfer of the goods or services to which the asset relates.

(b) an entity shall follow Section 27 *Impairment of Assets* to recognise and measure the impairment of the asset. However, the entity shall apply paragraphs 23.75–23.76 instead of paragraphs 27.11–27.20 to estimate the **recoverable amount** of the asset.

23.75 For the purpose of measuring impairment losses, the recoverable amount of an asset arising from the costs to fulfil a contract is:

(a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates (see paragraph 23.76); minus

(b) the remaining costs of providing those goods or services not yet incurred.

23.76 In measuring the remaining amount of consideration, the amount shall only include consideration for which collection is probable.

Contract balances

23.77 When either party to a contract has performed, an entity shall present the contract in the **statement of financial position** as either a **contract asset** or a **contract liability** based on the contract as a whole. The presentation of the contract balance depends on the relationship between:

(a) the entity’s performance in transferring the goods or services promised in the contract to the customer; and

(b) the customer’s payment.

23.78 If an entity has received consideration (or has a trade receivable) before it transfers goods or services to the customer, the entity shall recognise a contract liability when the payment is made or due, whichever is earlier. A contract liability is an entity’s obligation to transfer goods or services to the customer for which the entity has received consideration (or for which the amount is due) from the customer. When (or as) the entity transfers those goods or services to the customer, the entity shall derecognise the contract liability (or part of a contract liability) and recognise revenue, in accordance with Step 5.

23.79 If an entity transfers goods or services to a customer before the customer has paid (or before payment is due), the entity has a right to consideration. The entity shall present that right as a contract asset, excluding any amounts presented as a trade receivable (see paragraph 23.80). An entity shall assess a contract asset for impairment and recognise and measure any impairment loss in accordance with Section 11 *Financial Instruments*.

23.80 A receivable is an entity’s unconditional right to consideration. A right to consideration is unconditional if only the passage of time is necessary before payment of that consideration becomes due. An entity can have an unconditional right to consideration even though it might be required to refund the consideration in the future (for example, when a right of return exists). In those instances, the entity might recognise a trade receivable and a refund liability. An entity shall account for a trade receivable in accordance with Section 11. An entity shall present trade receivables separately from contract assets and contract liabilities in the statement of financial position.

23.81 An entity is permitted to use different descriptions in the statement of financial position for 'contract assets' and 'contract liabilities'. If an entity uses a different description for 'contract assets', the entity shall provide enough information for a user of the financial statements to distinguish between trade receivables and contract assets.

Disclosures

23.82 An entity shall disaggregate revenue from contracts with customers using categories based on the characteristics of the entity's revenue, contracts or customers that are relevant to an understanding of its financial performance. Examples of categories that might be appropriate include:

(a) type of good or service (for example, major product lines);

(b) geographical region (for example, country or region);

(c) market or type of customer (for example, **government** and non-government customers);

(d) type of contract (for example, fixed-price and time-and-materials contracts);

(e) contract duration (for example, short-term and long-term contracts);

(f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and

(g) nature of promise (for example, revenue from acting as a principal and revenue from acting as an agent).

23.83 If not otherwise separately presented or disclosed, an entity shall disclose:

(a) the opening and closing balances of trade receivables and contract assets separately; and

(b) total impairment losses recognised on trade receivables and contract assets during the reporting period in accordance with Section 11.

23.84 An entity shall disclose:

(a) the opening and closing balances of contract liabilities, if they are not otherwise separately presented or disclosed; and

(b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period.

23.85 An entity shall disclose information about its promises in contracts with customers, including a description of:

(a) when the entity typically fulfils its promises (for example, upon shipment, upon delivery, as services are rendered or upon completion of service);

(b) the main payment terms (for example, when payment is typically due, whether the contract constitutes a financing transaction and whether the consideration includes a variable amount);

(c) the nature of the goods or services that the entity has promised to transfer to customers, highlighting any promises to arrange for another party to transfer goods or services if the entity is an agent;

(d) obligations for returns, refunds and other similar obligations; and

(e) types of warranties and related obligations.

23.86 An entity shall disclose the methods it used to measure its progress towards fulfilment of promises fulfilled over time (for example, a description of the output or input methods it used and how those methods were applied).

23.87 An entity shall disclose any judgements it has made that had a significant effect on the amounts it recognised in its financial statements when:

(a) determining the transaction price; and

(b) allocating the transaction price to the promises identified in the contract.

23.88 An entity shall disclose the closing balance of assets arising from the costs to fulfil a contract (in accordance with paragraph 23.70) by main category of asset (for example, pre-contract costs and set-up costs).

23.89 If an entity chooses to use the option in paragraph 23.38 not to account for interest revenue separately from revenue from contracts with customers, it shall disclose that fact.

23.90 If an entity cannot account for an option to acquire additional goods or services that meets the criteria in paragraph 23A.9(a) as a separate promise without undue cost or effort, the entity shall disclose that fact and the reasons why accounting for the option as a separate promise would involve undue cost or effort.

Appendix to Section 23
Application guidance

This appendix is an integral part of Section 23.

23A.1 This guidance focuses on features found in some contracts with customers. The guidance covers:

(a) contract modifications (see paragraphs 23A.2–23A.4);

(b) warranties (see paragraphs 23A.5–23A.7);

(c) customer options for additional goods or services (see paragraphs 23A.8–23A.13);

(d) principal versus agent considerations (see paragraphs 23A.14–23A.20);

(e) non-cash consideration (see paragraphs 23A.21–23A.22);

(f) sales with a right of return (see paragraphs 23A.23–23A.27); and

(g) licensing (see paragraphs 23A.28–23A.37).

Contract modifications

23A.2 A contract modification is a change in the scope or price (or both) of a contract that the parties to the contract approve. A contract modification either changes the existing rights and obligations in a contract or creates new ones.

23A.3 An entity shall account for a contract modification as a separate contract if:

(a) additional goods or services are promised that are distinct from those in the original contract; and

(b) the price of the original contract increases by an amount that reflects the stand-alone selling price of the additional goods or services and any appropriate change to that price to reflect the circumstances of the modified contract.

23A.4 For a contract modification that is not a separate contract in accordance with paragraph 23A.3, an entity shall account for the contract modification in one of two ways. If the goods or services an entity will transfer after the contract modification are:

(a) *distinct* from the goods or services the entity has transferred before the contract modification, the entity shall account for the contract modification as if the original contract had been cancelled and a new contract created. The transaction price for the new contract is the sum of:

(i) the consideration included in the estimate of the transaction price for the original contract that the entity did not recognise as revenue; and

(ii) any increase or decrease in consideration promised as part of the contract modification.

(b) *not distinct* from the goods or services the entity has transferred before the contract modification, the entity shall account for the contract modification as if it had always been part of the original contract. The entity shall recognise the change in the transaction price and the entity's measure of progress towards fulfilment of the promise as an adjustment to revenue at the date of the contract modification (that is, on a cumulative catch-up basis).

Warranties

23A.5 An entity might sell a good or service with a warranty.

23A.6 If a customer can choose to buy the good or service either with or without a warranty, the warranty is distinct. In these circumstances, an entity shall account for the warranty as a separate promise and allocate a portion of the transaction price to that promise.

23A.7 If the customer has no option to buy the good or service without a warranty, the warranty is not distinct. In these circumstances, an entity shall account for the warranty in accordance with Section 21 *Provisions and Contingencies*.

Customer options for additional goods or services

23A.8 An entity might grant customers the option to acquire additional goods or services for free or at a discount. Such options include sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.

23A.9 An entity shall account for an option to acquire additional goods or services as a separate promise if:

(a) the option gives the customer a material right that:

(i) is only available to a customer that has entered into that contract; and

(ii) allows a customer to acquire an additional good or service at a discount to its stand-alone selling price; and

(b) the option can be accounted for as a separate promise without undue cost or effort.

23A.10 To account for the option as a separate promise, the entity shall:

(a) allocate a portion of the transaction price to the promise (see paragraphs 23A.11–23A.13); and

(b) recognise revenue when the entity transfers those future goods or services or when the option expires.

23A.11 In accordance with Step 4, an entity shall allocate the transaction price to each promise in the contract on a relative stand-alone selling price basis. If the stand-alone selling price is not directly observable, an entity shall estimate the price. The estimate of the stand-alone selling price of an option shall reflect the discount that the customer would obtain when exercising the option, adjusted for:

(a) any discount that the customer could receive without exercising the option; and

(b) the likelihood that the customer exercises the option.

23A.12 An entity might grant a customer an option to renew a contract on similar terms. If the entity accounts for the renewal option as a separate promise, it shall allocate the transaction price to the option based on the total expected consideration allocated to the total goods or services it expects to transfer, instead of estimating the stand-alone selling price of the option. The entity shall include expected renewal period(s) when estimating the total goods or services it expects to transfer and corresponding total expected consideration.

23A.13 The amount of the transaction price allocated to the renewal option is the difference between:

(a) the transaction price for the original contract; and

(b) the amount of the total expected consideration allocated to the goods or services to be transferred under the original contract.

Principal versus agent considerations

23A.14 If another party is involved in providing goods or services to a customer, an entity shall determine whether its promise is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for the other party to provide those goods or services (that is, the entity is an agent).

23A.15 To determine whether an entity is a principal or agent, the entity shall:

(a) identify the specified goods or services to be provided to the customer (see paragraph 23A.16); and

(b) evaluate whether it controls each specified good or service before that good or service is transferred to the customer (see paragraph 23A.18).

23A.16 A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. A right to a future service to be provided by another party might be a distinct good or service (for example, a ticket that gives the customer the right to fly on a specified flight).

23A.17 An entity is a principal if it controls the specified good or service before that good or service is transferred to the customer.

23A.18 An entity has control of a specified good or service if it has the present ability to direct the use of that good or service and obtain the economic benefits that might flow from it. Indicators that the entity controls the specified good or service before it is transferred to a customer (and is therefore a principal) include:

(a) the entity being primarily responsible for fulfilling the promise to transfer the specified good or service. This responsibility typically includes responsibility for the acceptability of the specified good or service.

(b) the entity having inventory risk before or after the specified good or service is transferred to the customer (for example, if the entity commits to obtain the good or service before it is sold or accepts responsibility for damaged or returned goods).

(c) the entity having discretion to set the price for the specified good or service.

23A.19 A principal shall recognise as revenue the gross amount of the consideration it expects to be entitled to in exchange for transferring the specified good or service when (or as) it transfers control of that good or service to the customer.

23A.20 An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. An agent shall recognise as revenue the amount of the fee or commission it expects to be entitled to in exchange for arranging for another party to provide the specified good or service as the agent fulfils its promise to arrange the transfer of that good or service.

Non-cash consideration

23A.21 The consideration promised by a customer might be in a form other than cash, such as goods or services. An example is an exchange of goods in a barter transaction.

23A.22 An entity shall measure the non-cash consideration at **fair value** unless the fair value cannot be reasonably estimated. If the entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall instead measure the consideration based on the stand-alone selling price of the goods or services promised to the customer in exchange for the consideration.

Sales with a right of return

23A.23 An entity might sell a product and give the customer the right to return the product in exchange for any combination of:

(a) a full or partial refund of any consideration paid;

(b) a credit that can be applied against amounts owed, or that will be owed, to the entity; or

(c) another product.

23A.24 To account for products sold with a right of return, an entity shall recognise:

(a) revenue for consideration received or receivable for transferred products the entity expects not to be returned;

(b) a refund liability for consideration received or receivable for transferred products the entity expects to be returned; and

(c) a returns asset for transferred products the entity expects to be returned (and corresponding adjustment to cost of sales) classified as **inventory** and measured in accordance with paragraphs 23A.26–23A.27.

23A.25 Products an entity expects to be returned shall exclude:

(a) products expected to be returned and exchanged for another of the same type, quality, condition and price (for example, one colour or size of product for another); and

(b) defective products expected to be returned and exchanged for functioning products.

23A.26 An entity shall initially measure the returns asset at the former **carrying amount** of the products the entity expects to be returned minus:

(a) any expected costs to recover those products; and

(b) any allowances for possible decreases in the value of those products (for example, because of damage, obsolescence or declining selling prices).

23A.27 At the end of each reporting period, an entity shall adjust the refund liability and returns asset for changes in its expectations about products to be returned. The entity shall recognise adjustments to:

(a) the refund liability in revenue; and

(b) the returns asset as an expense.

Licensing

23A.28 A licence gives a customer rights to an entity's intellectual property (such as software, technology, trademarks, patents, franchises, music and motion picture films).

23A.29 If a contract with a customer includes a licence (or licences) and other goods or services, an entity shall apply Step 2 to identify each of the promises in the contract. If the licence is not distinct from the other goods or services in the contract, an entity shall apply Step 5 to determine whether the promise to grant the licence is fulfilled over time or at a point in time. If the licence is distinct from the other goods or services in the contract, an entity shall apply paragraphs 23A.30–23A.36 to determine whether the promise to grant the licence is fulfilled over time or at a point in time.

23A.30 To determine whether the promise to grant a licence is fulfilled over time or at a point in time, an entity shall consider whether the licence gives the customer either:

(a) a right to access the entity's intellectual property as it exists throughout the licence period, in which case the entity fulfils the promise (and recognises revenue) over time; or

(b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted, in which case the entity fulfils the promise (and recognises revenue) at a point in time.

23A.31 A licence gives a customer a right to access an entity's intellectual property if the entity expects to undertake activities:

(a) that *will* substantively affect the customer's benefit from the intellectual property by changing the intellectual property's substance (see paragraph 23A.33); or

(b) that *could* substantively affect the customer's benefit from the intellectual property by directly exposing the customer to any positive or negative effects of those activities (see paragraph 23A.34).

23A.32 An entity's expected activities might be included in the terms of a contract or might be activities that a customer reasonably expects the entity will undertake. For the purpose of applying the criteria in paragraph 23A.31, the entity shall exclude activities that result in the transfer of a good or service to the customer.

23A.33 Activities undertaken by the entity that change the intellectual property's substance include activities that change the intellectual property's design, content or ability to do a function or task (for example, development activities that change the content to which the customer has rights).

23A.34 Activities undertaken by the entity that directly expose the customer to positive or negative effects include activities that support or maintain the value of intellectual property (for example, ongoing activities that maintain the value of the brand to which the customer has rights).

23A.35 If either criterion in paragraph 23A.31 is met, the promise to grant a licence is fulfilled over time. Otherwise, the promise is fulfilled at a point in time.

23A.36 If a promise to grant a licence is fulfilled over time, an entity shall apply paragraphs 23.62–23.67 to choose an appropriate method to measure its progress towards fulfilment of that promise. If a promise to grant a licence is fulfilled at a point in time, an entity shall apply paragraphs 23.57–23.61 to identify the point in time the licence transfers to the customer, which cannot be before the customer is able to use and benefit from the licence.

Sales-based or usage-based royalties

23A.37 An entity might grant a licence of intellectual property in exchange for a royalty based on sales or use. If the licence is the sole or main item to which the royalty relates, the entity shall recognise revenue for such a royalty when (or as) the later of two events happens:

(a) the promise to which some or all of the royalty has been allocated has been fulfilled (or partially fulfilled); or

(b) the subsequent sale or use takes place.

Section 24
Government Grants

Scope of this section

24.1 This section specifies the accounting for all **government grants**. A government grant is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.

24.3 This section does not cover government assistance that is provided for an entity in the form of benefits that are available in determining **taxable profit** or tax loss, or are determined or limited on the basis of **income tax** liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated **depreciation** allowances and reduced income tax rates. Section 29 *Income Tax* covers accounting for taxes based on **income**.

Recognition and measurement

24.4 An entity shall recognise government grants as follows:

(a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable;

(b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met; and

(c) grants received before the **revenue recognition** criteria are satisfied are recognised as a **liability**.

24.5 An entity shall measure grants at the **fair value** of the **asset** received or receivable.

Disclosures

24.6 An entity shall disclose the following:

(a) the nature and amounts of government grants recognised in the **financial statements**;

(b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and

(c) an indication of other forms of government assistance from which the entity has directly benefited.

24.7 Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. For the purpose of the disclosure required by paragraph 24.6(c), examples include free technical or marketing advice and the provision of guarantees.

Section 25
Borrowing Costs

Scope of this section

25.1 This section specifies the accounting for **borrowing costs**. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs include:

(a) interest **expense** calculated using the **effective interest method** as described in Section 11 *Financial Instruments*;

(b) finance charges in respect of **finance leases** recognised in accordance with Section 20 *Leases*; and

(c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Recognition

25.2 An entity shall recognise all borrowing costs as an expense in **profit or loss** in the period in which they are incurred.

Disclosures

25.3 Paragraph 5.5(b) requires disclosure of finance costs. Paragraph 11.48(b) requires disclosure of total interest expense (using the effective interest method) for **financial liabilities** that are not at **fair value** through profit or loss. This section does not require any additional disclosure.

Section 26
Share-based Payment

Scope of this section

26.1 This section specifies the accounting for all **share-based payment transactions** including those that are equity- or cash-settled or those in which the terms of the arrangement provide a choice of whether the entity settles the transaction in **cash** (or other **assets**) or by issuing **equity** instruments.

26.1A A share-based payment transaction may be settled by another group entity (or a shareholder of any **group** entity) on behalf of the entity receiving the goods or services. This section also applies to an entity that:

(a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction; or

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than the payment for goods or services supplied to the entity receiving them.

26.1B In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this section applies (see paragraph 26.17).

26.1C This section does not apply to share-based payment transactions in which an entity acquires goods as part of the net assets acquired in:

(a) a **business combination** as defined in Section 19 *Business Combinations and Goodwill*;

(b) a combination of entities or **businesses** under common **control** as described in paragraph 19.2; or

(c) the contribution of a business on the formation of a **jointly controlled entity** as defined in Section 15 *Joint Arrangements*.

Therefore, equity instruments issued in a business combination in exchange for control of the **acquiree** are not within the scope of this section. However, equity instruments granted to employees of the acquiree in their capacity as employees (for example, in return for continued service) are within the scope of this section. Similarly, the cancellation, replacement or other modification of **share-based payment arrangements** because of a business combination or other equity restructuring shall be accounted for in accordance with this section.

26.1D This section uses the term 'fair value' in a way that differs in some respects from the definition in the Glossary and in other sections of this Standard. When applying this section, an entity shall apply the definition of fair value in paragraph 26.1E and measure fair value in accordance with this section, not Section 12 *Fair Value Measurement*.

26.1E For the purpose of this section, fair value is the amount for which an asset could be exchanged, a **liability** settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

26.2 **Cash-settled share-based payment transactions** include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (instead of an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (for example, upon cessation of employment) or at the employee's option.

Recognition

26.3 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an **equity-settled share-based payment transaction** or a **liability** if the goods or services were acquired in a cash-settled share-based payment transaction.

26.4 When the goods or services received or acquired in a share-based payment transaction do not qualify for **recognition** as assets, the entity shall recognise them as **expenses**.

Recognition when there are vesting conditions

26.5 If the share-based payments granted to an employee or another party (the counterparty) **vest** immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those share-based payments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the share-based payments have been received. In this case, on the **grant date** the entity shall recognise the services received in full, with a corresponding increase in equity or liabilities.

26.6 If the share-based payments do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those share-based payments will be received in the future, during the **vesting period**. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity or liabilities.

Measurement of equity-settled share-based payment transactions

Measurement principle

26.7 For equity-settled share-based payment transactions, an entity shall measure the goods or services received, and the corresponding increase in equity, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, by reference to the fair value of the equity instruments granted. To apply this requirement to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received.

26.8 For transactions with employees and others providing similar services,[6] the fair value of the equity instruments shall be measured at the grant date. For transactions with parties other than employees, the measurement date is the date when the entity obtains the goods or the counterparty renders service.

26.9 A grant of equity instruments might be conditional upon satisfying specified **vesting conditions** related to service or performance. An example of a **service condition** is when a grant of shares or share options to an employee is conditional on the employee remaining in the entity's employ for a specified period of time. Examples of **performance conditions** are when a grant of shares or share options is conditional on a specified period of service and on the entity achieving a specified growth in profit (a non-market vesting condition) or a specified increase in the entity's share price (a **market vesting condition**). Vesting conditions and conditions that are not vesting conditions (non-vesting conditions) are accounted for as follows:

(a) service conditions and non-market vesting conditions shall be taken into account when estimating the number of equity instruments expected to vest and subsequently adjusting the number of equity instruments included in the measurement of the transaction amount. The entity shall initially recognise an amount for the goods or services received during the vesting period based on the number of equity instruments that are expected to vest. The entity shall revise that estimate if new information indicates that the number of equity instruments expected to vest differs from previous estimates. On the vesting date, the

[6] In the rest of this section, all references to employees also include others providing similar services.

entity shall revise the estimate to equal the number of equity instruments that ultimately vested. Service conditions and non-market vesting conditions shall not be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date.

(b) market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the shares, share options or other equity instruments at the measurement date, with no subsequent adjustment to the estimated fair value, irrespective of the outcome of the market vesting conditions and non-vesting conditions, provided that all other vesting conditions are satisfied.

Shares

26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as:

(i) a recent transaction in the entity's shares; or

(ii) a recent independent fair valuation of the entity or its principal assets.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is **impracticable**, indirectly measure the fair value of the shares using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method used shall be consistent with generally accepted valuation methodologies for valuing equity instruments.

Share options and equity-settled share appreciation rights

26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) if an observable market price is available for the equity instruments granted, use that price.

(b) if an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.

(c) if an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an option pricing model. The inputs for the model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends and the risk-free interest rate) shall use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity shall derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Modifications to the terms and conditions on which equity instruments were granted

26.12 An entity might modify the terms and conditions on which equity instruments are granted in a manner that is beneficial to the employee, for example, by reducing the exercise price of an option or reducing the vesting period or by modifying or eliminating a performance condition. Alternatively an entity might modify the terms and conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or adding a performance condition. The entity shall take the modified vesting conditions into account in accounting for the share-based payment transaction, as follows:

(a) if the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

(b) if the modification reduces the total fair value of the share-based payment arrangement, or apparently is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred.

The requirements in this paragraph are expressed in the context of share-based payment transactions with employees. The requirements also apply to share-based payment transactions with parties other than employees if these transactions are measured by reference to the fair value of the equity instruments granted, but reference to the grant date refers to the date that the entity obtains the goods or the counterparty renders service.

Cancellations and settlements

26.13 An entity shall account for a cancellation or settlement of an equity-settled share-based payment award as an acceleration of vesting, and therefore shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

Cash-settled share-based payment transactions

26.14 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each **reporting date** and at the date of settlement, with any changes in fair value recognised in **profit or loss** for the period.

26.14A A cash-settled share-based payment transaction might be conditional upon satisfying specified vesting conditions related to service or performance. Vesting conditions and conditions that are not vesting conditions (non-vesting conditions) are accounted for as follows:

(a) service conditions and non-market vesting conditions shall be taken into account when estimating the number of awards that are expected to vest and subsequently adjusting the number of awards included in the measurement of the liability arising from the transaction. The entity shall initially recognise an amount for the goods or services received during the vesting period based on the number of awards that are expected to vest. The entity shall revise that estimate if new information indicates that the number of awards expected to vest differs from previous estimates. On the vesting date, the entity shall revise the estimate to equal the number of awards that ultimately vested. Service conditions and non-market vesting conditions shall not be taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date.

(b) market vesting conditions and non-vesting conditions shall be taken into account when estimating the fair value of the cash-settled share-based payment granted and when remeasuring the fair value of the liability at the end of each **reporting period** and at the date of settlement.

26.14B As a result of applying paragraph 26.14A, the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share-based payment is equal to the cash paid.

Share-based payment transactions with cash alternatives

26.15 Some share-based payment transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) or by transfer of equity instruments. In such a case, the entity shall account for the transaction as a cash-settled share-based payment transaction unless:

(a) the entity has a past practice of settling by issuing equity instruments;

(b) the option has no commercial substance because the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument; or

(c) the choice of settlement relates only to a net settlement feature (see paragraph 26.15A) and the transaction satisfies the conditions in paragraph 26.15B.

In circumstances (a) and (b), the entity shall account for the transaction as an equity-settled share-based payment transaction in accordance with paragraphs 26.7–26.13. In circumstance (c), the entity shall account for the transaction in accordance with paragraphs 26.15B–26.15D.

Share-based payment transactions with a net settlement feature for withholding tax obligations

26.15A Tax laws or regulations might oblige an entity to withhold an amount for an employee's tax obligation associated with a share-based payment and transfer that amount, normally in cash, to the tax authority on the employee's behalf. A share-based payment arrangement has a net settlement feature if the terms of the arrangement require or permit an entity to withhold the number of equity instruments equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment.

26.15B The share-based payment transaction described in paragraph 26.15A shall be classified as an equity-settled share-based payment transaction if:

(a) it would have been so classified in the absence of the net settlement feature; and

(b) there is an obligation on the entity under tax laws or regulations to withhold an amount for an employee's tax obligation associated with that share-based payment.

26.15C For a transaction that satisfies the conditions in paragraph 26.15B, an entity shall account for the payment to the tax authority as a deduction from equity for the equity instruments withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.

26.15D Paragraph 26.15B does not apply to any equity instruments that the entity withholds in excess of the monetary value of the employee's tax obligation associated with the share-based payment. Such excess shares withheld shall be accounted for as a cash-settled share-based payment when this amount is paid in cash (or other assets) to the employee.

Group plans

26.16 If a share-based payment award is granted by an entity for goods or services received by one or more group entities, and the group presents **consolidated financial statements** using either the *HKFRS for Private Entities* Accounting Standard or **full HKFRS Accounting Standards**, the group entities are permitted, as an alternative to the treatment set out in paragraphs 26.3–26.15D, to measure the share-based payment expense on the basis of a reasonable allocation of the expense for the group.

Unidentifiable goods or services

26.17 If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or the liability incurred, this situation typically indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received. For example, some jurisdictions have programmes by which **owners** (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date. For cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraph 26.14.

Disclosures

26.18 An entity shall disclose the following information about the nature and extent of share-based payment arrangements that existed during the period:

(a) a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (for example, whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.

(b) the number and weighted average exercise prices of share options for each of the following groups of options:

(i) outstanding at the beginning of the period;

(ii) granted during the period;

(iii) forfeited during the period;

(iv) exercised during the period;

(v) expired during the period;

(vi) outstanding at the end of the period; and

(vii) exercisable at the end of the period.

26.19 For equity-settled share-based payment arrangements, an entity shall disclose information about how it measured the fair value of goods or services received or the value of the equity instruments granted. If a valuation methodology was used, the entity shall disclose the method and its reason for choosing it.

26.20 For cash-settled share-based payment arrangements, an entity shall disclose information about how the liability was measured.

26.21 For share-based payment arrangements that were modified during the period, an entity shall disclose an explanation of those modifications.

26.22 If the entity is part of a group share-based payment plan, and it measures its share-based payment expense on the basis of a reasonable allocation of the expense recognised for the group, it shall disclose that fact and the basis for the allocation (see paragraph 26.16).

26.23 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its **financial position**:

(a) the total expense recognised in profit or loss for the period; and

(b) the total **carrying amount** at the end of the period for liabilities arising from share-based payment transactions.

Section 27
Impairment of Assets

Objective and scope

27.1 An **impairment loss** occurs when the **carrying amount** of an **asset** exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this Standard establish impairment requirements:

(a) **deferred tax assets** (see Section 29 *Income Tax*);

(b) assets arising from **employee benefits** (see Section 28 *Employee Benefits*);

(c) **financial assets** within the scope of Section 11 *Financial Instruments*;

(d) **investment property** measured at **fair value** (see Section 16 *Investment Property*);

(e) **biological assets** related to **agricultural activity** measured at fair value less estimated costs to sell (see Section 34 *Specialised Activities*); and

(f) **contract assets** and assets arising from the costs of fulfilling a contract with a customer in accordance with paragraph 23.70.

Impairment of inventories

Selling price less costs to complete and sell

27.2 An entity shall assess at each **reporting date** whether any **inventories** are impaired. The entity shall make the assessment by comparing the carrying amount of each item of inventory (or group of similar items—see paragraph 27.3) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, the entity shall reduce the carrying amount of the inventory (or the group) to its selling price less costs to complete and sell. That reduction is an impairment loss and it is recognised immediately in **profit or loss**.

27.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area for the purpose of assessing impairment.

Reversal of impairment

27.4 An entity shall make a new assessment of selling price less costs to complete and sell at each subsequent reporting date. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

Impairment of assets other than inventories

General principles

27.5 If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. Paragraphs 27.11–27.20 provide guidance on measuring recoverable amount.

27.6 An entity shall recognise an impairment loss immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in Section 17 *Property, Plant and Equipment*. Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with paragraph 17.15D.

Indicators of impairment

27.7 An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.

27.8 If it is not possible to estimate the recoverable amount of the individual asset, an entity shall estimate the recoverable amount of the **cash-generating unit** to which the asset belongs. This may be the case because measuring recoverable amount requires forecasting cash flows and sometimes individual assets do not generate cash flows by themselves. An asset's cash-generating unit is the smallest identifiable group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

27.9 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect **materially** the discount rate used in calculating an asset's **value in use** and decrease the asset's fair value less costs to sell.

(d) the carrying amount of the net assets of the entity is more than the estimated fair value of the entity as a whole (such an estimate may have been made, for example, in relation to the potential sale of part or all of the entity).

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs and plans to dispose of an asset before the previously expected date.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

27.10 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining **useful life**, the **depreciation** (**amortisation**) method or the **residual value** for the asset and adjust it in accordance with the section of this Standard applicable to the asset (for example, Section 17 and Section 18 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring recoverable amount

27.11 The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. If it is not possible to estimate the recoverable amount of an individual asset, references in paragraphs 27.12–27.20 to an asset should be read as references also to an asset's cash-generating unit.

27.12 It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

27.13 If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal.

Fair value less costs to sell

27.14 When measuring fair value less costs to sell, an entity shall apply the guidance on measuring fair value in Section 12 *Fair Value Measurement* and deduct the costs of disposal.

Value in use

27.15 Value in use is the **present value** of the future cash flows expected to be derived from an asset. This present value calculation involves the following steps:

(a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) applying the appropriate discount rate to those future cash flows.

27.16 The following elements shall be reflected in the calculation of an asset's value in use:

(a) an estimate of the future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those future cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

27.17 In measuring value in use, estimates of future cash flows shall include:

(a) projections of cash inflows from the continuing use of the asset;

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

(c) net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life in an arm's length transaction between knowledgeable, willing parties.

The entity may wish to use any recent financial budgets or forecasts to estimate the cash flows, if available. To estimate cash flow projections beyond the period covered by the most recent budgets or forecasts an entity may wish to extrapolate the projections based on the budgets or forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified.

27.18 Estimates of future cash flows shall not include:

(a) cash inflows or outflows from financing activities; or

(b) **income tax** receipts or payments.

27.19 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future restructuring to which an entity is not yet committed; or

(b) improving or enhancing the asset's performance.

27.20 The discount rate (rates) used in the present value calculation shall be a pre-tax rate (rates) that reflect(s) current market assessments of:

(a) the time value of money; and

(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.

The discount rate (rates) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted, to avoid double-counting.

Recognising and measuring an impairment loss for a cash-generating unit

27.21 An impairment loss shall be recognised for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to reduce the carrying amount of any **goodwill** allocated to the cash-generating unit; and

(b) then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit.

27.22 However, an entity shall not reduce the carrying amount of any asset in the cash-generating unit below the highest of:

(a) its fair value less costs to sell (if determinable);

(b) its value in use (if determinable); and

(c) zero.

27.23 Any excess amount of the impairment loss that cannot be allocated to an asset because of the restriction in paragraph 27.22 shall be allocated to the other assets of the unit pro rata on the basis of the carrying amount of those other assets.

Additional requirements for impairment of goodwill

27.24 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Consequently, the fair value of goodwill must be derived from measurement of the fair value of the cash-generating unit(s) of which the goodwill is a part.

27.25 For the purpose of impairment testing, goodwill acquired in a **business combination** shall, from the acquisition date, be allocated to each of the **acquirer's** cash-generating units that is expected to benefit from the synergies of the combination, irrespective of whether other assets or **liabilities** of the **acquiree** are assigned to those units.

27.26 Part of the recoverable amount of a cash-generating unit is attributable to the **non-controlling interest** in goodwill. For the purpose of impairment testing a non-wholly-owned cash-generating unit with goodwill, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount, by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

27.27 If goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then for the purposes of testing goodwill the entity shall test the impairment of goodwill by determining the recoverable amount of either:

(a) the acquired entity in its entirety, if the goodwill relates to an acquired entity that has not been integrated (integrated means the acquired business has been restructured or dissolved into the **reporting entity** or other **subsidiaries**); or

(b) the entire group of entities, excluding any entities that have not been integrated, if the goodwill relates to an entity that has been integrated.

In applying this paragraph, an entity will need to separate goodwill into goodwill relating to entities that have been integrated and goodwill relating to entities that have not been integrated. Also the entity shall follow the requirements for cash-generating units in this section when calculating the recoverable amount of, and allocating impairment losses and reversals to assets belonging to, the acquired entity or group of entities.

Reversal of an impairment loss

27.28 An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

27.29 For all assets other than goodwill, an entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 27.9. If any such indication exists, the entity shall determine whether all or part of the prior impairment loss should be reversed. The procedure for making that determination will depend on whether the prior impairment loss on the asset was based on:

(a) the recoverable amount of that individual asset (see paragraph 27.30); or

(b) the recoverable amount of the cash-generating unit to which the asset belongs (see paragraph 27.31).

Reversal where recoverable amount was estimated for an individual impaired asset

27.30 When the prior impairment loss was based on the recoverable amount of the individual impaired asset, the following requirements apply:

(a) the entity shall estimate the recoverable amount of the asset at the current reporting date.

(b) if the estimated recoverable amount of the asset exceeds its carrying amount, the entity shall increase the carrying amount to recoverable amount, subject to the limitation described in (c). That increase is a reversal of an impairment loss. The entity shall recognise the reversal immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in paragraph 17.15B. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with paragraph 17.15C.

(c) the reversal of an impairment loss shall not increase the carrying amount of the asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

(d) after a reversal of an impairment loss is recognised, the entity shall adjust the depreciation (amortisation) charge for the asset in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal when recoverable amount was estimated for a cash-generating unit

27.31 When the original impairment loss was based on the recoverable amount of the cash-generating unit to which the asset belongs, the following requirements apply:

(a) the entity shall estimate the recoverable amount of that cash-generating unit at the current reporting date.

(b) if the estimated recoverable amount of the cash-generating unit exceeds its carrying amount, that excess is a reversal of an impairment loss. The entity shall allocate the amount of that reversal to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets, subject to the limitation described in (c). Those increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and be recognised immediately in profit or loss, unless the asset is carried at a revalued amount in accordance with the revaluation model in paragraph 17.15B. Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with paragraph 17.15C.

(c) in allocating a reversal of an impairment loss for a cash-generating unit, the reversal shall not increase the carrying amount of any asset above the lower of:

(i) its recoverable amount; and

(ii) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior periods.

(d) any excess amount of the reversal of the impairment loss that cannot be allocated to an asset because of the restriction in (c) shall be allocated pro rata to the other assets of the cash-generating unit, except for goodwill.

(e) after a reversal of an impairment loss is recognised, if applicable, the entity shall adjust the depreciation (amortisation) charge for each asset in the cash-generating unit in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Disclosures

27.32 An entity shall disclose the following for each **class of assets** indicated in paragraph 27.33:

(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) in the **statement of comprehensive income** (and in the **income statement**, if presented) in which those impairment losses are included; and

(b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) in the statement of comprehensive income (and in the income statement, if presented) in which those impairment losses are reversed.

27.33 An entity shall disclose the information required by paragraph 27.32 for each of the following classes of asset:

(a) inventories;

(b) **property, plant and equipment** (including investment property accounted for by the cost model);

(c) goodwill;

(d) **intangible assets** other than goodwill;

(e) investments in **associates**; and

(f) investments in **jointly controlled entities**.

Section 28
Employee Benefits

Scope of this section

28.1 **Employee benefits** are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for **share-based payment transactions**, which are covered by Section 26 *Share-based Payment*. Employee benefits covered by this section will be one of the following four types:

(a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are wholly due within twelve months after the end of the period in which the employees render the related service;

(b) **post-employment benefits**, which are employee benefits (other than termination benefits) that are payable after the completion of employment;

(c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not wholly due within twelve months after the end of the period in which the employees render the related service; and

(d) termination benefits, which are employee benefits payable as a result of either:

(i) an entity's decision to terminate an employee's employment before the normal retirement date; or

(ii) an employee's decision to accept an offer of benefits in exchange for termination of employment.

28.2 Employee benefits also include share-based payment transactions by which employees receive **equity** instruments (such as shares or share options) or **cash** or other **assets** of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity. An entity shall apply Section 26 in accounting for share-based payment transactions.

General recognition principle for all employee benefits

28.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the **reporting period**:

(a) as a **liability**, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee benefit fund. If the amount paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) as an **expense**, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as **inventories** or **property, plant and equipment**.

Short-term employee benefits

Examples

28.4 Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits

28.5 When an employee has rendered service to an entity during the reporting period, the entity shall measure the amounts recognised in accordance with paragraph 28.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

28.6 An entity may compensate employees for absence for various reasons including annual vacation leave and sick leave. Some short-term compensated absences accumulate—they can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. Examples include annual vacation leave and sick leave. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the undiscounted additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present this amount as a current liability at the reporting date.

28.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

28.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:

(a) the entity has a present legal or constructive obligation to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments); and

(b) a reliable estimate of the obligation can be made.

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

28.9 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are **post-employment benefit plans**. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law instead of by action of the entity. In some cases, these arrangements arise from actions of the entity even in the absence of a formal, documented plan.

28.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on their principal terms and conditions:

(a) defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.

(b) defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more or less than expected) and investment risk (that returns on assets set aside to fund the benefits will differ from expectations) are borne, in substance, by the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

Multi-employer plans and state plans

28.11 **Multi-employer plans** and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan or a state plan that is a defined benefit plan, an entity shall account for the plan in accordance with paragraph 28.13 as if it was a defined contribution plan and make the disclosures required by paragraph 28.40.

Insured benefits

28.12 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity has a legal or constructive obligation either:

(a) to pay the employee benefits directly when they become due; or

(b) to pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

Post-employment benefits: defined contribution plans

Recognition and measurement

28.13 An entity shall recognise the contribution payable for a period:

(a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.

(b) as an expense, unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Post-employment benefits: defined benefit plans

Recognition

28.14 In applying the general **recognition** principle in paragraph 28.3 to defined benefit plans, an entity shall recognise:

(a) a liability for its obligations under defined benefit plans net of **plan assets**—its '**defined benefit liability**' (see paragraphs 28.15–28.23); and

(b) the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 28.24–28.27).

Measurement of the defined benefit liability

28.15 An entity shall measure a defined benefit liability for its obligations under defined benefit plans at the net total of the following amounts:

(a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraphs 28.16–28.22 provide guidance for measuring this obligation); minus

(b) the **fair value** at the reporting date of plan assets (if any) out of which the obligations are to be settled directly. Section 12 *Fair Value Measurement* provides guidance for determining the fair values of those plan assets.

Inclusion of both vested and unvested benefits

28.16 The present value of an entity's obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 28.26) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan's benefit formula and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

28.17 An entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. For currencies for which there is no deep market in such high quality corporate bonds, the entity shall use the market yields (at the reporting date) on government bonds denominated in that currency. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

Actuarial valuation method

28.18 If an entity is able, without undue cost or effort, to use the **projected unit credit method** to measure its defined benefit obligation and the related expense, it shall do so. If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. Additionally, the projected unit credit method requires an entity to make various actuarial assumptions in measuring the defined benefit obligation, including discount rates, the expected rates of return on plan assets, expected rates of salary increases, employee turnover, mortality, and (for defined benefit medical plans) medical cost trend rates.

28.19 If using the projected unit credit method to measure an entity's obligation under defined benefit plans would involve undue cost or effort, the entity is permitted to measure the obligation with respect to current employees by both:

(a) assuming all the entity's employees terminate their employment at the reporting date and ignoring:

(i) estimated future salary increases.

(ii) future service.

(iii) possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (that is, assume all current employees will receive the post-employment benefits). Mortality after service (that is, life expectancy) shall be considered.

(b) not discounting that obligation.

An entity that uses the foregoing measurement simplification must still include both **vested benefits** and unvested benefits when measuring its obligation under defined benefit plans.

28.20 This Standard does not require an entity to engage an independent actuary to perform the comprehensive actuarial valuation needed to calculate its defined benefit obligation. Nor does it require that a comprehensive actuarial valuation must be done annually. In the periods between comprehensive actuarial valuations, if the principal actuarial assumptions have not changed significantly the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics such as number of employees and salary levels.

Plan introductions, changes, curtailments and settlements

28.21 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (**income**) in measuring **profit or loss** in the current period. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged) in the current period, the defined benefit obligation shall be decreased or eliminated and the entity shall recognise the resulting gain or loss in profit or loss in the current period.

Defined benefit plan asset

28.22 If the present value of the defined benefit obligation at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

28.23 An entity shall recognise the net change in its defined benefit liability during the period, other than a change attributable to benefits paid to employees during the period or to contributions from the employer, as the cost of its defined benefit plans during the period. That cost is recognised either entirely in profit or loss as an expense or partly in profit or loss and partly as an item of **other comprehensive income** (see paragraph 28.24) unless another section of this Standard requires the cost to be recognised as part of the cost of an asset such as inventories or property, plant and equipment.

Recognition–accounting policy election

28.24 An entity is required to recognise all actuarial gains and losses in the period in which they occur. An entity shall:

(a) recognise all actuarial gains and losses in profit or loss; or

(b) recognise all actuarial gains and losses in other comprehensive income.

as an accounting policy election. The entity shall apply its chosen accounting policy consistently to all of its defined benefit plans and all of its actuarial gains and losses. Actuarial gains and losses recognised in other comprehensive income shall be presented in the **statement of comprehensive income**.

28.25 The net change in the defined benefit liability that is recognised as the cost of a defined benefit plan includes:

(a) the change in the defined benefit liability arising from employee service rendered during the reporting period;

(b) interest on the defined benefit obligation during the reporting period;

(c) the returns on any plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 28.28) during the reporting period;

(d) actuarial gains and losses arising in the reporting period;

(e) increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan in the reporting period (see paragraph 28.21); and

(f) decreases in the defined benefit liability resulting from curtailing or settling an existing plan in the reporting period (see paragraph 28.21).

28.26 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not yet vested). In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits (such as post-employment medical benefits) become payable only if a specified event occurs when an employee is no longer employed (such as an illness), an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

28.27 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans, but only if:

(a) those plans were enacted before the reporting date; or

(b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

28.28 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In the statement of comprehensive income (or in the **income statement**, if presented), the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

Other long-term employee benefits

28.29 Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

28.30 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

(a) the present value of the benefit obligation at the reporting date; minus

(b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the net change in the liability during the period, other than a change attributable to benefits paid to employees during the period or to contributions from the employer, as the cost of its other long-term employee benefits during the period. That cost is recognised entirely in profit or loss as an expense unless another section of this Standard requires it to be recognised as part of the cost of an asset, such as inventories or property, plant and equipment.

Termination benefits

28.31 Termination benefits result from either an entity's decision to terminate employment or an employee's decision to accept an entity's offer of benefits in exchange for termination of employment. The form of the employee benefit does not determine whether it is provided in exchange for service or in exchange for termination of the employee's employment. Some termination benefits are provided in accordance with the terms of an employee benefit plan. For example, the benefits might be specified by statute, employment contract or union agreement, or might be implied as a result of the employer's past practice of providing similar benefits. Employee benefits provided in accordance with the terms of an employee benefit plan are termination benefits if they both result from an entity's decision to terminate employment and are not conditional on future service being provided.

Recognition

28.32 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.

28.33 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.

28.34 An entity shall recognise a liability and an expense for termination benefits at the earlier of:

(a) the date at which the entity can no longer withdraw the offer of those benefits; and

(b) the date at which the entity recognises costs for a restructuring that is within the scope of Section 21 *Provisions and Contingencies* and involves the payment of termination benefits.

28.34A For termination benefits payable as a result of an employee's decision to accept an offer of benefits in exchange for termination of employment, the time when an entity can no longer withdraw the offer of termination benefits is the earlier of:

(a) the date at which the employee accepts the offer; and

(b) the date at which a restriction (for example, a legal, regulatory or contractual restriction) on the entity's ability to withdraw the offer takes effect—which would be the date the offer is made, if the restriction existed at the time of the offer.

28.34B For termination benefits payable as a result of an entity's decision to terminate employment, the entity can no longer withdraw the offer after it has communicated to the affected employees a termination plan for which all of these criteria apply:

(a) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;

(b) the plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date; and

(c) the plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

28.35 [Deleted]

Measurement

28.36 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

28.37 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their present value.

Group plans

28.38 If a **parent** entity provides benefits to the employees of one or more **subsidiaries** in the **group**, and the parent presents **consolidated financial statements** using either the *HKFRS for Private Entities* Accounting Standard or **full HKFRS Accounting Standards**, such subsidiaries are permitted to recognise and measure employee benefit expense on the basis of a reasonable allocation of the expense recognised for the group.

Disclosures

Disclosures about short-term employee benefits

28.39 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

28.40 An entity shall disclose the amount recognised in profit or loss as an expense for defined contribution plans. If an entity treats a defined benefit multi-employer or state plan as a defined contribution plan because sufficient information for defined benefit accounting is not available (see paragraph 28.11) it shall disclose the fact that the plan is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Disclosures about defined benefit plans

28.41 Except for any defined benefit multi-employer or state plan that is accounted for as a defined contribution plan in accordance with paragraph 28.11 (and to which paragraph 28.40 applies), an entity shall disclose the following information about defined benefit plans:

(a) a general description of the type of plan, including the **funding** policy;

(b) the entity's accounting policy for recognising actuarial gains and losses (either in profit or loss or as an item of other comprehensive income) and the amount of actuarial gains and losses recognised during the period;

(c) if the entity applies paragraph 28.19 in measuring its defined benefit obligation, it shall disclose:

- (i) that fact;
- (ii) the reasons why using the projected unit credit method to measure its obligation and cost under defined benefit plans would involve undue cost or effort; and
- (iii) its assumptions for measuring its obligation;

(d) the date of the most recent comprehensive actuarial valuation and, if it was not as of the reporting date, a description of the adjustments that were made to measure the defined benefit obligation at the reporting date;

(e) a reconciliation of opening and closing balances of the defined benefit obligation showing separately, if applicable:

- (i) the change in the defined benefit liability arising from employee service rendered during the reporting period;
- (ii) the interest on the defined benefit obligation during the reporting period;
- (iii) actuarial gains and losses arising in the reporting period;
- (iv) the changes resulting from introducing a new plan or changing an existing plan in the reporting period;
- (v) the benefits paid; and
- (vi) all other changes;

(f) a reconciliation of the opening and closing balances of the plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, when applicable:

- (i) contributions;
- (ii) benefits paid;
- (iia) the return on plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 28.28) during the reporting period; and
- (iii) other changes in plan assets;

(g) [deleted]

(h) for each major class of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major class of plan assets constitutes of the fair value of the total plan assets at the reporting date;

(i) the amounts included in the fair value of plan assets for:

  (i) each class of the entity's own **financial instruments**; and

  (ii) any property occupied by, or other assets used by, the entity;

(j) [deleted]

(k) the principal actuarial assumptions used, including, when applicable:

  (i) the discount rates;

  (ii) the expected rates of return on any plan assets for the periods presented in the **financial statements**;

  (iii) the expected rates of salary increases;

  (iv) medical cost trend rates; and

  (v) any other **material** actuarial assumptions used; and

(l) the expected contributions to the defined benefit plan for the next annual reporting period.

28.41A The reconciliations in 28.41(e) and 28.41(f) are not required to be presented for prior periods.

28.41B If an entity has more than one defined benefit plan, the entity is permitted to make the disclosures required by paragraph 28.41 in total, separately for each plan, or in such groupings the entity considers to be the most useful.

28.41C If an entity participates in a defined benefit plan that is a group plan, it shall disclose:

(a) the contractual agreement or stated policy for charging the net defined benefit cost, or the fact that there is no such policy;

(b) the policy for determining the contribution to be paid by the entity; and

(c) if the entity accounts for an allocation of the net defined benefit cost as noted in paragraph 28.38, all the information about the plan as a whole required by paragraph 28.41.

28.41D The information required by paragraph 28.41C(c) can be disclosed by cross-reference to disclosures required by these subparagraphs in another group entity's financial statements if:

(a) that group entity's financial statements separately identify and disclose the information required about the plan; and

(b) that group entity's financial statements are available to users of the financial statements on the same terms as the financial statements of the entity and at the same time as, or earlier than, the financial statements of the entity.

28.41E If required by Section 21, an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Disclosures about other long-term employee benefits

28.42 For each category of other long-term employee benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.

Disclosures about termination benefits

28.43 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the extent of funding at the reporting date.

28.44 [Deleted]

Section 29
Income Tax

Scope of this section

29.1 For the purpose of this Standard, **income tax** includes all domestic and foreign taxes that are based on **taxable profit**. Income tax also includes taxes, such as withholding taxes, that are payable by a **subsidiary**, **associate** or **joint arrangement** on distributions to the **reporting entity**.

29.2 This section covers accounting for income tax. It requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the **financial statements**. These recognised tax amounts comprise **current tax** and **deferred tax**. Current tax is income tax payable (recoverable) in respect of the taxable profit (tax loss) for the current period or past periods. Deferred tax is income tax payable or recoverable in future periods, generally as a result of the entity recovering or settling its **assets** and **liabilities** for their current **carrying amount**, and the tax effect of the carryforward of currently unused tax losses and tax credits.

29.3 This section does not deal with the methods of accounting for **government grants** (see Section 24 *Government Grants*). However, this section does deal with the accounting for **temporary differences** that may arise from such grants.

29.3A This section applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules. Such tax law, and the income taxes arising from it, are hereafter referred to as 'Pillar Two legislation' and 'Pillar Two income taxes'. As an exception to the requirements in this section, an entity shall neither recognise deferred tax assets and liabilities related to Pillar Two income taxes nor disclose information that would otherwise be required by paragraphs 29.39–29.40 about deferred tax assets and liabilities related to Pillar Two income taxes.

Recognition and measurement of current tax

29.4 An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.

29.5 An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

29.6 An entity shall measure a current tax liability (asset) at the amount it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the **reporting date**. An entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so. Paragraphs 29.32–29.33 provide additional measurement guidance.

Recognition of deferred tax

General recognition principle

29.7 It is inherent in the **recognition** of an asset or a liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is **probable** that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this section requires an entity to recognise a **deferred tax liability** (**deferred tax asset**) with certain limited exceptions. If the entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability without affecting taxable profit, no deferred tax arises in respect of the asset or liability.

29.8 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the differences between the carrying amounts of the entity's assets and liabilities in the **statement of financial position** and the amounts attributed to those assets and liabilities by the tax authorities (such differences are called 'temporary differences'), and the carryforward of currently unused tax losses and tax credits.

Tax bases and temporary differences

29.9 The **tax base** of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

29.10 The tax base of a liability is its carrying amount less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of **revenue** that is received in advance, the tax base of the resulting liability is its carrying amount less any amount of the revenue that will not be taxable in future periods.

29.11 Some items have a tax base but are not recognised as assets and liabilities in the statement of financial position. For example, **research** and **development** costs are recognised as an **expense** when determining **accounting profit** in the period in which they are incurred but may not be permitted as a deduction when determining taxable profit (tax loss) until a later period. The difference between the tax base of the research and development costs, being the amount that the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a **deductible temporary difference** that results in a deferred tax asset.

29.12 Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. In **consolidated financial statements**, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each entity in the **group**.

29.13 Examples of situations in which temporary differences arise include:

(a) the identifiable assets acquired and liabilities assumed in a **business combination** are recognised at their **fair values** in accordance with Section 19 *Business Combinations and Goodwill*, but no equivalent adjustment is made for tax purposes (for example, the tax base of an asset may remain at cost to the previous owner). The resulting deferred tax asset or liability affects the amount of **goodwill** that an entity recognises.

(b) assets are remeasured but no equivalent adjustment is made for tax purposes. For example, this Standard permits or requires certain assets to be remeasured at fair value or to be revalued (for example, Section 16 *Investment Property* and Section 17 *Property, Plant and Equipment*).

(c) goodwill arises in a business combination, for example, the tax base of goodwill will be nil if taxation authorities do not allow the **amortisation** or the **impairment** of goodwill as a deductible expense when taxable profit is determined and do not permit the cost of goodwill to be treated as a deductible expense on disposal of the subsidiary.

(d) the tax base of an asset or a liability on initial recognition differs from its initial carrying amount.

(e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements becomes different from the tax base of the investment or interest.

Not all of these temporary differences will give rise to deferred tax assets and liabilities (see paragraphs 29.14 and 29.16).

Taxable temporary differences

29.14 A deferred tax liability shall be recognised for all **taxable temporary differences**, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or a liability in a transaction that:

(i) is not a business combination; and

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 29.25.

29.15 Some temporary differences arise when **income** or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as **timing differences**. The following are examples of temporary differences of this kind that are taxable temporary differences and that therefore result in deferred tax liabilities:

(a) interest revenue is included in accounting profit on a time-proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable with respect to such revenues is nil, because the revenues do not affect taxable profit until cash is collected.

(b) **depreciation** used when determining taxable profit (tax loss) may differ from that used when determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base, which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities when determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated. If the tax depreciation is less rapid than the accounting depreciation, a deductible temporary difference arises resulting in a deferred tax asset (see paragraph 29.16).

Deductible temporary differences

29.16 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or a liability in a transaction that:

(a) is not a business combination; and

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates and for interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 29.26.

29.16A In applying paragraph 29.16, an entity considers whether tax law restricts the sources of taxable profits against which the deductible temporary difference can be utilised.

29.17 The following are examples of deductible temporary differences that result in deferred tax assets:

(a) retirement benefit costs may be deducted when determining accounting profit at the time that the service is provided by the employee, but deducted when determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset because economic benefits will flow to the entity in the form of a deduction from taxable profits when contributions or retirement benefits are paid.

(b) certain assets may be carried at fair value, without an equivalent adjustment being made for tax purposes. A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

29.18 The reversal of deductible temporary differences results in deductions when taxable profits of future periods are determined. It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity that are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29.19 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

(a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). When evaluating whether it will have sufficient taxable profit in future periods, an entity:

(i) compares the deductible temporary differences with future taxable profit that excludes the tax deductions resulting from the reversal of those deductible temporary differences. This comparison shows the extent to which the future taxable profit is sufficient for the entity to deduct the amounts resulting from the reversal of those deductible temporary differences.

(ii) ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from those deductible temporary differences will itself require future taxable profit in order to be utilised.

(b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

29.19A The estimate of probable future taxable profit might include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this.

29.20 When an entity has a history of recent losses, the entity considers the guidance in paragraphs 29.21–29.22.

Unused tax losses and unused tax credits

29.21 A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. When assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, an entity considers the following criteria:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

29.22 The existence of unused tax losses is strong evidence that future taxable profit may not be available. Consequently, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or to the extent that there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Reassessment of unrecognised deferred tax assets

29.23 At the end of each **reporting period**, an entity reassesses any unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Investments in subsidiaries, branches and associates and interests in joint arrangements

29.24 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates and interests in joint arrangements (for example, in the **parent's** consolidated financial statements the carrying amount of a subsidiary is the net consolidated assets of that subsidiary, including the carrying amount of any related goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

(a) the existence of undistributed profits of subsidiaries, branches, associates and joint arrangements;

(b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

(c) a reduction in the carrying amount of an investment in an associate to its **recoverable amount**.

Investments may be accounted for differently in the parent's **separate financial statements** compared to the consolidated financial statements, in which case the temporary difference associated with that investment may also differ. For example, in the parent's separate financial statements the carrying amount of a subsidiary will depend on the accounting policy chosen in paragraph 9.26.

29.25 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor or party to the joint arrangement is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

29.26 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates and interests in joint arrangements, only to the extent that it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

Measurement of deferred tax

29.27 An entity shall measure a deferred tax liability (asset) using the tax rates and tax laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so.

29.28 When different tax rates apply to different levels of taxable profit, an entity shall measure deferred tax liabilities (assets) using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the deferred tax liability to be settled (deferred tax asset to be realised).

29.29 The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of the related assets and liabilities. Consequently, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement. For example, if the temporary difference arises from an item of income that is expected to be taxable as a capital gain in a future period, the deferred **tax expense** is measured using the capital gain tax rate and the tax base that is consistent with recovering the carrying amount through sale.

29.30 If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Section 17, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale. If a deferred tax liability or asset arises from **investment property** that is measured at fair value, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. Accordingly, unless the presumption is rebutted, the measurement of the deferred tax liability or the deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. This presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, instead of through sale. If the presumption is rebutted, the requirements of paragraph 29.29 shall be followed.

29.31 The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period. An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that recognised deferred tax asset to be utilised. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Measurement of both current and deferred tax

29.32 An entity shall not discount current or deferred tax assets and liabilities.

29.33 In some jurisdictions, income tax is payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income tax may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In both of those circumstances, an entity shall measure current and deferred tax at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset) and the related tax expense (income).

Withholding tax on dividends

29.34 When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Such an amount paid or payable to taxation authorities is charged to **equity** as a part of the dividends.

Uncertainty over income tax treatments

29.34A It might not be clear how tax law applies to a particular transaction or circumstance. An uncertain tax treatment is a tax treatment whose acceptability by the relevant taxation authority under tax law is uncertain.

29.34B An entity shall determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty.

29.34C An entity shall assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If an entity concludes that it is:

(a) probable that the taxation authority will accept an uncertain tax treatment, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings; or

(b) not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates by using either of the following methods, depending on which better predicts the resolution of the uncertainty:

(i) the most likely amount—the single most likely amount in a range of possible outcomes; or

(ii) the expected value—the sum of the probability-weighted amounts in a range of possible outcomes.

29.34D An entity shall reflect the effect of a change in relevant facts and circumstances, or of new information, on its judgements or estimates about uncertain tax treatments as a change in **accounting estimate** by applying Section 10 *Accounting Policies, Estimates and Errors*.

Presentation

Allocation in comprehensive income and equity

29.35 An entity shall recognise tax expense in the same component of **total comprehensive income** (ie continuing operations, **discontinued operations** or **other comprehensive income**) or equity as the transaction or other event that resulted in the tax expense.

Current/non-current distinction

29.36 When an entity presents current and non-current assets, and current and non-current liabilities, as separate **classifications** in its statement of financial position, it shall not classify any deferred tax assets (liabilities) as current assets (liabilities).

Offsetting

29.37 An entity shall offset current tax assets and current tax liabilities, if, and only if, it has a legally enforceable right to set off the amounts and the entity intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

29.37A An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

(a) it has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

(i) the same taxable entity; or

(ii) different taxable entities that intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

Disclosures

29.38 An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events (including the enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation).

29.39 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce tax expense;

(f) adjustments to deferred tax expense (income) arising from a change in the tax status of the entity or its shareholders;

(g) deferred tax expense (income) arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 29.31; and

(h) the amount of tax expense (income) relating to those changes in **accounting policies** and **errors** that are included in **profit or loss** in accordance with Section 10, because they cannot be accounted for retrospectively.

29.40 An entity shall disclose the following separately:

(a) the aggregate current and deferred tax relating to items that are recognised as items of other comprehensive income.

(b) the aggregate current and deferred tax relating to items that are charged or credited directly to equity.

(c) an explanation of any significant differences between the tax expense (income) and accounting profit multiplied by the applicable tax rate. For example such differences may arise from transactions such as revenue that are exempt from taxation or expenses that are not deductible in determining taxable profit (tax loss).

(d) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period.

(e) for each type of temporary difference and for each type of unused tax losses and tax credits:

  (i) the amount of deferred tax liabilities and deferred tax assets at the end of the reporting period; and

  (ii) an analysis of the change in deferred tax liabilities and deferred tax assets during the period.

(f) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the statement of financial position.

(g) in the circumstances described in paragraph 29.33, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.

29.41 [Deleted]

International tax reform—Pillar Two model rules

29.42 An entity within the scope of Pillar Two legislation shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes (see paragraph 29.3A).

29.43 An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.

Section 30
Foreign Currency Translation

Scope of this section

30.1 An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have **foreign operations**. In addition, an entity may present its **financial statements** in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** that derive their value from the change in a specified foreign exchange rate (for example, foreign currency forward exchange contracts) and hedge accounting of foreign currency items are dealt with in Part II of Section 11 *Financial Instruments*.

Functional currency

30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Consequently, the following are the most important factors an entity considers in determining its functional currency:

(a) the currency:

(i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and

(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

30.4 The following factors may also provide evidence of an entity's functional currency:

(a) the currency in which funds from financing activities (issuing debt and **equity** instruments) are generated; and

(b) the currency in which receipts from operating activities are usually retained.

30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its **subsidiary**, branch, **associate** or **joint arrangement**):

(a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, instead of being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs **expenses**, generates **income** and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Estimating the spot exchange rate when a currency is not exchangeable (paragraphs 30A.12–30A.18)

30.5A If, at a measurement date, a currency is not exchangeable into another currency (as described in paragraphs 30A.2–30A.11), an entity shall estimate the spot exchange rate at that date. An entity's objective in estimating the spot exchange rate is to reflect the rate at which an orderly exchange transaction would take place at the measurement date between **market participants** under prevailing economic conditions.

Reporting foreign currency transactions in the functional currency

Initial recognition

30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of **assets**, or incurs or settles **liabilities**, denominated in a foreign currency.

30.7 An entity shall record a foreign currency transaction, on initial **recognition** in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this Standard. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

30.8A When an entity pays or receives consideration in advance in a foreign currency, it recognises a non-monetary asset or non-monetary liability. The exchange rate to be used on the initial recognition of the related asset, expense or income (or part of it) is the exchange rate at the date on which the entity initially recognised the non-monetary asset or the non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

Reporting at the end of the subsequent reporting periods

30.9 At the end of each **reporting period**, an entity shall:

(a) translate foreign currency monetary items using the **closing rate**;

(b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and

(c) translate non-monetary items that are measured at **fair value** in a foreign currency using the exchange rates at the date when the fair value was determined.

30.10 An entity shall recognise, in **profit or loss** in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods, except as described in paragraph 30.13.

30.11 When another section of this Standard requires a gain or loss on a non-monetary item to be recognised in **other comprehensive income**, an entity shall recognise any exchange component of that gain or loss in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

Net investment in a foreign operation

30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the **separate financial statements** of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (for example, **consolidated financial statements** when the foreign operation is a subsidiary), such exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not be recognised in profit or loss on disposal of the net investment.

Change in functional currency

30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

30.15 As noted in paragraphs 30.2–30.5, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.

Use of a presentation currency other than the functional currency

Translation to the presentation currency

30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its items of income and expense and **financial position** into the presentation currency. For example, when a **group** contains individual entities with different functional currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:

(a) assets and liabilities for each **statement of financial position** presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;

(b) income and expenses for each **statement of comprehensive income** (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not subsequently be reclassified to profit or loss.

30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

30.20 The exchange differences referred to in paragraph 30.18(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate; and

(b) translating the opening net assets at a closing rate that differs from the previous closing rate.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to the **non-controlling interest** are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position.

30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation*.

Translation of a foreign operation into the investor's presentation currency

30.22 In incorporating the assets, liabilities, income and expenses of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements*) and the translation procedures set out in paragraphs 30.17–30.21. However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements, a reporting entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall recognise it as other comprehensive income.

30.23 Any **goodwill** arising on the acquisition of a foreign operation and any fair value adjustments to the **carrying amounts** of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

Disclosures

30.24 In paragraphs 30.26 and 30.27, references to 'functional currency' apply, in the case of a group, to the functional currency of the **parent**.

30.25 An entity shall disclose the following:

(a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11 *Financial Instruments*; and

(b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.

30.26 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.

30.27 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

30.28 When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency (see paragraph 30.5A), the entity shall disclose:

(a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

(b) a description of affected transactions;

(c) the carrying amount of affected assets and liabilities;

(d) the spot exchange rates used and whether those rates are:

(i) observable exchange rates without adjustment (see paragraphs 30A.13–30A.17); or

(ii) spot exchange rates estimated using another estimation technique (see paragraph 30A.18); and

(e) information about the estimation process, including qualitative and quantitative information about the inputs and assumptions used.

30.29 When a foreign operation's functional currency is not exchangeable into an entity's presentation currency or the presentation currency is not exchangeable into a foreign operation's functional currency, an entity shall disclose:

(a) the name of the foreign operation;

(b) whether the foreign operation is a subsidiary, jointly controlled entity, associate or branch;

(c) the foreign operation's principal place of business;

(d) summarised financial information about the foreign operation; and

(e) the nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss.

Appendix to Section 30
Application guidance

This appendix is an integral part of Section 30.

Exchangeability

30A.1 The purpose of this application guidance is to help entities assess whether a currency is exchangeable (see paragraphs 30A.2–30A.11) and to estimate the spot exchange rate when a currency is not exchangeable (see paragraphs 30A.12–30A.18).

Step 1—Assessing whether a currency is exchangeable

30A.2 A currency is exchangeable into another currency when an entity is able to obtain the other currency within a time frame that allows for a normal administrative delay and through a market or exchange mechanism in which an exchange transaction would create enforceable rights and obligations. An entity assesses whether a currency is exchangeable into another currency:

(a) at a measurement date; and

(b) for a specified purpose.

30A.3 If an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose, the currency is not exchangeable into the other currency.

30A.4 An entity might determine that a currency is not exchangeable into another currency, even though that other currency might be exchangeable in the other direction. For example, an entity might determine that currency PC is not exchangeable into currency LC, even though currency LC is exchangeable into currency PC.

Time frame

30A.5 A spot exchange rate is the exchange rate for immediate delivery. However, an exchange transaction might not always complete instantaneously because of legal or regulatory requirements, or for practical reasons such as public holidays. A normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other currency. What constitutes a normal administrative delay depends on the facts and circumstances surrounding the exchange transaction.

Ability to obtain the other currency

30A.6 In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency (either directly or indirectly), instead of its intention or decision to do so. For example, subject to the other requirements in paragraphs 30A.2–30A.11, regardless of whether the entity intends or decides to obtain currency PC, currency LC is exchangeable into currency PC if the entity is able either (directly) to exchange LC for PC, or (indirectly) to exchange LC for another currency (FC) and then exchange FC for PC.

Markets or exchange mechanisms

30A.7 In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. Enforceability is a matter of law. Whether an exchange transaction in a market or exchange mechanism would create enforceable rights and obligations depends on the facts and circumstances surrounding the exchange transaction.

Purpose of obtaining the other currency

30A.8 Exchange rates might vary depending on how the currency is to be used. For example, the relevant authorities of a jurisdiction might set a preferential exchange rate for imports of specific goods and a 'penalty' exchange rate for dividend payments to other jurisdictions.

30A.9 Accordingly, whether a currency is exchangeable into another currency could depend on the purpose for which an entity obtains (or hypothetically might need to obtain) the other currency. In assessing exchangeability, an entity shall assume its purpose in obtaining the other currency is:

(a) to realise or settle individual foreign currency transactions, assets or liabilities when the entity reports foreign currency transactions in its functional currency (see paragraphs 30.6–30.11 and 30.14–30.16).

(b) to realise or settle its net assets or net liabilities when the entity uses a presentation currency other than its functional currency (see paragraphs 30.17–30.21). The entity's net assets might be realised by, for example, payment of dividends to its shareholders or disposal of the investment in the entity by its shareholders.

(c) to realise or settle its net investment in the foreign operation when the entity translates the results and financial position of a foreign operation into the presentation currency (see paragraphs 30.22–30.23). The entity's net investment in a foreign operation might be realised by, for example, receipt of dividends from the foreign operation or disposal of the investment in the foreign operation.

30A.10 An entity shall assess whether a currency is exchangeable into another currency separately for each purpose specified in paragraph 30A.9.

Ability to obtain only limited amounts of the other currency

30A.11 A currency is not exchangeable into another currency at the measurement date if, for a purpose specified in paragraph 30A.9, an entity is able to obtain no more than an insignificant amount of the other currency. For example, an entity with a functional currency of LC has liabilities denominated in currency FC. The entity assesses whether the total amount of FC it can obtain for the purpose of settling those liabilities is no more than an insignificant amount compared with the aggregated amount (the sum) of its liability balances denominated in FC.

Step 2—Estimating the spot exchange rate when a currency is not exchangeable (paragraph 30.5A)

30A.12 This Standard does not specify how an entity estimates the spot exchange rate when a currency is not exchangeable. In estimating the spot exchange rate to meet the objective in paragraph 30.5A, an entity is permitted to use either:

(a) an observable exchange rate without adjustment (see paragraphs 30A.13–30A.17); or

(b) another estimation technique (see paragraph 30A.18).

Using an observable exchange rate without adjustment

30A.13 Examples of an unadjusted observable exchange rate include:

(a) a spot exchange rate for a purpose other than that for which an entity assesses exchangeability (see paragraphs 30A.14–30A.15); and

(b) the first exchange rate at which an entity is able to obtain the other currency for the specified purpose after exchangeability of the currency is restored (the first subsequent exchange rate) (see paragraphs 30A.16–30A.17).

Using an observable exchange rate for another purpose

30A.14 A currency that is not exchangeable into another currency for one purpose might be exchangeable into that currency for another purpose. For example, an entity might be able to obtain a currency to import specific goods but not to pay dividends. In such situations, the entity might conclude that an observable exchange rate for another purpose meets the objective described in paragraph 30.5A.

30A.15 An observable exchange rate for another purpose might not reflect the prevailing economic conditions when, for example:

(a) the rate includes an 'incentive' or 'penalty' set to encourage or deter entities from obtaining the other currency for particular purposes;

(b) an entity is able to obtain the other currency only for limited purposes (for example, to import emergency supplies);

(c) the rate is set through regular interventions by the relevant authorities; or

(d) the rate is unchanged over time instead of being updated daily (or more frequently).

Using the first subsequent exchange rate

30A.16 A currency that is not exchangeable into another currency at the measurement date for a specified purpose might subsequently become exchangeable into that currency for that purpose. In such situations, an entity might conclude that the first subsequent exchange rate meets the objective described in paragraph 30.5A.

30A.17 The first subsequent exchange rate might not reflect the prevailing economic conditions when, for example:

(a) the date at which exchangeability is restored is long after the measurement date; or

(b) an economy is subject to hyperinflation or high inflation and prices often change quickly, perhaps several times a day.

Using another estimation technique

30A.18 An entity using another estimation technique is permitted to use any observable exchange rate—including rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations—and adjust that rate, as necessary, to meet the objective described in paragraph 30.5A.

Section 31
Hyperinflation

Scope of this section

31.1 This section applies to an entity whose **functional currency** is the currency of a hyperinflationary economy. It requires such an entity to prepare **financial statements** that have been adjusted for the effects of hyperinflation.

Hyperinflationary economy

31.2 This section does not establish an absolute rate at which an economy is deemed hyperinflationary. An entity shall make that judgement by considering all available information including, but not limited to, the following possible indicators of hyperinflation:

(a) the general population prefers to keep its wealth in non-monetary **assets** or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.

(b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.

(c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.

(d) interest rates, wages and prices are linked to a price index.

(e) the cumulative inflation rate over three years is approaching, or exceeds, 100 per cent.

Measuring unit in the financial statements

31.3 All amounts in the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the end of the **reporting period**. The comparative information for the previous period required by paragraph 3.14, and any information presented in respect of earlier periods, shall also be stated in terms of the measuring unit current at the **reporting date**.

31.4 The restatement of financial statements in accordance with this section requires the use of a general price index that reflects changes in general purchasing power. In most economies there is a recognised general price index, normally produced by the government, that entities will follow.

Procedures for restating historical cost financial statements

Statement of financial position

31.5 **Statement of financial position** amounts not expressed in terms of the measuring unit current at the end of the reporting period are restated by applying a general price index.

31.6 **Monetary items** are not restated because they are expressed in terms of the measuring unit current at the end of the reporting period. Monetary items are money held and items to be received or paid in money.

31.7 Assets and **liabilities** linked by agreement to changes in prices, such as index-linked bonds and loans, are adjusted in accordance with the agreement and presented at this adjusted amount in the restated statement of financial position.

31.8 All other assets and liabilities are non-monetary:

(a) some non-monetary items are carried at amounts current at the end of the reporting period, such as net realisable value and **fair value**, so they are not restated. All other non-monetary assets and liabilities are restated.

(b) most non-monetary items are carried at cost or cost less **depreciation**; hence they are expressed at amounts current at their date of acquisition. The restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the end of the reporting period.

(ba) some non-monetary items are carried at amounts current at dates other than that of acquisition or the reporting date, for example, **property, plant and equipment** that has been revalued at some earlier date. In these cases, the **carrying amounts** are restated from the date of the revaluation.

(c) the restated amount of a non-monetary item is reduced, in accordance with Section 27 *Impairment of Assets*, when it exceeds its **recoverable amount**.

31.9 At the beginning of the first period of application of this section, the components of **equity**, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all the other amounts in the restated statement of financial position.

31.10 At the end of the first period and in subsequent periods, all components of **owners'** equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The changes for the period in owners' equity are disclosed in accordance with Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*.

Statement of comprehensive income and income statement

31.11 All items in the **statement of comprehensive income** (and in the **income statement**, if presented) shall be expressed in terms of the measuring unit current at the end of the reporting period. Consequently, all amounts need to be restated by applying the change in the general price index from the dates when the items of **income** and **expenses** were initially recognised in the financial statements. If general inflation is approximately even throughout the period, and the items of income and expense arose approximately evenly throughout the period, an average rate of inflation may be appropriate.

Statement of cash flows

31.12 An entity shall express all items in the **statement of cash flows** in terms of the measuring unit current at the end of the reporting period.

Gain or loss on net monetary position

31.13 In a period of inflation, an entity holding an excess of monetary assets over monetary liabilities loses purchasing power, and an entity with an excess of monetary liabilities over monetary assets gains purchasing power, to the extent the assets and liabilities are not linked to a price level. An entity shall include in **profit or loss** the gain or loss on the net monetary position. An entity shall offset the adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 31.7 against the gain or loss on net monetary position.

Economies ceasing to be hyperinflationary

31.14 When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this section, it shall treat the amounts expressed in the **presentation currency** at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

Disclosures

31.15 An entity to which this section applies shall disclose the following:

(a) the fact that financial statements and other prior period data have been restated for changes in the general purchasing power of the functional currency;

(b) the identity and level of the price index at the reporting date and changes during the current reporting period and the previous reporting period; and

(c) amount of gain or loss on monetary items.

Section 32
Events after the End of the Reporting Period

Scope of this section

32.1 This section defines events after the end of the **reporting period** and sets out principles for recognising, measuring and disclosing those events.

Events after the end of the reporting period defined

32.2 Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the **financial statements** are authorised for issue. There are two types of events:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period); and

(b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).

32.3 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of **profit or loss** or other selected financial information.

Recognition and measurement

Adjusting events after the end of the reporting period

32.4 An entity shall adjust the amounts recognised in its financial statements, including related disclosures, to reflect adjusting events after the end of the reporting period.

32.5 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the settlement after the end of the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised **provision** related to this court case in accordance with Section 21 *Provisions and Contingencies* or recognises a new provision. The entity does not merely disclose a **contingent liability**. Instead, the settlement provides additional evidence to be considered in determining the provision that should be recognised at the end of the reporting period in accordance with Section 21.

(b) the receipt of information after the end of the reporting period indicating that an **asset** was impaired at the end of the reporting period or that the amount of a previously recognised **impairment loss** for that asset needs to be adjusted. For example:

(i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the **carrying amount** of the trade receivable; and

(ii) the sale of **inventories** after the end of the reporting period may give evidence about their selling price at the end of the reporting period for the purpose of assessing impairment at that date.

(c) the determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 28 *Employee Benefits*).

(e) the discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

32.6 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.

32.7 Examples of non-adjusting events after the end of the reporting period include:

(a) a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Consequently, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure in accordance with paragraph 32.10.

(b) an amount that becomes receivable as a result of a favourable judgement or settlement of a court case after the **reporting date** but before the financial statements are authorised for issue. This would be a **contingent asset** at the reporting date (see paragraph 21.13) and disclosure may be required by paragraph 21.16. However, agreement on the amount of damages for a judgement that was reached before the reporting date, but was not previously recognised because the amount could not be measured reliably, may constitute an adjusting event.

Dividends

32.8 If an entity declares dividends to holders of its **equity** instruments after the end of the reporting period, the entity shall not recognise those dividends as a **liability** at the end of the reporting period. The amount of the dividend may be presented as a segregated component of retained earnings at the end of the reporting period.

Disclosure

Date of authorisation for issue

32.9 An entity shall disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's **owners** or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

Non-adjusting events after the end of the reporting period

32.10 An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:

(a) the nature of the event; and

(b) an estimate of its financial effect or a statement that such an estimate cannot be made.

32.11 The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure; the disclosures will reflect information that becomes known after the end of the reporting period but before the financial statements are authorised for issue:

(a) a major **business combination** or disposal of a major **subsidiary**;

(b) announcement of a plan to discontinue an operation;

(c) major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government;

(d) the destruction of a major production plant by a fire;

(e) announcement, or commencement of the implementation, of a major restructuring;

(f) issues or repurchases of an entity's debt or equity instruments;

(g) abnormally large changes in asset prices or foreign exchange rates;

(h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities;

(i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and

(j) commencement of major litigation arising solely out of events that occurred after the end of the reporting period.

Section 33
Related Party Disclosures

Scope of this section

33.1 This section requires an entity to include in its **financial statements** the disclosures necessary to draw attention to the possibility that its **financial position** and **profit or loss** have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.

Related party defined

33.2 A **related party** is a person or entity that is related to the **reporting entity**:

(a) a person or a **close member of that person's family** is related to a reporting entity if that person:

(i) is a member of the key management personnel of the reporting entity or of a **parent** of the reporting entity;

(ii) has **control** or **joint control** over the reporting entity; or

(iii) has significant influence over the reporting entity.

(b) an entity is related to a reporting entity if any of the following conditions applies:

(i) the entity and the reporting entity are members of the same **group** (which means that each parent, **subsidiary** and fellow subsidiary is related to the others).

(ii) one entity is an **associate** or **jointly controlled entity** of the other entity (or an associate or jointly controlled entity of a member of a group of which the other entity is a member).

(iii) both entities are jointly controlled entities of the same third entity.

(iv) one entity is a jointly controlled entity of a third entity and the other entity is an associate of the third entity.

(v) the entity is a **post-employment benefit plan** for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) the entity is controlled or jointly controlled by a person identified in (a).

(vii) the entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

(viii) a person identified in (a)(ii) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

33.3 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form.

33.4 In the context of this Standard, the following are not necessarily related parties:

(a) two entities simply because they have a director or other member of key management personnel in common;

(b) two parties simply because they share joint control over a jointly controlled entity;

(c) any of the following simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process):

(i) providers of finance;

(ii) trade unions;

(iii) public utilities; or

(iv) government departments and agencies.

(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence.

Disclosures

Disclosure of controlling party relationships

33.5 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been **related party transactions**. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.6 Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits (as defined in Section 28 *Employee Benefits*) including those in the form of share-based payment (see Section 26 *Share-based Payment*). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (for example, by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of goods or services provided to the entity.

33.7 An entity shall disclose key management personnel compensation in total.

33.7A An entity that obtains key management personnel services from another entity (management entity) is not required to make any disclosure that might otherwise be required by paragraph 33.7 in relation to the compensation paid or payable by the management entity to the management entity's employees or directors. However, the amounts incurred by the entity for the provision by a separate management entity of such services shall be disclosed.

Disclosure of related party transactions

33.8 A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged. Examples of related party transactions that are common to Private Entities include, but are not limited to:

(a) transactions between an entity and its principal **owner**(s);

(b) transactions between an entity and another entity when both entities are under the common control of a single entity or person; and

(c) transactions in which an entity or person that controls the reporting entity incurs **expenses** directly that otherwise would have been borne by the reporting entity.

33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall include:

(a) the amount of the transactions;

(b) the amount of outstanding balances, including commitments and:

(i) their terms and conditions, including whether they are secured and the nature of the consideration to be provided in settlement; and

(ii) details of any guarantees given or received.

(c) provisions for uncollectable receivables related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Such transactions could include purchases, sales or transfers of goods or services; **leases**; guarantees; and settlements by the entity on behalf of the related party or vice versa.

33.10 An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:

(a) entities with control, joint control or significant influence over the entity;

(b) entities over which the entity has control, joint control or significant influence;

(c) key management personnel of the entity or its parent (in the aggregate); and

(d) other related parties.

33.11 An entity is exempt from the disclosure requirements of paragraph 33.9 in relation to related party transactions and outstanding balances, including commitments, with:

(a) a **government** that has control, joint control or significant influence over the reporting entity; and

(b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

33.12 The following are examples of transactions that shall be disclosed if they are with a related party:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other **assets**;

(c) rendering or receiving of services;

(d) leases;

(e) transfers of **research** and **development**;

(f) transfers under licence agreements;

(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);

(h) provision of guarantees or collateral;

(ha) commitments to do something if a particular event occurs or does not occur in the future;

(i) settlement of **liabilities** on behalf of the entity or by the entity on behalf of another party; and

(j) participation by a parent or subsidiary in a **defined benefit plan** that shares risks between group entities.

33.13 An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm’s length transactions unless such terms can be substantiated.

33.14 An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

33.15 If a reporting entity applies the exemption in paragraph 33.11, it shall disclose the following about the transactions and related outstanding balances referred to in paragraph 33.11:

(a) the name of the government and the nature of its relationship with the reporting entity (that is, control, joint control or significant influence).

(b) the nature and amount of each individually significant transaction.

(c) for transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 33.12.

Section 34
Specialised Activities

Scope of this section

34.1 This section provides guidance on financial reporting by Private Entities involved in three types of specialised activities—agriculture, extractive activities, and service concessions.

Agriculture

34.2 An entity applying this Standard that is engaged in **agricultural activity** shall determine its accounting policy for each class of its **biological assets**, except for **bearer plants** that can be measured separately from the produce on them without undue cost or effort (see paragraph 34.2A), as follows:

(a) the entity shall use the **fair value** model in paragraphs 34.4–34.7 for those biological assets for which fair value is readily determinable without undue cost or effort; and

(b) the entity shall use the cost model in paragraphs 34.8–34.10 for all other biological assets.

34.2A This section does not apply to bearer plants that, at initial **recognition**, can be measured, both initially and on an ongoing basis, separately from the produce on them without undue cost or effort (see Section 17 *Property, Plant and Equipment*). However, this section applies to the produce on those bearer plants. If, at initial recognition, an entity determines that bearer plants cannot be measured separately from the produce on them without undue cost or effort initially or on an ongoing basis, this section applies to the entire plant.

34.2B Examples of plants that are not bearer plants:

(a) plants cultivated to be harvested as **agricultural produce** (for example, trees grown for use as lumber or trees that are cultivated both for their fruit and for their lumber); and

(b) annual crops (for example, maize and wheat).

Recognition

34.3 An entity shall recognise a biological asset or agricultural produce when, and only when:

(a) the entity controls the **asset** as a result of past events;

(b) it is **probable** that future economic benefits associated with the asset will flow to the entity; and

(c) the fair value or cost of the asset can be measured reliably without undue cost or effort.

Measurement—fair value model

34.4 An entity shall measure a biological asset on initial recognition and at each **reporting date** at its fair value less costs to sell. Changes in fair value less costs to sell shall be recognised in **profit or loss**.

34.5 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 *Inventories* or another applicable section of this Standard.

34.6 Section 12 *Fair Value Measurement* provides guidance on fair value measurement.

Disclosures—fair value model

34.7 An entity shall disclose the following with respect to its biological assets measured at fair value:

(a) a description of each class of its biological assets.

(b) [deleted]

(c) a reconciliation of changes in the **carrying amount** of biological assets between the beginning and the end of the current period. The reconciliation shall include:

(i) the gain or loss arising from changes in fair value less costs to sell;

(ii) increases resulting from purchases;

(iii) decreases resulting from harvest;

(iv) increases resulting from **business combinations**;

(v) net exchange differences arising on the translation of **financial statements** into a different **presentation currency** and on the translation of a **foreign operation** into the presentation currency of the **reporting entity**; and

(vi) other changes.

This reconciliation need not be presented for prior periods.

Measurement—cost model

34.8 The entity shall measure at cost less any accumulated **depreciation** and any accumulated **impairment** losses those biological assets whose fair value is not readily determinable without undue cost or effort.

34.9 The entity shall measure agricultural produce harvested from its biological assets at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 13 or other sections of this Standard.

Disclosures—cost model

34.10 An entity shall disclose the following with respect to its biological assets measured using the cost model:

(a) a description of each class of its biological assets;

(b) an explanation of why fair value cannot be measured reliably without undue cost or effort;

(c) the depreciation method used;

(d) the useful lives or the depreciation rates used; and

(e) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

Exploration for and evaluation of mineral resources

34.11 An entity using this Standard that is engaged in the exploration for, or evaluation of, mineral resources shall determine an accounting policy that specifies which expenditures are recognised as exploration and evaluation assets in accordance with paragraph 10.4 and apply the policy consistently. An entity is exempt from applying paragraph 10.5 to its **accounting policies** for the recognition and measurement of exploration and evaluation assets.

34.11A The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies;

(c) exploratory drilling;

(d) trenching;

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets.

34.11B Exploration and evaluation assets shall be measured on initial recognition at cost. After initial recognition, an entity shall apply Section 17 and Section 18 *Intangible Assets other than Goodwill* to the exploration and evaluation assets according to the nature of the assets acquired subject to paragraphs 34.11D–34.11F. If an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 17 and Section 21 *Provisions and Contingencies*.

34.11C Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its **recoverable amount**. An entity shall measure, present and disclose any resulting impairment loss in accordance with Section 27 *Impairment of Assets*, except as provided by paragraph 34.11F.

34.11D For the purposes of exploration and evaluation assets only, paragraph 34.11E shall be applied instead of paragraphs 27.7–27.10 when identifying an exploration and evaluation asset that may be impaired. Paragraph 34.11E uses the term 'assets' but applies equally to separate exploration and evaluation assets or a **cash-generating unit**.

34.11E One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):

(a) the period for which the entity has the right to explore in the specific area has expired during the period, or will expire in the near future, and is not expected to be renewed;

(b) substantive expenditure on further exploration for, and evaluation of, mineral resources in the specific area is neither budgeted nor planned;

(c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area; or

(d) sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

The entity shall perform an impairment test, and recognise any impairment loss, in accordance with Section 27.

34.11F An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

34.11G An entity shall treat exploration and evaluation assets as a separate **class of assets** and make the disclosures required by either Section 17 or Section 18 consistent with how the assets are classified.

Service concession arrangements

34.12 A **service concession arrangement** is an arrangement whereby a government or other public sector body (the grantor) contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. In those arrangements, the grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.

34.13 There are two principal categories of service concession arrangements:

(a) in one, the operator receives a **financial asset**—an unconditional contractual right to receive a specified or determinable amount of cash or another financial asset from the government in return for constructing or upgrading a public sector asset, and then operating and maintaining the asset for a specified period of time. This category includes guarantees by the government to pay for any shortfall between amounts received from users of the public service and specified or determinable amounts.

(b) in the other, the operator receives an **intangible asset**—a right to charge for use of a public sector asset that it constructs or upgrades and then operates and maintains for a specified period of time. A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service.

Sometimes, a single contract may contain both types: to the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

Accounting—financial asset model

34.14 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The operator shall measure the financial asset at fair value. Thereafter, it shall follow Section 11 *Financial Instruments* in accounting for the financial asset.

Accounting—intangible asset model

34.15 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator shall initially measure the intangible asset at fair value. Thereafter, it shall follow Section 18 in accounting for the intangible asset.

Operating revenue

34.16 The operator of a service concession arrangement shall recognise, measure and disclose **revenue** in accordance with Section 23 *Revenue from Contracts with Customers* for the services it performs.

Section 35
Transition to the HKFRS for Private Entities *Accounting Standard*

Scope of this section

35.1 This section applies to a **first-time adopter of the *HKFRS for Private Entities* Accounting Standard**, regardless of whether its previous accounting framework was **full HKFRS Accounting Standards** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards or another framework such as the local income tax basis.

35.2 An entity that has applied the *HKFRS for Private Entities* Accounting Standard in a previous **reporting period**, but whose most recent previous annual **financial statements** did not contain an explicit and unreserved statement of compliance with the *HKFRS for Private Entities* Accounting Standard, must either apply this section or apply the *HKFRS for Private Entities* Accounting Standard retrospectively in accordance with Section 10 *Accounting Policies, Estimates and Errors* as if the entity had never stopped applying the *HKFRS for Private Entities* Accounting Standard. When such an entity does not elect to apply this section, it is still required to apply the disclosure requirements in paragraph 35.12A in addition to the disclosure requirements in Section 10.

First-time adoption

35.3 A first-time adopter of the *HKFRS for Private Entities* Accounting Standard shall apply this section in its first financial statements that conform to this Standard.

35.4 An entity's first financial statements that conform to this Standard are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with the *HKFRS for Private Entities* Accounting Standard. Financial statements prepared in accordance with this Standard are an entity's first such financial statements if, for example, the entity:

(a) did not present financial statements for previous periods;

(b) presented its most recent previous financial statements under national requirements that are not consistent with this Standard in all respects; or

(c) presented its most recent previous financial statements in conformity with full HKFRS Accounting Standards.

35.5 Paragraph 3.17 defines a complete set of financial statements.

35.6 Paragraph 3.14 requires an entity to disclose, in a complete set of financial statements, comparative information in respect of the previous comparable period for all monetary amounts presented in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Consequently, an entity's **date of transition to the *HKFRS for Private Entities* Accounting Standard** is the beginning of the earliest period for which the entity presents full comparative information in accordance with this Standard in its first financial statements that conform to this Standard.

Procedures for preparing financial statements at the date of transition

35.7 Except as provided in paragraphs 35.9–35.11, an entity shall on its date of transition to the *HKFRS for Private Entities* Accounting Standard (ie the beginning of the earliest period presented):

(a) recognise all **assets** and **liabilities** whose **recognition** is required by the *HKFRS for Private Entities* Accounting Standard;

(b) not recognise items as assets or liabilities if this Standard does not permit such recognition;

(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of **equity**, but are a different type of asset, liability or component of equity under this Standard; and

(d) apply this Standard in measuring all recognised assets and liabilities.

35.8 The **accounting policies** that an entity uses on adoption of this Standard may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this Standard. Consequently, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this Standard.

35.9 On first-time adoption of this Standard, an entity shall not retrospectively change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) **derecognition** of **financial assets** and **financial liabilities**. Financial assets and liabilities derecognised under an entity's previous accounting framework before the date of transition shall not be recognised upon adoption of the *HKFRS for Private Entities* Accounting Standard. Conversely, for financial assets and liabilities that would have been derecognised under the *HKFRS for Private Entities* Accounting Standard in a transaction that took place before the date of transition, but that were not derecognised under an entity's previous accounting framework, an entity may choose (a) to derecognise them on adoption of the *HKFRS for Private Entities* Accounting Standard or (b) to continue to recognise them until disposed of or settled.

(b) hedge accounting. An entity shall not change its hedge accounting before the date of transition to the *HKFRS for Private Entities* Accounting Standard for hedging relationships that no longer exist at the date of transition. For hedging relationships that exist at the date of transition, the entity shall follow the hedge accounting requirements of Part II of Section 11 *Financial Instruments*, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions of Part II of Section 11.

(c) **accounting estimates**.

(d) **discontinued operations**.

(e) measuring **non-controlling interests**. The requirements of paragraph 5.6 to allocate **profit or loss** and **total comprehensive income** between non-controlling interest and **owners** of the **parent** shall be applied prospectively from the date of transition to the *HKFRS for Private Entities* Accounting Standard (or from such earlier date as this Standard is applied to restate **business combinations**—see paragraph 35.10(a)).

(f) government loans. A first-time adopter shall apply the requirements in Section 11 and Section 24 *Government Grants* prospectively to government loans existing at the date of transition to this Standard. Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan on a basis that is consistent with this Standard, it shall use its previous GAAP **carrying amount** of the loan at the date of transition to this Standard as the carrying amount of the loan at that date and shall not recognise the benefit of any government loan at a below-market rate of interest as a **government grant**.

(g) completed **contracts** with **customers**. An entity shall not restate contracts that were completed before the date of transition to the *HKFRS for Private Entities* Accounting Standard. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with its previous GAAP.

35.10 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this Standard:

(a) business combinations. A first-time adopter may elect not to apply Section 19 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this Standard. However, if a first-time adopter restates any business combination to comply with Section 19, it shall restate all later business combinations.

(b) **share-based payment transactions**. A first-time adopter is not required to apply Section 26 *Share-based Payment* to equity instruments that were granted before the date of transition to this Standard, or to liabilities arising from share-based payment transactions that were settled before the date of transition to this Standard.

(c) **fair value** as deemed cost. A first-time adopter may elect to measure an item of **property, plant and equipment**, an **investment property** or an **intangible asset** on the date of transition to this Standard at its fair value and use that fair value as its deemed cost at that date.

(d) revaluation as deemed cost. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment, an investment property or an intangible asset at, or before, the date of transition to this Standard as its deemed cost at the revaluation date.

(da) event-driven fair value measurement as deemed cost. A first-time adopter may have established a deemed cost in accordance with its previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event, for example, a valuation of the business, or parts of the business, for the purposes of a planned sale. If the measurement date:

(i) is at or before the date of transition to this Standard, the entity may use such event-driven fair value measurements as deemed cost at the date of that measurement.

(ii) is after the date of transition to this Standard, but during the periods covered by the first financial statements that conform to this Standard, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or, if appropriate, another category of equity) at the measurement date. At the date of transition to this Standard, the entity shall either establish the deemed cost by applying the criteria in paragraph 35.10(c)–(d) or measure those assets and liabilities in accordance with the other requirements in this section.

(e) cumulative translation differences. Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity. A first-time adopter may elect to deem the cumulative translation differences for all **foreign operations** to be zero at the date of transition to the *HKFRS for Private Entities* Accounting Standard (ie a 'fresh start').

(f) **separate financial statements**. When an entity prepares separate financial statements, paragraph 9.26 requires it to account for its investments in **subsidiaries**, **associates** and jointly controlled entities either:

(i) at cost less **impairment**;

(ii) at fair value with changes in fair value recognised in profit or loss; or

(iii) using the equity method following the procedures in paragraph 14.8.

If a first-time adopter measures such an investment at cost, it shall measure that investment at one of the following amounts at the date of transition:

(i) cost determined in accordance with Section 9 *Consolidated and Separate Financial Statements*; or

(ii) deemed cost, which shall be either fair value at the date of transition to the *HKFRS for Private Entities* Accounting Standard or previous GAAP carrying amount on that date.

(g) **compound financial instruments**. Paragraph 22.13 requires an entity to split a compound financial instrument into its liability and equity components at the date of issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this Standard.

(h) deferred income tax. A first-time adopter may apply Section 29 *Income Tax* prospectively from the date of transition to the *HKFRS for Private Entities* Accounting Standard, while applying the exception in paragraph 29.3A retrospectively.

(i) **service concession arrangements**. A first-time adopter is not required to apply paragraphs 34.12–34.16 to service concession arrangements entered into before the date of transition to this Standard.

(j) extractive activities. A first-time adopter using full cost accounting under previous GAAP may elect to measure oil and gas assets (those used in the exploration, evaluation, development or production of oil and gas) on the date of transition to the *HKFRS for Private Entities* Accounting Standard at the amount determined under the entity's previous GAAP. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section 27 *Impairment of Assets*.

(k) arrangements containing a **lease**. A first-time adopter may elect to determine whether an arrangement existing at the date of transition to the *HKFRS for Private Entities* Accounting Standard contains a lease (see paragraph 20.3) on the basis of facts and circumstances existing at that date, instead of when the arrangement was entered into.

(l) decommissioning liabilities included in the cost of property, plant and equipment. Paragraph 17.10(c) states that the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce **inventories** during that period. A first-time adopter may elect to measure this component of the cost of an item of property, plant and equipment at the date of transition to the *HKFRS for Private Entities* Accounting Standard, instead of on the date(s) when the obligation initially arose.

(m) operations subject to rate regulation. If a first-time adopter holds items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation (ie to provide goods or services to customers at prices/rates established by an authorised body) it may elect to use the previous GAAP carrying amount of those items at the date of transition to this Standard as their deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. The entity shall test those assets for impairment at the date of transition to this Standard in accordance with Section 27.

(n) **severe hyperinflation**. If a first-time adopter has a **functional currency** that was subject to severe hyperinflation:

  (i) if its date of transition to this Standard is on, or after, the **functional currency normalisation date**, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date at fair value on the date of transition to this Standard and use that fair value as the deemed cost of those assets and liabilities at that date; and

  (ii) if the functional currency normalisation date falls within a twelve month comparative period, an entity may use a comparative period of less than twelve months, provided that a complete set of financial statements (as required by paragraph 3.17) is provided for that shorter period.

(o) **revenue**. A first-time adopter is permitted to apply Section 23 *Revenue from Contracts with Customers* either retrospectively or prospectively in accordance with paragraph A27. The entity shall treat references to the date of initial application, in paragraphs A27, A32, A35 and A36, as referring to the date of transition to this Standard. The first-time adopter is not required to provide the disclosure in paragraph A31.

35.11 If it is **impracticable** for an entity to make one or more of the adjustments required by paragraph 35.7 at the date of transition, the entity shall apply paragraphs 35.7–35.10 for such adjustments in the earliest period for which it is practicable to do so, and shall identify which amounts in the financial statements have not been restated. If it is impracticable for an entity to provide any of the disclosures required by this Standard, including those for comparative periods, the omission shall be disclosed.

Disclosures

Explanation of transition to the *HKFRS for Private Entities* Accounting Standard

35.12 An entity shall explain how the transition from its previous financial reporting framework to this Standard affected its reported **financial position**, financial **performance** and **cash flows**.

35.12A An entity that has applied the *HKFRS for Private Entities* Accounting Standard in a previous period, as described in paragraph 35.2, shall disclose:

(a) the reason it stopped applying the *HKFRS for Private Entities* Accounting Standard;

(b) the reason it is resuming the application of the *HKFRS for Private Entities* Accounting Standard; and

(c) whether it has applied this section or has applied the *HKFRS for Private Entities* Accounting Standard retrospectively in accordance with Section 10.

Reconciliations

35.13 To comply with paragraph 35.12, an entity's first financial statements prepared using this Standard shall include:

(a) a description of the nature of each change in accounting policy;

(b) reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this Standard for both of the following dates:

(i) the date of transition to this Standard; and

(ii) the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework.

(c) a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss determined in accordance with this Standard for the same period.

35.14 If an entity becomes aware of **errors** made under its previous financial reporting framework, the reconciliations required by paragraph 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies.

35.15 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this Standard.

Appendix A
Effective date and transition

This appendix is an integral part of the Standard.

Effective date

A1 The revised *HKFRS for Private Entities* Accounting Standard issued in April 2025 amended and revised sections of the *HKFRS for Private Entities* Accounting Standard. An entity shall apply the amended and revised sections for annual periods beginning on or after 1 January 2027. Earlier application is permitted. If an entity applies the revised *HKFRS for Private Entities* Accounting Standard for an earlier period, the entity shall disclose that fact.

Transition

A2 An entity shall retrospectively apply the amended and revised sections in the revised *HKFRS for Private Entities* Accounting Standard in accordance with Section 10 *Accounting Policies, Estimates and Errors* except as stated in paragraphs A3–A49. In paragraphs A4–A49, the date of initial application is the beginning of the reporting period in which an entity first applies the revised Standard.

A3 An entity need not disclose the information required by paragraph 10.13(b) for the current period. Furthermore, if an entity has not restated comparative information in accordance with the requirements in this appendix, the entity is not required to disclose the amount of the adjustment for each affected line item for prior periods in accordance with paragraphs 10.13(b)–(c).

Materiality

A4 An entity shall prospectively apply the amended requirements in paragraphs 3.15A–3.16 from the date of initial application.

Control model

A5 If an entity applies the amended requirements in Section 9 *Consolidated and Separate Financial Statements* at the date of initial application and as a result consolidates an investee not previously consolidated, the entity shall:

(a) measure the **assets**, **liabilities** and **non-controlling interests** (including **goodwill**, if the investee is a **business**) as if the investee had been consolidated from the date the entity obtained **control**. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date the investor obtained control is earlier than the beginning of that period, the investor shall recognise, as an adjustment to equity at the beginning of that period, any difference between:

(i) the amount of assets, liabilities and non-controlling interests recognised; and

(ii) the previous **carrying amount** of the investor's involvement with the investee.

(b) if (a) is **impracticable**, make the adjustments required by paragraph (a) from the earliest period practicable, which might be the current period.

A6 If an entity applies the amended requirements in Section 9 at the date of initial application and as a result no longer consolidates an investee it previously consolidated, the entity shall:

(a) measure its interest in the investee as the amount the entity would have measured if the requirements in Section 9 had been effective when the entity initially recognised the investee. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. The entity shall also recognise as an adjustment to equity at the beginning of that period any difference between:

(i) the previous carrying amount of the assets, liabilities and non-controlling interests; and

(ii) the recognised amount of the interest in the investee.

(b) if measuring the interest in the investee in accordance with (a) is impracticable, make the adjustments required by paragraph (a) from the earliest period practicable, which might be the current period.

A7 If an entity applies paragraph A6(a) and applies the cost model in accordance with paragraph 14.4 or 15.9 and it is impracticable to determine the cost at the date of purchase, the entity is permitted to measure the cost (deemed cost) as either:

(a) **fair value** at the date of initial application; or

(b) the aggregate of the carrying amounts at the date of initial application of the assets and liabilities, including goodwill, that the entity had previously consolidated.

A8 At the date of initial application an entity is not required to make adjustments for previous accounting periods for its involvement in entities that:

(a) would have been consolidated before the date of initial application and are still consolidated applying the amended requirements in Section 9; and

(b) would not have been consolidated before the date of initial application and are not consolidated applying the amended requirements in Section 9.

A9 An entity applying the amended requirements in Section 9 is only required to disclose the amount of the adjustment for each line item affected in accordance with paragraph 10.13(b) for the annual period immediately preceding the date of initial application (and not earlier comparative periods), and only if it has restated comparative information in accordance with this appendix.

A10 An entity shall not restate the carrying amount of an investment in a former **subsidiary** if the entity lost control before the date of initial application. In addition, an entity shall not remeasure any gain or loss on the loss of control of a former subsidiary that occurred before the date of initial application. An entity is not required to apply the disclosure requirements in paragraph 9.23B to comparative information provided for periods before the date of initial application.

Transition from HKAS 39 *Financial Instruments: Recognition and Measurement*

A11 An entity that previously applied the **recognition** and measurement requirements in HKAS 39 *Financial Instruments: Recognition and Measurement* shall retrospectively apply the recognition and measurement requirements in Section 11 *Financial Instruments* in accordance with Section 10. However, such an entity shall:

(a) not recognise financial assets and liabilities derecognised in accordance with HKAS 39 before the date of initial application. If the entity did not derecognise financial assets and liabilities in accordance with HKAS 39 that would have been derecognised in accordance with Section 11 in a transaction before the date of initial application, the entity is permitted:

(i) to derecognise these financial assets and liabilities on the date of initial application; or

(ii) to continue to recognise these financial assets and liabilities until they are disposed of or settled.

(b) assess whether a financial asset meets the conditions described in paragraphs 11.9–11.9ZA based on the facts and circumstances at the date of initial application. The entity shall retrospectively apply the resulting classification.

(c) if it is impracticable to apply retrospectively the **effective interest method**, treat the fair value of the **financial asset** or the **financial liability**:

(i) at the end of each comparative period as the gross carrying amount of that financial asset or the amortised cost of that financial liability; and

(ii) at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application.

(d) prospectively apply the hedge accounting requirements in Part II of Section 11 from the date of initial application. An entity shall leave unchanged until the date of initial application its hedge accounting for hedging relationships that no longer exist at the date of initial application in accordance with the revised Standard. For hedging relationships that exist at the date of initial application, the entity shall follow the hedge accounting requirements in Section 11, including the requirements for discontinuing hedge accounting for hedging relationships that do not meet the conditions described in Section 11.

Fair value measurement

A12 An entity shall prospectively apply the new Section 12 *Fair Value Measurement* and paragraph 2.89 from the date of initial application.

A13 An entity is not required to apply the disclosure requirements in the new Section 12 to comparative information provided for periods before the date of initial application.

A14 The new Section 12 amended paragraphs 11.14(c), 11.43, 11.57, 13.3(a), 14.10, 14.15, 15.15, 15.21, 16.7, 17.15B, 27.9(c), 27.14, 28.15(b), 34.4 and 34.6; deleted paragraphs 11.27–11.32, 12.12, 16.10(a), 17.33(c) and 34.7(b); and added paragraphs 26.1D–26.1E. An entity shall also prospectively apply those amendments from the date of initial application.

Joint arrangements

A15 An entity applying the amended requirements in Section 15 *Joint Arrangements* is only required to disclose the amount of the adjustment for each line item affected in accordance with paragraph 10.13(b) for the annual period immediately preceding the date of initial application (and not earlier comparative periods).

Investment property

Business combinations

A16 An entity shall prospectively apply the requirements in paragraph 16.3A for acquisitions of **investment property** on or after the date of initial application.

Transfers of investment property

A17 An entity shall apply the amended requirements in paragraph 16.9 to changes in use that occur on or after the date of initial application. At the date of initial application, an entity shall reassess the classification of property held at that date and, if applicable, reclassify property by applying paragraphs 16.2–16.4 to reflect the conditions that exist at that date.

A18 If an entity reclassifies property at the date of initial application in accordance with paragraph 16.9, the entity shall disclose the amounts reclassified to or from investment property as part of the reconciliation between the carrying amounts of investment property at the beginning and at the end of the period as required by paragraph 16.10(e).

Depreciation of property, plant and equipment

A19 An entity shall prospectively apply the amended requirements in paragraphs 17.21–17.22 from the date of initial application.

Amortisation of intangible assets

A20 An entity shall prospectively apply the requirements in paragraph 18.22A from the date of initial application.

Business combinations and goodwill

A21 An entity shall prospectively apply the revised Section 19 *Business Combinations and Goodwill* to **business combinations** for which the acquisition date is on or after the date of initial application and to asset acquisitions that occur on or after the date of initial application. The entity is not required to apply the disclosure requirements in the revised Section 19 to comparative information provided for periods before the date of initial application.

A22 An entity shall leave unadjusted on the date of initial application assets and liabilities from business combinations whose acquisition dates preceded the date of initial application.

A23 The revised Section 19 amended paragraph 11.49(g), added paragraph 21.1(e) and deleted paragraph 22.2(c). An entity shall prospectively apply those amendments to business combinations for which the acquisition date is on or after the date of initial application and to asset acquisitions that occur on or after the date of initial application.

A24 An entity shall not adjust on the date of initial application any **contingent consideration** balances arising from business combinations whose acquisition dates preceded the date of initial application. An entity shall omit these balances from the information it discloses in accordance with paragraph 19.41. An entity shall prospectively apply paragraphs A25–A26 from the date of initial application. Paragraphs A25–A26 refer exclusively to business combinations whose acquisition dates precede the date of initial application.

A25 If a business combination agreement provides for an adjustment to the cost of the combination contingent on future events and the adjustment is **probable** and can be measured reliably, the **acquirer** shall include the amount of that adjustment in the cost of the business combination at the acquisition date.

A26 However, if a business combination agreement provides for such an adjustment and the adjustment either is not probable or cannot be measured reliably, an entity shall not include the adjustment in the cost of the combination at the time of initially accounting for the combination. If that adjustment subsequently becomes probable and can be measured reliably, the entity shall treat the additional consideration as an adjustment to the cost of the combination.

Revenue from contracts with customers

A27 An entity shall apply the revised Section 23 *Revenue from Contracts with Customers* consistently to all **contracts** with **customers** either:

(a) retrospectively in accordance with Section 10, subject to paragraphs A28–A31; or

(b) prospectively from the date of initial application in accordance with paragraphs A32–A36.

Retrospective application

A28 If an entity retrospectively applies the revised Section 23, it is permitted to use one or more of three exemptions:

(a) for completed contracts, an entity is not required to restate contracts that:

(i) begin and end within the same reporting period; or

(ii) were completed at the beginning of the earliest period presented.

(b) for completed contracts that have variable consideration, an entity is permitted to use the transaction price at the date the contracts were completed instead of estimating amounts of variable consideration for the comparative reporting periods.

(c) for contracts that were modified before the beginning of the earliest period presented, an entity is not required to retrospectively restate those contract modifications in accordance with paragraphs 23A.3–23A.4. Instead, the entity is permitted to reflect the aggregate effect of all modifications that occurred before the beginning of the earliest period presented when it:

(i) identifies the fulfilled and unfulfilled **promises**;

(ii) determines the transaction price; and

(iii) allocates the transaction price to the fulfilled and unfulfilled promises.

A29 In paragraph A28(a)–(b), a completed contract is a contract for which the entity has transferred all goods or services identified in accordance with the requirements for accounting for **revenue** from contracts with customers that were replaced by the revised Section 23.

A30 If an entity uses any of the exemptions in paragraph A28, the entity shall disclose that fact and apply that exemption consistently to all periods presented.

A31 An entity retrospectively applying the revised Section 23 shall disclose the amount of the adjustment for each line item affected for the annual period immediately preceding the date of initial application and not earlier comparative periods as required by paragraph 10.13(b).

Prospective application

A32 If an entity prospectively applies the revised Section 23, the entity shall apply the revised Section 23 to contracts that begin after the date of initial application. The entity shall not change its **accounting policy** for any contracts in progress at that date.

A33 The revised Section 23 amended paragraphs 4.11(b), 11.13, 11.14(a), 17.29, 18.1, 21.1(b), 27.1(f) and 34.16; deleted paragraphs 13.2(a), 13.14 and 21A.5; and added paragraphs 11.7(g), 11.7A, 11.13A–11.13B, 11.14A, 11.49(j), 11.55 and 13.2A. If an entity prospectively applies the revised Section 23, the entity shall apply those amendments in accordance with paragraph A32.

A34 An entity prospectively applying the revised Section 23 shall disclose:

(a) that it has not restated comparative information as a result of applying the revised Section 23; and

(b) the nature of the change in accounting policy.

A35 An entity prospectively applying the revised Section 23 is not required to apply the disclosure requirements in that section to comparative information provided for periods before the date of initial application.

A36 In the **financial statements** for periods in which contracts that were in progress at the date of initial application remain in progress, an entity prospectively applying the revised Section 23 shall disclose:

(a) the accounting policy for the recognition of revenue for those contracts, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and

(b) the revenue recognised in the current period from those contracts.

Share-based payment

Scope of Section 26 *Share-based Payment*

A37 An entity shall prospectively apply paragraph 26.1C for transactions occurring on or after the date of initial application.

Definition of fair value measurement

A38 An entity shall prospectively apply paragraphs 26.1D–26.1E from the date of initial application.

Definition of a vesting condition

A39 An entity shall prospectively apply the amendments to paragraph 26.9, the amended definitions of '**vesting condition**' and '**market vesting condition**' and the new definitions of '**performance condition**' and '**service condition**' to **share-based payment transactions** with a **grant date** on or after the date of initial application.

Effects of vesting conditions on the measurement of a cash-settled share-based payment

A40 An entity shall prospectively apply paragraphs 26.14A–26.14B to share-based payment transactions that are unvested at the date of initial application and to share-based payment transactions with a grant date on or after the date of initial application. For unvested share-based payment transactions granted before the date of initial application, an entity shall remeasure the liability at that date and recognise the effect of the remeasurement in the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Share-based payment transactions with a net settlement feature for withholding tax obligations

A41 An entity shall apply the amended requirements in paragraphs 26.15–26.15D to share-based payment transactions that are unvested (or vested but unexercised) at the date of initial application and to share-based payment transactions with a grant date on or after the date of initial application.

For unvested (or vested but unexercised) share-based payment transactions that were previously classified as cash-settled but then became classified as equity-settled in accordance with the amended requirements in paragraphs 26.15–26.15D, an entity shall reclassify the carrying amount of the share-based payment liability to equity at the date of initial application.

Measurement simplifications for defined benefit obligations

A42 An entity shall retrospectively apply the amended requirements in paragraph 28.19 in accordance with Section 10. However, an entity is not required to adjust the carrying amount of assets in the scope of other sections of this Standard for changes in employee benefit costs that were included in the carrying amount before the date of initial application.

Income tax

Recognition of deferred tax assets for unrealised losses

A43 An entity shall retrospectively apply the amended requirements in paragraphs 29.16A, 29.19(a) and 29.19A in accordance with Section 10. However, on initial application of these amended requirements, an entity is permitted to recognise the change in the opening equity of the earliest comparative period in the opening balance of retained earnings (or other component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. If an entity applies this relief, it shall disclose that fact.

Uncertainty over income tax treatments

A44 An entity shall retrospectively apply paragraphs 29.34A–29.34D either:

(a) in accordance with Section 10; or

(b) if (a) is impossible without the use of hindsight or is otherwise impracticable, recognising the cumulative effect of initially applying paragraphs 29.34A–29.34D as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Foreign currency translation

Lack of exchangeability

A45 An entity shall not retrospectively apply paragraph 30.5A. Instead, if the entity:

(a) reports foreign currency transactions in its **functional currency** and concludes at the date of initial application that the two currencies are not exchangeable, the entity shall at the date of initial application:

(i) translate affected foreign currency **monetary items** and non-monetary items measured at fair value in a foreign currency using the estimated spot exchange rate at that date; and

(ii) recognise any effect of initially applying the amendments as an adjustment to the opening balance of retained earnings; or

(b) uses a **presentation currency** other than its functional currency or translates the results and financial position of a **foreign operation** and concludes at the date of initial application that the functional currency and presentation currency are not exchangeable, the entity shall at the date of initial application:

(i) translate affected assets and liabilities using the estimated spot exchange rate at that date;

(ii) translate affected equity items using the estimated spot exchange rate at that date if the entity's functional currency is hyperinflationary; and

(iii) recognise any effect of initially applying paragraph 30.5A as an adjustment to the cumulative amount of translation differences, accumulated in a separate component of equity.

A46 An entity is not required to apply the disclosure requirements in paragraph 30.28 to comparative information provided for periods before the date of initial application.

Foreign currency transactions and advance consideration

A47 An entity is permitted to prospectively apply paragraph 30.8A to all assets, **expenses** and **income** within the scope of paragraph 30.8A that were initially recognised on or after either:

(a) the date of initial application; or

(b) the beginning of any comparative period presented.

A48 An entity that applies paragraph A47 shall apply paragraph 30.8A on initial application to assets, expenses and income initially recognised on or after the date in paragraph A47(a) or paragraph A47(b) for which the entity has recognised non-monetary assets or non-monetary liabilities arising from advance consideration before that date.

Bearer plants

A49 An entity is permitted to measure a **bearer plant** at its fair value at the beginning of the earliest period presented and use that fair value as its deemed cost at that date. The entity shall recognise any difference between the previous carrying amount and fair value in opening balance of retained earnings at the beginning of the earliest period presented.

Paragraph changes in the revised Standard

A50 Table A1 lists the paragraphs that have been added, amended and deleted in the revised Standard compared to the previous edition of the Standard.

Table A1—Paragraphs added, amended and deleted in the revised Standard.

Section	**Changes to paragraphs**
Section 1 *Private Entities*	• Amended: 1.1–1.3 and 1.5–1.7.
Section 2 *Concepts and Pervasive Principles*	• Section 2 is revised.
Section 3 *Financial Statement Presentation*	• Amended: 3.1–3.3, 3.5, 3.10–3.11, 3.16 and 3.17. • Added: 3.15A and 3.16A. (The requirements in paragraph 3.16A were previously presented in paragraph 2.36.)
Section 4 *Statement of Financial Position*	• Amended: 4.2–4.4, 4.9, 4.11 and 4.14.
Section 5 *Statement of Comprehensive Income and Income Statement*	• Amended: 5.4–5.5, 5.8 and 5.11.
Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*	• Added: 6.6.

continued…

…continued

Section	Changes to paragraphs
Section 7 *Statement of Cash Flows*	• Added: 7.12A and 7.19A–7.19C. • Amended: 7.4–7.5, 7.8, 7.11 and 7.20.
Section 8 *Notes to the Financial Statements*	• Amended: 8.4–8.6.
Section 9 *Consolidated and Separate Financial Statements*	• Added: 9.3D, 9.4A–9.4C, 9.7A–9.7B, 9.18A–9.18B, 9.20A, 9.23B and 9.25A. (The requirements in paragraph 9.20A were previously presented in paragraph 22.19.) • Amended: 9.1–9.3C, 9.4, 9.5–9.7, 9.8–9.14, 9.18, 9.19, 9.21–9.23A, 9.24–9.25 and 9.26–9.29.
Section 10 *Accounting Policies, Estimates and Errors*	• Added: 10.14A–10.14C. • Amended: 10.1, 10.4–10.6, 10.9–10.10, 10.11 and 10.15.
Section 11 *Financial Instruments* (Section 11 and Section 12 were combined to create a new Section 11. Paragraphs 12.3–12.8, 12.9–12.11 and 12.13–12.29 of the former Section 12 are renumbered accordingly as 11.49–11.54, 11.56–11.58 and 11.59–11.75. Paragraphs 12.1–12.2 and 12.12 of the former Section 12 were deleted.)	• Added: 11.7A, 11.9ZA, 11.11A, 11.13A–11.13B, 11.14A, 11.43A–11.43B and 11.55. • Amended: 11.1, 11.4–11.7, 11.8–11.9, 11.9A–11.9B, 11.11, 11.13, 11.14, 11.23–11.24, 11.39–11.41, 11.43, 11.44, 11.48, 11.49–11.51, 11.54, 11.57, 11.59–11.62, 11.64–11.65, 11.67, 11.69 and 11.71–11.75. • Deleted: 11.2 and 11.27–11.32.
Section 12 *Fair Value Measurement*	• A new Section 12 is added.
Section 13 *Inventories*	• Added: 13.2A. • Amended: 13.2, 13.3, 13.12 and 13.22. • Deleted: 13.14.
Section 14 *Investments in Associates*	• Amended: 14.2, 14.8, 14.10 and 14.12–14.15.
Section 15 *Joint Arrangements*	• Amended: 15.1–15.2, 15.3–15.18 and 15.19–15.21. • Added: 15.2A and 15.18A–15.18B.
Section 16 *Investment Property*	• Added: 16.3A. • Amended: 16.1, 16.6–16.7 and 16.9–16.10.
Section 17 *Property, Plant and Equipment*	• Amended: 17.3–17.4, 17.15B, 17.19, 17.21–17.23, 17.28–17.29, 17.31 and 17.33.

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Section	Changes to paragraphs
Section 18 *Intangible Assets other than Goodwill*	• Added: 18.22A and a footnote to paragraph 18.4. • Amended: 18.1, 18.4, 18.6, 18.24 and 18.26–18.27.
Section 19 *Business Combinations and Goodwill*	• Section 19 is revised.
Section 20 *Leases*	• Amended: 20.1, 20.6 and 20.12.
Section 21 *Provisions and Contingencies*	• Added: A footnote to paragraph 21.1, 21.1A, 21.6A–21.6B and 21.18–21.19. • Amended: 21.1, 21.2, 21.8, 21.12, 21A.7 and 21A.9. • Deleted: 21A.3 and 21A.5. (The requirements in paragraph 21A.3 are now presented in paragraphs 21.6A–21.6B).
Section 22 *Liabilities and Equity*	• Amended: 22.1–22.3, 22.7–22.8, 22.15 and 22.16. • Deleted: 22.19. (The requirements in paragraph 22.19 are now presented in paragraph 9.20A).
Section 23 *Revenue from Contracts with Customers*	• Section 23 is revised.
Section 24 *Government Grants*	• Amended: 24.7.
Section 25 *Borrowing Costs*	• Amended: 25.1.
Section 26 *Share-based Payment*	• Added: 26.1C–26.1E, a footnote to paragraph 26.8, 26.14A–26.14B and 26.15A–26.15D. • Amended: 26.5–26.9, 26.12, 26.15 and 26.16–26.17.
Section 27 *Impairment of Assets*	• Amended: 27.1, 27.9, 27.14, 27.25, 27.27 and 27.33.
Section 28 *Employee Benefits*	• Added: 28.34A–28.34B and 28.41A–28.41E. • Amended: 28.1, 28.4, 28.11, 28.14–28.15, 28.17, 28.19, 28.21, 28.26, 28.29, 28.31, 28.34, 28.37–28.38, 28.40–28.41 and 28.42. • Deleted: 28.35 and 28.44.

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Section	Changes to paragraphs
Section 29 *Income Tax*	• Added: 29.16A, 29.19A, 29.34A–29.34D and 29.37A. • Amended: 29.1, 29.3A, 29.6, 29.13–29.14, 29.16, 29.19, 29.24–29.26, 29.29, 29.36–29.37 and 29.39. • Deleted: 29.41.
Section 30 *Foreign Currency Translation*	• Added: 30.5A, 30.8A, 30.28–30.29 and Appendix to Section 30. • Amended: 30.1, 30.5, 30.9, 30.11 and 30.25.
Section 31 *Hyperinflation*	• Amended: 31.13.
Section 32 *Events after the End of the Reporting Period*	• Section 32 is not amended.
Section 33 *Related Party Disclosures*	• Added: 33.7A and 33.15. • Amended: 33.2, 33.4, 33.9 and 33.11–33.12.
Section 34 *Specialised Activities*	• Added: 34.2A–34.2B and 34.11G. • Amended: 34.2, 34.3–34.7, 34.11B, 34.14 and 34.16.
Section 35 *Transition to the* HKFRS for Private Entities *Accounting Standard*	• Amended: 35.1–35.4, 35.6–35.7, 35.9–35.10 and 35.12A.
Appendix A *Effective date and transition*	• Appendix A is revised.
Appendix B *Glossary of terms*	• Consequential amendments arising from the amendments to other sections of the Standard.

Appendix B
Glossary of terms

This Appendix is an integral part of the Standard.

accounting estimates	Monetary amounts in financial statements that are subject to measurement uncertainty.
accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accounting profit	Profit or loss for a period before deducting tax expense.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
acquiree	The business or businesses that the acquirer obtains control of in a business combination.
acquirer	The entity that obtains control of the acquiree.
active market	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
aggregation	The adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.
agricultural activity	The management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.
agricultural produce	The harvested product of the entity's biological assets.
amortisation	The systematic allocation of the depreciable amount of an asset over its useful life.
amortised cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability.
asset	A present economic resource controlled by the entity as a result of past events.
associate	An entity over which the investor has significant influence.
bearer plant	A bearer plant is a living plant that: (a) is used in the production or supply of agricultural produce; (b) is expected to bear produce for more than one period; and (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.
biological asset	A living animal or plant.
borrowing costs	Interest and other costs incurred by an entity in connection with the borrowing of funds.

business An integrated set of activities and assets that is capable of being conducted and managed for the purpose of:

(a) providing goods or services to customers;

(b) generating investment income (such as dividends or interest); or

(c) generating other income from ordinary activities.

business combination A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Standard.

carrying amount The amount at which an asset, a liability or equity is recognised in the statement of financial position.

cash Cash on hand and demand deposits.

cash equivalent Short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

cash flows Inflows and outflows of cash and cash equivalents.

cash-generating unit The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

cash-settled share-based payment transaction A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity.

class of assets A grouping of assets of a similar nature and use in an entity's operations.

classification The sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes.

close members of the family of a person Those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity, including:

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

closing rate The spot exchange rate at the end of the reporting period.

combined financial statements Financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent–subsidiary relationship.

component of an entity Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

compound financial instrument A financial instrument that, from the issuer's perspective, contains both a liability and an equity element.

consolidated financial statements The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

constructive obligation An obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

contingent asset	A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
contingent consideration	Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.
contingent liability	(a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or (ii) the amount of the obligation cannot be measured with sufficient reliability.
contract	An agreement between two or more parties that creates enforceable rights and obligations.
contract asset	An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
contract liability	An entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.
control (of an entity)	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
current tax	The amount of income tax payable (recoverable) in respect of the taxable profit (tax loss) for the current period or past periods.
customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.
date of transition to the *HKFRS for Private Entities* Accounting Standard	The beginning of the earliest period for which an entity presents full comparative information under the *HKFRS for Private Entities* Accounting Standard in its first financial statements that comply with the *HKFRS for Private Entities* Accounting Standard.
deductible temporary differences	Temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
deferred tax	Income tax payable (recoverable) in respect of the taxable profit (tax loss) for future periods as a result of past transactions or events.
deferred tax assets	The amounts of income tax recoverable in future periods in respect of: (a) deductible temporary differences; (b) the carryforward of unused tax losses; and (c) the carryforward of unused tax credits.
deferred tax liabilities	The amounts of income tax payable in future periods in respect of taxable temporary differences.

defined benefit liability	The defined benefit obligation at the reporting date minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.
defined benefit obligation	The present value of an entity's obligations under defined benefit plans.
defined benefit plans	Post-employment benefit plans other than defined contribution plans.
defined contribution plans	Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
depreciable amount	The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.
derecognition	The removal of all or part of a recognised asset or liability from an entity's statement of financial position.
development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.
discontinued operation	A component of an entity that either has been disposed of, or is held for sale, and: (a) represents a separate major line of business or geographical area of operations; (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) is a subsidiary acquired exclusively with a view to resale.
dividends	Distributions of profits to holders of equity instruments in proportion to their holdings of a particular class of capital.
economic resource	A right that has the potential to produce economic benefits.
effective interest method	A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.
effective interest rate	The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.
effectiveness of a hedge	The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.
enhancing qualitative characteristic	A qualitative characteristic that makes useful information more useful. The enhancing qualitative characteristics are comparability, verifiability, timeliness and understandability.
equity	The residual interest in the assets of the entity after deducting all its liabilities.

equity claim A claim on the residual interest in the assets of an entity after deducting all its liabilities.

equity-settled share-based payment transaction A share-based payment transaction in which the entity:

(a) receives goods or services as consideration for its own equity instruments (including shares or share options); or

(b) receives goods or services but has no obligation to settle the transaction with the supplier.

errors Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

executory contract A contract, or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

existence uncertainty Uncertainty about whether an asset or liability exists.

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

fair value The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

finance lease A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. A lease that is not a finance lease is an operating lease.

financial asset Any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

   (i) to receive cash or another financial asset from another entity; or

   (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and:

   (i) under which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

   (ii) that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial guarantee contract 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 original or modified terms of a debt instrument.

financial instrument A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

financial liability Any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and:

(i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or

(ii) will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial position The relationship of the assets, liabilities and equity of an entity as reported in the statement of financial position.

financial statements Structured representation of the financial position, financial performance and cash flows of an entity.

financing activities Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

firm commitment A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

first-time adopter of the *HKFRS for Private Entities* Accounting Standard An entity that presents its first annual financial statements that conform to the *HKFRS for Private Entities* Accounting Standard, regardless of whether its previous accounting framework was full HKFRS Accounting Standards or another set of accounting standards.

forecast transaction An uncommitted but anticipated future transaction.

foreign operation An entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

full HKFRS Accounting Standards Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). They comprise:

(a) Hong Kong Financial Reporting Standards;

(b) Hong Kong Accounting Standards; and

(c) Interpretations.

full IFRS Accounting Standards Standards and Interpretations issued by the International Accounting Standards Board (IASB). They comprise:

(a) International Financial Reporting Standards;

(b) International Accounting Standards;

(c) IFRIC Interpretations; and

(d) SIC Interpretations.

functional currency — The currency of the primary economic environment in which the entity operates.

functional currency normalisation date — The date when an entity's functional currency no longer has either, or both, of the two characteristics of severe hyperinflation, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.

fundamental qualitative characteristic — A qualitative characteristic that financial information must possess to be useful to the primary users of general purpose financial statements. The fundamental qualitative characteristics are relevance and faithful representation.

funding (of post-employment benefits) — Contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid.

general purpose financial statements — Financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses.

going concern — An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

goodwill — An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

government — Government, government agencies and similar bodies whether local, national or international.

government grants — Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

grant date — The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At the grant date, the entity confers on the counterparty the right to cash, other assets or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), the grant date is the date when that approval is obtained.

gross investment in a lease — The aggregate of:

(a) the minimum lease payments receivable by the lessor under a finance lease; and

(b) any unguaranteed residual value accruing to the lessor.

group — A parent and all its subsidiaries.

hedged item — For the purpose of special hedge accounting by Private Entities under Part II of Section 11, a hedged item is:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a firm commitment or a highly probable forecast transaction;

(c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

(d) foreign exchange risk in a net investment in a foreign operation.

hedging instrument — For the purpose of special hedge accounting by Private Entities under Part II of Section 11, a hedging instrument is a financial instrument that meets all of the following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 11.63 that is designated as the hedged risk;

(b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on);

(c) its notional amount is equal to the designated amount of the principal or notional amount of the hedged item;

(d) it has a specified maturity date not later than:

  (i) the maturity of the financial instrument being hedged;

  (ii) the expected settlement of the commodity purchase or sale commitment; or

  (iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

highest and best use The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (for example, a business) within which the asset would be used.

highly probable Significantly more likely than probable.

impairment (loss) The amount by which the carrying amount of an asset exceeds:

(a) in the case of inventories, its selling price less costs to complete and sell; or

(b) in the case of other non-financial assets, its recoverable amount.

impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

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

income statement A financial statement that presents all items of income and expense recognised in a reporting period, excluding the items of other comprehensive income.

income tax All domestic and foreign taxes that are based on taxable profits. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity.

insurance contract A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

intangible asset An identifiable non-monetary asset without physical substance. Such an asset is identifiable when it:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

interest rate implicit in the lease The discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.

interim financial report A financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.

interim period A financial reporting period shorter than a full financial year.

intrinsic value The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5.

inventories Assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

investing activities The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

investment property Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, instead of for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

joint arrangement An arrangement of which two or more parties have joint control. Joint arrangements can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

joint control The contractually agreed sharing of control of an arrangement. It exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

jointly controlled entity A joint arrangement that involves the establishment of a corporation, partnership or other entity in which each party has an interest. The entity operates in the same way as other entities, except that an arrangement between the parties establishes joint control.

lease An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

lessee's incremental borrowing rate of interest The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

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

loans payable Financial liabilities other than short-term trade payables on normal credit terms.

market participants Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

(a) they are independent of each other, that is, they are not related parties as defined in Section 33;

(b) they are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information;

(c) they are able to enter into a transaction for the asset or liability; and

(d) they are willing to enter into a transaction for the asset or liability—that is, they are motivated but not forced or otherwise compelled to do so.

market vesting condition A performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group), such as:

(a) attaining a specified share price or a specified amount of intrinsic value of a share option; or

(b) achieving a specified target that is based on the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group) relative to an index of market prices of equity instruments of other entities.

A market vesting condition requires the counterparty to complete a specified period of service (that is, a service condition); the service requirement can be explicit or implicit.

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 a specific reporting entity.

measure The result of applying a measurement basis to an asset or liability and related income and expenses.

measurement basis An identified feature—for example, historical cost, fair value or fulfilment value—of an item being measured.

measurement uncertainty Uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated.

minimum lease payments The payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or

(b) for a lessor, any residual value guaranteed to the lessor by:

(i) the lessee;

(ii) a party related to the lessee; or

(iii) a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

monetary items Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

most advantageous market	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.
multi-employer (benefit) plans	Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that: (a) pool the assets contributed by various entities that are not under common control; and (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.
net investment in a lease	The gross investment in a lease discounted at the interest rate implicit in the lease.
non-controlling interest	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
notes (to financial statements)	Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.
notional amount	The quantity of currency units, shares, bushels, pounds or other units specified in a financial instrument contract.
objective of financial statements	To provide financial information about an entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.
observable inputs	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
offsetting	Grouping an asset and liability that are recognised and measured as separate units of account into a single net amount in the statement of financial position.
onerous contract	A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.
orderly transaction	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).
ordinary share	An equity instrument that is subordinate to all other classes of equity instruments.
other comprehensive income	Items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by this Standard.
outcome uncertainty	Uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability.

owners Holders of instruments classified as equity.

parent An entity that controls one or more entities.

performance The relationship of the income and expenses of an entity, as reported in the statement of comprehensive income.

performance condition (of a share-based payment arrangement) A vesting condition that requires:

(a) the counterparty to complete a specified period of service (that is, a service condition); the service requirement can be explicit or implicit; and

(b) specified performance target(s) to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s):

(a) shall not extend beyond the end of the service period; and

(b) may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period.

A performance target is defined by reference to:

(a) the entity's own operations (or activities) or the operations or activities of another entity in the same group (that is, a non-market vesting condition); or

(b) the price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group (including shares and share options) (that is, a market vesting condition).

A performance target might relate either to the performance of the entity as a whole or to some part of the entity (or part of the group), such as a division or an individual employee.

plan assets (of an employee benefit plan) Assets held by a long-term employee benefit fund and qualifying insurance policies.

post-employment benefits Employee benefits (other than termination benefits) that are payable after the completion of employment.

post-employment benefit plans Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

potential to produce economic benefits Within an economic resource, a feature that already exists and that, in at least one circumstance, would produce for the entity economic benefits beyond those available to all other parties.

present value A current estimate of the present discounted value of the future net cash flows in the normal course of business.

presentation currency The currency in which the financial statements are presented.

primary users Existing and potential investors, lenders and other creditors.

principal market The market with the greatest volume and level of activity for the asset or liability.

private entities

Entities that:

(a) do not have public accountability; and

(b) publish general purpose financial statements for external users.

An entity has public accountability if:

(a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

probable

More likely than not.

profit or loss

The total of income less expenses, excluding the components of other comprehensive income.

projected unit credit method

An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method).

promise (in a contract with a customer)

An obligation to transfer a distinct good or service (or a distinct bundle of goods or services).

property, plant and equipment

Tangible assets that:

(a) are held for use in the production or supply of goods or services, for rental to others or for administrative purposes; and

(b) are expected to be used during more than one period.

provision

A liability of uncertain timing or amount.

prudence

The exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses.

public accountability

An entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (for example, banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks often meet this second criterion).

publicly traded (debt or equity instruments)

Traded, or in process of being issued for trading, in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

recognition

The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses. Recognition involves depicting the item in one of those statements—either alone or in aggregation with other items—in words and by a monetary amount, and including that amount in one or more totals in that statement.

recoverable amount

The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.

related party A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity):

(a) a person or a close member of that person's family is related to a reporting entity if that person:

(i) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity;

(ii) has control or joint control over the reporting entity; or

(iii) has significant influence over the reporting entity.

(b) an entity is related to a reporting entity if any of the following conditions applies:

(i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) one entity is an associate or jointly controlled entity of the other entity (or an associate or jointly controlled entity of a member of a group of which the other entity is a member).

(iii) both entities are jointly controlled entities of the same third entity.

(iv) one entity is a jointly controlled entity of a third entity and the other entity is an associate of the third entity.

(v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) the entity is controlled or jointly controlled by a person identified in (a).

(vii) the entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

(viii) a person identified in (a)(ii) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

related party transaction A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

relevant activities (of an investee) The activities that significantly affect the investee's returns.

reliability The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.

reporting date The end of the latest period covered by financial statements or by an interim financial report.

reporting entity An entity that is required, or chooses, to prepare general purpose financial statements.

reporting period The period covered by financial statements or by an interim financial report.

research Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

residual value (of an asset) The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

retrospective application (of a change in accounting policy)	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
revenue	Income arising in the course of an entity's ordinary activities.
separate financial statements	Those presented by an entity, in which the entity could elect, in accordance with paragraphs 9.25–9.26, to account for its investments in subsidiaries, jointly controlled entities and associates either at cost less impairment, at fair value with changes in fair value recognised in profit or loss or using the equity method following the procedures in paragraph 14.8.
service concession arrangement	An arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals.
service condition	A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failed to satisfy the condition. A service condition does not require a performance target to be met.
severe hyperinflation	The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics: (a) a reliable general price index is not available to all entities with transactions and balances in the currency; and (b) the currency is not exchangeable into a relatively stable foreign currency. Exchangeability is assessed in accordance with Section 30.
share-based payment arrangement	An agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive: (a) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity; or (b) equity instruments (including shares or share options) of the entity or another group entity provided the specified vesting conditions, if any, are met.
share-based payment transaction	A transaction in which the entity: (a) receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement; or (b) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.
state (employee benefit) plan	Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.
statement of cash flows	A financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.
statement of changes in equity	A financial statement that presents the profit or loss for a period, items of income and expense recognised directly in equity for the period, the effects of changes in accounting policy and corrections of errors recognised in the period

	and (depending on the format of the statement of changes in equity chosen by the entity) the amounts of transactions with owners acting in their capacity as owners during the period.
statement of comprehensive income	A financial statement that presents all items of income and expense recognised in a period, including those items recognised in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
statement of financial position	A financial statement that presents the relationship of an entity's assets, liabilities and equity as of a specific date (also called the balance sheet).
statement of income and retained earnings	A financial statement that presents the profit or loss and changes in retained earnings for a period.
subsidiary	An entity that is controlled by another entity.
tax base	The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.
tax expense	The aggregate amount included in total comprehensive income or equity for the reporting period in respect of current tax and deferred tax.
taxable profit (tax loss)	The profit (loss) for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the taxation authorities. Taxable profit equals taxable income less amounts deductible from taxable income.
taxable temporary differences	Temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
temporary differences	Differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.
termination benefits	Employee benefits provided in exchange for the termination of an employee's employment as a result of either: (a) an entity's decision to terminate an employee's employment before the normal retirement date; or (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment.
timeliness	Having information available to decision-makers in time to be capable of influencing their decisions.
timing differences	Income or expenses that are recognised in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period.
total comprehensive income	The change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners (equal to the sum of profit or loss and other comprehensive income).
transaction costs	The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria: (a) they result directly from and are essential to that transaction; and

	(b) they would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.
transaction costs (financial instruments)	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.
transaction price (for a contract with a customer)	The amount of consideration an entity expects to be entitled to in exchange for transferring goods or services promised to a customer, excluding amounts the entity has collected on behalf of third parties.
treasury shares	An entity's own equity instruments, held by the entity or other members of the consolidated group.
true and fair view	Faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.
understandability	Classifying, characterising and presenting information clearly and concisely makes it understandable.
unit of account	The right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.
unobservable inputs	Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.
useful life	The period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.
vest	Become an entitlement. Under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.
vested benefits	Benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.
vesting condition	A condition that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.
vesting period	The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Appendix C
Comparison with *IFRS for SMEs* Accounting Standard

This comparison appendix, which was prepared in April 2025 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the *HKFRS for Private Entities* Accounting Standard.

The following sets out the major textual differences between *HKFRS for Private Entities* Accounting Standard and *IFRS for SMEs* Accounting Standard and the reason for the differences.

Differences	Reason for the differences
(i) *IFRS for SMEs* Accounting Standard para 1.5 vs *HKFRS for Private Entities* Accounting Standard para 1.5 The phrase 'even if a law or regulation in that entity's jurisdiction permits or requires this Standard to be used by publicly accountable entities' in *IFRS for SMEs* Accounting Standard is deleted in *HKFRS for Private Entities* Accounting Standard	The phrase is not applicable to *HKFRS for Private Entities* Accounting Standard
(ii) *IFRS for SMEs* Accounting Standard paras 3.1, 3.2, 3.5 and 3.7, and Appendix B vs *HKFRS for Private Entities* Accounting Standard paras 3.1, 3.2, 3.5 and 3.7, and Appendix B The terms 'fair presentation' and 'present fairly' used in *IFRS for SMEs* Accounting Standard are replaced by the terms 'true and fair view' and 'present a true and fair view' in *HKFRS for Private Entities* Accounting Standard	To match with the terms used in the Hong Kong Companies Ordinance
(iii) *IFRS for SMEs* Accounting Standard para 4.7 vs *HKFRS for Private Entities* Accounting Standard para 4.7 Additional guidance is provided in footnote 3a of *HKFRS for Private Entities* Accounting Standard	To provide additional guidance on the classification by the borrower of a term loan that contains a repayment on demand clause

Basis for Conclusions

HKFRS for Private Entities Accounting Standard

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

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Basis for Conclusions on the *IFRS for SMEs* Accounting Standard

HKFRS for Private Entities Accounting Standard (HKFRS for PE) is based on IFRS for SMEs Accounting Standard (IFRS for SMEs). In approving HKFRS for PE, the Financial Reporting Standards Committee of the Hong Kong Institute of Certified Public Accountants considered and agreed with the Basis for Conclusions of International Accounting Standards Board (IASB) on IFRS for SMEs. Accordingly, there are no differences between HKFRS for PE and IFRS for SMEs. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS for SMEs referred to below generally correspond with those in HKFRS for PE.

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from paragraph

Basis for Conclusions on the *IFRS for SMEs* Accounting Standard

This Basis for Conclusions accompanies, but is not part of, the IFRS for SMEs *Accounting Standard.*

It summarises the considerations of the International Accounting Standards Board (IASB) in developing the third edition, and previous editions, of the IFRS for SMEs *Accounting Standard (Standard). Individual IASB® members gave greater weight to some factors than to others.*

The third edition of the IFRS for SMEs *Accounting Standard replaces the previous edition of the Standard.*

The IASB issued the first edition of the Standard in 2009, accompanied by a Basis for Conclusions summarising its considerations in developing that edition.

In 2015 the IASB completed its first comprehensive review of the Standard and issued a second edition of the Standard that incorporated the 2015 Amendments to the IFRS for SMEs*. The Basis for Conclusions on the first edition of the Standard was updated to reflect the IASB's considerations in developing these amendments.*

In 2023 the IASB issued International Tax Reform—Pillar Two Model Rules—Amendments to the *IFRS for SMEs* Standard*. The Basis for Conclusions on the second edition of the Standard was updated to reflect the IASB's considerations in developing these amendments.*

For convenience, the IASB has included in this Basis for Conclusions material from the Basis for Conclusions on the second edition of the Standard that discusses matters relevant to the development of the third edition. Paragraphs that the IASB did not reconsider in its second comprehensive review of the Standard are denoted by numbers with the prefix BCZ. In those paragraphs, cross-references have been updated and minor necessary editorial changes have been made.

The dissenting opinions of IASB members are set out after this Basis for Conclusions.

The IASB published a Feedback Statement and Effects Analysis describing the likely costs and benefits of the amendments made to the IFRS for SMEs *Accounting Standard in its second comprehensive review of the Standard. An effects analysis describing the likely costs and benefits of the amendments made to the IFRS for SMEs Accounting Standard in the first comprehensive review of the Standard was included in the Basis for Conclusions on the second edition of the IFRS for SMEs Accounting Standard.*

Introduction

BC1 The International Accounting Standards Board (IASB) issued the third edition of the *IFRS for SMEs* Accounting Standard (Standard) in 2025 to replace the previous edition of the Standard. The primary aim when developing the Standard was to provide a stand-alone, simplified set of accounting principles for entities without public accountability. These entities typically have transactions that are less complex than those of entities with public accountability, and limited resources with which to apply full IFRS® Accounting Standards. Entities without public accountability also operate in circumstances in which comparability with their listed peers is not an important consideration.

Background

Beginning the project

BC2 In 2001 the IASB began working on a project to develop accounting standards suitable for small and medium-sized entities (SMEs). The IASB set up a working group of experts to provide advice on issues affecting SMEs and potential solutions to those issues.

BCZ3 At public meetings during the second half of 2003 and early 2004, the IASB developed some preliminary and tentative views about the basic approach that it would follow in developing accounting standards for SMEs. It tested that approach by applying it to several IFRS Accounting Standards.

BC4 In 2005 the Trustees of the IASC Foundation (now the IFRS Foundation) formalised their support for the project by restating the objectives of the Foundation and the IASB as set out in the Foundation's *Constitution*.[1] The Trustees added an objective that, in developing IFRS Accounting Standards, the IASB should take account of, as appropriate, the special needs of SMEs and emerging economies. Similarly, the IFRS Advisory Council has consistently encouraged the IASB to pursue the project.

Why global financial reporting standards for SMEs?

BCZ5 Global financial reporting standards, applied consistently, enhance the comparability of financial information. Accounting differences can obscure the comparisons that investors, lenders and others make. By resulting in the presentation of high-quality comparable financial information, high-quality global financial reporting standards improve the efficiency of allocation and the pricing of capital. This benefits not only those who provide debt or equity capital but also those entities that seek capital because it reduces their compliance costs and removes uncertainties that affect their cost of capital. Global standards also improve consistency in audit quality and facilitate education and training.

BCZ6 The benefits of global financial reporting standards are not limited to entities whose securities are traded in public capital markets. In the IASB's judgement, SMEs—and those who use their financial statements—can benefit from a common set of accounting standards. SMEs' financial statements that are comparable from one country to the next are needed for the following reasons:

(a) financial institutions make loans across borders and operate multinationally. In most jurisdictions, over half of all SMEs, including the very small ones, have bank loans. Bankers rely on financial statements in making lending decisions and in establishing terms and interest rates.

(b) vendors want to evaluate the financial health of buyers in other countries before they sell goods or services on credit.

(c) credit rating agencies try to develop ratings uniformly across borders. Similarly, banks and other institutions that operate across borders often develop ratings in a manner similar to credit rating agencies. Reported financial information is crucial to the rating process.

(d) many SMEs have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

(e) venture capital firms provide funding to SMEs across borders.

(f) many SMEs have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other SMEs.

BCZ7 In deciding to develop a financial reporting standard for SMEs, the IASB was mindful of the following issues:

(a) should financial reporting standards for SMEs be developed by others (see paragraph BCZ8)?

(b) do national standard-setters support the IASB developing such a standard (see paragraph BC9)?

(c) is developing such a standard consistent with the IASB's mission (see paragraphs BC10–BC11)?

(d) existing IFRS Accounting Standards make some distinctions for SMEs (see paragraphs BCZ12–BCZ14).

[1] This reference to the Constitution of the International Accounting Standards Committee (IASC) Foundation is to the *IASC Foundation Constitution*, which was approved in its original form by the members of the IASC in May 2000. In 2005, the Trustees of the IASC Foundation completed their first review of the *IASC Foundation Constitution*. In 2010, the IASC Foundation changed its name to the IFRS Foundation.

Should financial reporting standards for SMEs be developed by others?

BCZ8 The IASB considered whether financial reporting standards for SMEs would best be developed by others—either globally, country by country, or perhaps at a regional level—while the IASB focused its efforts primarily on standards for entities that participate in public capital markets. However, the IASB noted that its mission, as set out in the IASC Foundation's *Constitution* (see paragraph BC4), is not restricted to standards for entities that participate in public capital markets. Focusing only on those entities is likely to result in standards or practices for other entities (which are over 99 per cent of all entities in virtually all jurisdictions) that may not address the needs of external users of financial statements, are not consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements*[2] or standards, may lack comparability across national boundaries or within a country, and may not allow for an easy transition to full IFRS Accounting Standards for entities that wish to enter the public capital markets. For those reasons, the IASB decided to undertake the project.

Do national standard-setters support the IASB developing a standard for SMEs?

BC9 During the development of the first edition of the Standard, feedback from national accounting standard-setters indicated they supported the IASB developing a global financial reporting standard for SMEs.

Is developing a standard for SMEs consistent with the IASB's mission?

BC10 Developing a standard for SMEs is consistent with the IASB's mission. The principal objective of the IASB, as set out in the *Constitution* of the IFRS Foundation, is:

> to develop, in the public interest, high-quality, understandable, enforceable and globally accepted standards… for general purpose financial reporting based on clearly articulated principles… to result in the provision of high-quality, transparent and comparable information in financial statements… that is useful to investors and other participants in the world's capital markets in making economic decisions.

BC11 The circumstances of SMEs can differ from those of larger, publicly accountable entities in several respects, including:

(a) the users of the entity's financial statements and their information needs;

(b) the ways in which the financial statements are used by those users;

(c) the depth and breadth of accounting expertise available to the entity; and

(d) SMEs' ability to bear the costs of following the same standards as larger, publicly accountable entities.

Existing IFRS Accounting Standards include some differences for non-public entities

BCZ12 IFRS Accounting Standards include several differences for entities whose securities are not publicly traded. For example:

(a) IFRS 8 *Operating Segments* requires disclosure of segment information only by entities whose debt or equity instruments are traded or registered for trading in a public market.

(b) IFRS 10 *Consolidated Financial Statements* exempts some parent entities from preparing consolidated financial statements if (i) the parent itself is a subsidiary of an IFRS parent and (ii) its debt or equity instruments are not traded in a public market. Similar exemptions are in IAS 28 *Investments in Associates and Joint Ventures*.

(c) IAS 33 *Earnings per Share* requires presentation of earnings per share data only by entities whose ordinary shares or potential ordinary shares are publicly traded.

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2 The IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001 and in effect when the IASB developed the first edition of the *IFRS for SMEs* Accounting Standard. In 2010 the IASB replaced this document with the *Conceptual Framework for Financial Reporting*, which it revised in 2018.

BCZ13 Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRS Accounting Standards than users of financial statements of entities whose securities are registered for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, profit or loss, and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing.

BCZ14 In the IASB's judgement, the nature and degree of the differences between full IFRS Accounting Standards and the *IFRS for SMEs* Accounting Standard must be determined on the basis of users' needs and cost–benefit analyses. In practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements. The related costs may not differ significantly. Therefore, consistently with the *Framework for the Preparation and Presentation of Financial Statements*, the IASB concluded that the cost–benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

Objective of the *IFRS for SMEs* Accounting Standard

BCZ15 The Standard is intended for entities without public accountability that publish general purpose financial statements for external users. The main groups of external users include:

(a) banks that make loans to SMEs;

(b) vendors that sell to SMEs and use SMEs' financial statements to make credit and pricing decisions;

(c) credit rating agencies and others that use SMEs' financial statements to rate SMEs;

(d) customers of SMEs that use SMEs' financial statements to decide whether to do business; and

(e) SMEs' shareholders that are not also managers of their SMEs.

Why determination of taxable income and determination of distributable income are not specific objectives of the *IFRS for SMEs* Accounting Standard

BCZ16 IFRS Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. General purpose financial statements are intended to meet the needs of users that are not in a position to demand reports tailored to their particular information needs. General purpose financial statements provide information about an entity's financial position, performance and cash flows.

BCZ17 Determining taxable income requires special purpose financial statements—ones designed to comply with the tax laws and regulations in a particular jurisdiction. Similarly, an entity's distributable income is defined by the laws and regulations of the country or other jurisdiction in which it is domiciled.

BCZ18 Tax authorities are also often important external users of the financial statements of SMEs. Almost invariably, tax authorities have the power to demand whatever information they need to meet their statutory tax assessment and collection obligations. Tax authorities often look to financial statements as the starting point for determining taxable profit, and some have policies to minimise the adjustments to accounting profit or loss for the purpose of determining taxable profit. Nonetheless, global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the *IFRS for SMEs* Accounting Standard can serve as the starting point for determining taxable profit in a given jurisdiction by means of a reconciliation that is easily developed at a national level.

BCZ19 A similar reconciliation can be developed to adjust profit or loss as measured by the *IFRS for SMEs* Accounting Standard to distributable income under national laws or regulations.

Why it is not the purpose of the *IFRS for SMEs* Accounting Standard to provide information to owner-managers to help them make management decisions

BCZ20 Owner-managers use SMEs' financial statements for many purposes. However, it is not the purpose of the *IFRS for SMEs* Accounting Standard to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. (The same is true for full IFRS Accounting Standards.) Nonetheless, general purpose financial statements will often also serve managers' needs by providing insights into the business's financial position, performance and cash flows.

BCZ21 SMEs often produce financial statements only for the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

Developing the *IFRS for SMEs* Accounting Standard

Initial research

BC22 In 2004 the IASB published the discussion paper *Preliminary Views on Accounting Standards for Small and Medium-Sized Entities* (Discussion Paper) and asked stakeholders to comment on:

(a) whether such standards were necessary;

(b) what the objectives and scope of such standards should be; and

(c) how the IASB should approach selecting topics and prescribing treatment for areas not covered by such standards.

BC23 Following publication of the Discussion Paper the IASB held round-table discussions and issued a recognition and measurement questionnaire. Responses to these consultations showed a clear demand for an International Financial Reporting Standard for SMEs. The IASB was told that in many jurisdictions entities would prefer to adopt such a standard instead of locally or regionally developed standards. Therefore, the IASB decided to publish an exposure draft of an International Financial Reporting Standard for SMEs as the next step.

BC24 The IASB considered the responses to the Discussion Paper and questionnaire to make tentative decisions that were included in the Exposure Draft of the first edition of the *IFRS for SMEs* Accounting Standard published in 2007 (2007 ED). It also considered comments received at round-table discussions, recommendations from the IASB's working group and requirements in national accounting standards for SMEs.

BC25 The 2007 ED was based on full IFRS Accounting Standards with modifications to reflect the needs of users of SMEs' financial statements and cost–benefit considerations. In the IASB's view, full IFRS Accounting Standards were the logical starting point for developing the Standard. The needs of users of SMEs' financial statements are similar in many ways to the needs of users of financial statements of publicly accountable entities.

BC26 An alternative approach would have been to develop the Standard without using full IFRS Accounting Standards or any other existing framework as the starting point. However, the IASB concluded that such an approach would be costly, time-consuming and, ultimately, futile. In the IASB's view, users' needs are similar in many ways, whether they are using the financial statements of entities with or without public accountability.

BC27 The 2007 ED proposed five types of simplifications of full IFRS Accounting Standards:

(a) excluding topics in full IFRS Accounting Standards that the IASB decided were not relevant to typical SMEs. However, for some of those omitted topics, the 2007 ED proposed a fallback. That is, if SMEs encountered circumstances or a transaction dealt with in full IFRS Accounting Standards, but not in the *IFRS for SMEs* Accounting Standard, then those SMEs would be required to follow the relevant full IFRS Accounting Standard.

(b) including only the simpler option in the 2007 ED if an IFRS Accounting Standard allowed an accounting policy choice, but proposing that SMEs be permitted to choose the more complex option by reverting to the relevant full Accounting Standard (see paragraph BC34).

(c) simplifying many of the principles in full IFRS Accounting Standards for recognising and measuring assets, liabilities, income and expenses.

(d) including substantially fewer disclosure requirements (see paragraphs BCZ30–BC31).

(e) redrafting to simplify the language.

BC28 The IASB completed a programme of field testing on the 2007 ED.

BCZ29 The goals of the field testing were:

(a) to assess understandability of the 2007 ED by identifying any parts that field testers found hard to understand;

(b) to assess appropriateness of the scope of topics covered by identifying transactions, events or conditions that the field tester encountered but that were not covered in the draft *IFRS for SMEs* Accounting Standard, and to find out how the field tester made its accounting policy decision, including whether it looked to full IFRS Accounting Standards as a reference;

(c) to assess the burden of applying the draft *IFRS for SMEs* Accounting Standard, for instance, whether information required to apply it was not available or available only with undue cost or effort;

(d) to assess the impact of the proposals by identifying the nature and degree of changes from the field tester's current GAAP or current reporting practices;

(e) to assess accounting policy choices made by the field testers, and why, where the 2007 ED would allow choices;

(f) to assess any special problems in applying the draft *IFRS for SMEs* Accounting Standard that arose for field testers that are so-called 'micro entities' (those with fewer than 10 employees) and for field testers in developing economies; and

(g) to assess the adequacy of implementation guidance by identifying where additional guidance would be helpful to the field tester.

Disclosure requirements

BCZ30 The disclosure requirements in the Standard are substantially reduced when compared with the disclosure requirements in full IFRS Accounting Standards. The reasons for the reductions are of four principal types:

(a) some disclosures are not included because they relate to topics covered in full IFRS Accounting Standards that are omitted from the Standard (see paragraph BC73);

(b) some disclosures are not included because they relate to recognition and measurement principles in full IFRS Accounting Standards that have been replaced by simplifications in the Standard;

(c) some disclosures are not included because they relate to options in full IFRS Accounting Standards that are not included in the Standard; and

(d) some disclosures are not included on the basis of users' needs or cost–benefit considerations (see paragraph BC31).

BC31 The IASB was guided by six broad principles when reducing the disclosure requirements in full IFRS Accounting Standards on the basis of users' needs (referred to as the principles for reducing disclosure requirements):

(a) users of SMEs' financial statements are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not they are recognised as liabilities. Disclosures in full IFRS Accounting Standards that provide this sort of information are necessary for SMEs as well.

(b) users of SMEs' financial statements are particularly interested in information about liquidity and solvency. Disclosures in full IFRS Accounting Standards that provide this sort of information are necessary for SMEs as well.

(c) information on measurement uncertainties is important for SMEs.

(d) information about an entity's accounting policy choices is important for SMEs.

(e) disaggregations of amounts presented in SMEs' financial statements are important for an understanding of those statements.

(f) some disclosures required by full IFRS Accounting Standards are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs.

First edition of the *IFRS for SMEs* Accounting Standard

BC32 In 2009 the IASB issued the first edition of the Standard. The Standard was based on the 2007 ED, but included some changes resulting from feedback on the 2007 ED.

BC33 The IASB decided that although the *IFRS for SMEs* Accounting Standard should be a stand-alone document, it would still be based on full IFRS Accounting Standards. This starting point, with which respondents to the 2007 ED agreed, was helpful to both preparers and users, many of whom were already familiar with the concepts underlying full IFRS Accounting Standards. This starting point also influenced the IASB's approach to deciding the extent of the requirements to be included in the Standard. Entities had to be able to prepare financial statements using only the information from the Standard without needing to refer to full IFRS Accounting Standards.

BC34 Having decided that the Standard would be a stand-alone document, the IASB rejected its proposal to restrict accounting policy choices and permit entities seeking other options to use a fallback and refer to full IFRS Accounting Standards (see paragraph BC27(b)). None of the options to revert to full IFRS Accounting Standards proposed in the 2007 ED were included in the first edition of the Standard, except those related to financial instruments (see paragraphs BC11.12–BC11.14). In addition to preventing entities from using a fallback and referring to full IFRS Accounting Standards, the Standard generally restricted accounting policy options so that entities would not have a choice between two or more treatments. This restriction maintained the simplicity of the Standard. Users could understand SMEs' accounting policies more easily than they would otherwise be able to and readily compare SMEs' financial statements.

First comprehensive review and second edition of the Standard

BC35 When the Standard was issued, the IASB stated its intention to undertake an initial comprehensive review of the Standard. The review would enable the IASB to assess entities' experience of implementing the Standard and to consider whether there was a need for any amendments. Jurisdictions did not start using the Standard at the same time; however, by 2010 entities in several jurisdictions had adopted the Standard. Therefore, the IASB decided to begin its initial comprehensive review in 2012.

BC36 The first comprehensive review began with the Request for Information *Comprehensive Review of the IFRS for SMEs* in 2012 (2012 RFI) and was followed by the Exposure Draft *Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities* in 2013 (2013 ED).

BC37 The IASB reviewed feedback on the 2013 ED and redeliberated the issues raised. Three significant changes were made to the *IFRS for SMEs* Accounting Standard for its second edition, which was issued in 2015:

(a) permitting a revaluation model for property, plant and equipment (see paragraphs BCZ17.3–BC17.4);

(b) aligning the main recognition and measurement requirements for deferred income tax with IAS 12 *Income Taxes* (see paragraph BC29.3); and

(c) aligning the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6 *Exploration for and Evaluation of Mineral Resources* (see paragraph BC34.10).

BC38 In the first comprehensive review the IASB decided not to align the Standard with IFRS 3 (2008) *Business Combinations*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 13 *Fair Value Measurement* and IAS 19 (2011) *Employee Benefits*. The IASB decided not to align with these Standards to provide a stable platform for SMEs and because of other factors specific to each of these Standards. The IASB later decided to reconsider alignment with these Standards in the second comprehensive review (see paragraph BC50).

BC39 The IASB stated that, in reviews of the *IFRS for SMEs* Accounting Standard, it would generally not consider new or revised full IFRS Accounting Standards issued after the publication of the related Exposure Draft of proposed amendments to the Standard. The exception to this approach would be if newly issued or revised Accounting Standards responded to an urgent need from SMEs or users of their financial statements. This principle means that the scope of each comprehensive review can be clearly defined. The principle also helps stakeholders understand when the IASB is likely to consider whether to include new or amended full IFRS Accounting Standards in the *IFRS for SMEs* Accounting Standard.

Second comprehensive review and third edition of the Standard

BC40 In 2016 the IASB discussed the timing of the second comprehensive review when it considered whether to perform an interim review of the Standard. The interim review would have considered any new or amended full IFRS Accounting Standards or any urgent issues. The IASB decided not to perform an interim review of the Standard ahead of the second comprehensive review because it did not identify any urgent need to amend the Standard. The IASB also wanted to continue to provide a stable platform for SMEs because many SMEs had only recently started applying the Standard.

BC41 The second comprehensive review began with the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* in 2020 (2020 RFI). The 2020 RFI was followed by the Exposure Draft *Third edition of the IFRS for SMEs Accounting Standard* in 2022 (2022 ED) and the Exposure Draft *Addendum to the Exposure Draft* Third edition of the *IFRS for SMEs* Accounting Standard in 2024 (2024 ED).

Alignment approach

BC42 As described in paragraph BC25, the IASB developed the Standard by using full IFRS Accounting Standards as the starting point. The Standard was based on the *Framework for the Preparation and Presentation of Financial Statements* and the principles and requirements in full IFRS Accounting Standards. These principles and requirements were simplified for SMEs, based on users' needs and cost–benefit considerations. As part of the second comprehensive review, the IASB wanted to understand if it should continue to develop the Standard in this way (referred to as the alignment approach). An alternative approach would have been for the IASB to consider only issues stakeholders raised about the Standard.

BC43 The IASB decided that, subject to further evidence, it should use the alignment approach for the second comprehensive review. Consequently, the IASB treated alignment with full IFRS Accounting Standards as the starting point for developing the 2020 RFI.

BC44 In developing the 2020 RFI, the IASB discussed how it should decide whether and, if so, how the Standard should be aligned with full IFRS Accounting Standards. To help make these decisions, the IASB developed principles that formalised how it applied the alignment approach. The alignment approach used for the second comprehensive review applied three principles:

(a) relevance to SMEs;

(b) simplicity; and

(c) faithful representation.

BC45 In the early stages of the second comprehensive review, the IASB applied the principle of relevance to SMEs by assessing whether the problem resolved by a new or amended requirement in full IFRS Accounting Standards (in the scope of the review) would affect the decisions of users of financial statements prepared in accordance with the Standard. As the review progressed, the IASB refined how it applied the principle of relevance to SMEs. In general, the IASB decided the principle was not met if the new or amended requirement in full IFRS Accounting Standards (in the scope of the review):

(a) would apply only to a small number of SMEs eligible to apply the Standard (for example, the requirements for investment entities in IFRS 10, see paragraph BC9.9);

(b) related to a transaction or other event that occurs infrequently among SMEs (for example, the requirements for reacquired rights in a business combination in IFRS 3 (2008), see paragraph BC19.10).

BC46 The IASB applied the simplicity principle to new or amended requirements in IFRS Accounting Standards that satisfy the relevance to SMEs principle. It then assessed which simplifications would be appropriate. The five main ways of simplifying full IFRS Accounting Standards described in paragraph BC27 remain applicable.

BC47 The principle of faithful representation helped the IASB assess whether financial statements prepared in accordance with the Standard would faithfully represent the substance of economic phenomena in words and numbers. Simplifications that would result in financial statements that do not meet this criterion could damage the quality of information reported to users.

BC48 Respondents to the 2020 RFI generally agreed with the alignment approach and principles while asking the IASB to ensure it considered costs and benefits in deciding what to propose in the 2022 ED.

BC49 The IASB noted that, in applying the principle of relevance to SMEs, the Standard would be amended only if the IASB decided that a new or amended requirement in full IFRS Accounting Standards would benefit users of SMEs' financial statements by affecting their decisions. However, the IASB acknowledged the limited resources of entities preparing financial statements in accordance with the Standard. Therefore, the IASB decided to consider separately the costs and benefits of aligning the Standard with each new or amended requirement in full IFRS Accounting Standards in the scope of the review.

Scope of the second comprehensive review

BC50 In the second comprehensive review, the IASB considered aligning the Standard with:

(a) IFRS Accounting Standards, amendments to IFRS Accounting Standards and IFRIC® Interpretations issued since the first comprehensive review and effective on or before 1 January 2019; and

(b) IFRS Accounting Standards issued before the first comprehensive review that did not result in amendments to the Standard (see paragraph BC38).

BC51 The IASB decided that the scope of the review would also include some amendments to IFRS Accounting Standards that were effective after 1 January 2019 either:

(a) because waiting until the next comprehensive review would unnecessarily delay improving the Standard for preparers and users of SMEs' financial statements; or

(b) because the amendments are linked to new or revised IFRS Accounting Standards, as described in paragraph BC50, and should be considered for alignment alongside those Accounting Standards.

BC52 For similar reasons as those described in paragraph BC51, the IASB decided that the scope of the review would also include the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), which was effective after 1 January 2019.

BC53 In addition to amending the Standard to reflect changes in full IFRS Accounting Standards, the IASB amended the Standard in response to issues stakeholders raised about the Standard.

IFRS 14 *Regulatory Deferral Accounts* and IFRS 16 *Leases*

BC54 The scope of the second comprehensive review included IFRS 14 *Regulatory Deferral Accounts* and IFRS 16 *Leases*.

BC55 IFRS 14 applies to entities whose activities are subject to rate regulation. The IASB decided not to align the *IFRS for SMEs* Accounting Standard with IFRS 14 in the second comprehensive review. Instead, it decided to reconsider whether to include requirements for regulatory assets and regulatory liabilities in a future review of the Standard, after considering the outcome of its project on Rate-regulated Activities.

BC56 IFRS 16 eliminated, for lessees, the classification of leases as either operating leases or finance leases required by IAS 17 *Leases* and introduced a single lessee accounting model. The IASB decided not to align the *IFRS for SMEs* Accounting Standard with IFRS 16 in the second comprehensive review. Instead, it decided to reconsider alignment with IFRS 16 in the next comprehensive review, when it will have more information about entities' experience of applying IFRS 16.

Disclosure requirements

BC57 As part of the second comprehensive review, the IASB assessed new disclosure requirements that had been introduced into full IFRS Accounting Standards. The IASB excluded disclosure requirements from the Standard for the reasons in paragraph BCZ30, and added disclosure requirements to the Standard by applying the principles in paragraph BC31. The IASB also decided that improvements could be made to the existing disclosure requirements in the Standard. The IASB changed disclosure requirements in some sections to improve alignment with the principles in paragraph BC31, even though it had not changed the disclosure requirements in the related IFRS Accounting Standards.

Language simplifications

BC58 The IASB decided, as part of the second comprehensive review, to simplify the language used in the new and revised sections of the *IFRS for SMEs* Accounting Standard. This decision affected Section 2 *Concepts and Pervasive Principles,* Section 12 *Fair Value Measurement*, Section 19 *Business Combinations and Goodwill* and Section 23 *Revenue from Contracts with Customers.* The decision was consistent with the alignment approach and main ways of simplifying full IFRS Accounting Standards described in paragraph BC27. The IASB's intention in simplifying the language was to make the requirements easier to apply. In most instances, the IASB does not expect the simplified language to result in an entity reaching different outcomes compared to those reached by applying full IFRS Accounting Standards. However, in some instances, the simplified language could result in different outcomes compared to those reached by applying full IFRS Accounting Standards. In such instances, the IASB would still expect financial statements prepared in accordance with the Standard to faithfully represent the substance of economic phenomena in words and numbers.

Development of the *IFRS for SMEs* Accounting Standard by section

BC59 This part summarises, by section, the IASB's considerations in developing the *IFRS for SMEs* Accounting Standard.

Section 1 *Small and Medium-sized Entities*

BC1.1 Section 1 *Small and Medium-sized Entities* describes the entities that are intended to apply the Standard, that is, entities without public accountability.

Definition of 'public accountability'

BCZ1.2 In the IASB's judgement, the *IFRS for SMEs* Accounting Standard is appropriate for an entity that does not have public accountability as defined in paragraph 1.3 of the Standard. An entity has public accountability (and, therefore, should use full IFRS Accounting Standards) if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

BCZ1.3 The IASB recognised that, ultimately, decisions on which entities should use the *IFRS for SMEs* Accounting Standard will rest with national regulatory authorities and standard-setters. However, a clear definition of the class of entity for which the Standard is intended is essential so that:

(a) the IASB can decide on the standard that is appropriate for that class of entity; and

(b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs* Accounting Standard.

In that way, jurisdictions will understand that there are some types of entities for which the *IFRS for SMEs* Accounting Standard is not intended.

Entities whose securities are traded in a public market

BCZ1.4 Public securities markets, by their nature, bring together entities that seek capital and investors who are not involved in managing the entity and who are considering whether to provide capital, and at what price. Although those public investors often provide longer-term risk capital, they do not have the power to demand the financial information they might find useful for investment decision-making. They must rely on general purpose financial statements. An entity's decision to enter a public capital market makes it publicly accountable—and it must provide the outside debt and equity investors with a broader range of financial information than may be needed by users of financial statements of entities that obtain capital only from private sources. Governments recognise this public accountability by establishing laws, regulations and regulatory agencies that deal with market regulation and disclosures to investors in public securities markets. The IASB concluded that, regardless of size, entities whose securities are traded in a public market should follow full IFRS Accounting Standards.

Financial institutions

BC1.5 Similarly, a primary business of banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks is often to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in managing the entity. Because such an entity acts in a public fiduciary capacity, it is publicly accountable.

Factors not taken into account in setting the scope of the Standard

BC1.6 The IASB considered other ways of defining entities eligible to apply the Standard, and rejected the idea of boundaries based on:

(a) the nature of the services an entity provides—for example, excluding entities that provide essential public services. The IASB decided that the nature of the users of the financial statements, instead of the nature of the business activity, should determine whether an entity is required to apply full IFRS Accounting Standards.

(b) the economic significance of an entity in its home jurisdiction. The IASB decided that economic significance does not automatically result in public accountability and may be more relevant to matters of political and societal accountability. In the IASB's view, local jurisdictions should decide whether political and societal accountability requires an entity to prepare general purpose financial statements in accordance with full IFRS Accounting Standards.

(c) the size of the entity compared to fixed criteria. At the time the IASB developed the first edition of the Standard, it noted that full IFRS Accounting Standards were used in more than 100 jurisdictions. The IASB concluded that it was not feasible to develop quantified size tests that would be applicable and long-lasting in all of those jurisdictions.

(d) the entity's parent, venturer or investor having public accountability and preparing financial statements in accordance with full IFRS Accounting Standards. The IASB decided that the circumstances of an entity, rather than the circumstances of its parent, venturer or investor, should determine whether it has public accountability.

Suitability of the Standard for micro entities

BCZ1.7 Some contend that it is unrealistic to design a single standard that could be used by all entities without public accountability, because the size range of this group of entities is simply too broad—from very large unlisted entities with hundreds or even several thousand employees down to 'micro-sized' entities with fewer than 10 employees. The IASB did not agree. The *IFRS for SMEs* Accounting Standard is designed for entities, regardless of size, that are required, or elect, to publish general purpose financial statements for external users. External users such as lenders, vendors, customers, rating agencies and employees need specific types of information but are not in a position to demand reports tailored to meet their particular information needs. They must rely on general purpose financial statements. This is as true for 'micros' as it is for larger SMEs. Financial statements prepared using the *IFRS for SMEs* Accounting Standard are intended to meet those needs.

BCZ1.8 Some who question whether the *IFRS for SMEs* Accounting Standard will be suitable for micros argue that many micro entities prepare financial statements solely to submit to income tax authorities for the purpose of determining taxable income. As explained more fully in paragraphs BCZ17–BCZ19, determining taxable income (and also determining legally distributable income) requires special purpose financial statements—ones designed to comply with tax and other laws and regulations in a particular jurisdiction.

BCZ1.9 Moreover, at the time of developing the first edition of the Standard, the IASB noted that, in many countries, full IFRS Accounting Standards are required for all or most limited liability companies, including the micros. The IASB also noted that many other countries permit the micros to use full IFRS Accounting Standards. At the time of developing the first edition of the Standard, the IASB was aware of research that shows that over 80 jurisdictions have decided that full IFRS Accounting Standards should be required or permitted for all or most entities, including micros. If full IFRS Accounting Standards have been judged suitable for all entities, then the *IFRS for SMEs* Accounting Standard will surely not be burdensome. The guidance in the *IFRS for SMEs* Accounting Standard is clear and concise. That guidance may cover some transactions or circumstances that micro SMEs do not typically encounter, but the IASB did not believe that this imposes a burden on micro SMEs. The topical organisation of the *IFRS for SMEs* Accounting Standard will make it easy for micro SMEs to identify those aspects of the Standard that are relevant to their circumstances.

BCZ1.10 Some favour a very simple and brief set of accounting requirements for micro SMEs—with broad principles of accrual basis accounting (some even suggest a cash basis or modified cash basis), specific recognition and measurement principles for only the most basic transactions, and requiring perhaps only a balance sheet and an income statement with limited note disclosures. The IASB acknowledged that this approach might result in relatively low costs to SMEs in preparing financial statements. However, the IASB concluded that the resulting statements would not meet the objective of decision-usefulness because they would omit information about the entity's financial position, performance and changes in financial position that is useful to a wide range of users in making economic decisions. Moreover, the IASB believed that financial statements prepared using such a simple and brief set of accounting requirements might not serve SMEs by improving their ability to obtain capital. Therefore, the IASB concluded that it should not develop this type of standard.

BCZ1.11 The IASB does not have the power to require any entity to use its Standards. That is the responsibility of legislators and regulators. In some countries, the government has delegated that power to a separately established independent standard-setter or to the professional accountancy body. They will have to decide which entities should be required or permitted to use, or perhaps prohibited from using, the *IFRS for SMEs* Accounting Standard. The IASB believes that the *IFRS for SMEs* Accounting Standard is suitable for all entities that do not have public accountability, including micros.

Preventing entities with public accountability from using the Standard

BC1.12 Paragraph 1.5 of the Standard prevents publicly accountable entities from stating compliance with the *IFRS for SMEs* Accounting Standard. Feedback on the first comprehensive review led the IASB to consider whether the paragraph is too restrictive. The IASB also considered whether jurisdictions should have the authority to decide whether publicly accountable entities should be able to use, and state compliance with, the Standard.

BCZ1.13 The IASB observed that the *IFRS for SMEs* Accounting Standard was specifically designed for SMEs and users of SME financial statements and so it may not be appropriate for a wider group of entities. Furthermore, the IASB noted that if the scope was widened to include some publicly accountable entities, it may lead to pressure to make changes to the *IFRS for SMEs* Accounting Standard to address issues that may arise from that wider group, which would increase the complexity of the Standard. The IASB also had concerns about the risks associated with the inappropriate use of the *IFRS for SMEs* Accounting Standard if the restriction on publicly accountable entities using the Standard was removed from paragraph 1.5 of the Standard. A majority of IFRS Advisory Council and SME Implementation Group (SMEIG) members shared the IASB's concerns and recommended keeping the requirement in paragraph 1.5 that prevents publicly accountable entities from stating compliance with the *IFRS for SMEs* Accounting Standard.

BCZ1.14 After considering the responses to the 2013 ED, the IASB decided that there was no new information that would lead the IASB to reconsider its previous decision. Consequently, it decided to keep paragraph 1.5 of the Standard. The IASB noted that jurisdictions can already incorporate the Standard into their local GAAP if they wish to allow certain publicly accountable entities to use it. However, those entities would state compliance with local GAAP, not with the Standard.

BC1.15 In the second comprehensive review of the Standard, the IASB discussed some feedback that the scope of the Standard should be widened by relaxing or removing the second criterion for public accountability, set out in paragraph 1.3(b) of the Standard. Some stakeholders said that the Standard would improve the financial reporting of credit unions and smaller financial institutions, especially in developing countries.

BC1.16 The IASB engaged with its consultative groups and national standard-setters to discuss whether to permit exceptions to the definition of 'public accountability' to allow some publicly accountable entities to apply the Standard. Stakeholders agreed with the IASB's view that changes to the scope of the Standard might require other changes that would increase its complexity. Stakeholders also raised concerns about the difficulty of clearly defining the group of entities with public accountability that should be permitted to apply the Standard. In the IASB's view, widening the scope to include a sub-group of financial institutions might lead to pressure to include additional requirements from full IFRS Accounting Standards omitted from the Standard. For example, widening the scope might lead to pressure to include additional requirements from IFRS 9 *Financial Instruments* and IFRS 13 to cater for more complex financial instruments than those used by entities that are not financial institutions, and pressure to include risk disclosure requirements from IFRS 7 *Financial Instruments: Disclosures*. Such additional requirements might include hedge accounting disclosures, and requirements to calculate expected credit losses and disclose credit risk management practices. Therefore, the IASB decided not to widen the scope of the Standard to include some publicly accountable entities.

Clarification of the definition of 'public accountability'

BC1.17 In the first and second comprehensive reviews of the Standard, the IASB received comments that the meaning of 'fiduciary capacity' in the definition of public accountability is unclear because the term does not have the same implications in every jurisdiction. However, respondents generally did not suggest alternative ways of describing public accountability or suggest what guidance would help to clarify the meaning of fiduciary capacity.

BC1.18 The IASB concluded that it would be difficult to provide a definition of fiduciary capacity or develop guidance on the term that could be translated and consistently applied in all jurisdictions that require or permit entities to use the Standard. In the second comprehensive review, the IASB considered other ways to clarify the definition of public accountability. However, feedback suggested that the other possible clarifications the IASB considered were subjective, would raise new questions, and could add complexity to the Standard.

BC1.19 In many jurisdictions in which the Standard is applied, practice is established in applying the Standard's definition of public accountability. Consequently, including a definition of fiduciary capacity in the Standard or otherwise providing guidance on public accountability could have unintended consequences in jurisdictions that have already determined which types of entities have public accountability.

BC1.20 Legal and regulatory requirements and types of entities vary between jurisdictions. Therefore, the IASB took the view that national standard-setters and regulatory authorities might be best placed to identify the types of entities in their jurisdiction that hold assets in a fiduciary capacity for a broad group of outsiders as a primary business. Furthermore, national standard-setters and regulatory authorities ultimately decide which entities use full IFRS Accounting Standards or the *IFRS for SMEs* Accounting Standard.

BC1.21 During the second comprehensive review, the IASB also received comments on the meaning of fiduciary capacity in the definition of public accountability from respondents to the IASB's Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures*. The Exposure Draft set out the IASB's proposal for a new IFRS Accounting Standard that would permit a subsidiary that does not have public accountability to apply reduced disclosure requirements when applying full IFRS Accounting Standards. The proposed description of public accountability was based on the definition of public accountability in paragraph 1.3 of the first edition of the Standard. Paragraph 1.3(b) stated that *most* banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet the second criterion for public accountability (that is, hold assets in a fiduciary capacity for a broad group of outsiders as a primary business).

BC1.22 Some respondents to ED/2021/7 said specifying how often entities hold assets in a fiduciary capacity is unhelpful within the definition of public accountability. The IASB agreed with these respondents and amended paragraph 1.3(b), so the categories of entities listed in the definition are presented as examples of entities that *often* meet the second criterion for public accountability. In developing the amendment, the IASB noted that it intends the change to clarify, and not relax, the criterion.

The term 'small and medium-sized entities'

BCZ1.23 'Small and medium-sized entities' (SMEs) as used by the IASB is defined in Section 1. The term is widely recognised and used around the world, although many jurisdictions have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantitative criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

BC1.24 The IASB considered whether to use another term. Even before publishing the 2007 ED, the IASB had used the term 'non-publicly accountable entity' (NPAE) for several months during 2005. In 2008, during its redeliberations of the proposals in the 2007 ED, the IASB also used both NPAE and 'private entities' for several months and considered the limitations of these terms, specifically:

(a) *non-publicly accountable entities*—because the IASB concluded that full IFRS Accounting Standards are necessary for entities with public accountability, the terms 'publicly accountable entity' and 'non-publicly accountable entity' had some appeal. However, stakeholders argued that this term was not widely recognised, whereas 'small and medium-sized entities' and the acronym 'SMEs' were universally recognised. Some stakeholders also said that non-publicly accountable entities seemed to incorrectly imply that smaller entities were not publicly accountable for anything. Furthermore, the objectives of the IASC Foundation and the IASB as set out in the IASC Foundation's *Constitution* used the term small and medium-sized entities.[3]

(b) *private entities*—the term 'private entities' was commonly used in some jurisdictions, especially in North America, to refer to the kinds of entities that meet the IASB's definition of 'SMEs' (entities without public accountability). In other jurisdictions, however, the term private entities was used much more restrictively to refer only to entities without government ownership. Such use was especially typical in jurisdictions in which government ownership of equity interests in business entities was common. In such jurisdictions, the term private entities would be likely to be misunderstood.

BC1.25 In both the first and second comprehensive reviews, some respondents raised concerns about the name of the Standard being misleading. They observed that, although the Standard's name refers to entities that are small and medium-sized, the Standard does not prescribe size criteria and large non-publicly accountable entities are eligible to use the Standard. Having considered the comments, the IASB decided to retain the name 'IFRS for SMEs' for the Standard, noting that:

(a) the IASB had discussed the alternative names suggested by these respondents when it developed the first edition of the Standard (see paragraph BC1.24);

(b) the name 'IFRS for SMEs' is established as a recognised brand and changes to the name would risk weakening this brand;

(c) it would potentially be confusing to change the name without a change in the scope of the Standard; and

(d) the SMEIG advised that the name has been included in national law in many jurisdictions and changing the name could have other consequences.

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3 This reference to the IASC Foundation's Constitution is to the *IASC Foundation Constitution*, which was approved in its original form by the members of the IASC in May 2000 and in effect when the IASB developed the first edition of the *IFRS for SMEs* Accounting Standard. In 2010, the IASC Foundation changed its name to the IFRS Foundation.

Section 2 *Concepts and Pervasive Principles*

BC2.1 Section 2 *Concepts and Pervasive Principles* describes the objective of financial statements of SMEs and sets out the concepts and basic principles underlying those financial statements. Section 2 was originally based on the 1989 *Framework for the Preparation and Presentation of Financial Statements* (1989 *Framework*). The section was revised in the second comprehensive review to align it with the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), which was issued in 2018.

BC2.2 In developing the revised Section 2, the IASB did not apply the alignment principles because these principles are not directly applicable. Instead, the IASB assessed the costs and benefits of amending the Standard to align it with the *Conceptual Framework*. The status of Section 2 means that preparers refer to the section when developing accounting policies for transactions, events or conditions that the Standard does not specifically address. The IASB decided that revising the section to include a more comprehensive set of concepts and principles will help preparers in such instances, which would improve the information in SMEs' financial statements. Consequently, the IASB concluded that aligning the section with the *Conceptual Framework* would benefit both preparers and users.

Status of Section 2

BC2.3 The *Conceptual Framework* is not an IFRS Accounting Standard, and nothing in the *Conceptual Framework* overrides IFRS Accounting Standards. In contrast, Section 2 is part of the Standard, meaning that it has equal authority to other sections in the Standard. Some respondents to the 2020 RFI and some SMEIG members acknowledged this distinction and expressed concern about potential inconsistencies between the revised Section 2 and other sections in the Standard.

BC2.4 To approach any inconsistencies that might arise between a revised Section 2 and the rest of the Standard, the IASB:

(a) added an override paragraph that states that the requirements in the other sections take precedence over the concepts and principles in the revised Section 2.

(b) decided that revising Section 2 would not automatically lead to changes in other sections of the Standard. However, the IASB made necessary clarifications to some sections.

(c) carried out a review for potential inconsistencies between the revised Section 2 and other sections of the Standard (see paragraphs BC2.5 to BC2.8).

Inconsistencies between the revised Section 2 and other sections of the Standard

BC2.5 In its review for potential inconsistencies, the IASB observed that the revision of Section 2 changed the recognition criteria for assets and liabilities. These changes could have led to inconsistency between the new Section 2 and the definitions in Section 18 *Intangible Assets other than Goodwill* and Section 21 *Provisions and Contingencies*, which rely on the 1989 *Framework* definitions of an asset and a liability.

BC2.6 The IASB decided to take the same approach as it took in full IFRS Accounting Standards to accommodate situations in which inconsistencies exist between the definitions in the *Conceptual Framework* and those in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets*. IAS 37 and IAS 38 include footnotes explaining that the definitions of an asset and a liability were not revised to reflect those in the *Conceptual Framework*. Similarly, the recognition requirements in Sections 18 and 21 continue to rely on the definitions of an asset and a liability from the previous version of Section 2, which were based on the 1989 *Framework*. The requirements include a footnote clarifying that it is only in these situations that the old definitions still apply.

BC2.7 In previous editions of the Standard, Section 2 used the term ‘reliability’ to describe what is referred to broadly as ‘faithful representation’ in the revised Section 2. The term reliability is no longer specified as a qualitative characteristic in the revised Section 2. However, some sections of the Standard use the term reliability with that meaning. The IASB found that it would be difficult to determine if the term reliability was being used in the broader sense of faithful representation or being used in the narrower sense of measurement uncertainty. Therefore, the IASB’s view was that replacing the term reliability with faithful representation could result in unintended consequences. The IASB also noted that it had decided to make no such changes in full IFRS Accounting Standards. Therefore, the IASB did not replace the term reliability with the term faithful representation in the other sections of the Standard, before it has made equivalent amendments to full IFRS Accounting Standards.

BC2.8 The IASB decided not to amend the classification requirements in Section 22 *Liabilities and Equity* when revising Section 2 of the Standard. The IASB noted that in developing the *Conceptual Framework* the IASB, similarly, made no changes to the classification requirements in IAS 32 *Financial Instruments: Presentation* because of its project on Financial Instruments with Characteristics of Equity. That project explored how to distinguish liabilities from equity. The IASB decided it should not amend the Standard before it has made equivalent amendments to full IFRS Accounting Standards.

Undue cost or effort

BC2.9 Section 2 of the first edition of the Standard emphasised the balance between benefits and costs that the IASB considered in developing the requirements. In addition to the IASB’s cost–benefit considerations, the Standard allows an undue cost or effort exemption from requirements in some specific and defined circumstances.

BC2.10 In the first comprehensive review, the IASB noted that some interested parties appeared to have misunderstood the undue cost or effort exemption. These interested parties had mistakenly concluded that the exemption is a general principle that can be applied throughout the Standard. Consequently, the IASB added guidance on applying the undue cost or effort exemption to help to avoid this misconception.

BCZ2.11 The IASB anticipated that the clarifying guidance would help to emphasise two further points:

(a) that the undue cost or effort exemption is not intended to be a low hurdle. This is because an entity is required to carefully weigh the expected effects of applying the exemption on the users of the financial statements against the cost or effort of complying with the related requirement. In particular, the IASB observed that it would expect that if an entity already had, or could easily and inexpensively acquire, the information necessary to comply with a requirement, any related undue cost or effort exemption would not be applicable. This is because, in that case, the benefits to the users of the financial statements of having the information would be expected to exceed any further cost or effort by the entity.

(b) that an entity must make a new assessment of whether a requirement will involve undue cost or effort at each reporting date.

BCZ2.12 Some respondents to the 2013 ED asked for further guidance and/or a definition of undue cost or effort. The IASB decided that it was not appropriate to provide further guidance in the Standard because, ultimately, application of an undue cost or effort exemption depends on an SME’s specific circumstances and on management’s judgement. The IASB also noted that the terms ‘undue cost’ and ‘undue cost or effort’ are used in full IFRS Accounting Standards and it would not be appropriate to define a term under the Standard that is used, but not defined, in full IFRS Accounting Standards. This is because it may be used to interpret requirements in full IFRS Accounting Standards. The IASB observed that the application of an undue cost or effort exemption necessitates consideration of how those that are expected to use the financial statements would be affected if that exemption is taken. Consequently, undue cost or effort would generally be easier to meet for SMEs than for entities with public accountability, because the notion is applied relative to the benefits to users and SMEs are not accountable to public stakeholders.

BC2.13 In response to feedback on the 2013 ED, the IASB decided to require an entity to disclose its reasoning each time it uses an undue cost or effort exemption. In the IASB's view, the disclosure would help to control the use of the exemption and provide useful information to users of SMEs' financial statements at little cost to SMEs. As an exception to the requirement, an entity is not required to disclose their reasoning for using the undue cost or effort exemption from separately recognising intangible assets acquired in a business combination (see paragraph 19.16 of the Standard). The IASB provided this exception because an entity is required to disclose a qualitative description of the factors that make up any goodwill recognised in a business combination. The IASB thought the disclosure about the goodwill recognised would provide more useful information than an entity's reasons for using the undue cost or effort exemption.

BC2.14 In the second comprehensive review, the IASB asked if it should retain the concept of 'undue cost or effort' even though the concept is not in the *Conceptual Framework*. Respondents and the SMEIG agreed with retaining the concept because it helps to balance the costs and benefits of the requirements in the Standard. Therefore, the IASB retained the concept of 'undue cost or effort' unchanged in the revised Section 2. SMEs that use the exemption will continue to be required to provide disclosures about how and why it has been applied.

Section 3 *Financial Statement Presentation*

BC3.1 Section 3 *Financial Statement Presentation* is based on IAS 1 *Presentation of Financial Statements*.[4]

Section 4 *Statement of Financial Position*

BC4.1 Section 4 *Statement of Financial Position* of the Standard is based on IAS 1 *Presentation of Financial Statements*.

Requirements for non-current assets held for sale and discontinued operations

BC4.2 The Standard is not aligned with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The IASB decided during the development of the first edition of the Standard that an accounting result similar to that reached by applying IFRS 5 could be achieved more simply:

(a) by including intention to sell as an indicator of impairment; and

(b) by requiring disclosure if an entity has a binding sale agreement for a major disposal of assets, or a group of assets or liabilities.

BC4.3 In the second comprehensive review, the IASB received requests from some respondents to reconsider its decision to include only disclosure requirements. The IASB took the view that adding presentation requirements based on requirements in IFRS 5 would introduce unnecessary complexity to the Standard.

Section 5 *Statement of Comprehensive Income and Income Statement* and Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*

BC5.1 Section 5 *Statement of Comprehensive Income and Income Statement* and Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings* are based on IAS 1 *Presentation of Financial Statements*.

BC5.2 Section 5 permits an entity to present a single statement of income and retained earnings in place of two separate statements—a statement of comprehensive income and a statement of changes in equity. Specifically, an entity is permitted to present a single statement of income and retained earnings if the only changes to its equity during the periods for which its financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy. No similar option is provided in full IFRS Accounting Standards. In the IASB's view, providing this option for SMEs was a reasonable simplification, based on users' needs and likely costs to smaller entities of preparing two separate statements.

4 In 2024 the IASB issued IFRS 18 *Presentation and Disclosure in Financial Statements*. The IASB will consider in a future review whether to align the *IFRS for SMEs* Accounting Standard with IFRS 18.

BC5.3 In the second comprehensive review, the IASB decided to add a disclosure requirement relating to disaggregating dividends payable between those payable to ordinary shareholders and to preference shareholders. This requirement was based on IAS 1, and the IASB judged that an entity applying the requirement would provide useful information on liquidity and solvency, satisfying one of the principles for reducing disclosure requirements in paragraph BC31.

Section 7 *Statement of Cash Flows*

BC7.1 Section 7 *Statement of Cash Flows* is based on IAS 7 *Statement of Cash Flows*.

Disclosure of changes in liabilities arising from financing activities

BC7.2 In 2016 the IASB issued an amendment to IAS 7 that required an entity to disclose more information about changes in the entity's liabilities arising from financing activities. In the second comprehensive review, the IASB decided to introduce a simplified disclosure requirement based on this amendment. Section 7 requires an SME to disclose a reconciliation between the opening and closing balances of liabilities in the statement of financial position arising from financing activities.

BC7.3 The IASB simplified the disclosure requirement by omitting the disclosure objective in IAS 7 that requires an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. Omitting this disclosure objective from the Standard means that an entity is not required to apply judgement in deciding how to disclose information about changes in liabilities arising from financing activities.

BC7.4 Some respondents to the 2022 ED expressed concerns about the difficulty for SMEs of preparing a reconciliation between the opening and closing balances of liabilities arising from financing activities and that the reconciliation would provide limited benefits for users. However, the IASB noted that including the reconciliation requirement in Section 7 was supported by feedback from users of SMEs' financial statements and consistent with the principles for reducing disclosure requirements in paragraph BC31.

Supplier finance arrangements

BC7.5 In 2023 the IASB issued *Supplier Finance Arrangements*, which amended IAS 7 and IFRS 7 to require an entity to provide disclosures about its supplier finance arrangements. Feedback from the SMEIG was that disclosures about supplier finance arrangements are relevant to SMEs because they are used by a broad range of SMEs and not concentrated in one industry. The IASB also noted that the disclosures in IAS 7 would provide useful information to users of SMEs' financial statements about an SME's short-term cash flows and obligations. Consequently, the IASB amended the scope of the second comprehensive review and published the Exposure Draft *Addendum to the Exposure Draft* Third edition of the *IFRS for SMEs* Accounting Standard in 2024 (2024 ED). The 2024 ED proposed introducing simplified disclosure requirements based on the amendments to IAS 7. The proposals were finalised in the third edition of the Standard.

BC7.6 IAS 7 requires an entity to disclose the terms and conditions of its supplier finance arrangements and includes examples of such terms and conditions. The IASB simplified this requirement in Section 7 by requiring an SME to disclose the key terms and conditions of its supplier finance arrangements and adding to the examples of terms and conditions.

BC7.7 IAS 7 also requires an entity to disclose the carrying amounts of financial liabilities that have been already settled by finance providers. Respondents to the 2024 ED suggested that most SMEs with supplier finance arrangements would need to obtain this information from the finance providers, but that some SMEs might not have the practical ability to do so. To respond to this scenario, the IASB decided an SME would disclose the carrying amounts of financial liabilities that have been already settled by finance providers unless it is impracticable to do so. In the IASB's view, including this exemption would alleviate some of the concerns about the disclosure requirement.

Section 8 *Notes to the Financial Statements*

BC8.1 Section 8 *Notes to the Financial Statements* is based on IAS 1 *Presentation of Financial Statements*.

BC8.2 In the second comprehensive review, the IASB amended paragraph 8.6 of the Standard to add examples of judgements an entity might disclose in accordance with that paragraph. The addition of the examples was intended to make the disclosure requirements about judgements easier to apply and to improve information about judgements in entities' financial statements.

Section 9 *Consolidated and Separate Financial Statements*

BC9.1 In the first edition of the Standard, Section 9 *Consolidated and Separate Financial Statements* was based on IAS 27 *Separate Financial Statements* and included guidance for special purpose entities based on SIC-12 *Consolidation—Special Purpose Entities*. The section was updated in the second comprehensive review to be based on IFRS 10 *Consolidated Financial Statements*, which was issued in 2011.

Definition of 'control'

BC9.2 In the second comprehensive review, the IASB revised the definition of 'control' in Section 9 to make it the same as the definition introduced in IFRS 10.

BC9.3 IFRS 10 sets out a single consolidation model based on the definition of control that applies to all investees. The IASB introduced the model to improve the consistency of consolidation decisions made by entities. The IASB decided introducing a similar model in Section 9 would result in similar improvements to consolidation decisions made by SMEs.

BC9.4 The post-implementation review of IFRS 10 was carried out simultaneously with the second comprehensive review of the Standard. Respondents to the post-implementation review of IFRS 10 said that, sometimes, applying IFRS 10 can involve the use of a significant amount of judgement. The IASB noted that the judgement required to apply IFRS 10 depends on the complexity of the transaction. An SME is not expected to engage in very complex transactions. Therefore, in most situations, applying the revised definition of control is not expected to involve the use of a significant amount of judgement for SMEs.

BC9.5 Section 9 includes a rebuttable presumption that control exists if the parent entity owns, directly or indirectly through subsidiaries, a majority of the voting rights of an entity. The rebuttable presumption was introduced as a simplification in the first edition of the Standard and retained in the second comprehensive review to ease application of the control model.

BC9.6 A few respondents to the 2022 ED suggested that an entity should be required to disclose if it has applied the rebuttable presumption. In the IASB's view, situations in which such a disclosure provides useful information are those in which determining whether control exists has a significant effect on the amounts recognised in an entity's financial statements. In those situations, an entity would disclose the judgements management has made in determining whether control exists, in accordance with paragraph 8.6 of the Standard, which requires information about judgements that have the most significant effect on the amounts recognised in the financial statements. Therefore, the IASB concluded that it is unnecessary to add such a disclosure requirement to Section 9 of the Standard. For similar reasons, the IASB also deleted the requirement in Section 9 for an entity to disclose the basis for concluding that control exists when a parent entity does not own, directly or indirectly through subsidiaries, more than half of the voting power of an entity.

Reporting date

BC9.7 IFRS 10 includes requirements on how to prepare consolidated financial statements if group entities have different reporting dates from each other. IFRS 10 permits an entity to prepare consolidated financial statements if the difference between the reporting date of the subsidiary and the parent is no more than three months and is consistent for each period. In the first comprehensive review, the IASB amended Section 9 to include similar requirements, but without the three-month restriction.

Loss of control

BC9.8 IFRS 10 requires an entity to measure its retained interest in a former subsidiary at fair value at the date control is lost, with any resulting gain or loss recognised in profit or loss. In the second comprehensive review of the Standard, the IASB added similar requirements to Section 9. The IASB added these requirements to make Section 9 consistent with the requirements in Section 19 for an acquisition achieved in stages (step acquisitions). Measuring the investment at fair value reflects the IASB's view that losing control of a subsidiary is a significant economic event.

Investment entities

BC9.9 IFRS 10 requires an investment entity to measure an investment in a subsidiary at fair value through profit or loss and not consolidate such a subsidiary. In the second comprehensive review, the IASB decided the requirements were not relevant to SMEs and therefore omitted the requirements from the Standard. The requirements were considered not to be relevant to SMEs because, given the scope of the Standard, few entities eligible to apply the Standard would meet the definition of an 'investment entity' in IFRS 10.

Section 10 *Accounting Policies, Estimates and Errors*

BC10.1 Section 10 *Accounting Policies, Estimates and Errors* is based on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, with some simplifications.[5]

Developing accounting policies

BC10.2 Section 10 includes requirements for entities that develop accounting policies for topics not covered in the Standard (see paragraphs BC73–BC74). An entity that develops accounting policies for these topics is permitted, but not required, to consider the requirements and guidance in full IFRS Accounting Standards dealing with similar and related issues. Not requiring entities to refer to full IFRS Accounting Standards is consistent with the Standard being a stand-alone document.

Third statement of financial position

BC10.3 IAS 1 requires an entity that applies an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items to present a statement of financial position as at the beginning of the earliest comparative period. The IASB decided not to include this requirement in Section 10. This simplification is based on users' needs and the likely costs for smaller entities if the requirement had been included.

Section 11 *Financial Instruments*

BC11.1 The requirements for financial instruments in the first edition of the Standard were based on IAS 39 *Financial Instruments: Recognition and Measurement*. In 2014, the IASB issued IFRS 9 *Financial Instruments*, completing its project to replace IAS 39. In the second comprehensive review the IASB considered whether to amend the section to be based on IFRS 9. The disclosure requirements for financial instruments in the section are based on IFRS 7 *Financial Instruments: Disclosures*.

BC11.2 When the *IFRS for SMEs* Accounting Standard was first issued, the requirements for financial instruments were in two sections (Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instrument Issues*). In the second comprehensive review, the IASB decided to combine Sections 11 and 12 into a single section renamed Section 11 *Financial Instruments*. Combining the sections allowed the fair value measurement and disclosure requirements to be included in a single section renamed Section 12 *Fair Value Measurement* (see paragraphs BC12.1–BC12.5). The requirements that had, in the first edition of the Standard, been included in Section 11 are included in Part I of the revised Section 11 and the requirements that had been included in Section 12 are included in Part II of the revised Section 11.

BC11.3 Topics for which requirements for financial instruments in Section 11 are simplified compared with either IAS 39 or IFRS 9 include:

(a) *classification and measurement*—financial instruments that meet specified conditions are measured at cost or amortised cost, and all others are measured at fair value through profit or loss. In addition, debt instruments are measured at amortised cost if they meet a supplementary principle based on IFRS 9, as discussed in paragraphs BC11.5–BC11.8.

(b) *derecognition*—Section 11 establishes a simple principle for derecognition. That principle does not align with the derecognition requirements in IAS 39 or IFRS 9, which are complex and relate to derecognition transactions that SMEs do not typically engage in.

[5] When issuing IFRS 18, the IASB revised the title of IAS 8 from *Accounting Policies, Changes in Accounting Estimates and Errors* to *Basis of Preparation of Financial Statements*. The IASB will consider the amendments to IAS 8 as part of a future review of the *IFRS for SMEs* Accounting Standard.

(c) *hedge accounting*—Section 11 includes requirements for the types of hedging that SMEs are likely to use, as discussed in paragraphs BC11.15–BCZ11.18.

(d) *derivative financial instruments*—Section 11 does not require separate accounting for 'embedded derivatives'. However, non-financial contracts that include an embedded derivative with economic characteristics not closely related to the host contract are accounted for in their entirety at fair value (see paragraph BCZ11.4).

BCZ11.4 Contracts to buy, sell, lease or insure a non-financial item such as a commodity, inventory, property, plant or equipment are accounted for as financial instruments within the scope of Part II of Section 11 if they could result in a loss to the buyer, seller, lessor, lessee or insured party as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties. Such contracts are accounted for as financial instruments because their terms include a financial risk component that alters the settlement amount of the contract that is unrelated to the purchase or sale of, or leasing or insuring, the non-financial item.

Classifying and measuring financial instruments

BC11.5 IFRS 9 applies a principle-based approach to classifying financial assets based on the contractual cash flow characteristics of the financial asset and the business model for managing the financial asset.

BC11.6 Section 11 provides a list of examples of basic financial instruments. The section also sets out the conditions a debt instrument is required to satisfy to be classified as a basic financial instrument and, therefore, be measured at amortised cost. In the second comprehensive review, the IASB supplemented the list of examples with a principle based on the contractual cash flow characteristics of a debt instrument (see paragraph 11.9ZA of the Standard). The IASB observed that supplementing the list of examples in Section 11 with such a principle would provide an entity with a clear rationale for classifying debt instruments and measuring them either at amortised cost or at fair value. Therefore, the principle would assist entities in making a judgement if a debt instrument does not match the characteristics in any of the examples.

BC11.7 In supplementing the list of examples in Section 11 with this principle, the IASB simplified the classification and measurement requirements for financial assets from IFRS 9 by excluding the requirement for an entity to determine how to classify and measure financial assets on the basis of the entity's business model for managing the financial asset. The IASB took the view that excluding the business model assessment would not impede faithful representation because SMEs do not usually hold debt instruments under more than one business model. Consequently, excluding the business model assessment is unlikely to significantly affect how entities applying the Standard classify their debt instrument.

BC11.8 The IASB also clarified that an entity is not required to reassess how a financial instrument is classified. This requirement is aligned with the reclassification requirements in IFRS 9, but is simplified for consistency with:

(a) the derecognition requirements in Section 11; and

(b) the IASB's decision not to introduce requirements for SMEs to determine how to classify financial assets on the basis of their business model (see paragraph BC11.7).

BC11.9 The requirements in Part I of Section 11 for measuring financial instruments require entities to determine if an arrangement constitutes a financing transaction (see paragraph 11.13 of the Standard). The IASB received feedback in the first comprehensive review that some entities were unsure how to determine whether a transaction constituted a financing transaction. The IASB amended the Standard to clarify that, when applying paragraph 11.13, an entity must consider whether an arrangement constitutes a financing transaction for the purposes of the Standard for either itself or the counterparty. In other words, the entity must consider both financial assets and financial liabilities.

BC11.10 IAS 39 included an option for entities to measure financial liabilities at fair value through profit or loss instead of amortised cost ('the fair value option'). IFRS 9 introduced requirements for entities that have chosen to use the fair value option to present changes in the fair value attributable to changes in a financial liability's own credit risk in other comprehensive income instead of in profit or loss. Similar requirements were not introduced in Section 11 because it does not include the fair value option and, therefore, the requirements would not be applicable to SMEs applying Section 11.

BC11.11 IFRS 9 also introduced an option for entities to irrevocably elect to present changes in the fair value of some equity instruments in other comprehensive income instead of in profit or loss. The IASB decided not to introduce a similar accounting policy option into Section 11 because such an option would add complexity to the Standard (see paragraph BC34).

Using recognition and measurement requirements in full IFRS Accounting Standards for financial instruments

BC11.12 When the *IFRS for SMEs* Accounting Standard was first issued, SMEs could choose to apply either:

(a) the requirements for financial instruments in the *IFRS for SMEs* Accounting Standard; or

(b) the recognition and measurement requirements in IAS 39 and the disclosure requirements for financial instruments in the *IFRS for SMEs* Accounting Standard.

BC11.13 The option to apply the recognition and measurement requirements in IAS 39 was the only option in the Standard that permitted SMEs to apply the requirements in full IFRS Accounting Standards (that is, the fallback to full IFRS Accounting Standards). The IASB's main reason for permitting the option was to give SMEs the same accounting policy options as those permitted in IAS 39, pending completion of the IASB's project to replace IAS 39 with IFRS 9.

BC11.14 Feedback on the second comprehensive review suggested SMEs did not use the option to apply the recognition and measurement requirements in IAS 39. Therefore, the IASB removed the option from the *IFRS for SMEs* Accounting Standard. Having considered aligning the Standard with IFRS 9, the IASB did not introduce a new option that permitted SMEs to apply the recognition and measurement requirements in IFRS 9. The IASB's decisions to remove and not to replace the option meant the third edition of the Standard was a stand-alone document.

Hedge accounting

BC11.15 IFRS 9 introduced new requirements that resulted in changes to the hedge accounting requirements in full IFRS Accounting Standards. Part II of Section 11 sets out requirements for the types of hedging transactions an SME is likely to use to manage risks. In the second comprehensive review, the IASB decided not to amend the requirements in the Standard for the hedging requirements in IFRS 9. The improvements introduced by IFRS 9 would generally not be relevant to SMEs because SMEs do not usually undertake the types of hedging for which IFRS 9 added requirements.

BCZ11.16 Section 11 focuses on the types of hedging that SMEs are likely to do, specifically hedges of:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction;

(c) price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell a commodity; and

(d) foreign exchange risk in a net investment in a foreign operation.

BCZ11.17 With regard to hedge accounting, Section 11 requires periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period, and hedge accounting is discontinued prospectively starting from that point, for hedges that no longer meet the conditions for hedge accounting. IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met—a requirement that SMEs said they find burdensome.

BCZ11.18 Section 11 also differs from IAS 39 with respect to hedge accounting in the following ways:

(a) hedge accounting cannot be achieved by using debt instruments ('cash instruments') as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk.

(b) hedge accounting is not permitted with an option-based hedging strategy. Because hedging with options involves incurring a cost, SMEs are more likely to use forward contracts as hedging instruments than options.

(c) hedge accounting for portfolios is not permitted. Hedging portfolios adds considerable accounting complexity because of the need to remeasure all of the hedged items individually at fair value to ensure that the appropriate amounts are derecognised when the instrument is sold and to ensure that the amortisation is appropriate when an instrument is no longer being hedged.

The simplification in (a) is appropriate since hedge accounting would not have a significant effect on the financial statements because of the offsetting effects of the accounting for a foreign currency debt instrument under Section 11 and the recognition of exchange differences on most monetary items in profit or loss under Section 30 *Foreign Currency Translation*. In addition, the IASB does not believe that the simplifications in (b) and (c) will affect SMEs adversely because these are not hedging strategies that are typical of SMEs.

Impairment of financial assets

BC11.19 The requirements for recognising and measuring impairment of financial assets measured at cost or amortised cost in the Standard are based on IAS 39. The impairment model in IAS 39 and Section 11 is an incurred loss model. IFRS 9 introduced an expected credit loss model to respond to criticisms of the model in IAS 39, including that IAS 39 overstated interest revenue in periods before a credit loss event occurs and delayed the recognition of credit losses.

BC11.20 In the second comprehensive review, the IASB decided not to update the requirements for impairment of financial assets in the Standard for an expected credit loss model based on IFRS 9. The IASB's decision was based on feedback on its proposals to introduce an expected credit loss model based on the simplified model in IFRS 9, and the results of field testing with accounting practitioners and users of SMEs' financial statements.

BC11.21 The scope of the Standard excludes any entity that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. In the IASB's view, this restricted scope means that entities that provide financing to customers as one of their primary businesses are generally not expected to be able to apply the Standard and, therefore, SMEs applying the Standard are unlikely to have significant exposure to credit risk. Instead, SMEs in the scope of the Standard are likely to hold only short-term, non-interest-bearing financial assets—specifically, trade receivables.

BC11.22 As a consequence of the Standard's scope, the IASB reasoned that the problem resolved by the expected credit loss model would affect the decisions of users of only a small number of SMEs' financial statements prepared in accordance with the Standard. Feedback also suggested that for SMEs holding only trade receivables, moving to an expected credit loss model would have been likely to involve substantial implementation costs. Furthermore, the model would have been unlikely to provide a substantial change in impairment information or benefits for users of those SMEs' financial statements. Based on this assessment of relevance and the costs and benefits of introducing an expected credit loss model, the IASB decided to retain the incurred loss model in Section 11.

BC11.23 Alongside its decision to retain the incurred loss model in Section 11, the IASB added a requirement for SMEs to disclose an analysis of the age of financial assets measured at amortised cost by reference to due date. IFRS 7 required entities to disclose a similar analysis before the introduction of the expected credit loss model. In the IASB's view, the analysis will provide useful information to users of SMEs' financial statements about an SME's exposure to credit risk and expected cash flows. The IASB does not expect the analysis to be costly for SMEs to prepare because a similar analysis would be expected to be provided by most SMEs' reporting systems or prepared for the purpose of managing receivables.

Issued financial guarantee contracts

BC11.24 Section 11 requires SMEs to account for intragroup financial guarantee contracts issued at nil consideration in accordance with Section 21. The IASB introduced these requirements in the second comprehensive review. The second edition of the Standard did not include any specific requirements for financial guarantee contracts. Consequently, SMEs would have accounted for these contracts as financial instruments and measured them at fair value through profit or loss, as set out in guidance published by the SMEIG in Q&A 2017/12.1 *Accounting for financial guarantee contracts in individual or separate financial statements of issuer*.

BC11.25 The IASB introduced requirements for intragroup financial guarantee contracts issued at nil consideration in response to feedback that:

(a) most financial guarantee contracts issued by SMEs are intragroup financial guarantee contracts; and

(b) the fair value of these intragroup financial guarantee contracts can be difficult and subjective to measure, and the costs of recognising these contracts at fair value do not justify the benefits of the fair value information to users of the financial statements.

BC11.26 The IASB also introduced specific disclosure requirements for intragroup financial guarantee contracts issued at nil consideration, which allow users to assess the effect of such guarantees on an entity's credit risk and future cash flows.

BC11.27 Section 21 applies to intragroup financial guarantee contracts issued at nil consideration, and not to other financial guarantee contracts, which are in the scope of Section 11. The IASB observed that if consideration is charged for intragroup financial guarantee contracts, there is likely to be a specific reason for doing so (for example, estimating a fair value amount for tax or legal requirements) and that it would be inappropriate to include such contracts within Section 21.

BC11.28 In a financial guarantee contract issued by a reporting entity, the reporting entity is required to repay a creditor if the other entity defaults (that is, there is a conditional repayment provision). Therefore, a financial guarantee contract does not satisfy the condition in paragraph 11.9(d) of the Standard to be accounted for as a basic financial instrument in accordance with Part I of Section 11. Consequently, financial guarantee contracts not accounted for in accordance with Section 21 are accounted for in accordance with Part II of Section 11.

BC11.29 IFRS 9 introduced requirements for financial guarantee contracts consistent with the expected credit loss model requirements. The IASB decided not to align the *IFRS for SMEs* Accounting Standard with these requirements in the second comprehensive review. Doing so would have been inconsistent with its decision to retain the incurred loss model in Section 11 of the Standard (see paragraphs BC11.19–BC11.23).

Other topics related to financial instruments

BC11.30 In the second comprehensive review, the IASB decided to add a requirement for entities to disclose a maturity analysis for financial liabilities. This requirement was based on IFRS 7, and the IASB judged that it would provide useful information about an entity's liquidity and solvency and expected cash flows, satisfying the principles for reducing disclosure requirements in paragraph BC31.

BC11.31 In the second comprehensive review, the IASB consulted the SMEIG and, based on its advice, decided to take no action on the amendments to full IFRS Accounting Standards relating to interest rate benchmark reform. The IASB made this decision because in many jurisdictions the reforms of interest rate benchmarks resulting from the Financial Stability Board's recommendations in 2014 were near completion, meaning any reliefs were unlikely to be helpful for SMEs and could lead to unnecessary complexity.

Section 12 *Fair Value Measurement*

BC12.1 Section 12 *Fair Value Measurement* of the Standard was introduced as part of the second comprehensive review and is based on IFRS 13 *Fair Value Measurement*. The definition of 'fair value' in the Standard is the same as the definition in IFRS 13 and the principles of the fair value hierarchy in IFRS 13 are included in Section 12.

Fair value definition and hierarchy

BC12.2 The IASB issued IFRS 13 in 2011. IFRS 13 defines fair value and provides a single source of fair value measurement requirements, providing a clear framework for measuring fair value and enhanced disclosure requirements about fair value measurements. The IASB completed its post-implementation review of IFRS 13 in 2018 and concluded that IFRS 13 is working as intended.

BC12.3 The definition of fair value and the requirements in IFRS 13 are clearer and more comprehensive than the definition of fair value and the requirements that had been in the second edition of the Standard. Consequently, the IASB concluded that aligning the Standard with IFRS 13 would lead to greater clarity and consistency when SMEs estimate fair values. The amendments improve the information provided to users of SMEs' financial statements and make the Standard simpler to apply.

BC12.4 In the second edition of the Standard, the requirements for measuring fair value were included in the section on basic financial instruments. Other sections of the Standard that require or permit the use of fair value either referred to that section or included requirements about fair value measurement specific to the assets and liabilities an entity is required to measure at fair value. The disclosure requirements related to how fair value was measured were also included in several sections of the Standard. When the IASB introduced Section 12, it decided to include the requirements for measuring fair value (and related disclosure requirements) in that section.

BC12.5 Share-based payment transactions within the scope of Section 26 *Share-based Payment* use the term 'fair value' with a meaning that differs in some respects from the definition of fair value in Section 12. Consequently, SMEs applying Section 26 measure fair value in accordance with this section, not Section 12.

Section 13 *Inventories*

BC13.1 Section 13 *Inventories* is based on IAS 2 *Inventories*.

Section 14 *Investments in Associates*

BC14.1 Section 14 *Investments in Associates* is based on IAS 28 *Investments in Associates and Joint Ventures*.

Cost and fair value methods for associates and jointly controlled entities

BC14.2 IAS 28 requires an entity to account for its investments in associates and joint ventures using the equity method, unless specified otherwise. When the IASB was developing the first edition of the Standard, many preparers of SMEs' financial statements questioned the usefulness of the equity method. These preparers told the IASB that SMEs find it difficult to apply the equity method because of an inability to obtain the required information and the need to conform to accounting policies and reporting dates. The cost method is permitted under IAS 27 in accounting for investments in associates and joint ventures in the investor's separate financial statements. In these preparers' view, the cost method should also be permitted under the *IFRS for SMEs* Accounting Standard in the investor's consolidated financial statements. Lenders generally indicated that information reported using the equity method is of limited use to them because it is not useful in assessing either future cash flows or loan security. Fair values are more relevant for those purposes. The IASB recognised the special problems of SMEs in applying the equity method and the relevance of fair values for lenders. It concluded that SMEs should be permitted to use, in both their consolidated and separate financial statements, either the equity method, the cost method, or fair value through profit or loss.

Fair value through profit or loss for associates and jointly controlled entities with published price quotations

BC14.3 IAS 28 does not make an accounting measurement distinction based on whether investments in associates or joint ventures have a published price quotation, and requires an entity to account for such investments using the equity method, unless specified otherwise.

BCZ14.4 Section 14 and Section 15 *Investments in Joint Arrangements* require that any investment in an associate or jointly controlled entity for which there is a published price quotation must be measured at fair value through profit or loss. The IASB's reasons for reaching this decision were:

(a) concerns about measurement reliability are substantially eliminated;

(b) the cost of obtaining a fair valuation is substantially eliminated; and

(c) such fair values are more relevant than cost-based measurements to lenders and other users of SMEs' financial statements.

Section 15 *Joint Arrangements*

BC15.1 In the first edition of the Standard, Section 15 *Investments in Joint Ventures* was based on IAS 31 *Interests in Joint Ventures*. In 2011 the IASB issued IFRS 11 *Joint Arrangements*, which replaced IAS 31.

BC15.2 In the second comprehensive review of the Standard, the IASB decided to align the Standard with some aspects of IFRS 11 as discussed in paragraphs BC15.3–BC15.8.

Definitions

BC15.3 In the second comprehensive review of the Standard, the IASB revised the definition of 'joint control' in Section 15 to make it the same as the definition in IFRS 11. The IASB decided that revising the definition was a necessary consequence of having revised the definition of 'control' in Section 9 to make it the same as the definition in IFRS 10 (see paragraphs BC9.2–BC9.5).

Classification of joint arrangements

BC15.4 Section 15 requires an entity to classify a joint arrangement based on the arrangement's legal form. For this purpose, joint arrangements are grouped into three categories: jointly controlled operations, jointly controlled assets and jointly controlled entities. The requirements are based on IAS 31. IFRS 11 requires an entity to classify a joint arrangement based on the parties' rights and obligation arising from the arrangement. For this purpose, joint arrangements are grouped into two categories: joint operations and joint ventures.

BC15.5 In the second comprehensive review, the IASB received mixed views from respondents on whether to align the classification requirements in Section 15 with those in IFRS 11. Some respondents said retaining the classification requirements in Section 15 would embed an inconsistency with full IFRS Accounting Standards and could confuse users of SMEs' financial statements, especially those familiar with full IFRS Accounting Standards. Other respondents said retaining the classification requirements in Section 15 would avoid increasing the judgement that SMEs would be required to exercise when classifying joint arrangements.

BC15.6 The IASB decided not to align the classification requirements in Section 15 with IFRS 11 because requiring an entity to classify a joint arrangement based on the arrangement's legal form keeps the Standard simple and straightforward to apply. Furthermore, the accounting outcome for jointly controlled assets and jointly controlled operations applying Section 15 is similar to the accounting outcome for joint operations applying IFRS 11. Therefore, retaining the classification requirements in Section 15 would not significantly impede faithful representation.

A party to a jointly controlled operation or a jointly controlled asset (without joint control)

BC15.7 IFRS 11 requires a party that participates in, but does not have joint control of, a jointly controlled operation or a jointly controlled asset to account for its interest according to the classification of that jointly controlled operation or jointly controlled asset. The IASB decided to align Section 15 with this requirement in IFRS 11 in the second comprehensive review. It concluded that this outcome would faithfully represent the party's interest—that is, its rights and obligations arising from the arrangement.

Accounting for jointly controlled entities

BC15.8 Paragraphs BC14.2–BCZ14.4 discuss accounting for investments in jointly controlled entities.

Section 16 *Investment Property*

BC16.1 Section 16 *Investment Property* is aligned with IAS 40 *Investment Property* with reduced accounting policy choices.

BCZ16.2 IAS 40 allows an accounting policy choice of either fair value through profit or loss or a cost-depreciation-impairment model (with some limited exceptions). An entity following the cost-depreciation-impairment model is required to provide supplemental disclosure of the fair value of its investment property. The Standard does not have an accounting policy choice but, rather, the accounting for investment property is driven by circumstances. If an entity knows or can measure the fair value of an item of investment property without undue cost or effort, it must use the fair value through profit or loss model for that investment property. It must use the cost-depreciation-impairment model for other investment property. Unlike IAS 40, the Standard does not require disclosure of the fair values of investment property measured on a cost basis.

BC16.3 A small number of respondents to the second comprehensive review asked the IASB to consider allowing entities an accounting policy choice between a fair value model or a cost model for the subsequent measurement of an investment property. Such an amendment would be consistent with the accounting policy options permitted in IAS 40. However, the IASB decided not to change the subsequent measurement requirements for investment property because allowing such an accounting policy option would add complexity to the Standard (see paragraph BC34).

Section 17 *Property, Plant and Equipment*

BC17.1 Section 17 *Property, Plant and Equipment* is based on IAS 16 *Property, Plant and Equipment*. The section was amended in the first comprehensive review to allow an entity to use the revaluation model for closer alignment with IAS 16.

No annual review of useful life, residual value and depreciation method

BC17.2 The Standard does not require an annual review of the useful life, residual value, and depreciation or amortisation method for property, plant and equipment. Instead, a review is required only if there is an indication that there has been a significant change since the last annual reporting date. IAS 16 requires a review at least at each financial year-end.

Revaluation model for property, plant and equipment

BCZ17.3 During its redeliberations on the 2013 ED, and in the light of the ongoing and widespread concerns raised by respondents, the IASB decided to permit an option for SMEs to revalue property, plant and equipment. Although the IASB thinks that limiting options is important for the reasons given in paragraph BC34, it acknowledges that, based on the responses to the 2012 RFI and the 2013 ED, not allowing a revaluation model for property, plant and equipment appears to be the single biggest impediment to adoption of the *IFRS for SMEs* Accounting Standard in some jurisdictions. The IASB also agreed with those respondents who stated that current value information is potentially more useful than historical cost information. The IASB therefore decided that the benefits of a wider use of the Standard, and hence the potential for global improvements in reporting and consistency, together with the usefulness of the information provided, outweigh the perceived costs to users and preparers of financial statements of adding this option. Furthermore, the IASB noted that the change introduces only an option, not a requirement. Consequently, it does not necessitate a change or additional costs for preparers. The IASB also noted that there was nothing to prevent authorities and standard-setters in individual jurisdictions from requiring all SMEs in their jurisdiction to use only the cost model or only the revaluation model for property, plant and equipment. Such action would not prevent SMEs from stating compliance with the Standard.

BC17.4 Consistent with full IFRS Accounting Standards, the Standard does not generally prescribe how, when or if amounts can be transferred between components of equity. Instead, these decisions are left to the discretion of preparers, subject to the constraints imposed by Section 2. The IASB noted that, in certain circumstances, it may be appropriate to transfer some or all of the accumulated other comprehensive income from the revaluation surplus for property, plant and equipment directly to retained earnings or another component of equity. The IASB also noted that in other circumstances, such transfers may be mandated or prohibited by local legislation. Consequently, consistent with the requirements for other elements of accumulated other comprehensive income, when adding an option to use the revaluation model for property, plant and equipment, the IASB decided not to prescribe how, when or if items of accumulated other comprehensive income should be transferred to other components of equity.

Section 18 *Intangible Assets other than Goodwill*

BC18.1 Section 18 *Intangible Assets other than Goodwill* is based on IAS 38 *Intangible Assets*, with simplifications.

Recognition requirements for development costs

BC18.2 IAS 38 requires an entity to recognise development costs as an asset if the costs meet specified criteria. At the time the first edition of the Standard was issued, feedback suggested that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis. Feedback also suggested that lenders disregard information about recognised development costs in making decisions about lending to SMEs. Therefore, the IASB decided that the Standard would require an entity to recognise all development costs as expenses when incurred.

BC18.3 The IASB reconsidered the simplification of requiring an entity to recognise all development costs as expenses in both the first and second comprehensive reviews because stakeholders raised the matter at the time of each review. The IASB sought views:

(a) on whether the simplification remained appropriate; and

(b) on the costs and benefits of introducing an accounting policy option that would permit an SME to recognise development costs as an asset if the costs met the criteria in IAS 38.

BC18.4 In both comprehensive reviews, most respondents and a majority of SMEIG members agreed with introducing an accounting policy option to recognise development costs as an asset if the costs meet specified criteria. Respondents in the second comprehensive review said that amending the Standard to allow an accounting policy choice would be appropriate because SMEs typically incur more development costs than they did when the Standard was first developed and can assess whether a project is commercially viable on an ongoing basis.

BC18.5 The IASB considered the arguments for introducing an accounting policy option but, on balance, decided not to amend the Standard. Adding an option would increase complexity and reduce comparability among SMEs. Furthermore, the IASB noted in the second comprehensive review that investors have other ways of accessing information about development costs incurred by SMEs. Paragraph BC34 explains the IASB's reasons for restricting accounting policy options.

Amortisation and impairment of intangible assets

BCZ18.6 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the requirement in IAS 36 *Impairment of Assets* for an annual calculation of the recoverable amount of goodwill and other indefinite-lived intangible assets is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill and other indefinite-lived intangible assets only if impairment is indicated. They proposed, further, that the Standard should include a list of indicators of impairment as guidance for SMEs. The IASB agreed with those proposals. Respondents to the 2007 ED supported the IASB's decision on an indicator approach to impairment. Consequently, the Standard establishes an indicator approach and includes a list of indicators based on both internal and external sources of information. In addition, if goodwill cannot be allocated to individual cash-generating units (or groups of cash-generating units) on a non-arbitrary basis, then the Standard provides relief by letting the entity test goodwill for impairment by determining the recoverable amount of the acquired entity in its entirety if the goodwill relates to an acquired entity that has not been integrated. If the goodwill relates to an entity that has been integrated into the group, the recoverable amount of the entire group of entities is tested.

BCZ18.7 In the 2007 ED, the IASB proposed an impairment-only approach to goodwill and other indefinite-lived intangible assets, combined with an indicator trigger for detailed impairment calculations. Many respondents to the 2007 ED disagreed with the proposal not to require amortisation of goodwill. Some respondents acknowledged that amortisation of goodwill and other indefinite-lived intangible assets may not be the most conceptually correct approach. However, from a practical standpoint, they pointed out that many smaller entities will find it difficult to assess impairment as accurately or as promptly as larger or listed entities, meaning the information could be less reliable. Amortisation, particularly if coupled with a relatively short maximum amortisation period, would reduce the circumstances in which an impairment calculation would be triggered. They also pointed out that in the context of SMEs, users of financial statements say they find little, if any, information content in goodwill at all; for example, lenders generally do not lend against goodwill as an asset.

BCZ18.8 After considering the various views expressed, the IASB concluded—for cost–benefit reasons, rather than conceptual reasons—that goodwill and other indefinite-lived intangible assets should be considered to have finite lives. Therefore, such assets should be amortised over their estimated useful lives, with a maximum amortisation period of 10 years. The assets must also be assessed for impairment using the 'indicator approach' in the Standard.

BC18.9 The IASB also decided not to permit a revaluation model for intangible assets.

Useful life of intangible assets

BCZ18.10 The IASB decided to require that if the useful life of goodwill or another intangible asset cannot be established reliably then the useful life shall be estimated by management, but shall not exceed 10 years. Previously, the Standard required that if a reliable estimate could not be made, the useful life would be presumed to be 10 years. The IASB noted that although a default useful life of 10 years is simple, it does not provide users of financial statements with any information about the period over which goodwill or another intangible asset is expected to be available for use. The IASB also noted that requiring management to make a best estimate is unlikely to require additional work, because paragraphs 18.20 and 19.34 of the Standard already require management to assess whether the useful life can be established reliably. Some respondents to the 2013 ED expressed concern about requiring management to estimate the useful life if the useful life cannot be established reliably. The IASB noted that SMEs are required to make best estimates in other sections of the Standard. Consequently, the IASB confirmed its decision to modify the requirements in the Standard.

No annual review of useful life, residual value and amortisation method

BC18.11 The Standard does not require an annual review of the useful life, residual value and amortisation method for intangible assets. Instead, a review is required only if there is an indication that there has been a significant change since the last annual reporting date. IAS 38 requires a review at least at each financial year-end.

Section 19 *Business Combinations and Goodwill*

BC19.1 In the first edition of the Standard, Section 19 *Business Combinations and Goodwill* was based on IFRS 3 (2004) *Business Combinations*, with simplifications.

BC19.2 IFRS 3 (2004) was revised in 2008 to resolve deficiencies in the Standard and to respond to application problems. In 2015 the IASB completed its post-implementation review of IFRS 3 (2008), providing the IASB with additional information about the application of IFRS 3 (2008).

BC19.3 In the second comprehensive review of the Standard, the IASB decided to align Section 19 with some of the requirements introduced by IFRS 3 (2008), with the simplifications discussed in paragraphs BC19.4–BC19.21. Aligning the section with some of the requirements in IFRS 3 (2008) resulted in the IASB making substantial amendments to the section, which meant the section was presented as a revised section in the third edition of the Standard.

Definition of a ‘business’ and a ‘business combination’

BC19.4 *Definition of a Business*, which amended IFRS 3 (2008), clarified the definition of a ‘business’ and how to apply that definition. The IASB decided to make the definition in the *IFRS for SMEs* Accounting Standard the same as the definition in IFRS 3 (2008) because the new definition was clearer than the definition in the first edition of the Standard and would make it easier for preparers to identify transactions within the scope of Section 19. After considering respondent feedback, the IASB also decided to include some of the guidance from IFRS 3 (2008) on applying the definition of a business in Section 19, including:

(a) an optional concentration test for a simplified assessment of whether an acquired set of activities and assets is a business; and

(b) a decision tree that summarises how an entity assesses whether an acquired process is substantive.

The acquisition method of accounting

BC19.5 IFRS 3 (2008) changed the method of accounting for a business combination from the purchase method to the acquisition method. The IASB decided to align Section 19 with the acquisition method because it provides users with more relevant information to assess the initial and subsequent performance of an entity’s investment compared with the purchase method. Consequently, Section 19 changed from requiring an entity to determine cost, then allocate that cost to the assets and liabilities assumed. Instead, an entity is required to recognise and measure assets, liabilities and non-controlling interests, then recognise and measure goodwill.

Identifying the acquirer

BC19.6 IFRS 3 (2008) explains that a new entity formed to effect a business combination is not necessarily the acquirer. The IASB included a similar explanation in Section 19 in response to feedback that SMEs commonly form new entities to effect business combinations.

Recognising and measuring identifiable assets and liabilities

BC19.7 IFRS 3 (2008) requires an entity to recognise, separately from goodwill, identifiable assets acquired and liabilities assumed in a business combination that meet the definitions of assets and liabilities in the *Conceptual Framework*. The IASB aligned Section 19 with the recognition principle in IFRS 3 (2008), including the amendment *Reference to the Conceptual Framework* issued in 2020. However, the IASB simplified the recognition principle by only requiring entities to recognise intangible assets acquired in a business combination if their fair value can be measured reliably without undue cost or effort (see paragraphs BC2.9–BC2.14).

BC19.8 IFRS 3 (2008) introduced new requirements for recognising and measuring identifiable assets acquired and liabilities assumed. The requirements affect the amount at which goodwill is initially recognised and measured.

BC19.9 In applying the simplicity principle, the IASB took into consideration that the Standard requires an entity to amortise goodwill acquired in a business combination over its useful life (see paragraphs BCZ18.6–BCZ18.8) and that this differs from the requirements in IFRS 3. As a consequence, intangible assets acquired in a business combination that are not recognised separately are consumed in goodwill. Therefore, unlike IFRS 3, the allocation of items to intangible assets or goodwill does not affect whether amortisation will be charged. The IASB decided it would not:

(a) change the recognition criteria for recognising an intangible asset acquired in a business combination;

(b) clarify that an assembled workforce is not recognised as an intangible asset; nor

(c) provide additional requirements for reacquired rights.

BC19.10 The IASB's decision not to provide requirements for reacquired rights was supported by advice from SMEIG members, who said that reacquired rights occur infrequently for entities applying the Standard. Therefore, the guidance was not relevant to SMEs because this type of transaction is not prevalent among SMEs.

Measuring non-controlling interests

BC19.11 IFRS 3 (2008) permits an acquirer, at the acquisition date, to measure any non-controlling interest in the acquiree either at fair value or the proportionate share in the recognised amounts of the acquiree's identifiable net assets. Section 19 does not permit an acquirer to measure such interests at fair value.

BC19.12 Some respondents in the second comprehensive review questioned not permitting a choice of measurement basis for non-controlling interests in Section 19, but the IASB decided that permitting a choice would add complexity to the Standard. Furthermore, the simplification is consistent with the IASB's aim to restrict accounting policy choices and permit only the simpler of the options available in full IFRS Accounting Standards (see paragraph BC27(b)).

Recognising contingent liabilities

BC19.13 IFRS 3 (2008) requires an entity to recognise, at the acquisition date, a contingent liability assumed in a business combination if it is a present obligation that arises from a past event and its fair value can be measured reliably. In the first edition of the Standard, Section 19 required SMEs to recognise a provision for a contingent liability assumed in a business combination if its fair value could be measured reliably.

BC19.14 In the second comprehensive review, the IASB aligned the recognition requirements for contingent liabilities assumed in a business combination with IFRS 3 (2008). This alignment included clarifying that an acquirer does not recognise a contingent liability assumed in a business combination that is not a liability. The clarification is consistent with the IASB's decision in paragraph BC19.7 to align the recognition principle in Section 19 for assets acquired and liabilities assumed in a business combination with principles that satisfy the definitions in Section 2 of the Standard.

Contingent consideration

BC19.15 In the first edition of the Standard, Section 19 required an entity to include contingent consideration in the cost of the business combination at the acquisition date if an outflow was probable and could be reliably measured. A change in the estimate of contingent consideration was treated as additional consideration and the cost of the business combination adjusted, amending the amount of goodwill.

BC19.16 IFRS 3 (2008) requires an entity to recognise contingent consideration at acquisition-date fair value and subsequently measure it at fair value at each reporting date, with changes in fair value recognised in profit or loss. Recognising contingent consideration at fair value improves users' ability to understand the cost of the business combination. This recognition approach also results in the amount of goodwill an entity recognises being a more faithful representation of the underlying economics of the business combination than was achieved by applying the approach required by the first edition of the Standard.

BC19.17 In the second comprehensive review, the IASB aligned Section 19 with these requirements. However, the IASB decided to simplify the requirements by permitting an SME to use the undue cost or effort exemption (see paragraphs BC2.9–BC2.14) and provide the related disclosures if measuring contingent consideration at fair value at the acquisition date would involve undue cost or effort.

Acquisition-related costs

BC19.18 IFRS 3 (2008) requires an entity to recognise acquisition-related costs as an expense at the time of the acquisition because they are not part of the consideration transferred between the acquirer and seller of the business combination. In the second comprehensive review, the IASB aligned Section 19 with IFRS 3 (2008), requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition.

BC19.19 Section 19 previously included in the cost of a business combination the costs directly attributable to the business combination. Requiring an entity to recognise acquisition-related costs as an expense simplified the Standard and is expected to result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination than the previous approach did.

Business combinations achieved in stages

BC19.20 IFRS 3 (2008) includes requirements for business combinations achieved in stages. In the second comprehensive review, the IASB introduced requirements for business combinations achieved in stages into Section 19 based on the requirements in IFRS 3 (2008).

BC19.21 In the second comprehensive review, SMEIG members and a few respondents to the 2022 ED had mixed views about whether business combinations achieved in stages are prevalent among SMEs. After considering the feedback, the IASB decided that introducing requirements for business combinations achieved in stages would improve comparability and provide better quality information to users by covering a transaction not addressed by the Standard.

Section 20 *Leases*

BC20.1 Section 20 *Leases* is based on IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease*.

Exception from straight-line basis by lessees for operating leases

BCZ20.2 The *IFRS for SMEs* Accounting Standard does not require a lessee to recognise lease payments under operating leases on a straight-line basis if the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases. That exception to the straight-line basis is not in IAS 17.

Leases with an interest rate variation clause linked to market interest rates

BCZ20.3 The IASB decided that a lease with an interest rate variation clause linked to market interest rates should be included in Section 20 instead of being accounted for at fair value through profit or loss under Part II of Section 11. The IASB noted that such clauses are occasionally found in leases entered into by SMEs. Furthermore, the IASB noted that such an embedded risk would not normally require separate accounting under full IFRS Accounting Standards.

Section 21 *Provisions and Contingencies*

BC21.1 Section 21 *Provisions and Contingencies* is based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. As described in paragraph BC11.24, the Standard was amended in the second comprehensive review to include in the scope of Section 21 intragroup financial guarantee contracts issued at nil consideration.

Section 22 *Liabilities and Equity*

BC22.1 Section 22 *Liabilities and Equity* is based on IAS 32 *Financial Instruments: Presentation*, IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*, IFRIC 17 *Distributions of Non-cash Assets to Owners* and IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*, with simplifications. The section was amended in the first comprehensive review to add further simplifications and in the second comprehensive review to resolve some conflicts with local legislation that arose because of a difference from full IFRS Accounting Standards.

Requirement to offset equity instruments

BC22.2 Paragraph 22.7(a) of the first edition of the Standard required that if an entity issues equity instruments before it receives cash or other resources, it presents the amount receivable as an offset to equity in the statement of financial position, not as an asset. Some feedback on the first and second comprehensive reviews suggested that this paragraph should be removed because:

(a) the requirement sometimes conflicts with local legislation; and

(b) full IFRS Accounting Standards include no similar requirement for equity instruments.

BC22.3 The IASB considered removing paragraph 22.7(a) of the Standard. However, it also observed that it could resolve the conflict with local legislation by providing relief from applying the requirement if local laws or regulations prohibit an offset to equity in the statement of financial position. In the third edition of the Standard, the IASB amended paragraph 22.7(a) to add this relief.

Common control exemptions

BCZ22.4 In response to the concerns raised by respondents to the 2012 RFI, the IASB decided to add exemptions for the following transactions:

(a) *paragraph 22.8 of the Standard*—exemption from determination of the value of equity issued as the fair value of cash or other resources received or receivable for equity instruments issued as part of a business combination under common control. The IASB further decided that the exemption added to paragraph 22.8 should cover equity instruments issued as part of a business combination (including business combinations under common control), because paragraph 19.25 provides specific guidance for the accounting for equity instruments that are issued as part of a business combination within the scope of Section 19.

(b) *paragraph 22.18B of the Standard*—exemption for distributions of non-cash assets that are ultimately controlled by the same parties before and after distribution in line with full IFRS Accounting Standards. The IASB noted that paragraph 22.18 was added to the Standard to incorporate the conclusions in IFRIC 17. The IASB agrees that it was an oversight not to include the scope exclusion in paragraph 5 of IFRIC 17.

BCZ22.5 The IASB noted that paragraph 10.4 of the accounting policy hierarchy in the Standard states that if the Standard does not specifically address a transaction, an entity's management uses its judgement in developing an accounting policy. Paragraph 10.5 states that the entity considers other guidance in the Standard dealing with similar and related issues. Consequently, the IASB observed that by not providing specific requirements for equity instruments issued as part of a business combination of entities or businesses under common control, SMEs would still be able to apply paragraphs 19.25 or 22.8 by analogy. Similarly, SMEs would be permitted to apply paragraph 22.18 by analogy to distributions of non-cash assets that are ultimately controlled by the same parties before and after distribution. However, SMEs would also be able to consider other accounting treatments for those transactions, provided that the accounting treatments chosen are applied consistently and comply with the accounting policy hierarchy in paragraphs 10.4–10.5. The IASB also observed that this would be the case for the types of transactions covered by the exemptions in paragraph 22.15C(a)–(b).

Extinguishing financial liabilities with equity instruments

BC22.6 Section 22 requires an entity that has extinguished its financial liability by issuing equity instruments to measure the equity instruments at fair value if they can be reliably measured without undue cost or effort (see paragraphs BC2.9–BC2.14). This requirement is based on IFRIC 19.

BCZ22.7 The IASB noted that the measurement of unquoted equity instruments is often very difficult for SMEs because it involves substantial judgement and complex calculations. The IASB also observed that it would usually expect that the benefits to users of an SME's financial statements of having fair value information about the SME's equity instruments would not justify the SME spending undue cost or effort to provide the information. Consequently, the IASB decided to include an undue cost or effort exemption from the requirement to measure own equity instruments at fair value in IFRIC 19, but to otherwise align the requirements with IFRIC 19.

Non-cash distributions

BC22.8 Section 22 requires an entity to measure the liability to pay a non-cash distribution at the fair value of the non-cash assets to be distributed, unless the fair value of the assets cannot be measured reliably without undue cost or effort (see paragraphs BC2.9–BC2.14). The IASB added the undue cost or effort exemption in the first comprehensive review.

Section 23 *Revenue from Contracts with Customers*

BC23.1 In the first edition of the Standard, Section 23 *Revenue* was based on IAS 11 *Construction Contracts* and IAS 18 *Revenue*. The section was revised in the second comprehensive review to be based on IFRS 15 *Revenue from Contracts with Customers*, which was issued in 2014 and replaced IAS 11 and IAS 18.

BC23.2 IFRS 15 introduced a more comprehensive and robust model for revenue recognition, measurement and disclosure. This model provides users of financial statements with more useful information about revenue compared with the approach based on IAS 11 and IAS 18. The IASB decided that aligning Section 23 with IFRS 15 would result in similar improvements to how SMEs account for revenue. The IASB aligned Section 23 with IFRS 15 by fully rewriting the section instead of amending it because this was the most straightforward way to reflect the principles of IFRS 15.

BC23.3 The IASB simplified the requirements from IFRS 15 as described in paragraphs BC23.5–BC23.10. The simplifications reflect that SMEs generally have simpler contracts with customers and fewer resources than entities that prepare financial statements in accordance with full IFRS Accounting Standards. The IASB developed the simplifications based on feedback from both those preparing financial statements in accordance with the Standard and with IFRS 15 (including the post-implementation review of IFRS 15). The feedback included the results of field testing the revised Section 23 proposed in the 2022 ED with 31 accounting practitioners from 12 jurisdictions.

BC23.4 The simplifications made to the requirements from IFRS 15 mean that some of the requirements in Section 23 differ from those in IFRS 15. In some instances, these differences could result in SMEs and entities that apply full IFRS Accounting Standards reporting different information about similar contracts with customers. Nonetheless, the IASB still expects that financial statements prepared in accordance with Section 23 will provide useful information to users of SMEs' financial statements.

BC23.5 When possible, Section 23 expresses the principles of IFRS 15 in simple, concise language. Section 23 uses some terms that differ from the language in IFRS 15, but that are consistent with the language used by SMEs when discussing contracts with customers. This simplified language is intended to make the requirements easier for SMEs to understand and apply compared with IFRS 15. The effects of these language differences on how SMEs account for revenue compared with entities that apply full IFRS Accounting Standards will vary.

BC23.6 In most instances, the IASB does not expect the simplified language in Section 23 to result in an entity reaching different outcomes compared to those reached by applying IFRS 15. For example, Section 23 uses the term 'promise' to identify the unit of account for goods and services promised in a contract with a customer, instead of the term 'performance obligation', which is used in IFRS 15. However, in some instances, the simplified language could result in different outcomes compared to those reached by applying IFRS 15. For example, Section 23 expresses the requirement to constrain estimates of variable consideration in relation to consideration to which the entity will become entitled, instead of in relation to revenue reversals that will not occur. SMEs that apply the Standard and entities that apply full IFRS Accounting Standards could recognise different amounts of variable consideration in similar circumstances because the requirements are expressed differently.

BC23.7 The IASB made simplifications to the recognition and measurement requirements in IFRS 15 to limit the amount of judgement and information entities need to apply Section 23. These simplifications include:

(a) *warranties*—no assessment is required of whether a warranty provides a customer with a service in addition to the assurance that a product complies with agreed-upon specifications;

(b) *customer options*—customer options for additional goods or services are accounted for separately only if an entity can do so without undue cost or effort (see paragraphs BC2.9–BC2.14);

(c) *allocation of the transaction price*—a principle, instead of specified criteria, is applied to decide whether a discount or an amount of variable consideration is required to be allocated between the promises in a contract on a stand-alone selling price basis; and

(d) *contract costs*—costs of obtaining a contract are recognised as an expense when incurred.

BC23.8 Section 23 also includes simplifications of the disclosure requirements from IFRS 15 (see paragraph BC57).

BC23.9 Some requirements in IFRS 15 are omitted from Section 23 because they are not relevant to SMEs by virtue of applying to transactions that are not prevalent among SMEs. Other requirements that apply to transactions that are prevalent among SMEs are omitted from Section 23 because, in the IASB's view:

(a) the costs of applying new requirements would not justify the improvement to the information provided to users of SMEs' financial statements (for example, unexercised rights); or

(b) the requirements and guidance in the Standard for similar and related issues are expected to result in SMEs developing accounting policies that are similar to those developed by entities applying IFRS 15.

BC23.10 Section 23 is structured around the five steps of the revenue recognition model. Requirements that apply to features found in more complex contracts with customers are included in application guidance (see Appendix to Section 23). This structure means Section 23 provides a clear route for entities to follow in accounting for simpler contracts.

Section 24 *Government Grants*

BC24.1 Section 24 *Government Grants* is based on IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, with simplifications.

BCZ24.2 Section 24 requires a single, simplified method of accounting for all government grants. All grants are recognised in income when the performance conditions are met or earlier if there are no performance conditions. All grants are measured at the fair value of the asset received or receivable. IAS 20 permits a range of other methods that are not allowed by the Standard.

Section 25 *Borrowing Costs*

BC25.1 Section 25 *Borrowing Costs* is based on IAS 23 *Borrowing Costs*, with simplifications.

BCZ25.2 IAS 23 requires borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of the asset. For cost–benefit reasons, Section 25 requires such costs to be charged to expense.

BC25.3 In both the first and second comprehensive reviews, some respondents suggested the IASB consider amending Section 25 in ways that would more closely align it with IAS 23. These respondents requested the introduction of either a requirement or an accounting policy option for SMEs to recognise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

BC25.4 Section 25 requires an entity to recognise all borrowing costs as an expense in profit or loss in the period in which they are incurred. The entity is not required to assess which expenditure will give rise to qualifying assets or to allocate borrowing costs to assets. Therefore, the requirements are simpler to apply and easier for users to understand than the requirements in IAS 23.

BC25.5 The IASB considered the requests in both comprehensive reviews to change the requirements for borrowing costs, but in its view the arguments for changing the requirements or introducing an accounting policy option were not as strong as those for prioritising simplicity. Therefore, the IASB decided to retain the requirements in the Standard for recognising borrowing costs as an expense in profit or loss. This decision was consistent with the IASB's aim of restricting accounting policy options (see paragraph BC34) and maintaining the simple application of the Standard. In the IASB's view, the requirements in the Standard also provide more transparent information for users of SMEs' financial statements than would be provided if SMEs were required to recognise some borrowing costs as an expense and some as part of an asset.

Section 26 *Share-based Payment*

BC26.1 Section 26 *Share-based Payment* is based on IFRS 2 *Share-based Payment*, with simplifications.

BC26.2 In developing the first edition of the Standard, the IASB decided to require an entity to recognise an expense for equity-settled share-based payments and measure the expense on the basis of observable market prices, if available. If observable market prices are unavailable, the entity measures the expense using the entity's best estimate of the fair value of the equity-settled share-based payment. The IASB decided that it would be inappropriate for an entity to disclose information without also recognising an expense.

BCZ26.3 The IASB also decided that for SMEs' share-based payment transactions that give either the entity or the counterparty a choice of settlement in cash or equity instruments, the entity should account for the transaction as a cash-settled share-based payment transaction unless either:

(a) the entity has a past practice of issuing equity instruments under similar arrangements; or

(b) the option to settle in cash has no commercial substance.

In circumstances (a) and (b), the transaction is accounted for as equity-settled.

BCZ26.4 Paragraph 26.17 of the Standard deals with the scenario in which the identifiable consideration received by an entity appears to be less than the fair value of the equity instruments granted or the liability incurred. However, the IASB observed that it only addressed government-mandated plans. The IASB noted that in some jurisdictions the issue arises in instances that are not restricted to government-mandated plans. Consequently, the IASB decided to modify paragraph 26.17 during its first comprehensive review to require the guidance to be applied to all share-based payment transactions in which the identifiable consideration appears to be less than the fair value of the equity instruments granted or the liability incurred, and not only to share-based payment transactions provided in accordance with programmes established under law.

BC26.5 In the first comprehensive review, the IASB also amended Section 26 to clarify the simplification for group entities making share-based payments. The section was amended to state that a group entity measuring a share-based payment expense on the basis of a reasonable allocation of the expense for the group is still required to recognise an expense for share-based payments.

BC26.6 In the second comprehensive review, the IASB specified which transactions that occur when businesses or entities restructure their equity, or combine or form a jointly controlled entity, are included in or excluded from the scope of Section 26. The amendment aligns the scope of the section with the scope of IFRS 2.

Section 27 *Impairment of Assets*

BC27.1 Section 27 *Impairment of Assets* is based on IAS 2 *Inventories* and IAS 36 *Impairment of Assets*.

Section 28 *Employee Benefits*

BC28.1 Section 28 *Employee Benefits* is based on IAS 19 *Employee Benefits*, with simplifications relating to defined benefit plans. In the second comprehensive review this section was updated to align it with some aspects of the 2011 modifications to IAS 19.

Measurement of the defined benefit obligation

BCZ28.2 IAS 19 requires that a defined benefit obligation should always be measured using the projected unit credit actuarial method. For cost–benefit reasons, the *IFRS for SMEs* Accounting Standard provides for some measurement simplifications that retain the basic IAS 19 principles but reduce the need for SMEs to engage external specialists. Therefore, the IASB decided:

(a) if information based on the projected unit credit calculations of IAS 19 is already available or can be obtained without undue cost or effort, SMEs must use that method.

(b) if information based on the projected unit credit method is not available and cannot be obtained without undue cost or effort, SMEs must apply an approach that is based on IAS 19 but does not consider future salary progression, future service or possible mortality during an employee's period of service. This approach still takes into account life expectancy of employees after retirement age. The resulting defined benefit pension obligation reflects both vested and unvested benefits.

(c) the *IFRS for SMEs* Accounting Standard clarifies that comprehensive valuations would not normally be necessary annually. In the interim periods, the valuations would be rolled forward for aggregate adjustments for employee composition and salaries, but without changing the turnover or mortality assumptions.

BC28.3 In the second comprehensive review, feedback on the need for the measurement simplification in paragraph 28.19 of the Standard varied. Respondents from jurisdictions in which SMEs apply the simplification noted it was widely applied and removing it would increase actuarial costs. In contrast, respondents from jurisdictions where either the simplification is not applied, or where defined benefit plans are uncommon among SMEs, said the simplification could be removed.

BC28.4 Feedback before and during the second comprehensive review also suggested the simplification in paragraph 28.19 of the Standard was not applied consistently. In the light of this feedback, the IASB amended paragraph 28.19 to clarify that an SME applying the simplification measures a defined benefit liability for its obligation under defined benefit plans by assuming all its employees terminate their employment at the reporting date and not discounting that obligation. The IASB also added a requirement for an SME applying the simplification to disclose its assumptions for measuring its obligation.

Actuarial gains and losses on defined benefit plans

BC28.5 Section 28 requires an SME to recognise actuarial gains and losses immediately, with an option to present the amount either in profit or loss or in other comprehensive income. This requirement simplified the requirements that were included in IAS 19 before the amendment described in paragraph BC28.6 for an entity to allocate actuarial gains and losses between profit or loss and other comprehensive income using a 'corridor' approach.

BC28.6 In 2011 the IASB amended IAS 19—including by eliminating the corridor approach and requiring an entity to recognise all actuarial gains and losses in other comprehensive income. In the first comprehensive review, the IASB observed that this recognition in other comprehensive income would be the change most likely to affect SMEs. At the time of the first comprehensive review, the IASB was working on the project that led to the 2018 *Conceptual Framework*. As part of that project, the IASB considered the role of other comprehensive income in the financial statements. Therefore, the project could have resulted in further changes to the requirements relating to other comprehensive income in full IFRS Accounting Standards. Taking into account those possible changes, the IASB decided it would be better to continue to permit SMEs to choose whether to recognise actuarial gains or losses in profit or loss or in other comprehensive income.

BC28.7 In the second comprehensive review, the IASB revised Section 2 of the Standard to align it with the 2018 *Conceptual Framework*. In the Conceptual Framework project, the IASB said it would use other comprehensive income cautiously. The option in Section 28 results in entities that apply the Standard using other comprehensive income less often than entities that apply full IFRS Accounting Standards. In both the first and second comprehensive reviews, the IASB observed that aligning the Standard with IAS 19 (2011) would require an SME to recognise actuarial gains and losses in other comprehensive income—possibly increasing the use of other comprehensive income. Respondents did not request a change to this treatment in the second comprehensive review. Therefore, the IASB decided not to align the recognition of actuarial gains and losses with IAS 19 (2011).

Termination benefits

BC28.8 The 2011 amendments to IAS 19 also clarified that an entity is required to recognise termination benefits at the earlier of:

(a) when an entity can no longer withdraw the offer of those benefits; and

(b) when any related restructuring costs are recognised.

BC28.9 The IASB amended Section 28 to include this clarification because aligning the recognition requirements for termination benefits would result in an entity providing information that faithfully represents its liabilities. Most respondents in the second comprehensive review agreed with this alignment. The aligned requirements mean an entity recognises a liability for termination benefits only if the entity has an obligation that it has no practical ability to avoid.

Section 29 *Income Tax*

BC29.1 Section 29 *Income Tax* was originally based on the 2009 Exposure Draft *Income Tax* (2009 IAS 12 ED). Section 29 was amended in the first comprehensive review to align it with IAS 12 *Income Taxes*, with simplifications. In 2023 the section was amended outside the periodic reviews of the Standard to give entities temporary relief from the deferred tax accounting related to Pillar Two income taxes. The section was amended in the second comprehensive review to include the requirements from IFRIC 23 *Uncertainty over Income Tax Treatments*.

Accounting for income tax

BCZ29.2 During development of the first edition of the Standard, many preparers and auditors of SMEs' financial statements said that the temporary difference approach to accounting for income taxes in IAS 12 is difficult for SMEs to implement. They said that SMEs do not routinely prepare 'tax balance sheets' and generally do not track the tax bases of many assets. Some advocated a 'current taxes payable' method of accounting for income taxes, under which SMEs would not recognise deferred taxes.

BC29.3 In the first edition of the Standard, Section 29 was based on the 2009 IAS 12 ED and proposed a simplified replacement for IAS 12. However, the changes proposed in the 2009 IAS 12 ED were never finalised by the IASB. Consequently, in the first comprehensive review, the IASB decided to align the main requirements for recognising and measuring deferred taxes in Section 29 with the approach in IAS 12. These requirements were modified to make them consistent with the other requirements in the Standard. The IASB noted that most of the respondents in the first comprehensive review agreed with this approach. The IASB also observed that in many jurisdictions IAS 12 had been applied by entities, including SMEs, for years. Aligning the requirements with IAS 12 would have the advantage of enabling SMEs to draw on this experience—and the education material available on IAS 12—to better understand the requirements.

BC29.4 In the first comprehensive review, the IASB decided to keep the simplified presentation and disclosure requirements in the first edition of the Standard, except for minor consequential amendments. The IASB also made one further simplification to the requirements for offsetting income tax assets and liabilities. The IASB noted that IAS 12 has separate requirements for offsetting deferred tax assets and liabilities to make detailed scheduling unnecessary. Conversely, the requirements in Section 29 for offsetting deferred tax assets and liabilities were the same as those for offsetting current tax assets and liabilities. Therefore, the IASB decided to add an undue cost or effort exemption (see paragraphs BC2.9–BC2.14) so that an entity would not be required to offset income tax assets and liabilities if significant, detailed scheduling is required. The exemption was intended to provide similar relief to IAS 12 without including the more complex wording used in IAS 12.

BC29.5 In the second comprehensive review, some respondents stated that the simplified presentation requirements had a higher hurdle for offsetting income tax assets and liabilities than the requirements in IAS 12. Consequently, in the second comprehensive review the IASB decided to align the requirements for offsetting income tax assets and liabilities with IAS 12 and remove the undue cost or effort exemption.

International Tax Reform—Pillar Two Model Rules

BCZ29.6 In September 2023 the IASB issued *International Tax Reform—Pillar Two Model Rules—Amendments to the* IFRS for SMEs *Standard*. The amendments:

(a) introduced a temporary exemption to the requirements:

(i) to recognise deferred tax assets and liabilities related to Pillar Two income taxes; and

(ii) to disclose information that would otherwise be required by paragraphs 29.39–29.41 of the Standard about deferred tax assets and liabilities related to Pillar Two income taxes.

(b) introduced targeted disclosure requirements for affected SMEs in periods when Pillar Two legislation is in effect; and

(c) clarified that ‘other events’ in the disclosure objective in paragraph 29.38 of the Standard include the enactment or substantive enactment of tax rates and tax laws, such as Pillar Two legislation.

Background

Pillar Two model rules

BCZ29.7 In October 2021 more than 135 jurisdictions agreed to the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting’s *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. Since then, the OECD has published model rules and other documents related to the second pillar of this solution (Pillar Two model rules).

BCZ29.8 The Pillar Two model rules provide a template that jurisdictions can translate into domestic tax laws and implement as part of an agreed common approach. The rules:

(a) aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate;

(b) would achieve that aim by applying a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%; and

(c) typically require the ultimate parent entity of a group to pay top-up tax—in the jurisdiction in which it is domiciled—on profits of its subsidiaries that are taxed below 15%.

BCZ29.9 The rules apply to multinational groups with revenue in their consolidated financial statements exceeding €750 million in at least two of the four preceding fiscal years. The rules specify inclusion thresholds for some jurisdictions and exclude some types of entities from their scope.

Potential implications for income tax accounting

BCZ29.10 Stakeholders informed the IASB of concerns about the implications for income tax accounting—and specifically deferred tax accounting—resulting from jurisdictions implementing the Pillar Two model rules within a short period of time. Those concerns related to entities affected by Pillar Two legislation and applying IAS 12.

BCZ29.11 Because the requirements for accounting for income taxes in Section 29 of the Standard are based on those in IAS 12, the IASB considered whether to amend Section 29.

Relevance to SMEs

BCZ29.12 In considering whether to amend the Standard, the IASB first determines whether a new or amended full IFRS Accounting Standard is relevant to SMEs. The IASB determines relevance to SMEs by assessing whether the problem addressed by a new requirement in full IFRS Accounting Standards would make a difference in the decisions of users of financial statements prepared applying the Standard.

BCZ29.13 The staff consulted the SMEIG and other stakeholders to obtain evidence about the relevance of the Pillar Two model rules (and the IASB's proposals in the Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed amendments to IAS 12*) to SMEs. The feedback provided evidence that the Pillar Two model rules could have a material effect on the financial statements of a subset of SMEs, particularly some subsidiaries of large multinational groups.

Urgency

BCZ29.14 The IASB undertakes periodic reviews of the Standard, during which the IASB considers whether, and if so how, to align the Standard with any new and amended full IFRS Accounting Standards. In undertaking its reviews, the IASB decided that it should not consider any new and amended full IFRS Accounting Standards until they have been issued because its views remain tentative and subject to change until that time.

BCZ29.15 Furthermore, paragraph P16 of the Preface to the Standard states that urgent matters may need to be considered outside the periodic reviews of the Standard. That said, such occasions are expected to be rare.

BCZ29.16 Given the expected timing of the third edition of the *IFRS for SMEs* Accounting Standard—the product of the second comprehensive review of the Standard—and considering stakeholders' concerns, the IASB decided to amend the Standard to align the Standard with the amendments to IAS 12 relating to the Pillar Two model rules outside its periodic review.

BCZ29.17 After considering the relevance to SMEs and the urgency of the matter, the IASB set out its proposals and published the Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed amendments to the* IFRS for SMEs *Standard* in June 2023 (2023 ED).

Temporary exception to the deferred tax accounting

BCZ29.18 The IASB agreed that SMEs affected by the Pillar Two legislation need time to determine how to apply the principles and requirements in the Standard to account for deferred taxes related to top-up tax. The IASB also needs time to engage further with its stakeholders and to consider whether any action is needed to support the consistent application of the Standard. The IASB concluded that it was not feasible to complete these activities before jurisdictions enact new tax laws and, thus, before SMEs are required to reflect those laws in accounting for deferred taxes.

BCZ29.19 The IASB, therefore, decided to introduce a temporary exception to the requirements in Section 29 of the Standard to recognise deferred tax assets and liabilities related to Pillar Two income taxes and to disclose information that would otherwise be required by paragraphs 29.39–29.41 about deferred tax assets and liabilities related to Pillar Two income taxes. The IASB concluded that introducing this exception would:

(a) provide affected SMEs with relief from accounting for deferred tax assets and liabilities in relation to complex new tax legislation to be enacted by multiple jurisdictions in a short period;

(b) prevent the development of diverse interpretations of Section 29 and any resulting inconsistent application of that section; and

(c) allow time for stakeholders to assess how the Pillar Two model rules have been implemented in different jurisdictions, for SMEs to assess how they are affected, and for the IASB to consider whether to do further work.

BCZ29.20 The IASB also decided to require an SME within the scope of Pillar Two legislation to disclose that it has applied the temporary exception. The IASB concluded that this requirement would:

(a) provide entity-specific information because some SMEs are unaffected by Pillar Two legislation and, therefore, would not apply the exception; and

(b) make the exception's application transparent to users of financial statements during the periods in which it is applied.

BCZ29.21 The IASB decided it was unnecessary to expand the scope of the temporary exception to include the measurement of deferred taxes recognised under domestic tax regimes. The IASB concluded that an entity would not remeasure such deferred taxes to reflect Pillar Two income taxes it expects to pay when recovering or settling a related asset or liability because the temporary exception applies to deferred tax assets and liabilities related to such income taxes.

BCZ29.22 For the reasons in paragraph BCZ29.19, the IASB also decided to make a consequential amendment to paragraph 35.10(h) of the Standard to clarify that if a first-time adopter uses the exemption in paragraph 35.10(h) to apply Section 29 prospectively, the exception in paragraph 29.3A applies retrospectively. The IASB noted that without this clarification, a first-time adopter could incur additional costs applying Section 29 compared to SMEs already applying the Standard.

Mandatory application

BCZ29.23 The IASB decided to make the application of the temporary exception mandatory because doing so would:

(a) result in greater comparability between SMEs' financial statements and, therefore, provide more useful information for users of financial statements; and

(b) eliminate the risk that SMEs might inadvertently develop accounting policies that are inconsistent with the principles and requirements in Section 29 of the Standard.

Duration

BCZ29.24 The IASB concluded that it was not possible to determine how much time the activities described in paragraph BCZ29.18 would require because they would depend on how and when jurisdictions implement the Pillar Two model rules. Therefore, the IASB decided not to specify how long the temporary exception will be in place. The IASB will monitor developments related to the implementation of the Pillar Two model rules to determine when to do further work. Any further work would not necessarily coincide with the next periodic review of the Standard.

Disclosures

Periods before legislation is in effect

BCZ29.25 When amending IAS 12 in May 2023 the IASB added a disclosure objective. An entity applying full IFRS Accounting Standards is required to disclose—in periods when Pillar Two legislation is enacted or substantively enacted but not yet in effect—information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.

BCZ29.26 The disclosure objective in paragraph 29.38 of the Standard requires an SME to disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events. The IASB observed that:

(a) paragraph 29.38 (which applies to all income tax consequences) is not the same as the objective developed as part of the IAS 12 amendments (which specifically deals with an entity's exposure to Pillar Two income taxes). Nonetheless, the IASB concluded that the objective in paragraph 29.38 would be expected to result in SMEs affected by Pillar Two legislation disclosing some information about the nature and financial effect of income tax consequences of such enacted (or substantively enacted) legislation in periods before the legislation is in effect (for example, information available from an SME's assessment of its exposure to Pillar Two income taxes). These disclosures would be expected because, in the IASB's view 'other events' in paragraph 29.38 include the enactment (or substantive enactment) of Pillar Two legislation.

(b) although it is still uncertain when jurisdictions will implement the Pillar Two model rules, feedback on the Exposure Draft *International Tax Reform—Pillar Two Model Rules—Proposed amendments to IAS 12* confirmed that many jurisdictions are expected to enact in 2023 Pillar Two legislation that has effect from 1 January 2024. Consequently, any amendments to introduce new disclosure requirements or to amend existing disclosure requirements for SMEs for periods before such legislation is in effect would be applied for only a relatively short period.

(c) the information needs of users of SMEs' financial statements might differ from those of users of financial statements of entities applying full IFRS Accounting Standards. Indeed, the absence of any new specific disclosure requirements would allow an SME to retain flexibility in deciding which information to disclose to meet the disclosure objective in paragraph 29.38.

BCZ29.27 A few respondents to the 2023 ED said the amendment to paragraph 29.38 might not result in SMEs providing the disclosures expected in paragraph BCZ29.26(a). In their view, in periods before the Pillar Two legislation is in effect no current or deferred tax consequences would arise because the amendments introduce an exception to recognising deferred tax assets or liabilities related to Pillar Two income taxes.

BCZ29.28 The IASB observed that this view may have arisen from a narrow reading of the disclosure objective in paragraph 29.38, particularly of 'other events'. The IASB disagreed with this view, noting paragraph 29.38 does not state that 'other events' are recognised in the financial statements, nor does it limit the required information to only information about recognised current or deferred tax consequences. That is, paragraph 29.38 does not exclude unrecognised income tax consequences of other events (even if such other events are not yet recognised in the financial statements).

BCZ29.29 After considering responses to the 2023 ED, the IASB confirmed its conclusion that 'other events' in paragraph 29.38 of the Standard includes the enactment (or substantive enactment) of tax rates and tax laws, which would include, for example, Pillar Two legislation. The IASB decided to amend paragraph 29.38 to provide more clarity about 'other events'.

BCZ29.30 The IASB noted that an SME needs to consider its specific circumstances in deciding which information to disclose to meet the disclosure objective in paragraph 29.38 of the Standard. An SME would also consider the disclosure requirements in other sections of the Standard, including:

(a) Section 33 *Related Party Disclosures*, which requires subsidiaries to provide information about transactions and outstanding balances, including commitments, with group entities;

(b) paragraphs 8.6–8.7 of the Standard, which require information about judgements and sources of estimation uncertainty; and

(c) paragraph 3.2 of the Standard, which requires additional disclosures when compliance with the specific requirements in the *IFRS for SMEs* Accounting Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance.

Periods when legislation is in effect

BCZ29.31 The IASB decided to require an SME to disclose separately its current tax expense or income related to Pillar Two income taxes because doing so would:

(a) help users of financial statements understand the magnitude of Pillar Two income taxes relative to the SME's overall tax expense—disaggregation of amounts presented in an SME's financial statements helps users understand those statements; and

(b) not be costly to prepare because the SME would already be required to recognise current tax related to Pillar Two income taxes.

Effects analysis

BCZ29.32 The IASB concluded that the benefits of the amendments outweigh the costs because the amendments would:

(a) provide timely relief for affected SMEs;

(b) avoid diverse interpretations of Section 29 of the Standard developing in practice;

(c) safeguard the usefulness of the information disclosed by an SME applying the *IFRS for SMEs* Accounting Standard until questions about how to apply Section 29 of the Standard to Pillar Two income taxes have been resolved; and

(d) improve the information provided to users of SMEs' financial statements before and after Pillar Two legislation is in effect.

Effective date and transition

BCZ29.33 The IASB concluded that, for the temporary exception to be effective, it is necessary for it to be available to SMEs immediately upon issue of the amendments. The IASB decided to require retrospective application of the temporary exception in paragraph 29.3A because such application would:

(a) allow an SME to apply the exception from the date the Pillar Two legislation is enacted or substantively enacted, even if that date is before the issue date of the amendments; and

(b) not result in additional costs.

BCZ29.34 The IASB decided to require an SME to apply the disclosure requirements in proposed new paragraph 29.43 for annual reporting periods beginning on or after 1 January 2023. The IASB concluded that this effective date would provide an SME with enough time to prepare the required information. The IASB expects that the disclosure requirements in paragraph 29.43 will only be applicable from 1 January 2024, when Pillar Two legislation is expected to be in effect in many jurisdictions.

Section 30 *Foreign Currency Translation*

BC30.1 Section 30 *Foreign Currency Translation* is based on IAS 21 *The Effects of Changes in Foreign Exchange Rates*, with some simplifications. It was amended in the second comprehensive review to include the requirements from IFRIC 22 *Foreign Currency Translation and Advance Consideration*.

Exchange differences on the translation of a foreign subsidiary

BCZ30.2 IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation. In the financial statements that include the foreign operation and the reporting entity (for example, consolidated financial statements when the foreign operation is a subsidiary), IAS 21 recognises such exchange differences initially in other comprehensive income and reclassifies them from equity to profit or loss on disposal of the net investment. The Standard provides for one difference: an exchange difference that is recognised initially in other comprehensive income is not reclassified in profit or loss on disposal of the investment. The reason for the difference is that not requiring reclassification is less burdensome for SMEs because it eliminates the need for tracking the exchange differences after initial recognition.

BCZ30.3 Some respondents to the 2013 ED said cumulative exchange differences from the translation of a foreign subsidiary should be recognised in profit or loss on disposal of a subsidiary, which would be consistent with full IFRS Accounting Standards. The IASB noted that not requiring 'recycling' through profit and loss was a change specifically made during the IASB's redeliberations in response to comments on the 2007 ED. Some of the respondents to the 2013 ED also noted that if there is no requirement to recycle the exchange differences to profit or loss on disposal of a subsidiary, an SME should be permitted to recognise those exchange differences in retained earnings either immediately or on disposal; otherwise they will remain as a separate component of equity forever. The IASB noted that the Standard does not contain any requirements that prohibit SMEs from transferring amounts recognised in other comprehensive income within equity. Consequently, an SME could, in accordance with the Standard, transfer any cumulative exchange differences recognised in other comprehensive income and shown as a separate component of equity (for example, in a foreign currency translations reserve) directly into retained earnings on disposal of the related subsidiary. Nevertheless, the IASB observed that an entity would also need to consider whether there were jurisdiction-specific restrictions on transfers between components of equity.

Lack of exchangeability

BC30.4 In 2023 the IASB issued *Lack of Exchangeability*, which amended IAS 21 to require an entity to apply a consistent approach to assess whether a currency is exchangeable into another currency and, when it is not, to determine the exchange rate to use and the disclosures to provide. Feedback from the SMEIG was that requirements on accounting for a lack of exchangeability between currencies are relevant to SMEs because they would apply to a wide range of SMEs. The IASB also observed that adding requirements on the topic would improve the information provided to users of SMEs' financial statements and make the Standard easier to apply. Consequently, the IASB amended the scope of the second comprehensive review and published the Exposure Draft *Addendum to the Exposure Draft* Third edition of the *IFRS for SMEs* Accounting Standard in 2024 (2024 ED). The 2024 ED proposed introducing requirements and guidance based on the amendments to IAS 21. The proposals were finalised in the third edition of the Standard.

BC30.5 The requirements and guidance in Section 30 are shorter than, and structured differently from, the requirements and guidance in IAS 21, so that the section is consistent with and in proportion to other sections of the Standard. The IASB also simplified the requirements from IAS 21 to disclose information about when a currency is not exchangeable into another currency. The simplifications make use of the principles in paragraph BC31 for reducing disclosure requirements.

Section 31 *Hyperinflation*

BC31.1 Section 31 *Hyperinflation* is based on IAS 29 *Financial Reporting in Hyperinflationary Economies*.

Section 32 *Events after the End of the Reporting Period*

BC32.1 Section 32 *Events after the End of the Reporting Period* is based on IAS 10 *Events after the Reporting Period*.

Section 33 *Related Party Disclosures*

BC33.1 Section 33 *Related Party Disclosures* is based on IAS 24 *Related Party Disclosures*. The section was updated in the first and second comprehensive reviews for closer alignment with IAS 24.

BC33.2 In the first comprehensive review, the IASB amended the definition of a 'related party' to make it consistent with the definition in IAS 24.

BC33.3 In the second comprehensive review, the IASB improved the disclosure requirements about related party transactions with government and government-related entities by adding a disclosure requirement from IAS 24 to Section 33. Specifically, if an entity applies the exemption from providing more detailed information about these transactions in paragraph 33.11 of the Standard, the entity is nonetheless required to disclose specified information about those transactions. The first edition of the Standard did not require entities making use of the exemption to disclose any information about these transactions. The IASB added the disclosure requirement because of feedback that information about related party transactions is important to users of SMEs' financial statements.

BC33.4 Similarly, in the second comprehensive review the IASB improved disclosure requirements for transactions with management entities by adding a disclosure requirement from IAS 24. Section 33 requires an entity to disclose the amounts incurred for the provision of key management personnel services from another entity (a management entity). In the first comprehensive review, the IASB amended the definition of a related party to include management entities but did not include the disclosure requirement.

Section 34 *Specialised Activities*

BC34.1 Section 34 *Specialised Activities* is based on several IFRS Accounting Standards.

Agriculture

BC34.2 The requirements in Section 34 on agriculture are based on IAS 41 *Agriculture*.

Fair value through profit or loss model for agriculture

BC34.3 During the development of the first edition of the Standard, the IASB favoured SMEs following the 'fair value through profit or loss' model in IAS 41 for agriculture assets, instead of a 'cost-depreciation-impairment' model.

BCZ34.4 Not only is fair value generally regarded as a more relevant measure in this industry, quoted prices are often readily available, markets are active, and measuring cost is actually more burdensome and arbitrary because of the extensive allocations required. Moreover, managers of most SMEs that undertake agricultural activities say that they manage on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry.

BCZ34.5 Some preparers and auditors of the financial statements of SMEs engaged in agricultural activities said that the 'fair value through profit or loss' model is burdensome for SMEs, particularly when applied to biological assets of those SMEs operating in inactive markets or developing countries. They said that the presumption in IAS 41 that fair value can be estimated for biological assets and agricultural produce is unrealistic with respect to biological assets of some SMEs. Some proposed that SMEs should be permitted or required to use a 'cost-depreciation-impairment' model for all such assets. The IASB did not support this approach for the reasons explained in paragraph BCZ34.4. However, the IASB concluded, both because of the measurement problems in inactive markets and developing countries and for cost–benefit reasons, that SMEs should be required to use the fair value through profit or loss model only when fair value is readily determinable without undue cost or effort. When that is not the case, the IASB concluded that SMEs should follow the cost-depreciation-impairment model.

Bearer plants

BC34.6 In 2014 the IASB issued *Agriculture: Bearer Plants* which amended IAS 16 and IAS 41. These amendments require entities to account for bearer plants—such as grape vines, rubber trees and oil palms—in the same way as property, plant and equipment in IAS 16. The amendments provided relief under full IFRS Accounting Standards by requiring an entity to account for bearer plants in accordance with IAS 16, which permits a cost model, rather than requiring an entity to measure those assets at fair value through profit or loss in accordance with IAS 41.

BC34.7 In the second comprehensive review, a few stakeholders expressed concerns about aligning Section 34 with *Agriculture: Bearer Plants*. They suggested it might be costly and complex for SMEs to measure the fair value of produce growing on a bearer plant separately from the plant itself. Furthermore, separately measuring the bearer plant from the produce might provide little benefit to users of SMEs' financial statements.

BC34.8 Considering this feedback, the IASB decided to align the Standard with *Agriculture: Bearer Plants* but provide an undue cost or effort exemption (see paragraphs BC2.9–BC2.14). Under this exemption, an entity would not be required to separate bearer plants from the produce on them if the entity determines, at initial recognition, that bearer plants cannot be measured separately from the produce without undue cost or effort—initially or on an ongoing basis.

Exploration for and evaluation of mineral resources

BC34.9 The requirements in Section 34 on the exploration for and evaluation of mineral resources are based on IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

BC34.10 In the first comprehensive review, the IASB decided to add requirements in Section 34 that align the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6. The IASB noted that this alignment would ensure that the *IFRS for SMEs* Accounting Standard provides the same relief for these activities as full IFRS Accounting Standards. In the IASB's view, this alignment is important for the reasons set out in paragraphs BC2–BC5 of the Basis for Conclusions on IFRS 6. The IASB noted that adding these requirements was consistent with maintaining stability during the early years of implementing the Standard because the requirements:

(a) only affect SMEs with one specific type of activity; and

(b) respond to a need for clarity and constitute a simplification for those entities, particularly those making the transition to the Standard.

BC34.11 In the first comprehensive review, the IASB did not introduce any specific disclosure requirements that apply to entities involved in the exploration for, or evaluation of, mineral resources. However, in the second comprehensive review, the IASB decided to add requirements in Section 34 that align the disclosure requirements for exploration and evaluation assets with those in IFRS 6. An entity is required to treat exploration and evaluation assets as a separate class of assets. An entity is also required to make the disclosures required by either Section 17 or Section 18 consistent with how the entity classifies the assets (either as tangible assets or intangible assets). The disclosure requirements in those sections are considered to provide useful information to users of financial statements at minimal additional cost to entities.

Service concession arrangements

BC34.12 The requirements in Section 34 on service concession arrangements are based on IFRIC 12 *Service Concession Arrangements*.

Section 35 *Transition to the* IFRS for SMEs *Accounting Standard*

BC35.1 Section 35 *Transition to the* IFRS for SMEs *Accounting Standard* applies to an entity that prepares its first financial statements using the Standard (a first-time adopter). The section is based on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which contains exemptions that apply when entities first adopt full IFRS Accounting Standards.

BCZ35.2 IFRS 1 requires an entity's first IFRS financial statements to include at least one year of comparative information under IFRS Accounting Standards. Some preparers and auditors of SMEs' financial statements explained to the IASB that a requirement to prepare restated prior period data in all cases would be burdensome for SMEs adopting the Standard for the first time. Thus, the Standard includes an 'impracticability' exemption. Similarly, it provides an impracticability exemption with respect to some requirements for restating the opening statement of financial position.

BC35.3 In the second comprehensive review, the IASB added an exemption to Section 35 related to Section 23. The exemption allows first-time adopters to prospectively apply Section 23 by applying the section to contracts that begin after the date the entity makes the transition to the Standard. The exemption was based on the transition requirements for revenue for entities applying the third edition of the Standard (see paragraph BC68). The IASB did not consider it necessary to add any other exemptions for other changes made in the review because of the 'impracticability' exemption included in the Standard.

Effective date and transition

Effective date of the third edition of the *IFRS for SMEs* Accounting Standard

BC60 The IASB decided to make the third edition of the *IFRS for SMEs* Accounting Standard effective for annual reporting periods beginning on or after 1 January 2027 and to permit earlier application.

BC61 In determining the effective date, the IASB observed that the second comprehensive review resulted in a large number of amendments to the Standard. However, typical SMEs are expected to make limited changes to their financial reporting as a consequence of the amendments.

BC62 Even though the changes to SMEs' financial reporting are generally expected to be limited, SMEs will need time to assess and implement the amended requirements—specifically the revised requirements for revenue. In assessing how much time SMEs would need, the IASB considered that the Standard includes transition requirements that relieve SMEs from retrospectively applying some of the amendments. Notably, SMEs can choose to prospectively apply the revised revenue requirements (see paragraph BC68). The IASB also considered:

(a) the effect that additional time would have on when SMEs would begin preparing their processes and systems for the amendments;

(b) the implementation experiences various entities, auditors and consultants have had when implementing similar amendments in full IFRS Accounting Standards; and

(c) the effect of the timing on the next comprehensive review if a later effective date is set.

BC63 Considering the extent of change and the transition requirements, the IASB concluded that an effective date of annual reporting periods beginning on or after 1 January 2027 would provide SMEs with enough time to implement the revised and amended requirements.

Transition to the third edition of the *IFRS for SMEs* Accounting Standard

BC64 Appendix A to the Standard sets out the transition requirements for entities making the transition to the third edition of the Standard. In developing the Appendix, the IASB's approach was to reflect the comparable transition requirements in new or amended full IFRS Accounting Standards and IFRIC Interpretations, if applicable, with appropriate simplifications for SMEs.

BC65 Appendix A relieves an entity from retrospectively applying some new and amended paragraphs in the third edition of the Standard, as required by Section 10 of the Standard. For all new and amended paragraphs in the Standard, Appendix A also relieves entities from disclosing, for the current period, the amount of the adjustment for each financial statement line item affected. This disclosure on transition is required by Section 10 of the Standard. To provide this disclosure, an entity would need to maintain parallel accounting systems in the reporting period in which it first applies the third edition of the Standard. In the IASB's view, the cost to SMEs of maintaining such systems would outweigh the benefits of this disclosure to users.

BC66 Other than the relief described in paragraph BC65, the IASB did not amend Appendix A to provide entities with any of the other general transition reliefs suggested by respondents to the 2022 ED. This was because the effect of any additional relief on the comparability of the information presented by entities was expected to outweigh any practical benefits for preparers.

BC67 The third edition of the Standard does not include the option for entities to apply the recognition and measurement requirements in IAS 39 included in the first edition (see paragraph BC11.14). Consequently, entities making the transition to the third edition of the Standard, that previously applied the option, will apply the recognition and measurement requirements in Section 11 of the Standard. These entities' transition to the third edition of the Standard will be similar to that of entities adopting IFRS 9 and first-time adopters making the transition to the *IFRS for SMEs* Accounting Standard. Consequently, the IASB provided transition requirements for these entities similar to the transition requirements in IFRS 9 and Section 35 of the Standard.

BC68 Appendix A to the Standard provides an entity with relief from retrospectively applying the revised Section 23. Entities may prospectively apply the revised Section 23 by applying the section to contracts that begin after the date of initial application. The IASB decided to permit entities to prospectively apply the revised Section 23 to relieve some of the burden of applying a new revenue recognition model. An entity that chooses to prospectively apply the revised Section 23 is required to disclose information that allows users to understand the extent of revenue not accounted for in accordance with the section.

BC69 Unlike IFRS 15, the Standard prohibits an entity from retrospectively applying the revised Section 23, with the cumulative effect of initially applying the section recognised at the date of initial application ('cumulative catch-up' transition method). The IASB decided to exclude the cumulative catch-up transition method because if entities can prepare the information necessary to apply this method, they are likely to be able to retrospectively apply the revised Section 23. Furthermore, entities that cannot prepare the information necessary to retrospectively apply the revised Section 23 may choose to prospectively apply the section.

BC70 In some instances, the comparable transition requirements in full IFRS Accounting Standards included an accounting policy option for entities to apply the amendments retrospectively instead of prospectively. The Standard does not include similar options for SMEs to retrospectively apply the amendments to the Standard. The IASB's decision to omit these options is consistent with the approach of only including the simpler option in the Standard if full IFRS Accounting Standards allow an accounting policy choice (see paragraph BC27(b)).

BC71 The third edition of the Standard introduces a requirement for SMEs to disclose a reconciliation between the opening and closing balances of liabilities arising from financing activities. The requirement is based on disclosure requirements introduced by amendments to IAS 7 (see paragraphs BC7.2–BC7.4). The transition requirements for the amendments to IAS 7 provided relief from applying the new disclosures in comparative periods. The IASB decided similar relief for SMEs was unnecessary because SMEs will have more time to make the transition to the third edition of the Standard than entities had when they adopted the amendments to IAS 7. Also, disclosing the reconciliation in comparative periods would provide information that users of SMEs' financial statements are particularly interested in.

Topics covered in the *IFRS for SMEs* Accounting Standard that are not covered in full IFRS Accounting Standards

BCZ72 The Standard covers several issues that, in the IASB's judgement, are relevant to SMEs but are not addressed in full IFRS Accounting Standards:

(a) combined financial statements in paragraphs 9.28–9.30 of the Standard.

(b) original issue of shares or other equity instruments in paragraphs 22.7–22.10 of the Standard.

(c) sale of options, rights and warrants in paragraph 22.11 of the Standard.

(d) capitalisation or bonus issues of shares and share splits in paragraph 22.12 of the Standard.

Topics covered in full IFRS Accounting Standards that are omitted from the *IFRS for SMEs* Accounting Standard

BC73 Some topics covered in full IFRS Accounting Standards are omitted from the *IFRS for SMEs* Accounting Standard, specifically:

(a) earnings per share;

(b) interim financial reporting;

(c) segment reporting;

(d) rate-regulated activities (see paragraph BC55);

(e) special accounting for assets held for sale (see paragraphs BC4.2–BC4.3);

(f) investment entities (see paragraph BC9.9);

(g) reacquired rights in a business combination (see paragraphs BC19.9–BC19.10); and

(h) some topics related to revenue from contracts with customers (see paragraph BC23.9).

BC74 Paragraph BC73 only includes topics covered in new or amended full IFRS Accounting Standards that the IASB decided to omit in a comprehensive review of the *IFRS for SMEs* Accounting Standard.

Maintaining the *IFRS for SMEs* Accounting Standard

BC75 The Preface to the *IFRS for SMEs* Accounting Standard explains how the IASB expects to maintain the Standard.

BC76 During the development of the first edition of the Standard, the IASB consulted on how the Standard should be updated to reflect each new or amended Accounting Standard or IFRIC Interpretation. Stakeholders did not agree with the IASB updating the Standard every time full IFRS Accounting Standards change because SMEs do not have internal accounting resources or the ability to hire accounting advisers on an ongoing basis. Consequently, the IASB decided it should update the Standard periodically.

BC77 In the first comprehensive review, the IASB discussed its approach to future reviews of the Standard. The IASB decided on a tentative approach of commencing a comprehensive review of the Standard approximately two years after the effective date of the amendments to the Standard resulting from a previous comprehensive review. This approach would allow time for SMEs to apply the amendments. It would also allow time for interested parties to identify and comment on any implementation issues or unintended consequences that result from those amendments.

BC78 Issues on the implementation and application of the Standard might arise between the IASB's reviews of the Standard. The SMEIG considers these issues, decides which issues require a response, and develops timely educational material in the form of Q&As. The Q&As are published by the SMEIG and are publicly available on the IFRS Foundation's website.

BC79 In each review of the Standard, the IASB decides whether to include material from Q&As in the Standard, use it in educational material on the Standard or withdraw it. Q&As are then deleted from the IFRS Foundation's website.

Dissenting opinions

Dissent of James J Leisenring from the first edition of the *IFRS for SMEs* Accounting Standard

DO1 Mr Leisenring dissents from the issue of the IFRS because he believes that the *IFRS for SMEs* Accounting Standard is neither necessary nor desirable.

DO2 It is unnecessary because the vast majority of accounting policy decisions of SMEs are straightforward and extensive reference to IFRS Accounting Standards will not be required and, when required, not burdensome.

DO3 It is undesirable because the IFRS would produce non-comparable information. SMEs will not be comparable with each other and will not be comparable with publicly accountable entities. That result is inconsistent with the IASB *Framework* and the concepts and pervasive principles of the IFRS.[6]

DO4 Non-comparability will result because the *IFRS for SMEs* Accounting Standard would allow SMEs, as a result of paragraph 10.5, to ignore the requirements of other IFRS Accounting Standards even when the specific accounting issue is addressed in those IFRS Accounting Standards. If an entity is satisfied with the result of applying paragraph 10.5 there is never a requirement to look to full IFRS Accounting Standards. Thus, identical transactions can be accounted for differently by different SMEs and differently from publicly accountable entities. If the IASB finds it necessary to develop educational materials to assist SMEs in applying IFRS Accounting Standards, that would certainly be appropriate. However, Mr Leisenring believes that in all circumstances IFRS Accounting Standards should ultimately be the source of accounting guidance for all entities.

DO5 Mr Leisenring does not believe that the IASB has demonstrated the need to make modifications to recognition and measurement requirements in IFRS Accounting Standards for application by SMEs on the basis of either cost–benefit analysis or user needs. As a result, he would not have any differences in recognition and measurement requirements from full IFRS Accounting Standards. Alternatively, he would much more extensively modify the disclosure requirements to meet special user needs. That modification might well create disclosures not required at present, such as information about economic dependency and common control.

DO6 Mr Leisenring also believes that the *IFRS for SMEs* Accounting Standard is inconsistent with the Constitution of the IASC Foundation and the *Preface to International Financial Reporting Standards*.[7] Those documents set out an objective of a single set of accounting standards taking account of the special needs of SMEs and emerging economies. Mr Leisenring accepts that objective but does not believe it implies separate sets of standards for entities in differing circumstances as indicated in paragraph BC42 [of the first edition of the *IFRS for SMEs* Accounting Standard]. The conclusion of that paragraph suggests that many sets of accounting standards would be appropriate depending on different circumstances.

Dissent of Ms Tokar from *2015 Amendments to the IFRS for SMEs*

DO1 Ms Tokar is dissenting because of the IASB's decision to make reporting of non-cash distributions at fair value subject to an undue cost or effort exemption. She is concerned that the undue cost or effort relief will deprive financial statement users of relevant information about the value of assets distributed to owners. While she could accept that an undue cost or effort exemption may be appropriate with respect to remeasuring the asset to be distributed between the time of recognition of the distribution payable and the time of settlement, she dissents from providing an undue cost or effort exemption in respect of the initial measurement of the transaction.

DO2 In her view, fair value information should normally be used to assess the merits of the distribution decision from a corporate governance perspective, and thus this information should be available when financial statements are prepared. Although the IASB has sought to clarify, in these

6 This reference to the IASB *Framework* is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, which was adopted by the IASB in 2001 and in effect when the first edition of the *IFRS for SMEs* Accounting Standard was issued.

7 This reference to the Constitution of the IASC Foundation is to the *IASC Foundation Constitution*, which was approved in its original form by the members of the IASC in May 2000 and in effect when the first edition of the *IFRS for SMEs* Accounting Standard was issued.

amendments, the circumstances in which an undue cost or effort exemption is available, Ms Tokar is concerned that allowing an undue cost or effort exemption for transactions for which fair value information should be available implies a lower hurdle than the IASB intends for the use of such an exemption. She believes that the effectiveness of the *IFRS for SMEs* Accounting Standard, which includes a number of undue cost or effort exemptions, requires the exemption to be used only in circumstances in which the costs (both monetary and in entity resources or 'effort') clearly outweigh the benefits to users of having the information.

Dissent of Zach Gast from the third edition of the *IFRS for SMEs* Accounting Standard

DO1 Mr Gast is dissenting because he disagrees with the IASB's decision to retain the incurred loss model for impairment losses on financial assets for entities applying the Standard. He believes that, for some entities in the scope of the Standard, an expected credit loss (ECL) model based on the simplified approach in IFRS 9 *Financial Instruments* would give a more faithful representation than the incurred loss model.

DO2 The financial statements of many entities within the scope of the Standard do not include operating assets that have significant exposure to credit risk. However, some entities that engage in financing or investing as one of their primary businesses have significant exposure to credit risk within their operating assets. Mr Gast believes that there are enough entities in the scope of the Standard that hold such assets to make it necessary to include requirements relating to them.

DO3 For these entities, he believes that a simplified ECL would provide a more faithful representation of their financial assets than the incurred loss model in the Standard, which all entities are required to apply.

DO4 Mr Gast also believes that the IASB has underestimated how many entities will be affected. There is sufficient evidence that entities exist that engage in financing or investing as a primary activity but nonetheless do not have public accountability. In Mr Gast's opinion, the amendments to paragraph 1.3(b) of the Standard are likely to allow more entities to apply the Standard. There would therefore be an increase in the number of entities in the scope of the Standard for which an ECL model would be appropriate.

DO5 Mr Gast believes that an alternative to introducing an ECL model would be for the IASB to change the scope of the Standard so that entities for whom an ECL model would be most appropriate would not be eligible to apply the Standard. These entities would instead apply full IFRS Accounting Standards, including the ECL model in IFRS 9.

Appendix A
Tables showing the history of the *IFRS for SMEs* Accounting Standard and treatment of amendments to full IFRS Accounting Standards

A1 Table A1 lists due process documents issued by the IASB when developing the *IFRS for SMEs* Accounting Standard.

Table A1—History of the development of the *IFRS for SMEs* Accounting Standard

Table A1—History of the development of the *IFRS for SMEs* Accounting Standard

Consultation document	Issued date	Finalised	Published date	Effective date
Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities*	June 2004	*International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*	July 2009	Immediately effective
Exposure Draft *International Financial Reporting Standard for Small and Medium-sized Entities*	February 2007			
Request for Information *Comprehensive Review of the IFRS for SMEs*	June 2012	*2015 Amendments to the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs)*	May 2015	1 January 2017
Exposure Draft ED/2013/9 *Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*	October 2013	*2015 IFRS for SMEs (bound volume)*	October 2015	1 January 2017
Exposure Draft IASB/ED/2023/3 *International Tax Reform—Pillar Two Model Rules—Proposed Amendments to the* IFRS for SMEs *Standard*	June 2023	*International Tax Reform—Pillar Two Model Rules—Amendments to the* IFRS for SMEs *Standard*	September 2023	1 January 2023
Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*	January 2020	The third edition of the *IFRS for SMEs* Accounting Standard	February 2025	1 January 2027
Exposure Draft IASB/ED/2022/1 *Third edition of the* IFRS for SMEs *Accounting Standard*	September 2022			
Exposure Draft IASB/ED/2024/2 *Addendum to the Exposure Draft* Third edition of the *IFRS for SMEs* Accounting Standard	March 2024			

A2 Table A2 identifies:

(a) amendments to full IFRS Accounting Standards in the scope of the second comprehensive review of the *IFRS for SMEs* Accounting Standard; and

(b) amendments to the *IFRS for SMEs* Accounting Standard made in the second comprehensive review as a result of those amendments in (a).

Table A2—Overview of the treatment of amendments to full IFRS Accounting Standards

Amendment to full IFRS Accounting Standards	Effective date	Treatment in the second comprehensive review of the *IFRS for SMEs* Accounting Standard
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)	Indefinitely deferred	The amendments are outside the scope of this review because the IASB deferred the effective date indefinitely.
Effective Date of Amendments to IFRS 10 and IAS 28	–	No amendments made to the Standard.
IFRS 3 (2008) *Business Combinations*	1 July 2009	Considered in this review and resulted in the revised Section 19.
IFRS 10 *Consolidated Financial Statements*	1 January 2013	Considered in this review and resulted in amendments to the Standard. See Section 9.
IFRS 11 *Joint Arrangements*	1 January 2013	Considered in this review and resulted in amendments to the Standard. See Section 15.
IFRS 12 *Disclosure of Interests in Other Entities*	1 January 2013	Considered in this review and resulted in amendments to the Standard. See paragraphs 9.23B and 15.19(d).
IFRS 13 *Fair Value Measurement*	1 January 2013	Considered in this review and resulted in the new Section 12.
IAS 19 (2011) *Employee Benefits*	1 January 2013	Considered in this review and resulted in amendments to the Standard. See Section 28.
Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)	1 January 2013	Considered in this review and resulted in amendments to the Standard. See paragraphs A5–A10.
Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)	1 January 2014	Considered in this review. No amendments made to the Standard.
IFRIC 21 *Levies*	1 January 2014	Considered in this review. No amendments made to the Standard.
Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)	1 January 2014	Considered in this review. No amendments made to the Standard.
Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)	1 January 2014	Considered in this review. No amendments made to the Standard.
Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)	1 July 2014	Considered in this review. No amendments made to the Standard.

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Annual Improvements to IFRSs 2010–2012 Cycle *Definition of vesting condition* (Amendments to IFRS 2)	1 July 2014	Considered in this review and resulted in amendments to the Standard. See paragraph 26.9.
Annual Improvements to IFRSs 2010–2012 Cycle *Accounting for contingent consideration in a business combination* (Amendments to IFRS 3)	1 July 2014	Considered in this review as part of revising Section 19 and resulted in amendments to the Standard.
Annual Improvements to IFRSs 2010–2012 Cycle *Aggregation of operating segments* (Amendments to IFRS 8)	1 July 2014	No amendments made to the Standard.
Annual Improvements to IFRSs 2010–2012 Cycle *Reconciliation of the total of the reportable segments' assets to the entity's assets* (Amendments to IFRS 8)	1 July 2014	No amendments made to the Standard.
Annual Improvements to IFRSs 2010–2012 Cycle *Short-term receivables and payables* (Amendments to IFRS 13)	1 July 2014	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2010–2012 Cycle *Revaluation Method—proportionate restatement of accumulated depreciation* (Amendments to IAS 16 and IAS 38)	1 July 2014	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2010–2012 Cycle *Key management personnel* (Amendments to IAS 24)	1 July 2014	Considered in this review and resulted in amendments to the Standard. See paragraph 33.7A.
Annual Improvements to IFRSs 2011–2013 Cycle *Meaning of 'effective IFRSs'* (Amendments to IFRS 1)	1 July 2014	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2011–2013 Cycle *Scope exceptions for joint ventures* (Amendments to IFRS 3)	1 July 2014	Considered in this review as part of revising Section 19 and resulted in amendments to the Standard.
Annual Improvements to IFRSs 2011–2013 Cycle *Scope of paragraph 52 (portfolio exception)* (Amendments to IFRS 13)	1 July 2014	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2011–2013 Cycle *Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property* (Amendments to IAS 40)	1 July 2014	Considered in this review and resulted in amendments to the Standard. See paragraph 16.3A.
IFRS 14 *Regulatory Deferral Accounts*	1 January 2016	Considered in this review. No amendments made to the Standard.
Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)	1 January 2016	Considered in this review. No amendments made to the Standard.

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Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)	1 January 2016	Considered in this review and resulted in amendments to the Standard. See paragraphs 17.21(c), 17.22 and 18.22A.
Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)	1 January 2016	Considered in this review and resulted in amendments to the Standard. See paragraphs 17.3(a) and 34.2–34.2B.
Equity Method in Separate Financial Statements (Amendments to IAS 27)	1 January 2016	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2012–2014 Cycle *Changes in methods of disposal* (Amendments to IFRS 5)	1 January 2016	No amendments made to the Standard.
Annual Improvements to IFRSs 2012–2014 Cycle *Servicing contracts* (Amendments to IFRS 7)	1 January 2016	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRSs 2012–2014 Cycle *Applicability of the amendments to IFRS 7 to condensed interim financial statements* (Amendments to IFRS 7)	1 January 2016	No amendments made to the Standard.
Annual Improvements to IFRSs 2012–2014 Cycle *Discount rate: regional market issue* (Amendments to IAS 19)	1 January 2016	Considered in this review and resulted in amendments to the Standard. See paragraph 28.17.
Annual Improvements to IFRSs 2012–2014 Cycle *Disclosure of information 'elsewhere in the interim financial report'* (Amendments to IAS 34)	1 January 2016	No amendments made to the Standard.
Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)	1 January 2016	Considered in this review. No amendments made to the Standard.
Disclosure Initiative (Amendments to IAS 1)	1 January 2016	Considered in this review and resulted in amendments to the Standard. See paragraphs 3.15A, 3.17(e) and 4.3.
Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)	1 January 2017	Considered in this review and resulted in amendments to the Standard. See paragraphs 29.16A, 29.19(a) and 29.19A.
Annual Improvements to IFRS Standards 2014–2016 Cycle *Clarification of the scope of the Standard* (Amendment to IFRS 12)	1 January 2017	Considered in this review. No amendments made to the Standard.
Disclosure Initiative (Amendments to IAS 7)	1 January 2017	Considered in this review and resulted in amendments to the Standard. See paragraph 7.19A.
IFRS 15 *Revenue from Contracts with Customers*	1 January 2018	Considered in this review and resulted in the revised Section 23.
Effective Date of IFRS 15	1 January 2018	Considered in this review. No amendments made to the Standard.
Clarifications to IFRS 15 Revenue from Contracts with Customers	1 January 2018	Considered in this review as part of revising Section 23 and resulted in amendments to the Standard.

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IFRS 9 (2014) *Financial Instruments*	1 January 2018	
Classification and Measurement		Considered in this review and resulted in amendments to the Standard. See paragraph 11.9ZA.
Impairment		Considered in this review. No amendments made to the Standard.
Hedge Accounting		Considered in this review. No amendments made to the Standard.
Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)	1 January 2018	Considered in this review and resulted in amendments to the Standard. See paragraphs 26.14A–26.15D.
Applying IFRS 9 Financial Instruments *with IFRS 4* Insurance Contracts (Amendments to IFRS 4)	1 January 2018	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRS Standards 2014–2016 Cycle *Deletion of short-term exemptions for first-time adopters* (Amendments to IFRS 1)	1 January 2018	Considered in this review. No amendments made to the Standard.
Annual Improvements to IFRS Standards 2014–2016 Cycle *Measuring an associate or joint venture at fair value* (Amendments to IAS 28)	1 January 2018	Considered in this review. No amendments made to the Standard.
Transfers of Investment Property (Amendments to IAS 40)	1 January 2018	Considered in this review and resulted in amendments to the Standard. See paragraph 16.9.
IFRIC 22 *Foreign Currency Transactions and Advance Consideration*	1 January 2018	Considered in this review and resulted in amendments to the Standard. See paragraph 30.8A.
IFRS 16 *Leases*	1 January 2019	Considered in this review. No amendments made to the Standard at this time.
IFRIC 23 *Uncertainty over Income Tax Treatments*	1 January 2019	Considered in this review and resulted in amendments to the Standard. See paragraphs 29.34A–29.34D.
Prepayment Features with Negative Compensation (Amendments to IFRS 9)	1 January 2019	Considered in this review and resulted in amendments to the Standard. See paragraph 11.9(b).
Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)	1 January 2019	Considered in this review and resulted in amendments to the Standard. See paragraph 14.8(d).
Annual Improvements to IFRS Standards 2015–2017 Cycle *Previously held interests in a joint operation* (Amendments to IFRS 3 and IFRS 11)	1 January 2019	Considered in this review as part of revising Section 19 and resulted in amendments to the Standard.
Annual Improvements to IFRS Standards 2015–2017 Cycle *Income tax consequences of payments on financial instruments classified as equity* (Amendments to IAS 12)	1 January 2019	No amendments made to the Standard.
Annual Improvements to IFRS Standards 2015–2017 Cycle *Borrowing costs eligible for capitalisation* (Amendments to IAS 23)	1 January 2019	Considered in this review. No amendments made to the Standard.

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Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)	1 January 2019	Considered in this review. No amendments made to the Standard.
Conceptual Framework for Financial Reporting	1 January 2020	Considered in this review and resulted in the revised Section 2.
Amendments to References to the Conceptual Framework in IFRS Standards	1 January 2020	Considered in this review and resulted in amendments to the Standard. See footnotes to paragraphs 18.4 and 21.1.
Definition of a Business (Amendments to IFRS 3)	1 January 2020	Considered in this review as part of revising Section 19 and resulted in amendments to the Standard.
Definition of Material (Amendments to IAS 1 and IAS 8)	1 January 2020	Considered in this review and resulted in amendments to the Standard. See paragraph 3.16.
Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)	1 January 2020	Considered in this review. No amendments made to the Standard.
Covid-19-Related Rent Concessions (Amendment to IFRS 16)	1 June 2020	Outside the scope of this review. This will be considered in a future review of the Standard.
Extension of the Temporary Exemption from Applying IFRS 9 (Amendments to IFRS 4)	25 June 2020	Outside the scope of this review. This will be considered in a future review of the Standard.
Interest Rate Benchmark Reform—Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)	1 January 2021	Considered in this review. No amendments made to the Standard.
Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendment to IFRS 16)	1 April 2021	Outside the scope of this review. This will be considered in a future review of the Standard.
Annual Improvements to IFRS Standards 2018–2020	1 January 2022	Outside the scope of this review. This will be considered in a future review of the Standard.
Reference to the Conceptual Framework (Amendments to IFRS 3)	1 January 2022	Considered in this review as part of revising Section 19 and resulted in amendments to the Standard.
Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)	1 January 2022	Outside the scope of this review. This will be considered in a future review of the Standard.
Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)	1 January 2022	Outside the scope of this review. This will be considered in a future review of the Standard.
IFRS 17 *Insurance Contracts*	1 January 2023	Outside the scope of this review. This will be considered in a future review of the Standard.
Amendments to IFRS 17	1 January 2023	Outside the scope of this review. This will be considered in a future review of the Standard.
Initial Application of IFRS 17 and IFRS 9—Comparative Information (Amendment to IFRS 17)	1 January 2023	Outside the scope of this review. This will be considered in a future review of the Standard.
Classification of Liabilities as Current or Non-current—Deferral of Effective Date (Amendment to IAS 1)	1 January 2023	Outside the scope of this review. This will be considered in a future review of the Standard.

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Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2)	1 January 2023	Considered in this review and resulted in amendments to the Standard. See paragraphs 3.17(e) and 8.4–8.6.
Definition of Accounting Estimates (Amendments to IAS 8)	1 January 2023	Considered in this review and resulted in amendments to the Standard. See paragraphs 10.14A–10.15.
Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)	1 January 2023	Outside the scope of this review. This will be considered in a future review of the Standard.
International Tax Reform—Pillar Two Model Rules (Amendments to IAS 12)	1 January 2023	The IASB amended the Standard in September 2023 for this amendment.
Classification of Liabilities as Current or Non-current (Amendments to IAS 1)	1 January 2024	Outside the scope of this review. This will be considered in a future review of the Standard.
Lease Liability in a Sale and Leaseback (Amendments to IFRS 16)	1 January 2024	Outside the scope of this review. This will be considered in a future review of the Standard.
Non-current Liabilities with Covenants (Amendments to IAS 1)	1 January 2024	Outside the scope of this review. This will be considered in a future review of the Standard.
Supplier Finance Arrangements (Amendments to IAS 7 and IFRS 7)	1 January 2024	Considered in this review and resulted in amendments to the Standard. See paragraphs 7.19B–7.19C.
Lack of Exchangeability (Amendments to IAS 21)	1 January 2025	Considered in this review and resulted in amendments to the Standard. See paragraphs 30.5A, 30.28–30.29 and Appendix to Section 30.
Amendments to the Classification and Measurement of Financial Instruments (Amendments to IFRS 9 and IFRS 7)	1 January 2026	Outside the scope of this review. This will be considered in a future review of the Standard.
Annual Improvements to IFRS Accounting Standards—Volume 11	1 January 2026	Outside the scope of this review. This will be considered in a future review of the Standard.
Contracts Referencing Nature-dependent Electricity (Amendments to IFRS 9 and IFRS 7)	1 January 2026	Outside the scope of this review. This will be considered in a future review of the Standard.
IFRS 18 *Presentation and Disclosure in Financial Statements*	1 January 2027	Outside the scope of this review. This will be considered in a future review of the Standard.
IFRS 19 *Subsidiaries without Public Accountability: Disclosures*	1 January 2027	Outside the scope of this review. This will be considered in a future review of the Standard.

Appendix B
Amendments to the bases for conclusions on the *Conceptual Framework for Financial Reporting*, IFRS 19 *Subsidiaries without Public Accountability: Disclosures* and IFRS Practice Statement 2 *Making Materiality Judgements*

This appendix sets out the amendments to the bases for conclusions on the Conceptual Framework for Financial Reporting*, IFRS 19* Subsidiaries without Public Accountability: Disclosures *and IFRS Practice Statement 2* Making Materiality Judgements*. The amendments are a consequence of the IASB issuing the third edition of the* IFRS for SMEs *Accounting Standard.*

Conceptual Framework for Financial Reporting

A footnote is added to the end of paragraph BC0.26. New text is underlined.

* In 2025 the Board issued the third edition of the *IFRS for SMEs* Accounting Standard and revised the section. The section is now based on the 2018 *Conceptual Framework*.

IFRS 19 *Subsidiaries without Public Accountability: Disclosures*

A footnote is added to 'paragraph BC47 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard' in paragraph BC23(b). New text is underlined.

* The third edition of the *IFRS for SMEs* Accounting Standard was issued in 2025. The reference to paragraph BC47 relates to the Basis for Conclusions on the second edition of that Accounting Standard. The paragraph was replaced by paragraph BC11 of the Basis for Conclusions on the third edition of the Accounting Standard.

A footnote is added to 'paragraph BC163 of the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard' in paragraph BC23(e). New text is underlined.

* The third edition of the *IFRS for SMEs* Accounting Standard was issued in 2025. The reference to paragraph BC163 relates to the Basis for Conclusions on the second edition of that Accounting Standard. The paragraph was replaced by paragraph BC74 of the Basis for Conclusions on the third edition of the Accounting Standard.

A footnote is added to the end of paragraph BC65. New text is underlined.

* The requirement was included in the third edition of the *IFRS for SMEs* Accounting Standard issued in 2025. The explanation in paragraph BC163 of the Basis for Conclusions on the second edition of the Standard was deleted from the Basis for Conclusions on the third edition of the Accounting Standard.

IFRS Practice Statement 2 *Making Materiality Judgements*

A footnote is added to the end of the third sentence of paragraph BC12. New text is underlined.

<u>*</u> <u>In 2025 the IASB issued the third edition of the *IFRS for SMEs* Accounting Standard, which aligned the Standard with the *Conceptual Framework* and *Disclosure Initiative—Definition of Material* issued in 2018. The IASB did not change the scope of the Practice Statement.</u>

Illustrative Financial Statements

HKFRS for Private Entities Accounting Standard

This illustrative financial statements is based on the relevant documents of *IFRS for SMEs* Accounting Standard, which was published by the International Accounting Standards Board, and do not contain guidance on the disclosure requirements of the Hong Kong Companies Ordinance.

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

Illustrative Financial Statements for the *IFRS for SMEs* Accounting Standard

HKFRS for Private Entities Accounting Standard (HKFRS for PE) is based on IFRS for SMEs Accounting Standard (IFRS for SMEs). In approving HKFRS for PE, the Financial Reporting Standards Committee of the Hong Kong Institute of Certified Public Accountants considered and agreed with the Illustrative Financial Statements of International Accounting Standards Board (IASB) on IFRS for SMEs. Accordingly, there are no differences between HKFRS for PE and IFRS for SMEs. The IASB's Illustrative Financial Statements is reproduced below. The paragraph numbers of IFRS for SMEs referred to below generally correspond with those in HKFRS for PE.

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from page

Illustrative Financial Statements for the *IFRS for SMEs* Accounting Standard

This guidance accompanies, but is not part of, the IFRS for SMEs *Accounting Standard*.

Introduction

F1 Section 3 *Financial Statement Presentation* of the *IFRS for SMEs* Accounting Standard defines a complete set of financial statements and prescribes general requirements for presenting financial statements. Section 4 *Statement of Financial Position*, Section 5 *Statement of Comprehensive Income and Income Statement*, Section 6 *Statement of Changes in Equity and Statement of Income and Retained Earnings*, Section 7 *Statement of Cash Flows* and Section 8 *Notes to the Financial Statements* prescribe the format and content of the individual financial statements and notes. Other sections of the *IFRS for SMEs* Accounting Standard set out additional presentation and disclosure requirements. These Illustrative Financial Statements show how those presentation and disclosure requirements might be met by a typical small or medium-sized entity. The Illustrative Financial Statements should not be regarded as a template appropriate for all entities. Each entity will need to consider the content, sequencing and format of their presentation and the descriptions it uses for line items to achieve 'fair presentation' in that entity's particular circumstances.

F2 The illustrative statement of financial position presents current assets followed by non-current assets, and presents current liabilities followed by non-current liabilities and then by equity (that is, the most liquid items are presented first). In some jurisdictions, the sequencing is typically reversed (that is, the most liquid items are presented last), and that is also permitted by the *IFRS for SMEs* Accounting Standard. In accordance with paragraph 3.22 of the *IFRS for SMEs* Accounting Standard, an entity may use titles for the financial statements other than those used in these illustrations.

F3 In accordance with paragraph 3.18, the Illustrative Financial Statements present a single statement of comprehensive income and retained earnings in place of two separate statements—a statement of comprehensive income and a statement of changes in equity. An entity can take this approach if the only changes to its equity during the periods for which it presents financial statements arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy. (Because no items of other comprehensive income are presented, this statement could have been titled 'Statement of income and retained earnings'.) Two statements of comprehensive income and retained earnings are provided to illustrate the alternative classifications of income and expenses, by nature and by function—see paragraph 5.11 of the *IFRS for SMEs* Accounting Standard.

F4 The Illustrative Financial Statements are not intended to illustrate all aspects of the *IFRS for SMEs* Accounting Standard. The IFRS® Foundation's supporting materials for the *IFRS for SMEs* Accounting Standard, available on the IFRS Foundation's website (www.ifrs.org), contain, by section, further illustrations of the presentation and disclosure requirements of the *IFRS for SMEs* Accounting Standard.

F5 The *IFRS for SMEs* Accounting Standard does not require a statement of financial position at the beginning of the earliest comparative period. However, the illustrative statement of financial position includes a column for the opening statement of financial position to assist understanding of the calculations of the underlying amounts in the statement of cash flows.

XYZ Group
Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 1—illustrating the classification of expenses by function)

	Notes	**20X2**	**20X1**
		CU	**CU**
Revenue	5	6,846,037	5,785,275
Cost of sales		(5,162,249)	(4,404,400)
Gross profit		1,683,788	1,380,875
Other income	6	88,850	25,000
Distribution costs		(175,550)	(156,800)
Administrative expenses		(810,230)	(660,389)
Other expenses		(106,763)	(100,030)
Finance costs	7	(28,120)	(36,712)
Profit before tax	8	651,975	451,944
Income tax expense	9	(270,250)	(189,559)
Profit for the year		381,725	262,385
Retained earnings at start of year		2,166,150	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,397,875	2,166,150

Note: In this format, the entity aggregates expenses according to their function (for example, cost of sales, distribution and administrative). Because the only changes to XYZ Group’s equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

XYZ Group
Consolidated statement of comprehensive income and retained earnings for the year ended 31 December 20X2

(Alternative 2—illustrating the classification of expenses by nature)

	Notes	20X2	20X1
		CU	CU
Revenue	5	6,846,037	5,785,275
Other income	6	88,850	25,000
Changes in inventories of finished goods, work in progress and returns asset		6,416	10,595
Raw material and consumables used		(4,786,699)	(4,092,185)
Employee salaries and benefits		(936,142)	(879,900)
Depreciation and amortisation expense		(277,060)	(221,247)
Impairment of property, plant and equipment		(30,000)	–
Other expenses		(231,307)	(138,882)
Finance costs	7	(28,120)	(36,712)
Profit before tax	8	651,975	451,944
Income tax expense	9	(270,250)	(189,559)
Profit for the year		381,725	262,385
Retained earnings at start of year		2,166,150	2,003,765
Dividends		(150,000)	(100,000)
Retained earnings at end of year		2,397,875	2,166,150

Note: In this format, the entity aggregates expenses according to their nature (for example, raw materials and consumables, employee salaries and benefits, depreciation and amortisation, impairment and other expenses). Because the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a single statement of comprehensive income and retained earnings instead of separate statements of comprehensive income and changes in equity.

XYZ Group
Consolidated statement of financial position at 31 December 20X2

	Notes	20X2	20X1	20X0
ASSETS		**CU**	**CU**	**CU**
Current assets				
Cash		32,905	22,075	18,478
Trade and other receivables	10	585,548	573,862	521,234
Inventories	12	96,837	66,095	45,050
		715,290	662,032	584,762
Non-current assets				
Investment in associate	13	107,500	107,500	107,500
Property, plant and equipment	14	2,604,945	2,401,455	2,186,002
Intangible assets	15	850	2,550	4,250
Deferred tax asset	16	4,309	2,912	2,155
		2,717,604	2,514,417	2,299,907
Total assets		3,432,894	3,176,449	2,884,669
LIABILITIES AND EQUITY				
Current liabilities				
Bank overdraft	17	83,600	115,507	20,435
Trade and other payables	18	482,571	443,898	412,690
Interest payable		2,000	1,200	–
Current tax liability		271,647	190,316	173,211
Provision for warranty obligations	21	4,200	5,040	2,000
Current portion of employee benefit obligations	22	4,944	4,754	4,571
Current portion of obligations under finance leases	23	30,330	19,884	18,423
		879,292	780,599	631,330
Non-current liabilities				
Bank loan	17	50,000	150,000	150,000
Long-term employee benefit obligations	22	5,679	5,076	5,066
Obligations under finance leases	23	70,048	44,624	64,508
		125,727	199,700	219,574
Total liabilities		1,005,019	980,299	850,904

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Equity				
Share capital	25	30,000	30,000	30,000
Retained earnings	4	2,397,875	2,166,150	2,003,765
		2,427,875	2,196,150	2,033,765
Total liabilities and equity		3,432,894	3,176,449	2,884,669

Note: The *IFRS for SMEs* Accounting Standard does not require a statement of financial position at the beginning of the earliest comparative period. This opening statement of financial position is presented here, in the shaded column, to aid understanding of the calculations underlying amounts in the statement of cash flows.

XYZ Group
Consolidated statement of cash flows for the year ended 31 December 20X2

	Notes	20X2	20X1
		CU	CU
Cash flows from operating activities			
Profit for the year		381,725	262,385
Adjustments for non-cash income and expenses:			
Non-cash finance costs[(a)]		800	1,200
Non-cash income tax expense[(b)]		79,934	16,348
Depreciation of property, plant and equipment		275,360	219,547
Impairment loss		30,000	–
Amortisation of intangibles		1,700	1,700
Cash flow included in investing activities:			
Gain on sale of equipment		(63,850)	–
Changes in operating assets and liabilities:			
Increase in trade and other receivables		(11,686)	(52,628)
Increase in inventories		(30,742)	(21,045)
Increase in trade and other payables[(c)]		38,673	31,208
Increase (decrease) in provision for warranty obligations		(840)	3,040
Increase in current and long-term employee benefit payable		793	193
Net cash from operating activities		701,867	461,948
Cash flows from investing activities			
Proceeds from sale of equipment		100,000	–
Purchases of equipment		(485,000)	(435,000)
Net cash used in investing activities		(385,000)	(435,000)
Cash flows from financing activities			
Payment of finance lease liabilities		(24,130)	(18,423)
Repayment of borrowings		(100,000)	–
Dividends paid		(150,000)	(100,000)
Net cash used in financing activities		(274,130)	(118,423)
Net increase (decrease) in cash and cash equivalents		42,737	(91,475)
Cash and cash equivalents at beginning of year		(93,432)	(1,957)
Cash and cash equivalents at end of year	26	(50,695)	(93,432)
(a) Finance costs paid in cash		27,320	35,512
(b) Income taxes paid in cash		190,316	173,211
(c) Includes unrealised foreign exchange loss		1,000	–

XYZ Group
Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office is__________. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. The Group manufactures and sells candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the *IFRS for SMEs* Accounting Standard issued by the International Accounting Standards Board. They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the Group's right to receive payment has been established, it is probable that the economic benefits associated with the dividend will flow to the Group and the amount of the dividend can be measured reliably. Dividend income from investments in associates is included in other income.

Revenue recognition

Revenue from the sale of goods is recognised when control of the goods is transferred to the customer, which is upon delivery to the customer. Revenue from licensing candle-making patents for use by others is based on a percentage of revenue generated by the patent, as specified in the relevant licence agreement. Royalty revenue is recognised when the sales associated with the patent occur. Revenue is measured at the amount of the consideration to which the Group expects to be entitled, net of sales-related taxes collected on behalf of the government of A Land and after considering rights to returns.

Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (known as temporary differences). Deferred tax liabilities are generally recognised for all temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (taxable temporary differences). Deferred tax assets are generally recognised for all temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (deductible temporary differences). However, deferred tax assets are recognised only to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are recognised in profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which the entity expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The annual rates used for the depreciation of property, plant and equipment are:

Buildings	2%
Fixtures and equipment	10%–30%

If there is an indication that there has been a significant change in depreciation rate, useful life or residual value of an asset, the depreciation of that asset is revised prospectively to reflect the new expectations.

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated amortisation and any accumulated impairment losses. Computer software is amortised over its estimated life of five years using the straight-line method. If there is an indication that there has been a significant change in amortisation rate, useful life or residual value of an intangible asset, the amortisation is revised prospectively to reflect the new expectations.

Impairment of assets

At each reporting date, property, plant and equipment, intangible assets and investments in associates are reviewed for indications that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of any affected asset (or group of related assets) is estimated and compared with its carrying amount. If the estimated recoverable amount is lower, the carrying amount is reduced to its estimated recoverable amount and an impairment loss is recognised immediately in profit or loss.

Similarly, at each reporting date, inventories are assessed for impairment by comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell. If an item of inventory (or group of similar items) is impaired, its carrying amount is reduced to selling price less costs to complete and sell, and an impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of related assets) is increased to the revised estimate of its recoverable amount (selling price less costs to complete and sell, in the case of inventories). However, the carrying amount is not increased in excess of the amount that would have been determined had no impairment loss been recognised for the asset (or group of related assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of a lease transfer substantially all the risks and rewards of ownership of the leased asset to the Group. All other leases are classified as operating leases.

Rights to assets held under finance leases are recognised as assets of the Group at the fair value of the leased property (or, if lower, the present value of minimum lease payments) at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are deducted in measuring profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciated and assessed for impairment losses in the same way as owned assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method. Inventories include a returns asset which represents the right to recover goods expected to be returned by customers. The asset is measured at the former carrying amount of the goods less any expected costs to recover the goods and any expected reduction in value.

Trade receivables

Most sales are made on the basis of normal credit terms (30 days from the date of invoice) and the receivables do not bear interest. Trade receivables are measured at cost, except when credit is extended to customers that are not expected to pay within one year from the date of delivery. In such instances, the receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of the receivables are reviewed to assess whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

Trade and other payables

Trade payables are obligations on the basis of normal credit terms and do not bear interest. Trade payables denominated in a foreign currency are translated into CU using the exchange rate at the reporting date. Foreign exchange gains or losses are included in other income or other expenses.

Customers may return any unused goods within 30 days and receive a full refund. The refund liability is the amount of consideration received or receivable that is expected to be refunded to customers in respect of returned goods.

Bank loans and overdrafts

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Employee benefits—Long-service payment

The liability for employee benefit obligations relates to government-mandated long-service payments. All full-time staff, excluding directors, are covered by the programme. A payment is made of 5% of salary (as determined for the 12 months before the payment) at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The Group's cost and obligation to make long-service payments to employees are recognised during the employees' periods of service. The cost and obligation are measured using the projected unit credit method, assuming a 4% average annual salary increase, with employee turnover based on the Group's recent experience, discounted using the current market yield for high-quality corporate bonds.

Provision for warranty obligations

All goods sold by the Group are warranted to be free of manufacturing defects for a period of one year. Goods are repaired or replaced at the Group's option. When revenue is recognised, a provision is made for the estimated cost of the warranty obligation.

3. Key sources of estimation uncertainty

Long-service payments

In determining the liability for long-service payments (explained in note 22), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation and the number of employees expected to leave before they receive the benefits.

Refund liability for expected returns

In determining the liability for expected returns (included in other payables—see note 18), management must make an estimate of the candles expected to be returned by customers, which is based on historical rates of returns.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

	20X2	**20X1**
	CU	**CU**
Sale of goods to wholesale customers	6,380,040	5,438,664
Sale of goods to retail customers	335,792	226,611
Royalties—licensing of candle-making patents	130,205	120,000
	6,846,037	5,785,275

6. Other income

Other income includes dividends received from an associate of CU25,000 in both 20X1 and 20X2 and a gain on the disposal of property, plant and equipment of CU63,850 in 20X2.

7. Finance costs

	20X2	20X1
	CU	CU
Interest on bank loan and overdraft	21,250	30,135
Interest on finance leases	6,870	6,577
	28,120	36,712

8. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Inventories recognised as an expense	5,157,249	4,404,400
Research and development cost (included in other expenses)	31,620	22,778
Foreign exchange loss on trade payables (included in other expenses)	1,000	–
Warranty expense (included in cost of sales*)	5,260	7,340
Impairment losses on trade receivables (included in other expenses)	70,807	71,108

* If the entity classifies its expenses by nature in its statement of comprehensive income, this would say 'included in raw materials and consumables used'.

9. Income tax expense

	20X2	20X1
	CU	CU
Current tax	271,647	190,316
Deferred tax (see note 16)	(1,397)	(757)
	270,250	189,559

Income tax is calculated at 40% (20X1: 40%) of the estimated assessable profit for the year.

Income tax expense for the year CU270,250 in 20X2 (CU189,559 in 20X1) differs from the amount that would result from applying the tax rate of 40% (both 20X2 and 20X1) to profit before tax because, under the tax laws of A Land, some employee compensation expenses (CU23,651 in 20X2 and CU21,953 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

10. Trade and other receivables

	20X2	20X1
	CU	CU
Trade receivables	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

11. Analysis of the age of trade receivables

The table analyses the age of the Group's trade receivables by reference to their due date.

	Not yet due	Less than 1 month	1–3 months	3 months –1 year	1–5 years	More than 5 years	Total
	CU	CU	CU	CU	CU	CU	CU
20X2							
Amortised cost before impairment	190,000	130,000	245,000	115,000	85,000	15,000	780,000
Impairment	–	(10,000)	(68,000)	(80,000)	(78,654)	(14,558)	(251,212)
	190,000	120,000	177,000	35,000	6,346	442	528,788
20X1							
Amortised cost before impairment	175,000	160,000	251,000	116,500	91,000	21,000	814,500
Impairment	–	(13,212)	(72,100)	(90,000)	(90,014)	(20,790)	(286,116)
	175,000	146,788	178,900	26,500	986	210	528,384

12. Inventories

	20X2	20X1
	CU	CU
Raw materials	60,776	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
Returns asset	21,281	18,175
	96,837	66,095

13. Investment in associate

The Group owns 35% of an associate whose shares are not publicly traded.

	20X2	20X1
	CU	CU
Cost of investment in associate	107,500	107,500
Dividend received from associate (included in other income)	25,000	25,000

14. Property, plant and equipment

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X2	1,960,000	1,102,045	3,062,045
Additions	–	545,000	545,000
Disposals	–	(241,000)	(241,000)
31 December 20X2	1,960,000	1,406,045	3,366,045
Accumulated depreciation and impairment			
1 January 20X2	390,000	270,590	660,590
Annual depreciation	30,000	245,360	275,360
Impairment (included in cost of sales*)	–	30,000	30,000
Less accumulated depreciation on assets disposed of	–	(204,850)	(204,850)
31 December 20X2	420,000	341,100	761,100
Carrying amount			
31 December 20X2	1,540,000	1,064,945	2,604,945
1 January 20X1			
Cost	1,960,000	895,234	2,855,234
Accumulated depreciation and impairment	(360,000)	(309,232)	(669,232)
Carrying amount	1,600,000	586,002	2,186,002

* If the entity classified its expenses by nature in its statement of comprehensive income and included the line item 'impairment of property, plant and equipment', this disclosure of the line item would not be necessary.

During 20X2 the Group noticed a significant decline in the efficiency of a major piece of equipment and so carried out a review of its recoverable amount. The review led to the recognition of an impairment loss of CU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU95,000 (20X1: CU60,000) in respect of assets held under finance leases.

On 10 December 20X2 the directors resolved to dispose of a machine. The machine's carrying amount of CU1,472 is included in fixtures and equipment at 31 December 20X2, and trade payables include the Group's remaining obligation of CU1,550 on the acquisition of this machine. Because the proceeds on disposal are expected to exceed the net carrying amount of the asset and related liability, no impairment loss has been recognised.

15. Intangible assets

Software:

Cost	**CU**
1 January 20X2	8,500
Additions	–
Disposals	–
31 December 20X2	8,500
Accumulated amortisation and impairment	
1 January 20X2	5,950
Annual amortisation (included in administrative expenses*)	1,700
31 December 20X2	7,650
Carrying amount	
31 December 20X2	850
1 January 20X1	
Cost	8,500
Accumulated amortisation and impairment	(4,250)
Carrying amount	4,250

* If the entity classifies its expenses by nature in its statement of comprehensive income, this would say ‘included in depreciation and amortisation expense’.

16. Deferred tax

Differences between amounts recognised in the financial statements and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax assets are the tax effects of expected future income tax benefits relating to:

(a) the long-service benefit (see note 22), which will not be tax-deductible until the benefit is actually paid, but which has already been recognised as an expense in measuring the Group's profit for the year; and

(b) the foreign exchange loss on trade payables, which will not be tax-deductible until the payables are settled, but which has already been recognised as an expense in measuring the Group's profit for the year.

Management considers it probable that taxable profits will be available against which the future income tax deductions can be utilised.

The deferred tax liabilities (assets) recognised by the Group are:

	Software	**Foreign exchange loss**	**Long-service benefit**	**Total**
	CU	**CU**	**CU**	**CU**
1 January 20X1	1,700	–	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	–	(77)	(757)
1 January 20X2	1,020	–	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(400)	(317)	(1,397)
31 December 20X2	340	(400)	(4,249)	(4,309)

The deferred tax assets for the foreign exchange loss and the long-service benefits and the deferred tax liability for software relate to income tax in the same jurisdiction, and the law allows net settlement. Consequently, they have been offset in the statement of financial position as follows:

	20X2	**20X1**
	CU	**CU**
Deferred tax liability	340	1,020
Deferred tax asset	(4,649)	(3,932)
	(4,309)	(2,912)

17. Bank overdraft and loan

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Bank loan—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,507

The bank overdraft and loan are secured by a floating lien over land and buildings owned by the Group with a carrying amount of CU266,000 at 31 December 20X2 (CU412,000 at 31 December 20X1).

Interest is payable on the bank overdraft at 200 points above the Sterling Overnight Index Average (SONIA). Interest is payable on the seven-year bank loan at a fixed rate of 5% of the principal amount.

18. Trade and other payables

	20X2	20X1
	CU	CU
Trade payables	454,858	420,520
Refund liability for expected returns	27,713	23,378
	482,571	443,898

Trade payables at 31 December 20X2 include CU42,600 denominated in foreign currencies (nil at 31 December 20X1).

19. Financial liabilities

The Group's financial liabilities are measured at amortised cost.

	20X2	20X1
	CU	CU
Bank overdraft	83,600	115,507
Trade payables	454,858	420,520
Interest payable	2,000	1,200
Bank loan	50,000	150,000
	590,458	687,227

20. Maturity analysis of financial liabilities

The table analyses the Group's financial liabilities based on their remaining contractual maturities. The amounts are the contractual undiscounted cash flows, including interest payments.

	Total	Less than 1 month	1–3 months	3 months–1 year	1–5 years
	CU	CU	CU	CU	CU
20X2					
Bank overdraft	83,600	83,600	–	–	–
Trade payables	454,858	174,858	250,000	30,000	–
Interest payable	2,000	1,200	800	–	–
Bank loan	55,000	–	625	1,875	52,500
20X1					
Bank overdraft	115,507	115,507	–	–	–
Trade payables	420,520	170,520	200,000	50,000	–
Interest payable	1,200	–	1,200	–	–
Bank loan	172,500	–	1,875	5,625	165,000

21. Provision for warranty obligations

Changes in the provision for warranty obligations during 20X2 were:

	20X2
	CU
1 January 20X2	5,040
Additional accrual during the year	5,260
Cost of warranty repairs and replacement during the year	(6,100)
31 December 20X2	4,200

The obligation is classified as a current liability because the warranty is limited to twelve months.

22. Employee benefit obligation—long-service payments

The Group's employee benefit obligation for long-service payments under a government-mandated plan is based on a comprehensive actuarial valuation as of 31 December 20X2 and is as follows:

	20X2
	CU
Obligation at 1 January 20X2	9,830
Additional accrual during the year	7,033
Benefit payments made in year	(6,240)
Obligation at 31 December 20X2	10,623

The obligation is classified as:

	20X2	**20X1**
	CU	**CU**
Current liability	4,944	4,754
Non-current liability	5,679	5,076
Total	10,623	9,830

23. Obligations under finance leases

The Group holds specialised machinery under finance lease. The length of the leases and estimated useful life of the machinery are both five or six years. The future minimum lease payments are:

	20X2	**20X1**
	CU	**CU**
Within one year	37,000	25,000
Later than one year, but within five years	73,000	50,000
Later than five years	6,000	–
	116,000	75,000

The obligation is classified as:

	20X2	**20X1**
	CU	**CU**
Current liability	30,330	19,884
Non-current liability	70,048	44,624
	100,378	64,508

24. Commitments under operating leases

The Group rents several sales offices under operating leases. The leases are for an average period of three years, with fixed rentals over the same period.

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At year-end, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2	20X1
	CU	CU
Within one year	13,050	26,100
Later than one year, but within five years	–	13,050
Later than five years	–	–
	13,050	39,150

25. Share capital

Balances as at 31 December 20X2 and 20X1 of CU30,000 comprise 30,000 ordinary shares with par value CU1 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised, but unissued.

26. Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	32,905	22,075
Overdrafts	(83,600)	(115,507)
	(50,695)	(93,432)

27. Reconciliation of liabilities arising from financing activities

	Interest payable	Bank loan	Finance leases	Total
	CU	CU	CU	CU
1 January 20X1	–	(150,000)	(82,931)	(232,931)
Cash payments	–	6,300	25,000	31,300
Interest	–	(7,500)	(6,577)	(14,077)
Non-cash finance costs	(1,200)	1,200	–	–
31 December 20X1	(1,200)	(150,000)	(64,508)	(215,708)
Cash payments	–	106,700	31,000	137,700
Interest	–	(7,500)	(6,870)	(14,370)
Non-cash finance costs	(800)	800	–	–
Finance leases entered into	–	–	(60,000)	(60,000)
31 December 20X2	(2,000)	(50,000)	(100,378)	(152,378)

28. Contingent liabilities

During 20X2 a customer initiated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has initiated litigation claiming this amount.

The Group’s legal counsel takes the view that the claim has no merit and the Company intends to contest the claim. No provision has been recognised in these financial statements because the Group’s management has not deemed it probable that a loss will arise.

29. Events after the end of the reporting period

On 25 January 20X3 there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

On 14 February 20X3 the directors voted to declare a dividend of CU1 per share (CU30,000 total) payable on 15 April 20X3 to registered shareholders on 31 March 20X3. Because the obligation arose in 20X3, a liability is not shown in the statement of financial position at 31 December 20X2.

30. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 13), which is a related party, as follows:

	Sales of goods		**Amounts owed to the Group by the related party and included in trade receivables at year-end**	
	20X2	**20X1**	**20X2**	**20X1**
	CU	**CU**	**CU**	**CU**
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 23) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The total remuneration of directors and other members of key management in 20X2 (including salaries and benefits) was CU249,918 (20X1: CU208,260).

31. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.