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

MEMBERS' HANDBOOK

Update No. 113

(Issued 28 February 2012)

Handbook Improvements only

Document Reference and Title	***Instructions***	***Explanations***

VOLUME II

Contents of Volume II	Insert the revised pages i and ii. Discard the replaced pages i and ii.	Revised contents pages

Amendments to the following Standards, Basis for Conclusions and Implementation Guidance were previously set out in the Appendix to the Standards as they were not yet effective. The Institute has taken this opportunity to incorporate the amendments applicable on 1 January 2012 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*	Replace the Standard, Basis for Conclusions and Implementation Guidance with revised Standard, Basis for Conclusions and Implementation Guidance	Amendments due to - HK(IFRIC) – Int 19 *Extinguishing Financial Liabilities with Equity Instruments* - *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendments to HKFRS 1) - *Improvements to HKFRSs 2010* - *Disclosures – Transfers of Financial Assets* (Amendments to HKFRS 7) - *Severe*

		Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to HKFRS 1)
HKFRS 3 (Revised) *Business Combinations* (Standard)	Replace the cover page and pages 1A, 3-4, 6, 9-12, 19 and 34-35 with revised cover page and pages 1A, 3-4, 6, 9-12, 19 and 34-35. Insert page 19A after page 19 and page 35A after page 35. Discard page 43	Amendments due to - *Improvements to HKFRSs 2010*
HKFRS 3 (Revised) *Business Combinations* (Basis for Conclusions)	Replace the cover page and pages 3-5, 47-48, 68 and 92 with revised cover page and pages 3-5, 47-48, 68 and 92. Insert page 48A after page 48, page 65A after page 65 and page 92A after page 92. Discard page 98	Amendments due to - *Improvements to HKFRSs 2010*
HKFRS 3 (Revised) *Business Combinations* (Illustrative Examples)	Replace the cover page and pages 2, 6 and 12 with revised cover page and pages 2, 6 and 12. Insert page 12A after page 12	Amendments due to - *Improvements to HKFRSs 2010*
HKFRS 7 *Financial Instruments: Disclosures*	Replace the Standard, Basis for Conclusions and Implementation Guidance with revised Standard, Basis for Conclusions and Implementation Guidance	Amendments due to - *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendments to HKFRS 1) - *Improvements to HKFRSs 2010* - *Disclosures – Transfers of Financial Assets* (Amendments to HKFRS 7)

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MEMBERS' HANDBOOK
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(Updated to February 2012)

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

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Revised ~~November 2011~~February 2012

Effective for annual periods
beginning on or after 1 July 2009

Hong Kong Financial Reporting Standards 1 (Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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

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Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1–40 and Appendices A–E and G. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the HKFRS. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 1 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of Financial Statements~~Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the HKFRS

IN1 The Hong Kong Institute of Certified Public Accountants (HKICPA) issued HKFRS 1 in October 2003. This HKFRS prescribes the accounting treatment that an entity shall apply when it adopts HKFRSs for the first time as the basis for preparing its financial statements and interim financial reports.

IN2 Subsequently, HKFRS 1 was amended many times to accommodate first-time adoption requirements resulting from new or amended HKFRSs. As a result, the HKFRS became more complex and less clear. Therefore, the HKICPA revised HKFRS 1 to make it easier for the reader to understand and to design it to better accommodate future changes. The version of HKFRS 1 issued in 2008 retains the substance of the previous version, but within a changed structure. It replaces the previous version and is effective for entities applying HKFRSs for the first time for annual periods beginning on or after 1 July 2009. Earlier application is permitted.

Main features of the HKFRS

IN3 The HKFRS applies when an entity adopts HKFRSs for the first time by an explicit and unreserved statement of compliance with HKFRSs.

IN4 In general, the HKFRS requires an entity to comply with each HKFRS effective at the end of its first HKFRS reporting period. In particular, the HKFRS requires an entity to do the following in the opening HKFRS statement of financial position that it prepares as a starting point for its accounting under HKFRSs:

(a) recognise all assets and liabilities whose recognition is required by HKFRSs;

(b) not recognise items as assets or liabilities if HKFRSs do not permit such recognition;

(c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under HKFRSs; and

(d) apply HKFRSs in measuring all recognised assets and liabilities.

IN5 The HKFRS grants limited exemptions from these requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements. The HKFRS also prohibits retrospective application of HKFRSs in some areas, particularly where retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known.

IN6 The HKFRS requires disclosures that explain how the transition from previous GAAP to HKFRSs affected the entity's reported financial position, financial performance and cash flows.

IN7 An entity is required to apply the HKFRS if its first HKFRS financial statements are for a period beginning on or after 1 July 2009. Earlier application is encouraged.

Hong Kong Financial Reporting Standard 1
First-time Adoption of Hong Kong Financial Reporting Standards

Objective

1 The objective of this HKFRS is to ensure that an entity's *first HKFRS financial statements*, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) is transparent for users and comparable over all periods presented;

(b) provides a suitable starting point for accounting in accordance with *Hong Kong Financial Reporting Standards (HKFRSs)*; and

(c) can be generated at a cost that does not exceed the benefits.

Scope

2 An entity shall apply this HKFRS in:

(a) its first HKFRS financial statements; and

(b) each interim financial report, if any, that it presents in accordance with HKAS 34 *Interim Financial Reporting* for part of the period covered by its first HKFRS financial statements.

3 An entity's first HKFRS financial statements are the first annual financial statements in which the entity adopts HKFRSs, by an explicit and unreserved statement in those financial statements of compliance with HKFRSs. Financial statements in accordance with HKFRSs are an entity's first HKFRS financial statements if, for example, the entity:

(a) presented its most recent previous financial statements:

(i) in accordance with other accounting requirements that are not consistent with HKFRSs in all respects;

(ii) in conformity with HKFRSs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with HKFRSs;

(iii) containing an explicit statement of compliance with some, but not all, HKFRSs;

(iv) in accordance with other accounting requirements inconsistent with HKFRSs, using some individual HKFRSs to account for items for which other accounting requirements did not exist; or

(v) in accordance with other accounting requirements, with a reconciliation of some amounts to the amounts determined in accordance with HKFRSs;

(b) prepared financial statements in accordance with HKFRSs for internal use only, without making them available to the entity's owners or any other external users;

(c) prepared a reporting package in accordance with HKFRSs for consolidation purposes without preparing a complete set of financial statements as defined in HKAS 1 *Presentation of Financial Statements* (as revised in 2007); or

(d) did not present financial statements for previous periods.

4 This HKFRS applies when an entity first adopts HKFRSs. It does not apply when, for example, an entity:

(a) stops presenting financial statements in accordance with other accounting requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with HKFRSs;

(b) presented financial statements in the previous year in accordance with other accounting requirements and those financial statements contained an explicit and unreserved statement of compliance with HKFRSs; or

(c) presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with HKFRSs, even if the auditors qualified their audit report on those financial statements.

5 This HKFRS does not apply to changes in accounting policies made by an entity that already applies HKFRSs. Such changes are the subject of:

(a) requirements on changes in accounting policies in HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

(b) specific transitional requirements in other HKFRSs.

Recognition and measurement

Opening HKFRS statement of financial position

6 An entity shall prepare and present an *opening HKFRS statement of financial position* at the *date of transition to HKFRSs*. This is the starting point for its accounting in accordance with HKFRSs.

Accounting policies

7 An entity shall use the same accounting policies in its opening HKFRS statement of financial position and throughout all periods presented in its first HKFRS financial statements. Those accounting policies shall comply with each HKFRS effective at the end of its *first HKFRS reporting period*, except as specified in paragraphs 13–19 and Appendices B–E.

8 An entity shall not apply different versions of HKFRSs that were effective at earlier dates. An entity may apply a new HKFRS that is not yet mandatory if that HKFRS permits early application.

Example: Consistent application of latest version of HKFRSs

Background

The end of entity A's first HKFRS reporting period is 31 December 20X5. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 21). Therefore, its date of transition to HKFRSs is the beginning of business on 1 January 20X4 (or, equivalently, close of business on 31 December 20X3). Entity A presented financial statements in accordance with its *previous GAAP* annually to 31 December each year up to, and including, 31 December 20X4.

Application of requirements

Entity A is required to apply the HKFRSs effective for periods ending on 31 December 20X5 in:

(a) preparing and presenting its opening HKFRS statement of financial position at 1 January 20X4; and

(b) preparing and presenting its statement of financial position for 31 December 20X5 (including comparative amounts for 20X4), statement of comprehensive income, statement of changes in equity and statement of cash flows for the year to 31 December 20X5 (including comparative amounts for 20X4) and disclosures (including comparative information for 20X4).

If a new HKFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that HKFRS in its first HKFRS financial statements.

9 The transitional provisions in other HKFRSs apply to changes in accounting policies made by an entity that already uses HKFRSs; they do not apply to a *first-time adopter*'s transition to HKFRSs, except as specified in Appendices B–E.

10 Except as described in paragraphs 13–19 and Appendices B–E, an entity shall, in its opening HKFRS statement of financial position:

(a) recognise all assets and liabilities whose recognition is required by HKFRSs;

(b) not recognise items as assets or liabilities if HKFRSs do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with HKFRSs; and

(d) apply HKFRSs in measuring all recognised assets and liabilities.

11 The accounting policies that an entity uses in its opening HKFRS statement of financial position may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to HKFRSs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to HKFRSs.

12 This HKFRS establishes two categories of exceptions to the principle that an entity's opening HKFRS statement of financial position shall comply with each HKFRS:

(a) paragraphs 14-17 and Appendix B prohibit retrospective application of some aspects of other HKFRSs.

(b) Appendices C–E grant exemptions from some requirements of other HKFRSs.

Exceptions to the retrospective application of other HKFRSs

13 This HKFRS prohibits retrospective application of some aspects of other HKFRSs. These exceptions are set out in paragraphs 14–17 and Appendix B.

Estimates

14 An entity's estimates in accordance with HKFRSs at the date of transition to HKFRSs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

15 An entity may receive information after the date of transition to HKFRSs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with HKAS 10 *Events after the Reporting Period*. For example, assume that an entity's date of transition to HKFRSs is 1 January 20X4 and new information on 15 July 20X4 requires the revision of an estimate made in accordance with previous GAAP at 31 December 20X3. The entity shall not reflect that new information in its opening HKFRS statement of financial position (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 December 20X4.

16 An entity may need to make estimates in accordance with HKFRSs at the date of transition to HKFRSs that were not required at that date under previous GAAP. To achieve consistency with HKAS 10, those estimates in accordance with HKFRSs shall reflect conditions that existed at the date of transition to HKFRSs. In particular, estimates at the date of transition to HKFRSs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.

17 Paragraphs 14–16 apply to the opening HKFRS statement of financial position. They also apply to a comparative period presented in an entity's first HKFRS financial statements, in which case the references to the date of transition to HKFRSs are replaced by references to the end of that comparative period.

Exemptions from other HKFRSs

18 An entity may elect to use one or more of the exemptions contained in Appendices C–E. An entity shall not apply these exemptions by analogy to other items.

19 Some exemptions in Appendices C–E refer to *fair value*. In determining fair values in accordance with this HKFRS, an entity shall apply the definition of fair value in Appendix A and any more specific guidance in other HKFRSs on the determination of fair values for the asset or liability in question. Those fair values shall reflect conditions that existed at the date for which they were determined.

Presentation and disclosure

20 This HKFRS does not provide exemptions from the presentation and disclosure requirements in other HKFRSs.

Comparative information

21 To comply with HKAS 1, an entity's first HKFRS financial statements shall include at least three statements of financial position, two statements of comprehensive income, two separate income statements (if presented), two statements of cash flows and two statements of changes in equity and related notes, including comparative information.

Non-HKFRS comparative information and historical summaries

22 Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information in accordance with HKFRSs. This HKFRS does not require such summaries to comply with the recognition and measurement requirements of HKFRSs. Furthermore, some entities present comparative information in accordance with previous GAAP as well as the comparative information required by HKAS 1. In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:

(a) label the previous GAAP information prominently as not being prepared in accordance with HKFRSs; and

(b) disclose the nature of the main adjustments that would make it comply with HKFRSs. An entity need not quantify those adjustments.

Explanation of transition to HKFRSs

23 An entity shall explain how the transition from previous GAAP to HKFRSs affected its reported financial position, financial performance and cash flows.

Reconciliations

24 To comply with paragraph 23, an entity's first HKFRS financial statements shall include:

(a) reconciliations of its equity reported in accordance with previous GAAP to its equity in accordance with HKFRSs for both of the following dates:

(i) the date of transition to HKFRSs; and

(ii) the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.

(b) a reconciliation to its total comprehensive income in accordance with HKFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP.

(c) if the entity recognised or reversed any impairment losses for the first time in preparing its opening HKFRS statement of financial position, the disclosures that HKAS 36 *Impairment of Assets* would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to HKFRSs.

25 The reconciliations required by paragraph 24(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the statement of financial position and statement of comprehensive income. If an entity presented a statement of cash flows under its previous GAAP, it shall also explain the material adjustments to the statement of cash flows.

26 If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 24(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.

27 HKAS 8 does not ~~deal with~~apply to the changes in accounting policies ~~that occur when~~ an entity ~~first~~ makes when it adopts HKFRSs or to changes in those policies until after it presents its first HKFRS financial statements. Therefore, HKAS 8's requirements ~~for disclosures~~ about changes in accounting policies do not apply in an entity's first HKFRS financial statements.

27A If during the period covered by its first HKFRS financial statements an entity changes its accounting policies or its use of the exemptions contained in this HKFRS, it shall explain the changes between its first HKFRS interim financial report and its first HKFRS financial statements, in accordance with paragraph 23, and it shall update the reconciliations required by paragraph 24(a) and (b).

28 If an entity did not present financial statements for previous periods, its first HKFRS financial statements shall disclose that fact.

Designation of financial assets or financial liabilities

29 An entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or a financial asset as available for sale in accordance with paragraph D19. The entity shall disclose the fair value of financial assets or financial liabilities designated into each category at the date of designation and their classification and carrying amount in the previous financial statements.

Use of fair value as deemed cost

30 If an entity uses fair value in its opening HKFRS statement of financial position as *deemed cost* for an item of property, plant and equipment, an investment property or an intangible asset (see paragraphs D5 and D7), the entity's first HKFRS financial statements shall disclose, for each line item in the opening HKFRS statement of financial position:

(a) the aggregate of those fair values; and

(b) the aggregate adjustment to the carrying amounts reported under previous GAAP.

Use of deemed cost for investments in subsidiaries, jointly controlled entities and associates

31 Similarly, if an entity uses a deemed cost in its opening HKFRS statement of financial position for an investment in a subsidiary, jointly controlled entity or associate in its separate financial statements (see paragraph D15), the entity's first HKFRS separate financial statements shall disclose:

(a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;

(b) the aggregate deemed cost of those investments for which deemed cost is fair value; and

(c) the aggregate adjustment to the carrying amounts reported under previous GAAP.

Use of deemed cost for oil and gas assets

31A If an entity uses the exemption in paragraph D8A(b) for oil and gas assets, it shall disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated.

Use of deemed cost for operations subject to rate regulation

31B If an entity uses the exemption in paragraph D8B for operations subject to rate regulation, it shall disclose that fact and the basis on which carrying amounts were determined under previous GAAP.

Use of deemed cost after severe hyperinflation

31C If an entity elects to measure assets and liabilities at fair value and to use that fair value as the deemed cost in its opening HKFRS statement of financial position because of severe hyperinflation (see paragraphs D26–D30), the entity's first HKFRS financial statements shall disclose an explanation of how, and why, the entity had, and then ceased to have, a functional currency that 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.

(b) exchangeability between the currency and a relatively stable foreign currency does not exist.

Interim financial reports

32 To comply with paragraph 23, if an entity presents an interim financial report in accordance with HKAS 34 for part of the period covered by its first HKFRS financial statements, the entity shall satisfy the following requirements in addition to the requirements of HKAS 34:

(a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include:

(i) a reconciliation of its equity in accordance with previous GAAP at the end of that comparable interim period to its equity under HKFRSs at that date; and

(ii) a reconciliation to its total comprehensive income in accordance with HKFRSs for that comparable interim period (current and year to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.

(b) In addition to the reconciliations required by (a), an entity's first interim financial report in accordance with HKAS 34 for part of the period covered by its first HKFRS financial statements shall include the reconciliations described in paragraph 24(a) and (b) (supplemented by the details required by paragraphs 25 and 26) or a cross-reference to another published document that includes these reconciliations.

(c) If an entity changes its accounting policies or its use of the exemptions contained in this HKFRS, it shall explain the changes in each such interim financial report in accordance with paragraph 23 and update the reconciliations required by (a) and (b).

33 HKAS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual financial statements. However, HKAS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its most recent annual financial statements in accordance with previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it.

Effective date

34 An entity shall apply this HKFRS if its first HKFRS financial statements are for a period beginning on or after 1 July 2009. Earlier application is permitted.

35 An entity shall apply the amendments in paragraphs D1(n) and D23 for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 23 *Borrowing Costs* (as revised in 2007) for an earlier period, those amendments shall be applied for that earlier period.

36 HKFRS 3 *Business Combinations* (as revised in 2008) amended paragraphs 19, C1 and C4(f) and (g). If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

37 HKAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) amended paragraphs B1 and B7. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

38 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to HKFRS 1 and HKAS 27), issued in October 2008, added paragraphs 31, D1(g), D14 and D15. An entity shall apply those paragraphs for annual periods beginning on or after 1 July 2009. Earlier application is permitted. If an entity applies the paragraphs for an earlier period, it shall disclose that fact.

39 Paragraph B7 was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

39a An entity shall apply paragraphs B2 to B6 and D18 for annual periods beginning on or after 1 January 2005. Earlier application of those paragraphs is encouraged.

39A *Additional Exemptions for First-time Adopters* (Amendments to HKFRS 1), issued in August 2009, added paragraphs 31A, D8A, D9A and D21A and amended paragraph D1(c), (d) and (l). An entity shall apply those amendments for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

39B *[This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]*

39C HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments* added paragraph D25. An entity shall apply that amendment when it applies HK(IFRIC)-Int 19.

39D *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendment to HKFRS 1), issued in February 2010, added paragraph E3. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

39E *Improvements to HKFRSs* issued in May 2010 added paragraphs 27A, 31B and D8B and amended paragraphs 27, 32, D1(c) and D8. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. Entities that adopted HKFRSs in periods before the effective date of HKFRS 1 or applied HKFRS 1 in a previous period are permitted to apply the amendment to paragraph D8 retrospectively in the first annual period after the amendment is effective. An entity applying paragraph D8 retrospectively shall disclose that fact.

39F *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7), issued in October 2010, added paragraph E4. An entity shall apply that amendment for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

39G *[This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]*

39H *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters* (Amendments to HKFRS 1), issued in December 2010, amended paragraphs B2, D1 and D20 and added paragraphs 31C and D26–D30. An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted.

Withdrawal of HKFRS 1 (issued 2003)

40 This HKFRS supersedes HKFRS 1 (issued in 2003 and amended at December 2008).

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

date of transition to HKFRSs	The beginning of the earliest period for which an entity presents full comparative information under HKFRSs in its **first HKFRS financial statements**.
deemed cost	An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
first HKFRS financial statements	The first annual financial statements in which an entity adopts **Hong Kong Financial Reporting Standards (HKFRSs)**, by an explicit and unreserved statement of compliance with HKFRSs.
first HKFRS reporting period	The latest reporting period covered by an entity's **first HKFRS financial statements.**
first-time adopter	An entity that presents its **first HKFRS financial statements**.
Hong Kong Financial Reporting Standards (HKFRSs)	Standards and Interpretations ~~adopted~~ 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.
opening HKFRS statement of financial position	An entity's statement of financial position at the **date of transition to HKFRSs**.
previous GAAP	The basis of accounting that a **first-time adopter** used immediately before adopting HKFRSs.

Appendix B
Exceptions to the retrospective application of other HKFRSs

This appendix is an integral part of the HKFRS.

B1 An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);

(b) hedge accounting (paragraphs B4–B6); and

(c) non-controlling interests (paragraph B7).

Derecognition of financial assets and financial liabilities

B2 Except as permitted by paragraph B3, a first-time adopter shall apply the derecognition requirements in HKAS 39 *Financial Instruments: Recognition and Measurement* prospectively for transactions occurring on or after ~~1 January 2004~~the date of transition to HKFRSs. ~~In other words~~For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before ~~1 January 2004~~the date of transition to HKFRSs, it shall not recognise those assets and liabilities in accordance with HKFRSs (unless they qualify for recognition as a result of a later transaction or event).

B3 Notwithstanding paragraph B2, an entity may apply the derecognition requirements in HKAS 39 retrospectively from a date of the entity's choosing, provided that the information needed to apply HKAS 39 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

Hedge accounting

B4 As required by HKAS 39, at the date of transition to HKFRSs, an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

B5 An entity shall not reflect in its opening HKFRS statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with HKAS 39 (for example, many hedging relationships where the hedging instrument is a cash instrument or written option; where the hedged item is a net position; or where the hedge covers interest risk in a held-to-maturity investment). However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate an individual item within that net position as a hedged item in accordance with HKFRSs, provided that it does so no later than the date of transition to HKFRSs.

B6 If, before the date of transition to HKFRSs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in HKAS 39, the entity shall apply paragraphs 91 and 101 of HKAS 39 to discontinue hedge accounting. Transactions entered into before the date of transition to HKFRSs shall not be retrospectively designated as hedges.

Non-controlling interests

B7 A first-time adopter shall apply the following requirements of HKAS 27 (as amended in 2008) prospectively from the date of transition to HKFRSs:

(a) the requirement in paragraph 28 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;

(b) the requirements in paragraphs 30 and 31 for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

(c) the requirements in paragraphs 34–37 for accounting for a loss of control over a subsidiary, and the related requirements of paragraph 8A of HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

However, if a first-time adopter elects to apply HKFRS 3 (as revised in 2008) retrospectively to past business combinations, it shall also apply HKAS 27 (as amended in 2008) in accordance with paragraph C1 of this HKFRS.

Appendix C
Exemptions for business combinations

This appendix is an integral part of the HKFRS. An entity shall apply the following requirements to business combinations that the entity recognised before the date of transition to HKFRSs.

C1 A first-time adopter may elect not to apply HKFRS 3 (as amended in 2008) retrospectively to past business combinations (business combinations that occurred before the date of transition to HKFRSs). However, if a first-time adopter restates any business combination to comply with HKFRS 3 (as amended in 2008), it shall restate all later business combinations and shall also apply HKAS 27 (as amended in 2008) from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X6, it shall restate all business combinations that occurred between 30 June 20X6 and the date of transition to HKFRSs, and it shall also apply HKAS 27 (amended 2008) from 30 June 20X6.

C2 An entity need not apply HKAS 21 *The Effects of Changes in Foreign Exchange Rates* retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to HKFRSs. If the entity does not apply HKAS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.

C3 An entity may apply HKAS 21 retrospectively to fair value adjustments and goodwill arising in either:

(a) all business combinations that occurred before the date of transition to HKFRSs; or

(b) all business combinations that the entity elects to restate to comply with HKFRS 3, as permitted by paragraph C1 above.

C4 If a first-time adopter does not apply HKFRS 3 retrospectively to a past business combination, this has the following consequences for that business combination:

(a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.

(b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to HKFRSs that were acquired or assumed in a past business combination, other than:

(i) some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph B2); and

(ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated statement of financial position in accordance with previous GAAP and also would not qualify for recognition in accordance with HKFRSs in the separate statement of financial position of the acquiree (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g)(i) below).

(c) The first-time adopter shall exclude from its opening HKFRS statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under HKFRSs. The first-time adopter shall account for the resulting change as follows:

 (i) the first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with HKAS 38 *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and non-controlling interests) as part of goodwill (unless it deducted goodwill directly from equity in accordance with previous GAAP, see (g)(i) and (i) below).

 (ii) the first-time adopter shall recognise all other resulting changes in retained earnings.*

(d) HKFRSs require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure these assets and liabilities on that basis in its opening HKFRS statement of financial position, even if they were acquired or assumed in a past business combination. It shall recognise any resulting change in the carrying amount by adjusting retained earnings (or, if appropriate, another category of equity), rather than goodwill.

(e) Immediately after the business combination, the carrying amount in accordance with previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost in accordance with HKFRSs at that date. If HKFRSs require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.

(f) If an asset acquired, or liability assumed, in a past business combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening HKFRS statement of financial position. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that HKFRSs would require in the statement of financial position of the acquiree. To illustrate: if the acquirer had not, in accordance with its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as HKAS 17 *Leases* would require the acquiree to do in its HKFRS statement of financial position. Similarly, if the acquirer had not, in accordance with its previous GAAP, recognised a contingent liability that still exists at the date of transition to HKFRSs, the acquirer shall recognise that contingent liability at that date unless HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* would prohibit its recognition in the financial statements of the acquiree. Conversely, if an asset or liability was subsumed in goodwill in accordance with previous GAAP but would have been recognised separately under HKFRS 3, that asset or liability remains in goodwill unless HKFRSs would require its recognition in the financial statements of the acquiree.

(g) The carrying amount of goodwill in the opening HKFRS statement of financial position shall be its carrying amount in accordance with previous GAAP at the date of transition to HKFRSs, after the following two adjustments:

 (i) If required by (c)(i) above, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset in accordance with previous GAAP. Similarly, if (f) above requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill in accordance with previous GAAP, the first-time adopter

* Such changes include reclassifications from or to intangible assets if goodwill was not recognised in accordance with previous GAAP as an asset. This arises if, in accordance with previous GAAP, the entity (a) deducted goodwill directly from equity or (b) did not treat the business combination as an acquisition.

shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and non-controlling interests).

(ii) Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply HKAS 36 in testing the goodwill for impairment at the date of transition to HKFRSs and in recognising any resulting impairment loss in retained earnings (or, if so required by HKAS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to HKFRSs.

(h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to HKFRSs. For example, the first-time adopter shall not restate the carrying amount of goodwill:

(i) to exclude in-process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition in accordance with HKAS 38 in the statement of financial position of the acquiree);

(ii) to adjust previous amortisation of goodwill;

(iii) to reverse adjustments to goodwill that HKFRS 3 would not permit, but were made in accordance with previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to HKFRSs.

(i) If the first-time adopter recognised goodwill in accordance with previous GAAP as a deduction from equity:

(i) it shall not recognise that goodwill in its opening HKFRS statement of financial position. Furthermore, it shall not reclassify that goodwill to profit or loss if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.

(ii) adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings.

(j) In accordance with its previous GAAP, the first-time adopter may not have consolidated a subsidiary acquired in a past business combination (for example, because the parent did not regard it as a subsidiary in accordance with previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that HKFRSs would require in the subsidiary's statement of financial position. The deemed cost of goodwill equals the difference at the date of transition to HKFRSs between:

(i) the parent's interest in those adjusted carrying amounts; and

(ii) the cost in the parent's separate financial statements of its investment in the subsidiary.

(k) The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect non-controlling interests and deferred tax.

C5 The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for paragraph C1 applies equally for all such acquisitions.

Appendix D
Exemptions from other HKFRSs

This appendix is an integral part of the HKFRS.

D1 An entity may elect to use one or more of the following exemptions:

(a) share-based payment transactions (paragraphs D2 and D3);

(b) insurance contracts (paragraph D4);

(c) deemed cost (paragraphs D5–D8~~A~~B);

(d) leases (paragraphs D9 and D9A);

(e) employee benefits (paragraphs D10 and D11);

(f) cumulative translation differences (paragraphs D12 and D13);

(g) investments in subsidiaries, jointly controlled entities and associates (paragraphs D14 and D15);

(h) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs D16 and D17);

(i) compound financial instruments (paragraph D18);

(j) designation of previously recognised financial instruments (paragraph D19);

(k) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph D20);

(l) decommissioning liabilities included in the cost of property, plant and equipment (paragraphs D21 and D21A);

(m) financial assets or intangible assets accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph D22);

(n) borrowing costs (paragraph D23);

(o) transfers of assets from customers (paragraph D24)~~.~~;

(p) extinguishing financial liabilities with equity instruments (paragraph D25); and

(q) severe hyperinflation (paragraphs D26–D30).

An entity shall not apply these exemptions by analogy to other items.

Share-based payment transactions

D2 A first-time adopter is encouraged, but not required, to apply HKFRS 2 *Share-based Payment* to equity instruments that were granted on or before 7 November 2002. A first-time adopter is also encouraged, but not required, to apply HKFRS 2 to equity instruments that were granted after 7 November 2002 and vested before the later of (a) the date of transition to HKFRSs and (b) 1 January 2005. However, if a first-time adopter elects to apply HKFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in HKFRS 2. For all grants of equity instruments to which HKFRS 2 has not been applied (eg equity instruments granted on or before 7 November 2002), a first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of HKFRS 2. If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which HKFRS 2 has not been applied, the entity is not required to apply paragraphs 26–29 of HKFRS 2 if the modification occurred before the date of transition to HKFRSs.

D3 A first-time adopter is encouraged, but not required, to apply HKFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to HKFRSs. A first-time adopter is also encouraged, but not required, to apply HKFRS 2 to liabilities that were settled before 1 January 2005. For liabilities to which HKFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.

Insurance contracts

D4 A first-time adopter may apply the transitional provisions in HKFRS 4 *Insurance Contracts*. HKFRS 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.

Deemed cost

D5 An entity may elect to measure an item of property, plant and equipment at the date of transition to HKFRSs at its fair value and use that fair value as its deemed cost at that date.

D6 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to HKFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost in accordance with HKFRSs, adjusted to reflect, for example, changes in a general or specific price index.

D7 The elections in paragraphs D5 and D6 are also available for:

(a) investment property, if an entity elects to use the cost model in HKAS 40 *Investment Property,* and

(b) intangible assets that meet:

(i) the recognition criteria in HKAS 38 (including reliable measurement of original cost); and

(ii) the criteria in HKAS 38 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

D8 A first-time adopter may have established a deemed cost in accordance with 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 such as a privatisation or initial public offering. ~~It~~

(a) If the measurement date is *at or before* the date of transition to HKFRSs, the entity may use such event-driven fair value measurements as deemed cost for HKFRSs at the date of that measurement.

(b) If the measurement date is *after* the date of transition to HKFRSs, but during the period covered by the first HKFRS financial statements, 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 HKFRSs, the entity shall either establish the deemed cost by applying the criteria in paragraphs D5–D7 or measure assets and liabilities in accordance with the other requirements in this HKFRS.

D8A Under some other accounting requirements exploration and development costs for oil and gas properties in the development or production phases are accounted for in cost centres that include all properties in a large geographical area. A first-time adopter using such accounting under previous GAAP may elect to measure oil and gas assets at the date of transition to HKFRSs on the following basis:

(a) exploration and evaluation assets at the amount determined under the entity's previous GAAP; and

(b) assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP. The entity shall allocate this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

The entity shall test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to HKFRSs in accordance with HKFRS 6 *Exploration for and Evaluation of Mineral Resources* or HKAS 36 respectively and, if necessary, reduce the amount determined in accordance with (a) or (b) above. For the purposes of this paragraph, oil and gas assets comprise only those assets used in the exploration, evaluation, development or production of oil and gas.

D8B Some entities hold items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. The carrying amount of such items might include amounts that were determined under previous GAAP but do not qualify for capitalisation in accordance with HKFRSs. If this is the case, a first-time adopter may elect to use the previous GAAP carrying amount of such an item at the date of transition to HKFRSs as deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. At the date of transition to HKFRSs, an entity shall test for impairment in accordance with HKAS 36 each item for which this exemption is used. For the purposes of this paragraph, operations are subject to rate regulation if they provide goods or services to customers at prices (ie rates) established by an authorised body empowered to establish rates that bind the customers and that are designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.

Leases

D9 A first-time adopter may apply the transitional provisions in HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*. Therefore, a first-time adopter may determine whether an arrangement existing at the date of transition to HKFRSs contains a lease on the basis of facts and circumstances existing at that date.

D9A If a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by HK(IFRIC)-Int 4 but at a date other than that required by HK(IFRIC)-Int 4, the first-time adopter need not reassess that determination when it adopts HKFRSs. For an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, that determination would have to have given the same outcome as that resulting from applying HKAS 17 *Leases* and HK(IFRIC)-Int 4.

Employee benefits

D10 In accordance with HKAS 19 *Employee Benefits*, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognised. Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to HKFRSs into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to HKFRSs, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

D11 An entity may disclose the amounts required by paragraph 120A(p) of HKAS 19 as the amounts are determined for each accounting period prospectively from the date of transition to HKFRSs.

Cumulative translation differences

D12 HKAS 21 requires an entity:

(a) to recognise some translation differences in other comprehensive income and accumulate these in a separate component of equity; and

(b) on disposal of a foreign operation, to reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) from equity to profit or loss as part of the gain or loss on disposal.

D13 However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to HKFRSs. If a first-time adopter uses this exemption:

(a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to HKFRSs; and

(b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to HKFRSs and shall include later translation differences.

Investments in subsidiaries, jointly controlled entities and associates

D14 When an entity prepares separate financial statements, HKAS 27 (as amended in 2008) requires it to account for its investments in subsidiaries, jointly controlled entities and associates either:

(a) at cost; or

(b) in accordance with HKAS 39.

D15 If a first-time adopter measures such an investment at cost in accordance with HKAS 27, it shall measure that investment at one of the following amounts in its separate opening HKFRS statement of financial position:

(a) cost determined in accordance with HKAS 27; or

(b) deemed cost. The deemed cost of such an investment shall be its:

(i) fair value (determined in accordance with HKAS 39) at the entity's date of transition to HKFRSs in its separate financial statements; or

(ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, jointly controlled entity or associate that it elects to measure using a deemed cost.

Assets and liabilities of subsidiaries, associates and joint ventures

D16 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

(a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to HKFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or

(b) the carrying amounts required by the rest of this HKFRS, based on the subsidiary's date of transition to HKFRSs. These carrying amounts could differ from those described in (a):

(i) when the exemptions in this HKFRS result in measurements that depend on the date of transition to HKFRSs.

(ii) when the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in HKAS 16 *Property, Plant and Equipment*, whereas the group may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

D17 However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, if a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

Compound financial instruments

D18 HKAS 32 *Financial Instruments: Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of HKAS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this HKFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to HKFRSs.

Designation of previously recognised financial instruments

D19 HKAS 39 permits a financial asset to be designated on initial recognition as available for sale or a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through profit or loss. Despite this requirement exceptions apply in the following circumstances:

(a) an entity is permitted to make an available-for-sale designation at the date of transition to HKFRSs.

(b) an entity is permitted to designate, at the date of transition to HKFRSs, any financial asset or financial liability as at fair value through profit or loss provided the asset or liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at that date.

Fair value measurement of financial assets or financial liabilities at initial recognition

D20 Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in the last sentence of HKAS 39 paragraph AG76 and in paragraph AG76A~~, in either of the following ways:~~

~~(a)~~ prospectively to transactions entered into on or after ~~25 October 2002; or~~the date of transition to HKFRSs

~~(b) prospectively to transactions entered into after 1 January 2004~~.

Decommissioning liabilities included in the cost of property, plant and equipment

D21 HK(IFRIC)-Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to HKFRSs. If a first-time adopter uses this exemption, it shall:

(a) measure the liability as at the date of transition to HKFRSs in accordance with HKAS 37;

(b) to the extent that the liability is within the scope of HK(IFRIC)-Int 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and

(c) calculate the accumulated depreciation on that amount, as at the date of transition to HKFRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with HKFRSs.

D21A An entity that uses the exemption in paragraph D8A(b) (for oil and gas assets in the development or production phases accounted for in cost centres that include all properties in a large geographical area under previous GAAP) shall, instead of applying paragraph D21 or HK(IFRIC)-Int 1:

(a) measure decommissioning, restoration and similar liabilities as at the date of transition to HKFRSs in accordance with HKAS 37; and

(b) recognise directly in retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to HKFRSs determined under the entity's previous GAAP.

Financial assets or intangible assets accounted for in accordance with HK(IFRIC)-Int 12

D22 A first-time adopter may apply the transitional provisions in HK(IFRIC)-In 12.

Borrowing costs

D23 A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of HKAS 23, as revised in 2007. In those paragraphs references to the effective date shall be interpreted as 1 January 2009 or the date of transition to HKFRSs, whichever is later.

Transfers of assets from customers

D24 A first-time adopter may apply the transitional provisions set out in paragraph 22 of HK(IFRIC)-Int 18 *Transfers of Assets from Customers*. In that paragraph, reference to the effective date shall be interpreted as 1 July 2009 or the date of transition to HKFRSs, whichever is later. In addition, a first-time adopter may designate any date before the date of transition to HKFRSs and apply HK(IFRIC)-Int 18 to all transfers of assets from customers received on or after that date.

Extinguishing financial liabilities with equity instruments

D25 A first-time adopter may apply the transitional provisions in HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments*.

Severe hyperinflation

D26 If an entity has a functional currency that was, or is, the currency of a hyperinflationary economy, it shall determine whether it was subject to severe hyperinflation before the date of transition to HKFRSs. This applies to entities that are adopting HKFRSs for the first time, as well as entities that have previously applied HKFRSs.

D27 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.

(b) exchangeability between the currency and a relatively stable foreign currency does not exist.

D28 The functional currency of an entity ceases to be subject to severe hyperinflation on the functional currency normalisation date. That is the date when the functional currency no longer has either, or both, of the characteristics in paragraph D27, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.

D29 When an entity's date of transition to HKFRSs 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 HKFRSs. The entity may use that fair value as the deemed cost of those assets and liabilities in the opening HKFRS statement of financial position.

D30 When the functional currency normalisation date falls within a 12-month comparative period, the comparative period may be less than 12 months, provided that a complete set of financial statements (as required by paragraph 10 of HKAS 1) is provided for that shorter period.

Appendix E
Short-term exemptions from HKFRSs

This appendix is an integral part of the HKFRS.

[*Paragraphs E1 and E2 are amendments with an effective date after 1 January 2012 and are therefore not included in this edition.*]

Disclosures about financial instruments

E3 A first-time adopter may apply the transition provisions in paragraph 44G of HKFRS 7.*

E4 A first-time adopter may apply the transitional provisions in paragraph 44M of HKFRS 7.†

* Paragraph E3 was added as a consequence of *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendment to HKFRS 1) issued in February 2010. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current HKFRS preparers, first-time adopters should be permitted to use the same transition provisions permitted for existing preparers of financial statements prepared in accordance with HKFRSs that are included in *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7).

† Paragraph E4 was added as a consequence of *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7) issued in October 2010. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current HKFRS preparers, first-time adopters should be permitted to use the same transition provisions permitted for existing preparers of financial statements prepared in accordance with HKFRSs that are included in *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7).

APPENDIX F
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared as at December 2008 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 1.

The International Financial Reporting Standard comparable with HKFRS 1 (Revised) is IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The following sets out the major textual differences between HKFRS 1 (Revised) and IFRS 1 and the reasons for such differences.

Differences	Reasons for the differences
1. IFRS 1 Paras 3(a) and 4 **HKFRS 1 Paras 3(a) and 4** IFRS 1 contains references to "national" requirements whereas HKFRS 1 uses references to "other accounting" requirements.	IFRS 1 is an international statement whereas HKFRS 1 is a national statement.

Appendix G
Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standards and this appendix will be deleted.

HK(IFRIC)-Int 20 *Stripping Costs in the Production Phase of a Surface Mine* (issued in November 2011) - effective for annual periods beginning on or after 1 January 2013

In Appendix D, paragraph D1 is amended as follows (new text is underlined and deleted text is struck through):

D1 An entity may elect to use one or more of the following exemptions:

(a) share-based payment transactions (paragraphs D2 and D3);

…

(m) financial assets or intangible assets accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph D22);

(n) borrowing costs (paragraph D23);

(o) transfers of assets from customers (paragraph D24);

(p) extinguishing financial liabilities with equity instruments (paragraph D25);

(q) severe hyperinflation (paragraphs D26–D30); ~~and~~

(r) joint arrangements (paragraph D31)~~.~~; and

(s) stripping costs in the production phase of a surface mine (paragraph D32).

After paragraph D31 a heading and paragraph D32 are added:

Stripping costs in the production phase of a surface mine

D32 A first-time adopter may apply the transitional provisions set out in paragraphs A1 to A4 of HK(IFRIC)-Int 20 *Stripping Costs in the Production Phase of a Surface Mine*. In that paragraph, reference to the effective date shall be interpreted as 1 January 2013 or the beginning of the first HKFRS reporting period, whichever is later.

After paragraph 39L paragraph 39M is added:

39M HK(IFRIC)-Int 20 *Stripping Costs in the Production Phase of a Surface Mine* added paragraph D32 and amended paragraph D1. An entity shall apply that amendment when it applies HK(IFRIC)-Int 20.

HKFRS 1 (Revised) BC
Revised ~~December 2010~~February 2012

Effective for annual periods
beginning on or after 1 July 2009

Basis for Conclusions on
Hong Kong Financial Reporting Standards 1 (Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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

Basis for Conclusions
HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

HKFRS 1 (Revised) is based on IFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards.* In approving HKFRS 1 (Revised), the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 1. Accordingly, there are no significant differences between HKFRS 1 (Revised) and IFRS 1. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 1 referred to below generally correspond with those in HKFRS 1 (Revised).

CONTENTS

Basis for Conclusions on
IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This Basis for Conclusions accompanies, but is not part of, IFRS 1.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007).*

This Basis for Conclusions has not been revised to reflect the restructuring of FRS 1 in November 2008, but cross-references have been updated.

References to the Framework *are to IASC's* Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the* Framework *with the* Conceptual Framework for Financial Reporting*.*

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Individual Board members gave greater weight to some factors than to others.

BC2 SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*, issued in 1998, dealt with matters that arose when an entity first adopted IASs. In 2001, the Board began a project to review SIC-8. In July 2002, the Board published ED 1 *First-time Application of International Financial Reporting Standards*, with a comment deadline of 31 October 2002. The Board received 83 comment letters on ED 1. IFRS 1 was issued by the Board in June 2003.

BC2A IFRS 1 replaced SIC-8. The Board developed the IFRS to address concerns that:

(a) some aspects of SIC-8's requirement for full retrospective application caused costs that exceeded the likely benefits for users of financial statements. Moreover, although SIC-8 did not require retrospective application when this would be impracticable, it did not explain whether a first-time adopter should interpret impracticability as a high hurdle or a low hurdle and it did not specify any particular treatment in cases of impracticability.

(b) SIC-8 could require a first-time adopter to apply two different versions of a standard if a new version were introduced during the periods covered by its first financial statements prepared under IASs and the new version prohibited retrospective application.

(c) SIC-8 did not state clearly whether a first-time adopter should use hindsight in applying recognition and measurement decisions retrospectively.

(d) there was some doubt about how SIC-8 interacted with specific transitional provisions in individual standards.

BC2B Like SIC-8, IFRS 1 requires retrospective application in most areas. Unlike SIC-8, it:

(a) includes targeted exemptions to avoid costs that would be likely to exceed the benefits to users of financial statements, and a small number of other exceptions for practical reasons.

(b) clarifies that an entity applies the latest version of IFRSs.

(c) clarifies how a first-time adopter's estimates in accordance with IFRSs relate to the estimates it made for the same date in accordance with previous GAAP.

(d) specifies that the transitional provisions in other IFRSs do not apply to a first-time adopter.

(e) requires enhanced disclosure about the transition to IFRSs.

BC3 The project took on added significance because of the requirement for listed European Union companies to adopt IFRSs in their consolidated financial statements from 2005. Several other countries announced that they would permit or require entities to adopt IFRSs in the next few years. Nevertheless, the Board's aim in developing the IFRS was to find solutions that would be appropriate for any entity, in any part of the world, regardless of whether adoption occurs in 2005 or at a different time.

Restructuring of the IFRS

BC3A Since it was issued in 2003, IFRS 1 has been amended many times to accommodate first-time adoption requirements resulting from new or amended IFRSs. Because of the way IFRS 1 was structured, those amendments made the IFRS more complex and less clear. As more amendments become necessary, this problem will become worse.

BC3B As part of its improvements project in 2007, therefore, the Board proposed to change the structure of IFRS 1 without amending its substance. Respondents to the exposure draft published in October 2007 supported the restructuring. The revised structure of the IFRS issued in November 2008 is easier for the reader to understand and is better designed to accommodate future changes. The focus of the restructuring was to move to appendices all specific exemptions and exceptions from the requirements of IFRSs. Exemptions are categorised into business combinations, exemptions and short-term exemptions. Exemptions are applicable to all first-time adopters regardless of their date of transition to IFRSs. Short-term exemptions are those exemptions applicable to users for a short time. Once those exemptions have become out of date, they will be deleted.

Scope

BC4 The IFRS applies to an entity that presents its first IFRS financial statements (a first-time adopter). Some suggested that an entity should not be regarded as a first-time adopter if its previous financial statements contained an explicit statement of compliance with IFRSs, except for specified (and explicit) departures. They argued that an explicit statement of compliance establishes that an entity regards IFRSs as its basis of accounting, even if the entity does not comply with every requirement of every IFRS. Some regarded this argument as especially strong if an entity previously complied with all recognition and measurement requirements of IFRSs, but did not give some required disclosures—for example, segmental disclosures that IAS 14 *Segment Reporting*[*] requires or the explicit statement of compliance with IFRSs that IAS 1 *Presentation of Financial Statements* requires.

BC5 To implement that approach, it would be necessary to establish how many departures are needed—and how serious they must be—before an entity would conclude that it has not adopted IFRSs. In the Board's view, this would lead to complexity and uncertainty. Also, an entity should not be regarded as having adopted IFRSs if it does not give all disclosures required by IFRSs, because that approach would diminish the importance of disclosures and undermine efforts to promote full compliance with IFRSs. Therefore, the IFRS contains a simple test that gives an unambiguous answer: an entity has adopted IFRSs if, and only if, its financial statements contain an explicit and unreserved statement of compliance with IFRSs (paragraph 3 of the IFRS).

BC6 If an entity's financial statements in previous years contained that statement, any material disclosed or undisclosed departures from IFRSs are errors. The entity applies IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in correcting them.

[*] In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

Basic concepts

Useful information for users

BC7 In developing recognition and measurement requirements for an entity's opening IFRS balance sheet, the Board referred to the objective of financial statements, as set out in the *Framework for the Preparation and Presentation of Financial Statements*. The *Framework* states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

BC8 The *Framework* identifies four qualitative characteristics that make information in financial statements useful to users. In summary, the information should be:

(a) readily understandable by users.

(b) relevant to the decision-making needs of users.

(c) reliable, in other words financial statements should:

(i) represent faithfully the transactions and other events they either purport to represent or could reasonably be expected to represent;

(ii) represent transactions and other events in accordance with their substance and economic reality and not merely their legal form;

(iii) be neutral, that is to say, free from bias;

(iv) contend with the uncertainties that inevitably surround many events and circumstances by the exercise of prudence; and

(v) be complete within the bounds of materiality and cost.

(d) comparable with information provided by the entity in its financial statements through time and with information provided in the financial statements of other entities.

Comparability

BC9 The previous paragraph notes the need for comparability. Ideally, a regime for first-time adoption of IFRSs would achieve comparability:

(a) within an entity over time;

(b) between different first-time adopters; and

(c) between first-time adopters and entities that already apply IFRSs.

BC10 SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already applied IASs. It was based on the principle that a first-time adopter should comply with the same standards as an entity that already applied IASs. However, the Board decided that it is more important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date; achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

Current version of IFRSs

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions. This:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC12 In general, the transitional provisions in other IFRSs do not apply to a first-time adopter (paragraph 9 of the IFRS). Some of these transitional provisions require or permit an entity already reporting in accordance with IFRSs to apply a new requirement prospectively. These provisions generally reflect a conclusion that one or both of the following factors are present in a particular case:

(a) Retrospective application may be difficult or involve costs exceeding the likely benefits. The IFRS permits prospective application in specific cases where this could occur (paragraphs BC30–BC73).

(b) There is a danger of abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. The IFRS prohibits retrospective application in some areas where this could occur (paragraphs BC74–BC84).

BC13 Some have suggested three further reasons for permitting or requiring prospective application in some cases:

(a) to alleviate unforeseen consequences of a new IFRS if another party uses financial statements to monitor compliance with a contract or agreement. However, in the Board's view, it is up to the parties to an agreement to determine whether to insulate the agreement from the effects of a future IFRS and, if not, how they might renegotiate it so that it reflects changes in the underlying financial condition rather than changes in reporting (paragraph 21* of the *Preface to International Financial Reporting Standards*).

(b) to give a first-time adopter the same accounting options as an entity that already applies IFRSs. However, permitting prospective application by a first-time adopter would conflict with the Board's primary objective of comparability within an entity's first IFRS financial statements (paragraph BC10). Therefore, the Board did not adopt a general policy of giving first-time adopters the same accounting options of prospective application that existing IFRSs give to entities that already apply IFRSs. Paragraphs BC20–BC23 discuss one specific case, namely derecognition of financial assets and financial liabilities.

(c) to avoid difficult distinctions between changes in estimates and changes in the basis for making estimates. However, a first-time adopter need not make this distinction in preparing its opening IFRS balance sheet, so the IFRS does not include exemptions on these grounds. If an entity becomes aware of errors made under previous GAAP, the IFRS requires it to disclose the correction of the errors (paragraph 26 of the IFRS).

BC14 The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements. However, if the Board concludes in a particular case that prospective application by a first-time adopter is justified, it will amend the IFRS on first-time adoption of IFRSs. As a result, IFRS 1 will contain all material on first-time adoption of IFRSs and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).

* amended to paragraph 20 when the *Preface* was revised in January 2010.

BC15 Under the proposals in ED 1, a first-time adopter could have elected to apply IFRSs as if it had always applied IFRSs. This alternative approach was intended mainly to help an entity that did not wish to use any of the exemptions proposed in ED 1 because it had already been accumulating information in accordance with IFRSs without presenting IFRS financial statements. To enable an entity using this approach to use the information it had already accumulated, ED 1 would have required it to consider superseded versions of IFRSs if more recent versions required prospective application. However, as explained in paragraphs BC28 and BC29, the Board abandoned ED 1's all-or-nothing approach to exemptions. Because this eliminated the reason for the alternative approach, the Board deleted it in finalising the IFRS.

Opening IFRS balance sheet

BC16 An entity's opening IFRS balance sheet is the starting point for its accounting in accordance with IFRSs. The following paragraphs explain how the Board used the *Framework* in developing recognition and measurement requirements for the opening IFRS balance sheet.

Recognition

BC17 The Board considered a suggestion that the IFRS should not require a first-time adopter to investigate transactions that occurred before the beginning of a 'look back' period of, say, three to five years before the date of transition to IFRSs. Some argued that this would be a practical way for a first-time adopter to give a high level of transparency and comparability, without incurring the cost of investigating very old transactions. They noted two particular precedents for transitional provisions that have permitted an entity to omit some assets and liabilities from its balance sheet:

(a) A previous version of IAS 39 *Financial Instruments: Recognition and Measurement* prohibited restatement of securitisation, transfer or other derecognition transactions entered into before the beginning of the financial year in which it was initially applied.

(b) Some national accounting standards and IAS 17 *Accounting for Leases* (superseded in 1997 by IAS 17 *Leases*) permitted prospective application of a requirement for lessees to capitalise finance leases. Under this approach, a lessee would not be required to recognise finance lease obligations and the related leased assets for leases that began before a specified date.

BC18 However, limiting the look back period could lead to the omission of material assets or liabilities from an entity's opening IFRS balance sheet. Material omissions would undermine the understandability, relevance, reliability and comparability of an entity's first IFRS financial statements. Therefore, the Board concluded that an entity's opening IFRS balance sheet should:

(a) include all assets and liabilities whose recognition is required by IFRSs, except:

(i) some financial assets or financial liabilities derecognised in accordance with previous GAAP before the date of transition to IFRSs (paragraphs BC20–BC23); and

(ii) goodwill and other assets acquired, and liabilities assumed, in a past business combination that were not recognised in the acquirer's consolidated balance sheet in accordance with previous GAAP and also would not qualify for recognition in accordance with IFRSs in the balance sheet of the acquiree (paragraphs BC31–BC40).

(b) not report items as assets or liabilities if they do not qualify for recognition in accordance with IFRSs.

BC19 Some financial instruments may be classified as equity in accordance with previous GAAP but as financial liabilities in accordance with IAS 32 *Financial Instruments: Presentation*. Some respondents to ED 1 requested an extended transitional period to enable the issuer of such instruments to renegotiate contracts that refer to debt-equity ratios. However, although a new

IFRS may have unforeseen consequences if another party uses financial statements to monitor compliance with a contract or agreement, that possibility does not, in the Board's view, justify prospective application (paragraph BC13(a)).

Derecognition in accordance with previous GAAP

BC20 An entity may have derecognised financial assets or financial liabilities in accordance with its previous GAAP that do not qualify for derecognition in accordance with IAS 39. ED 1 proposed that a first-time adopter should recognise those assets and liabilities in its opening IFRS balance sheet. Some respondents to ED 1 requested the Board to permit or require a first-time adopter not to restate past derecognition transactions, on the following grounds:

(a) Restating past derecognition transactions would be costly, especially if restatement involves determining the fair value of retained servicing assets and liabilities and other components retained in a complex securitisation. Furthermore, it may be difficult to obtain information on financial assets held by transferees that are not under the transferor's control.

(b) Restatement undermines the legal certainty expected by parties who entered into transactions on the basis of the accounting rules in effect at the time.

(c) IAS 39 did not, before the improvements proposed in June 2002, require (or even permit) entities to restate past derecognition transactions. Without a similar exemption, first-time adopters would be unfairly disadvantaged.

(d) Retrospective application would not result in consistent measurement, as entities would need to recreate information about past transactions with the benefit of hindsight.

BC21 The Board had considered these arguments in developing ED 1. The Board's reasons for the proposal in ED 1 were as follows:

(a) The omission of material assets or liabilities would undermine the understandability, relevance, reliability and comparability of an entity's financial statements. Many of the transactions under discussion are large and will have effects for many years.

(b) Such an exemption would be inconsistent with the June 2002 exposure draft of improvements to IAS 39.

(c) The Board's primary objective is to achieve comparability over time within an entity's first IFRS financial statements. Prospective application by a first-time adopter would conflict with that primary objective, even if prospective application were available to entities already applying IFRSs.

(d) Although a new IFRS may have unforeseen consequences if another party uses financial statements to monitor compliance with a contract or agreement, that possibility does not justify prospective application (paragraph BC13(a)).

BC22 Nevertheless, in finalising the IFRS, the Board concluded that it would be premature to require a treatment different from the current version of IAS 39 before completing the proposed improvements to IAS 39. Accordingly, the IFRS originally required the same treatment as the then current version of IAS 39 for derecognition transactions before the effective date of the then current version of IAS 39, namely that any financial assets or financial liabilities derecognised in accordance with previous GAAP before financial years beginning on 1 January 2001 remain derecognised. The Board agreed that when it completed the improvements to IAS 39, it might amend or delete this exemption.

BC22A The Board reconsidered this issue in completing the revision of IAS 39 in 2003. The Board decided to retain the transition requirements as set out in IFRS 1, for the reasons given in paragraph BC20. However, the Board amended the date from which prospective application was required to transactions that occur on or after 1 January 2004 in order to overcome the practical difficulties of restating transactions that had been derecognised before that date. In 2010 the Board was asked to reconsider whether 1 January 2004 is the appropriate date from which a first-time adopter should be required to restate past derecognition transactions. Constituents were concerned that, as time passes, the fixed transition date of 1 January 2004 becomes more remote and increasingly less relevant to the financial reports as additional jurisdictions adopt IFRSs. The Board accepted that the cost of reconstructing transactions back in time to 1 January 2004 was likely to outweigh the benefit to be achieved in doing so. It therefore amended the fixed date of 1 January 2004 in paragraph B2 to 'the date of transition to IFRSs'. The Board also amended the wording of the illustration in paragraph B2, in order to clarify that it is providing an example.

BC22B The Board also noted that financial statements that include financial assets and financial liabilities that would otherwise be omitted under the provisions of the IFRS would be more complete and therefore more useful to users of financial statements. The Board therefore decided to permit retrospective application of the derecognition requirements. It also decided that retrospective application should be limited to cases when the information needed to apply the IFRS to past transactions was obtained at the time of initially accounting for those transactions. This limitation prevents the unacceptable use of hindsight.

BC23 The Board removed from IAS 39 the following consequential amendments to IAS 39 made when IFRS 1 was issued, because, for first-time adopters, these clarifications are clear in paragraphs IG26–IG31 and IG53 of the guidance on implementing IFRS 1. These were:

(a) the clarification that an entity is required to apply IAS 39 to all derivatives or other interests retained after a derecognition transaction, even if the transaction occurred before the effective date of IAS 39; and

(b) the confirmation that there are no exemptions for special purpose entities that existed before the date of transition to IFRSs.

Measurement

BC24 The Board considered whether it should require a first-time adopter to measure all assets and liabilities at fair value in the opening IFRS balance sheet. Some argued that this would result in more relevant information than an aggregation of costs incurred at different dates, or of costs and fair values. However, the Board concluded that a requirement to measure all assets and liabilities at fair value at the date of transition to IFRSs would be unreasonable, given that an entity may use an IFRS-compliant cost-based measurement before and after that date for some items.

BC25 The Board decided as a general principle that a first-time adopter should measure all assets and liabilities recognised in its opening IFRS balance sheet on the basis required by the relevant IFRSs. This is needed for an entity's first IFRS financial statements to present understandable, relevant, reliable and comparable information.

Benefits and costs

BC26 The *Framework* acknowledges that the need for a balance between the benefits of information and the cost of providing it may constrain the provision of relevant and reliable information. The Board considered these cost-benefit constraints and developed targeted exemptions from the general principle described in paragraph BC25. SIC-8 did not include specific exemptions of this kind, although it provided general exemptions from:

(a) retrospective adjustments to the opening balance of retained earnings 'when the amount of the adjustment relating to prior periods cannot be reasonably determined'.

(b) provision of comparative information when it is 'impracticable' to provide such information.

BC27 The Board expects that most first-time adopters will begin planning on a timely basis for the transition to IFRSs. Accordingly, in balancing benefits and costs, the Board took as its benchmark an entity that plans the transition well in advance and can collect most information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs.

BC28 ED 1 proposed that a first-time adopter should use either all the exemptions in ED 1 or none. However, some respondents disagreed with this all or nothing approach for the following reasons:

(a) Many of the exemptions are not interdependent, so there is no conceptual reason to condition use of one exemption on use of other exemptions.

(b) Although it is necessary to permit some exemptions on pragmatic grounds, entities should be encouraged to use as few exemptions as possible.

(c) Some of the exemptions proposed in ED 1 were implicit options because they relied on the entity's own judgement of undue cost or effort and some others were explicit options. Only a few exemptions were really mandatory.

(d) Unlike the other exceptions to retrospective application, the requirement to apply hedge accounting prospectively was not intended as a pragmatic concession on cost benefit grounds. Retrospective application in an area that relies on designation by management would not be acceptable, even if an entity applied all other aspects of IFRSs retrospectively.

BC29 The Board found these comments persuasive. In finalising the IFRS, the Board grouped the exceptions to retrospective application into two categories:

(a) Some exceptions consist of optional exemptions (paragraphs BC30–BC63E).

(b) The other exceptions prohibit full retrospective application of IFRSs to some aspects of derecognition (paragraphs BC20–BC23), hedge accounting (paragraphs BC75–BC80), and estimates (paragraph BC84).

Exemptions from other IFRSs

BC30 An entity may elect to use one or more of the following exemptions:

(a) business combinations (paragraphs BC31–BC40);

(b) deemed cost (paragraphs BC41–BC47E);

(c) employee benefits (paragraphs BC48–BC52);

(d) cumulative translation differences (paragraphs BC53–BC55);

(e) compound financial instruments (paragraphs BC56–BC58);

(f) investments in subsidiaries, jointly controlled entities and associates (paragraphs BC58A–BC58M);

(g) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs BC59–BC63);

(h) designation of previously recognised financial instruments (paragraph BC63A);

(i) share-based payment transactions (paragraph BC63B);

(j) changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment (paragraphs BC63C and BC63CA);

(k) leases (paragraphs BC63D-BC63DB);~~ and~~

(l) borrowing costs (paragraph BC63E)~~.~~; and

(m) severe hyperinflation (paragraphs BC63F – BC63J).

Business combinations

BC31 The following paragraphs discuss various aspects of accounting for business combinations that an entity recognised in accordance with previous GAAP before the date of transition to IFRSs:

(a) whether retrospective restatement of past business combinations should be prohibited, permitted or required (paragraphs BC32–BC34).

(b) whether an entity should recognise assets acquired and liabilities assumed in a past business combination if it did not recognise them in accordance with previous GAAP (paragraph BC35).

(c) whether an entity should restate amounts assigned to the assets and liabilities of the combining entities if previous GAAP brought forward unchanged their pre-combination carrying amounts (paragraph BC36).

(d) whether an entity should restate goodwill for adjustments made in its opening IFRS balance sheet to the carrying amounts of assets acquired and liabilities assumed in past business combinations (paragraphs BC37–BC40).

BC32 Retrospective application of IFRS 3 *Business Combinations* could require an entity to recreate data that it did not capture at the date of a past business combination and make subjective estimates about conditions that existed at that date. These factors could reduce the relevance and reliability of the entity's first IFRS financial statements. Therefore, ED 1 would have prohibited restatement of past business combinations (unless an entity used the proposed alternative approach, discussed in paragraph BC15, of applying IFRSs as if it had always applied IFRSs). Some respondents agreed, arguing that restatement of past business combinations would involve subjective, and potentially selective, use of hindsight that would diminish the relevance and reliability of financial statements.

BC33 Other respondents disagreed. They argued that:

(a) effects of business combination accounting can last for many years. Previous GAAP may differ significantly from IFRSs, and in some countries there are no accounting requirements at all for business combinations. Previous GAAP balances might not result in decision-useful information in these countries.

(b) restatement is preferable and may not involve as much cost or effort for more recent business combinations.

BC34 In the light of these comments, the Board concluded that restatement of past business combinations is conceptually preferable, although for cost-benefit reasons this should be permitted but not required. The Board decided to place some limits on this election and noted that information is more likely to be available for more recent business combinations. Therefore, if a first-time adopter restates any business combination, the IFRS requires it to restate all later business combinations (paragraph C1 of the IFRS).

BC35 If an entity did not recognise a particular asset or liability in accordance with previous GAAP at the date of the business combination, ED 1 proposed that its deemed cost in accordance with IFRSs would be zero. As a result, the entity's opening IFRS balance sheet would not have included that asset or liability if IFRSs permit or require a cost-based measurement. Some respondents to ED 1 argued that this would be an unjustifiable departure from the principle that the opening IFRS balance sheet should include all assets and liabilities. The Board agreed with that conclusion. Therefore, paragraph C4(f) of the IFRS requires that the acquirer should recognise those assets and liabilities and measure them on the basis that IFRSs would require in the separate balance sheet of the acquiree.

BC36 In accordance with previous GAAP, an entity might have brought forward unchanged the pre-combination carrying amounts of the combining entities' assets and liabilities. Some argued that it would be inconsistent to use these carrying amounts as deemed cost in accordance with IFRSs, given that the IFRS does not permit the use of similar carrying amounts as deemed cost for assets and liabilities that were not acquired in a business combination. However, the Board identified no specific form of past business combination, and no specific form of accounting for past business combinations, for which it would not be acceptable to bring forward cost-based measurements made in accordance with previous GAAP.

BC37 Although the IFRS treats amounts assigned in accordance with previous GAAP to goodwill and other assets acquired and liabilities assumed in a past business combination as their deemed cost in accordance with IFRSs at the date of the business combination, an entity needs to adjust their carrying amounts in its opening IFRS balance sheet, as follows.

(a) Assets and liabilities measured in accordance with IFRSs at fair value or other forms of current value: remeasure to fair value or that other current value.

(b) Assets (other than goodwill) and liabilities for which IFRSs apply a cost-based measurement: adjust the accumulated depreciation or amortisation since the date of the business combination if it does not comply with IFRSs. Depreciation is based on deemed cost, which is the carrying amount in accordance with previous GAAP immediately following the business combination.

(c) Assets (other than goodwill) and liabilities not recognised in accordance with previous GAAP: measure on the basis that IFRSs would require in the separate balance sheet of the acquiree.

(d) Items that do not qualify for recognition as assets and liabilities in accordance with IFRSs: eliminate from the opening IFRS balance sheet.

BC38 The Board considered whether a first-time adopter should recognise the resulting adjustments by restating goodwill. Because intangible assets and goodwill are closely related, the Board decided that a first-time adopter should restate goodwill when it:

(a) eliminates an item that was recognised in accordance with previous GAAP as an intangible asset but does not qualify for separate recognition in accordance with IFRSs; or

(b) recognises an intangible asset that was subsumed within goodwill in accordance with previous GAAP.

However, to avoid costs that would exceed the likely benefits to users, the IFRS prohibits restatement of goodwill for most other adjustments reflected in the opening IFRS balance sheet, unless a first-time adopter elects to apply IFRS 3 retrospectively (paragraph C4(g) of the IFRS).

BC39 To minimise the possibility of doubl-counting an item that was included in goodwill in accordance with previous GAAP, and is included in accordance with IFRSs either within the measurement of another asset or as a deduction from a liability, the IFRS requires an entity to test goodwill recognised in its opening IFRS balance sheet for impairment (paragraph C4(g)(ii) of the IFRS).

This does not prevent the implicit recognition of internally generated goodwill that arose after the date of the business combination. However, the Board concluded that an attempt to exclude such internally generated goodwill would be costly and lead to arbitrary results.

BC40 Some respondents to ED 1 suggested that a formal impairment test should be required only if there is a possibility of double-counting—ie when additional, previously unrecognised, assets relating to a past business combination are recognised in the opening IFRS balance sheet (or an indicator of impairment is present). However, the Board decided that a first-time adopter should carry out a formal impairment test of all goodwill recognised in its opening IFRS balance sheet, as previous GAAP might not have required a test of comparable rigour.

Deemed cost

BC41 Some measurements in accordance with IFRSs are based on an accumulation of past costs or other transaction data. If an entity has not previously collected the necessary information, collecting or estimating it retrospectively may be costly. To avoid excessive cost, ED 1 proposed that an entity could use the fair value of an item of property, plant and equipment at the date of transition to IFRSs as its deemed cost at that date if determining a cost-based measurement in accordance with IFRSs would involve undue cost or effort.

BC42 In finalising the IFRS, the Board noted that reconstructed cost data might be less relevant to users, and less reliable, than current fair value data. Furthermore, the Board concluded that balancing costs and benefits was a task for the Board when it sets accounting requirements rather than for entities when they apply those requirements. Therefore, the IFRS permits an entity to use fair value as deemed cost in some cases without any need to demonstrate undue cost or effort.

BC43 Some expressed concerns that the use of fair value would lead to lack of comparability. However, cost is generally equivalent to fair value at the date of acquisition. Therefore, the use of fair value as the deemed cost of an asset means that an entity will report the same cost data as if it had acquired an asset with the same remaining service potential at the date of transition to IFRSs. If there is any lack of comparability, it arises from the aggregation of costs incurred at different dates, rather than from the targeted use of fair value as deemed cost for some assets. The Board regarded this approach as justified to solve the unique problem of introducing IFRSs in a cost-effective way without damaging transparency.

BC44 The IFRS restricts the use of fair value as deemed cost to those assets for which reconstructing costs is likely to be of limited benefit to users and particularly onerous: property, plant and equipment, investment property (if an entity elects to use the cost method in IAS 40 *Investment Property*) and intangible assets that meet restrictive criteria (paragraphs D5 and D7 of the IFRS).

BC45 Under the revaluation model in IAS 16 *Property, Plant and Equipment*, if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents selective revaluation of only those assets whose revaluation would lead to a particular result. Some suggested a similar restriction on the use of fair value as deemed cost. However, IAS 36 *Impairment of Assets* requires an impairment test if there is any indication that an asset is impaired. Thus, if an entity uses fair value as deemed cost for assets whose fair value is above cost, it cannot ignore indications that the recoverable amount of other assets may have fallen below their carrying amount. Therefore, the IFRS does not restrict the use of fair value as deemed cost to entire classes of asset.

BC46 Some revaluations in accordance with previous GAAP might be more relevant to users than original cost. If so, it would not be reasonable to require time-consuming and expensive reconstruction of a cost that complies with IFRSs. In consequence, the IFRS permits an entity to use amounts determined using previous GAAP as deemed cost for IFRSs in the following cases:

(a) if an entity revalued one of the assets described in paragraph BC44 using its previous GAAP and the revaluation met specified criteria (paragraphs D6 and D7 of the IFRS).

(b) if an entity established a deemed cost in accordance with previous GAAP for some or all assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering (paragraph D8 of the IFRS).

BC46A In *Improvements to IFRSs* issued in May 2010, the Board extended the scope of paragraph D8 for the use of the deemed cost exemption for an event-driven fair value. In some jurisdictions, local law requires an entity to revalue its assets and liabilities to fair value for a privatisation or initial public offering (IPO) and to treat the revalued amounts as deemed cost for the entity's previous GAAP. Before the amendment made in May 2010, if that revaluation occurred after the entity's date of transition to IFRSs, the entity could not have used that revaluation as deemed cost for IFRSs. Therefore, the entity would have had to prepare two sets of measurements for its assets and liabilities—one to comply with IFRSs, and one to comply with local law. The Board considered this unduly onerous. Therefore, the Board amended paragraph D8 to allow an entity to recognise an event-driven fair value measurement as deemed cost when the event occurs, provided that this is during the periods covered by its first IFRS financial statements. In addition, the Board concluded that the same relief should apply to an entity that adopted IFRSs in periods before the effective date of IFRS 1 or applied IFRS 1 in a previous period, provided the measurement date is within the period covered by its first IFRS financial statements.

BC46B The Board also decided to require the entity to present historical costs or other amounts already permitted by IFRS 1 for the periods before that date. In this regard, the Board considered an approach where an entity could 'work back' to the deemed cost on the date of transition, using the revaluation amounts obtained on the measurement date, adjusted to exclude any depreciation, amortisation or impairment between the two dates. Although some believed that this presentation would have provided greater comparability throughout the first IFRS reporting period, the Board rejected it because making such adjustments would require hindsight and the computed carrying amounts on the date of transition to IFRSs would be neither the historical costs of the revalued assets nor their fair values on that date.

BC47 Paragraph D6 of the IFRS refers to revaluations that are broadly comparable to fair value or reflect an index applied to a cost that is broadly comparable to cost determined in accordance with IFRSs. It may not always be clear whether a previous revaluation was intended as a measure of fair value or differs materially from fair value. The flexibility in this area permits a cost-effective solution for the unique problem of transition to IFRSs. It allows a first-time adopter to establish a deemed cost using a measurement that is already available and is a reasonable starting point for a cost-based measurement.

BC47A Under their previous GAAP many oil and gas entities accounted for exploration and development costs for properties in development or production in cost centres that include all properties in a large geographical area. (In some jurisdictions, this is referred to as full cost accounting.) Those entities will in most cases have to determine the carrying amounts for oil and gas assets at the date of transition to IFRSs. Information about oil and gas assets recorded in an accounting system using this method of accounting will almost always be at a larger unit of account than the unit of account that is acceptable under IFRSs. Amortisation at the IFRS unit of account level would also have to be calculated (on a unit of production basis) for each year, using a reserves base that has changed over time because of changes in factors such as geological understanding and prices for oil and gas. In many cases, particularly for older assets, this information may not be available. The Board was advised that even if such information is available the effort and associated cost to determine the opening balances at the date of transition would usually be very high.

BC47B IFRS 1 permits an entity to measure an item of property, plant and equipment at its fair value at the date of transition to IFRSs and to use that fair value as the item's deemed cost at that date. Determining the fair value of oil and gas assets is a complex process that begins with the difficult task of estimating the volume of reserves and resources. When the fair value amounts must be audited, determining significant inputs to the estimates generally requires the use of qualified external experts. For entities with many oil and gas assets, the use of this fair value as deemed cost alternative would not meet the Board's stated intention of avoiding excessive cost (see paragraph BC41).

BC47C The Board decided that for oil and gas assets in the development or production phases, it would permit entities that used the method of accounting described in paragraph BC47A under their previous GAAP to determine the deemed cost at the date of transition to IFRSs using an allocation of the amount determined for a cost centre under the entity's previous GAAP on the basis of the reserves associated with the oil and gas assets in that cost centre.

BC47D The deemed cost of oil and gas assets determined in this way may include amounts that would not have been capitalised in accordance with IFRSs, such as some overhead costs, costs that were incurred before the entity obtained legal rights to explore a specific area (and cannot be capitalised in accordance with IAS 38 *Intangible Assets*) and, most significantly, unsuccessful exploration costs. This is a consequence of having included these costs in the single carrying amount under the method of accounting described in paragraph BC47A. To avoid the use of deemed costs resulting in an oil and gas asset being measured at more than its recoverable amount, the Board decided that oil and gas assets should be tested for impairment at the date of transition to IFRSs.

BC47E Not all oil and gas entities used the method of accounting described in paragraph BC47A under their previous GAAP. Some used a method of accounting that requires a unit of account that is generally consistent with IFRSs and does not cause similar transition issues. Therefore, the Board decided that the exemption would apply only to entities that used the method of accounting described in paragraph BC47A under their previous GAAP.

BC47F In *Improvements to IFRSs* issued in May 2010, the Board extended the use of the deemed cost exemption to entities with operations subject to rate regulation. An entity might have items of property, plant and equipment or intangible assets that it holds for use in operations subject to rate regulation, or that it once used for this purpose and now holds for other purposes. Under previous GAAP, an entity might have capitalised, as part of the carrying amount of items of property, plant and equipment or intangible assets held for use in operations subject to rate regulation, amounts that do not qualify for capitalisation under IFRSs. For example, when setting rates regulators often permit entities to capitalise, as part of the cost of property, plant and equipment or intangible assets acquired, constructed or produced over time, an allowance for the cost of financing the asset's acquisition, construction or production. This allowance typically includes an imputed cost of equity. IFRSs do not permit an entity to capitalise an imputed cost of equity.

BC47G Before this amendment, an entity with such items whose carrying amounts include amounts that do not qualify for capitalisation under IFRSs would have had either to restate those items retrospectively to remove the non-qualifying amounts, or to use the exemption in paragraphD5 (fair value as deemed cost). Both of those alternatives pose significant practical challenges, the cost of which can often outweigh the benefit.

BC47H Typically, once amounts are included in the total cost of an item of property, plant and equipment, they are no longer tracked separately. The restatement of property, plant and equipment to remove amounts not in compliance with IFRSs would require historical information that, given the typical age of some of the assets involved, is probably no longer available and would be difficult to estimate. Obtaining the fair value information necessary to use the exemption in paragraph D5 may not be a practical alternative, given the lack of readily available fair value information for those assets.

BC47I The Board decided it would permit entities with operations subject to rate regulation to use as deemed cost at the date of transition to IFRSs the carrying amount of the items of property, plant and equipment or intangible assets determined under the entity's previous GAAP. The Board views this exemption as consistent with the exemptions already included in IFRS 1 in that it avoids excessive costs while meeting the objectives of the IFRS.

BC47J The Board understands that most first-time adopters with operations subject to rate regulation have previously accounted for property, plant and equipment largely in accordance with a historical cost model consistent with IAS 16. The Board concluded that the cost and effort required to achieve total compliance in this area for the purposes of preparing an entity's first IFRS financial statements is not warranted to meet the objective of providing a suitable starting point for accounting under IFRSs. IFRS 1 requires that each item for which the exemption is used is tested for impairment, either individually or at the cash-generating unit to which the item belongs in accordance with IAS 36, at the date of transition. This requirement provides further assurance that this objective is met.

BC47K Consistent with the Board's rationale for the use of fair value as deemed cost in paragraphs BC43 and BC44, this exemption means that an entity will report the same cost data as if it had acquired an asset with the same remaining service potential for that amount at the date of transition to IFRSs. An entity's use of this exemption results in a new cost basis for the item and previous GAAP depreciation methods and capitalisation policies are not relevant. Thus, if an entity uses this exemption for items of property, plant and equipment or intangible assets, it does not also apply the exemption for borrowing costs provided in paragraph D23.

Employee benefits

BC48 If an entity elects to use the 'corridor' approach in IAS 19 *Employee Benefits*, full retrospective application of IAS 19 would require the entity to determine actuarial gains or losses for each year since the inception of the plan in order to determine the net cumulative unrecognised gains or losses at the date of transition to IFRSs. The Board concluded that this would not benefit users and would be costly. Therefore, the IFRS permits a first-time adopter to recognise all actuarial gains or losses up to the date of transition to IFRSs, even if its accounting policy in accordance with IAS 19 involves leaving some later actuarial gains and losses unrecognised (paragraph D10 of the IFRS).

BC49 The revision of IAS 19 in 1998 increased the reported employee benefit liabilities of some entities. IAS 19 permitted entities to amortise that increase over up to five years. Some suggested a similar transitional treatment for first-time adopters. However, the Board has no general policy of exempting transactions occurring before a specific date from the requirements of new IFRSs (paragraph 21[*] of the *Preface to International Financial Reporting Standards*). Therefore, the Board did not include a similar transitional provision for first-time adopters.

BC50 An entity's first IFRS financial statements may reflect measurements of pension liabilities at three dates: the reporting date, the end of the comparative year and the date of transition to IFRSs. Some suggested that obtaining three separate actuarial valuations for a single set of financial statements would be costly. Therefore, they proposed that the Board should permit an entity to use a single actuarial valuation, based, for example, on assumptions valid at the reporting date, with service costs and interest costs based on those assumptions for each of the periods presented.

BC51 However, the Board concluded that a general exemption from the principle of measurement at each date would conflict with the objective of providing understandable, relevant, reliable and comparable information for users. If an entity obtains a full actuarial valuation at one or two of these dates and rolls that (those) valuation(s) forward or back to the other date(s), any such roll forward or roll back needs to reflect material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19 paragraph 57).

BC52 Some suggested that the Board should exempt a first-time adopter from the requirement to identify and amortise the unvested portion of past service cost at the date of transition to IFRSs. However, this requirement is less onerous than the retrospective application of the corridor for actuarial gains and losses because it does not require the recreation of data since the inception of the plan. The Board concluded that no exemption was justified for past service cost.

Cumulative translation differences

BC53 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify some cumulative translation differences (CTDs) relating to a net investment in a foreign operation as a separate component of equity. The entity transfers the CTDs to the income statement on subsequent disposal of the foreign operation. The proposals in ED 1 would have permitted a first-time adopter to use the CTDs in accordance with previous GAAP as the deemed CTDs in accordance with IFRSs if reconstructing CTDs would have involved undue cost or effort.

[*] amended to paragraph 20 when the *Preface* was revised in January 2010.

BC54 Some respondents to ED 1 argued that it would be more transparent and comparable to exempt an entity from the requirement to identify CTDs at the date of transition to IFRSs, for the following reasons:

(a) An entity might know the aggregate CTDs, but might not know the amount for each subsidiary. If so, it could not transfer that amount to the income statement on disposal of that subsidiary. This would defeat the objective of identifying CTDs as a separate component of equity.

(b) The amount of CTDs in accordance with previous GAAP might be inappropriate as it might be affected by adjustments made on transition to IFRSs to assets and liabilities of foreign entities.

BC55 The Board found these arguments persuasive. Therefore, a first-time adopter need not identify the CTDs at the date of transition to IFRSs (paragraphs D12 and D13 of the IFRS). The first-time adopter need not show that identifying the CTDs would involve undue cost or effort.

Compound financial instruments

BC56 IAS 32 requires an entity to split a compound financial instrument at inception into separate liability and equity components. Even if the liability component is no longer outstanding, retrospective application of IAS 32 would involve separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component of the instrument.

BC57 Some respondents to ED 1 argued that separating these two portions would be costly if the liability component of the compound instrument is no longer outstanding at the date of transition to IFRSs. The Board agreed with those comments. Therefore, if the liability component is no longer outstanding at the date of transition to IFRSs, a first-time adopter need not separate the cumulative interest on the liability component from the equity component (paragraph D18 of the IFRS).

BC58 Some respondents requested an exemption for compound instruments even if still outstanding at the date of transition to IFRSs. One possible approach would be to use the fair value of the components at the date of transition to IFRSs as deemed cost. However, as the IFRS does not include any exemptions for financial liabilities, the Board concluded that it would be inconsistent to create such an exemption for the liability component of a compound instrument.

Investments in subsidiaries, jointly controlled entities and associates

BC58A IAS 27 *Consolidated and Separate Financial Statements* requires an entity, in its separate financial statements, to account for investments in subsidiaries, jointly controlled entities and associates either at cost or in accordance with IAS 39. For those investments that are measured at cost, the previous version of IAS 27 (before *Cost of an Investment* in a *Subsidiary, Jointly Controlled Entity or Associate* was issued in May 2008) required an entity to recognise income from the investment only to the extent the entity received distributions from post-acquisition retained earnings (the ‘cost method’). Distributions received in excess of such profits were regarded as a recovery of investment and were recognised as a reduction in the cost of the investment.

BC58B For some jurisdictions, these aspects of IAS 27 led to practical difficulties on transition to IFRSs. In order to apply IAS 27 retrospectively, it would be necessary:

(a) to measure the fair value of the consideration given at the date of acquisition; and

(b) to determine whether any dividends received from a subsidiary after its acquisition were paid out of pre-acquisition retained earnings, which would reduce the carrying amount of the investment in the subsidiary in the parent’s separate financial statements.

BC58C If a parent held an investment in a subsidiary for many years, such an exercise might be difficult, or even impossible, and perhaps costly. For example, in some jurisdictions, entities accounted for some previous acquisitions that were share-for-share exchanges using so-called 'merger relief' or 'group reconstruction relief'. In this situation, the carrying amount of the investment in the parent's separate financial statements was based on the nominal value of the shares given rather than the value of the purchase consideration. This might make it difficult or impossible to measure the fair value of the shares given.

BC58D The Board published *Cost of an Investment in a Subsidiary*, an exposure draft of proposed amendments to IFRS 1, in January 2007. In response to the issues outlined in paragraphs BC58A–BC58C, the Board proposed two exemptions from applying the requirements of IAS 27 retrospectively upon first-time adoption of IFRSs:

(a) an alternative approach for determining the cost of an investment in a subsidiary in the separate financial statements of a parent; and

(b) simplification of the process for determining the pre-acquisition retained earnings of that subsidiary.

BC58E In developing that exposure draft, the Board considered three ways of determining a deemed cost of an investment in a subsidiary at the parent's date of transition to IFRSs in its separate financial statements. These were:

(a) the previous GAAP cost of the investment (previous GAAP deemed cost).

(b) the parent's interest in the subsidiary's assets less liabilities, using the carrying amounts that IFRSs would require in the subsidiary's statement of financial position (net asset deemed cost).

(c) the fair value of the investment (fair value deemed cost).

BC58F The Board decided that the net asset deemed cost option would provide relevant information to users about the subsidiary's financial position at the date of transition to IFRSs and would be relatively easy to determine. The fair value deemed cost option would provide relevant information at the date of transition to IFRSs, but might be more costly and difficult to determine.

BC58G In some situations, the cost of an investment in a subsidiary determined using the previous GAAP carrying amount might bear little resemblance to cost determined in accordance with IAS 27. Therefore, the Board rejected the use of a deemed cost based on the previous GAAP carrying amount. The Board proposed to allow entities a choice between the net asset deemed cost and the fair value deemed cost.

BC58H Respondents to the exposure draft stated that the previous GAAP carrying amount is a more appropriate deemed cost. They argued that:

(a) a net asset deemed cost would not include goodwill or other intangible assets that might be present in a carrying amount determined in accordance with previous GAAP. When this is the case, the net asset deemed cost option would understate the assets of the entities for which it is used. The resulting reduction in the carrying amount of the investment could reduce the distributable profits of the parent.

(b) it was difficult to see why, in the light of the exemption in IFRS 1 from applying IFRS 3 retrospectively, the Board did not propose to permit the cost of the investment in a subsidiary in accordance with previous GAAP to be used as a deemed cost. When an entity had chosen not to apply IFRS 3 retrospectively to a past business combination, it would be logical not to require it to restate the cost of the related investment in the separate financial statements of the parent.

BC58I In the light of respondents' comments, the Board observed that, in many instances, neither the previous GAAP carrying amount nor the net asset deemed cost represents 'cost'—both numbers could be viewed as being equally arbitrary.

BC58J In order to reduce the cost of adopting IFRSs in the parent entity's separate financial statements without significantly reducing the benefits of those statements, the Board decided to allow entities a choice between the previous GAAP carrying amount and the fair value as deemed cost.

BC58K The Board also agreed with respondents that similar issues arise for investments in associates and jointly controlled entities. As a result, paragraph D15 of the IFRS applies to such investments.

BC58L The Board published its revised proposals in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, an exposure draft of proposed amendments to IFRS 1 and IAS 27, in December 2007. Respondents generally supported the proposed amendments to IFRS 1. The Board included the amendments in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

BC58M In developing the December 2007 exposure draft, the Board decided to address the simplification of the process for determining the pre-acquisition retained earnings of a subsidiary more generally through an amendment to IAS 27 (see paragraph 38A of IAS 27 and paragraphs BC66D–BC66J of the Basis for Conclusions on IAS 27).

Assets and liabilities of subsidiaries, associates and joint ventures

BC59 A subsidiary may have reported to its parent in the previous period using IFRSs without presenting a full set of financial statements in accordance with IFRSs. If the subsidiary subsequently begins to present financial statements that contain an explicit and unreserved statement of compliance with IFRSs, it becomes a first-time adopter at that time. This might compel the subsidiary to keep two parallel sets of accounting records based on different dates of transition to IFRSs, because some measurements in accordance with the IFRS depend on the date of transition to IFRSs.

BC60 In developing ED 1, the Board concluded that a requirement to keep two parallel sets of records would be burdensome and not be beneficial to users. Therefore, ED 1 proposed that a subsidiary would not be treated as a first-time adopter for recognition and measurement purposes if the subsidiary was consolidated in IFRS financial statements for the previous period and all owners of the minority interests consented.[*]

BC61 Some respondents to ED 1 opposed the exemption, on the following grounds:

(a) The exemption would not eliminate all differences between the group reporting package and the subsidiary's own financial statements. The reporting package does not constitute a full set of financial statements, the parent may have made adjustments to the reported numbers (for example, if pension cost adjustments were made centrally), and the group materiality threshold may be higher than for the subsidiary.

(b) The Board's objective of comparability between different entities adopting IFRSs for the first time at the same date (paragraph BC10) should apply equally to any entity, including subsidiaries, particularly if the subsidiary's debt or equity securities are publicly traded.

BC62 However, the Board retained the exemption because it will ease some practical problems. Although the exemption does not eliminate all differences between the subsidiary's financial statements and a group reporting package, it does reduce them. Furthermore, the exemption does not diminish the relevance and reliability of the subsidiary's financial statements because it permits a measurement that is already acceptable in accordance with IFRSs in the consolidated financial statements of the parent. Therefore, the Board also eliminated the proposal in ED 1 that the exemption should be conditional on the consent of minorities.

[*] In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interests' to 'non-controlling interests'.

BC63 In finalising the IFRS, the Board simplified the description of the exemption for a subsidiary that adopts IFRSs after its parent. In accordance with the IFRS, the subsidiary may measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. Alternatively, it may elect to measure them at the carrying amounts required by the rest of the IFRS, based on the subsidiary's date of transition to IFRSs. The Board also extended the exemption to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it (paragraph D16 of the IFRS). However, if a parent adopts IFRSs later than a subsidiary, the parent cannot, in its consolidated financial statements, elect to change IFRS measurements that the subsidiary has already used in its financial statements, except to adjust for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (paragraph D17 of the IFRS).

Designation of previously recognised financial instruments

BC63A IAS 39 permits an entity to designate, on initial recognition only, a financial instrument as (a) available for sale (for a financial asset) or (b) a financial asset or financial liability at fair value through profit or loss (provided the asset or liability qualifies for such designation in accordance with paragraph 9(b)(i), 9(b)(ii) or 11A of IAS 39). Despite this requirement, an entity that had already applied IFRSs before the effective date of IAS 39 (as revised in March 2004) may (a) designate a previously recognised financial asset as available for sale on initial application of IAS 39 (as revised in March 2004), or (b) designate a previously recognised financial instrument as at fair value through profit or loss in the circumstances specified in paragraph 105B of IAS 39. The Board decided that the same considerations apply to first-time adopters as to entities that already apply IFRSs. Accordingly, a first-time adopter of IFRSs may similarly designate a previously recognised financial instrument in accordance with paragraph D19 of the IFRS. Such an entity shall disclose the fair value of the financial assets or financial liabilities designated into each category at the date of designation and their classification and carrying amount in the previous financial statements.

Share-based payment transactions

BC63B IFRS 2 *Share-based Payment* contains various transitional provisions. For example, for equity-settled share-based payment arrangements, IFRS 2 requires an entity to apply IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not vested at the effective date of IFRS 2. IFRS 2 is effective for annual periods beginning on or after 1 January 2005. There are also transitional arrangements for liabilities arising from cash-settled share-based payment transactions, and for modifications of the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, if the modification occurs after the effective date of IFRS 2. The Board decided that, in general, first-time adopters should be treated in the same way as entities that already apply IFRSs. For example, a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted on or before 7 November 2002. Similarly, a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before 1 January 2005. In addition, the Board decided that a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before the date of transition to IFRSs. Similarly, the Board decided that a first-time adopter should not be required to apply IFRS 2 to liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before the date of transition to IFRSs.

Changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment

BC63C IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in decommissioning, restoration and similar liabilities to be added to, or deducted from, the cost of the assets to which they relate, and the adjusted depreciable amount to be depreciated prospectively over the remaining useful life of those assets. Retrospective application of this requirement at the date of transition would require an entity to construct a historical record of all such adjustments that would have been made in the past. In many cases this will not be practicable. The Board agreed that, as an alternative to complying with this requirement, an entity should be permitted to include in the depreciated cost of the asset, at the date of transition to IFRSs, an amount calculated by discounting the liability at that date back to, and depreciating it from, when the liability was first incurred.

BC63CA Paragraph D21 of the IFRS exempts from the requirements of IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* changes in decommissioning costs incurred before the date of transition to IFRSs. Use of this exemption would require detailed calculations that would not be practicable for entities that used the method of accounting described in paragraph BC47A under their previous GAAP. The Board noted that adjustments to liabilities as a result of initial adoption of IFRSs arise from events and transactions before the date of transition to IFRSs and are generally recognised in retained earnings. Therefore, the Board decided that, for entities that used the method of accounting described in paragraph BC47A, any adjustment for a difference between decommissioning, restoration and similar liabilities measured in accordance with IAS 37 and the liability determined under the entity's previous GAAP should be accounted for in the same manner.

Leases

BC63D IFRIC 4 *Determining whether an Arrangement contains a Lease* contains transitional provisions because the IFRIC acknowledged the practical difficulties raised by full retrospective application of the Interpretation, in particular the difficulty of going back potentially many years and making a meaningful assessment of whether the arrangement satisfied the criteria at that time. The Board decided to treat first-time adopters in the same way as entities that already apply IFRSs.

BC63DA IFRIC 4 permits an entity to apply its requirements to arrangements existing at the start of the earliest period for which comparative information is presented on the basis of facts and circumstances existing at the start of that period. Before adopting IFRSs, a jurisdiction might adopt a national standard having the same effect as the requirements of IFRIC 4, including the same transitional provisions. An entity in that jurisdiction might then apply requirements having the same effect as the requirements of IFRIC 4 to some or all arrangements (even if the wording of those requirements is not identical). However, the entity might apply the requirements at a date different from the date in the transitional provisions of IFRIC 4. IFRS 1 would require such an entity to reassess that accounting retrospectively on first-time adoption. This might result in additional costs, with no obvious benefits. Accordingly, the Board decided that if a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRSs.

BC63DB The Board considered a more general modification to IFRS 1. It considered whether to modify IFRS 1 so that entities need not reassess, at the date of transition to IFRSs, prior accounting if that prior accounting permitted the same prospective application as IFRSs with the only difference from IFRSs being the effective date from when that accounting was applied. In this regard, the Board noted that any such proposal must apply to assessments resulting in the *same* determination, rather than *similar* determinations, because it would be too difficult to determine and enforce what constitutes a sufficient degree of similarity. The Board noted that many of the circumstances in which this situation might arise have been dealt with in IFRS 1 or other IFRSs. Accordingly, the Board decided to focus on IFRIC 4 only.

Borrowing costs

BC63E IAS 23 *Borrowing Costs* (as revised in 2007) contains transitional provisions because the Board acknowledged that if an entity has been following the accounting policy of immediately recognising borrowing costs as an expense and has not previously gathered the necessary information for capitalisation of borrowing costs, getting the information retrospectively may be costly. First-time adopters of IFRSs face problems similar to those facing entities that already apply IFRSs. Moreover, although first-time adopters have the option of using fair value as the deemed cost of an asset at the date of transition to IFRSs, this option is not applicable to all qualifying assets, such as inventories. Furthermore, the Board concluded that the existence of the deemed cost option is not sufficient to justify a more stringent requirement for the application of IAS 23 for first-time adopters than for entities that already apply IFRSs. A more stringent requirement for the adoption of the capitalisation treatment could be justified when IFRS 1 was originally issued because capitalisation was then an option. The requirements for the application of mandatory capitalisation, on the other hand, should be the same for entities that already apply IFRSs and for first-time adopters. Therefore, the Board decided to amend IFRS 1, allowing first-time adopters transitional provisions equivalent to those available to entities that already apply IFRSs in paragraphs 27 and 28 of IAS 23, as revised in 2007.

Severe hyperinflation

BC63F In 2010 the Board was asked to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period of severe hyperinflation, during which the entity had been unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*. An entity would be unable to comply with IAS 29 if a reliable general price index is not available to all entities with that same functional currency, and exchangeability between the currency and a relatively stable foreign currency does not exist. However, once the functional currency changes to a non-hyperinflationary currency, or the currency ceases to be severely hyperinflationary, an entity would be able to start applying IFRSs to subsequent transactions.

BC63G The Board noted that IFRSs did not provide sufficient guidance in these circumstances. The Board therefore decided to amend IFRS 1 to provide guidance on how an entity can present IFRS financial statements after its currency ceases to be severely hyperinflationary, by presenting an opening IFRS statement of financial position on or after the functional currency normalisation date. The Board believed that allowing an entity to apply the exemption when presenting an opening IFRS statement of financial position after, and not just on, the functional currency normalisation date, would address practical concerns that may arise if the functional currency normalisation date and the entity’s date of transition to IFRSs are different. The Board decided that this amendment would also be available to entities that were emerging from a period of severe hyperinflation but had not applied IFRSs in the past.

BC63H The Board decided to permit an entity emerging from a period of severe hyperinflation to elect to measure its assets and liabilities at fair value. That fair value could then be used as the deemed cost in its opening IFRS statement of financial position. The Board believed that this approach would expand the scope of the deemed cost exemptions in IFRS 1 to enable them to be applied in these specific circumstances. However, because severe hyperinflation is a specific set of circumstances, the Board wanted to ensure that the fair value measurement option was applied only to those assets and liabilities that were held before the functional currency normalisation date, and not to other assets and liabilities held by the entity at the time it made the transition to IFRSs. Furthermore, where a parent entity’s functional currency has been subject to severe hyperinflation, but its subsidiary company’s functional currency has not been subject to severe hyperinflation, the Board decided it was inappropriate for such a subsidiary company to be able to apply this exemption.

BC63I The Board decided that any adjustments arising on electing to measure assets and liabilities at fair value in the opening IFRS statement of financial position arise from events and transactions before the date of transition to IFRSs. Consequently, those adjustments should be accounted for in accordance with paragraph 11 of IFRS 1, and an entity should recognise those adjustments directly in retained earnings (or, if appropriate, in another category of equity) at the date of transition to IFRSs.

BC63J The Board observed that entities are required to apply paragraph 21 of IFRS 1 and prepare and present comparative information in accordance with IFRSs. The Board noted that preparation of information in accordance with IFRSs for periods before the functional currency normalisation date may not be possible; hence the exemption refers to a date of transition on or after the functional currency normalisation date. This may lead to a comparative period of less than 12 months. The Board identified that entities should consider whether disclosure of non-IFRS comparative information and historical summaries, in accordance with paragraph 22 of IFRS 1, would provide useful information to users of financial statements. The Board also noted that an entity should clearly explain the transition to IFRSs in accordance with paragraphs 23–28.

Other possible exemptions rejected

BC64 The Board considered and rejected suggestions for other exemptions. Each such exemption would have moved the IFRS away from a principle-based approach, diminished transparency for users, decreased comparability over time within an entity's first IFRS financial statements and created additional complexity. In the Board's view, any cost savings generated would not have outweighed these disadvantages. Paragraphs BC65–BC73 discuss some of the specific suggestions the Board considered for embedded derivatives, hyperinflation, intangible assets and transaction costs on financial instruments.

Embedded derivatives

BC65 IAS 39 requires an entity to account separately for some embedded derivatives at fair value. Some respondents to ED 1 argued that retrospective application of this requirement would be costly. Some suggested either an exemption from retrospective application of this requirement, or a requirement or option to use the fair value of the host instrument at the date of transition to IFRSs as its deemed cost at that date.

BC66 The Board noted that US GAAP provides an option in this area. Under the transitional provisions of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, an entity need not account separately for some pre-existing embedded derivatives. Nevertheless, the Board concluded that the failure to measure embedded derivatives at fair value would diminish the relevance and reliability of an entity's first IFRS financial statements. The Board also observed that IAS 39 addresses an inability to measure an embedded derivative and the host contract separately. In such cases, IAS 39 requires an entity to measure the entire combined contract at fair value.

Hyperinflation

BC67 Some argued that the cost of restating financial statements for the effects of hyperinflation in periods before the date of transition to IFRSs would exceed the benefits, particularly if the currency is no longer hyperinflationary. However, the Board concluded that such restatement should be required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

Intangible assets

BC68 For the following reasons, some proposed that a first-time adopter's opening IFRS balance sheet should exclude intangible assets that it did not recognise in accordance with previous GAAP:

(a) Using hindsight to assess retrospectively when the recognition criteria for intangible assets were met could be subjective, open up possibilities for manipulation and involve costs that might exceed the benefits to users.

(b) The benefits expected from intangible assets are often not related directly to the costs incurred. Therefore, capitalising the costs incurred is of limited benefit to users, particularly if the costs were incurred in the distant past.

(c) Such an exclusion would be consistent with the transitional provisions in IAS 38 *Intangible Assets*. These encourage (but do not require) the recognition of intangible assets acquired in a previous business combination that was an acquisition and prohibit the recognition of all other previously unrecognised intangible assets.

BC69 In many cases, internally generated intangible assets do not qualify for recognition in accordance with IAS 38 at the date of transition to IFRSs because an entity did not, in accordance with previous GAAP, accumulate cost information or did not carry out contemporaneous assessments of future economic benefits. In these cases, there is no need for a specific requirement to exclude those assets. Furthermore, when these assets do not qualify for recognition, first-time adopters will not generally, in the Board's view, need to perform extensive work to reach this conclusion.

BC70 In other cases, an entity may have accumulated and retained sufficient information about costs and future economic benefits to determine which intangible assets (whether internally generated or acquired in a business combination or separately) qualify in accordance with IAS 38 for recognition in its opening IFRS balance sheet. If that information is available, no exclusion is justified.

BC71 Some argued that fair value should be used as deemed cost for intangible assets in the opening IFRS balance sheet (by analogy with a business combination). ED 1 would not have permitted this. However, in finalising the IFRS, the Board concluded that this approach should be available for those intangible assets for which IFRSs already permit fair value measurements. Therefore, in accordance with the IFRS, a first-time adopter may elect to use fair value or some previous GAAP revaluations of intangible assets as deemed cost for IFRSs, but only if the intangible assets meet:

(a) the recognition criteria in IAS 38 (including reliable measurement of original cost); and

(b) the criteria in IAS 38 for revaluation (including the existence of an active market) (paragraph D7 of the IFRS).

Transaction costs: financial instruments

BC72 To determine the amortised cost of a financial asset or financial liability using the effective interest method, it is necessary to determine the transaction costs incurred when the asset or liability was originated. Some respondents to ED 1 argued that determining these transaction costs could involve undue cost or effort for financial assets or financial liabilities originated long before the date of transition to IFRSs. They suggested that the Board should permit a first-time adopter:

(a) to use the fair value of the financial asset or financial liability at the date of transition to IFRSs as its deemed cost at that date; or

(b) to determine amortised cost without considering transaction costs.

BC73 In the Board's view, the unamortised portion of transaction costs at the date of transition to IFRSs is unlikely to be material for most financial assets and financial liabilities. Even when the unamortised portion is material, reasonable estimates should be possible. Therefore, the Board created no exemption in this area.

Retrospective designation

BC74 The Board considered practical implementation difficulties that could arise from the retrospective application of aspects of IAS 39:

(a) hedge accounting (paragraphs BC75–BC80);

(b) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs (paragraphs BC81–BC83); and

(c) 'day 1' gain or loss recognition (paragraph BC83A).

Hedge accounting

BC75 Before beginning their preparations for adopting IAS 39 (or a local standard based on IAS 39), it is unlikely that most entities would have adopted IAS 39's criteria for (a) documenting hedges at their inception and (b) testing the hedges for effectiveness, even if they intended to continue the same hedging strategies after adopting IAS 39. Furthermore, retrospective designation of hedges (or retrospective reversal of their designation) could lead to selective designation of some hedges to report a particular result.

BC76 To overcome these problems, the transitional requirements in IAS 39 require an entity already applying IFRSs to apply the hedging requirements prospectively when it adopts IAS 39. As the same problems arise for a first-time adopter, the IFRS requires prospective application by a first-time adopter.

BC77 ED 1 included a redrafted version of the transitional provisions in IAS 39 and related *Questions and Answers* (Q&As) developed by the IAS 39 Implementation Guidance Committee. The Board confirmed in the Basis for Conclusions published with ED 1 that it did not intend the redrafting to create substantive changes. However, in the light of responses to ED 1, the Board decided in finalising IFRS 1 that the redrafting would not make it easier for first-time adopters and others to understand and apply the transitional provisions and Q&As. However, the project to improve IAS 32 and IAS 39 resulted in certain amendments to the transition requirements. In addition, this project incorporated selected other Q&As (ie not on transition) into IAS 39. The Board therefore took this opportunity to consolidate all the guidance for first-time adopters in one place, by incorporating the Q&As on transition into IFRS 1.

BC78 Some respondents to ED 1 asked the Board to clarify what would happen if hedge accounting in accordance with previous GAAP involved hedging relationships of a type that does not qualify for hedge accounting in accordance with IAS 39. The problem can be seen most clearly for a hedge of a net position (macro hedge). If a first-time adopter were to use hedge accounting in its opening IFRS balance sheet for a hedge of a net position, this would involve either:

(a) recognising deferred debits and credits that are not assets and liabilities (for a fair value hedge); or

(b) deferring gains or losses in equity when there is, at best, a weak link to an underlying item that defines when they should be transferred to the income statement (for a cash flow hedge).

BC79 As either of these treatments would diminish the relevance and reliability of an entity's first IFRS financial statements, the Board decided that an entity should not apply hedge accounting in its opening IFRS balance sheet to a hedge of a net position that does not qualify as a hedged item in accordance with IAS 39. However, the Board concluded that it would be reasonable (and consistent with IAS 39 paragraph 133[*]) to permit a first-time adopter to designate an individual item as a hedged item within the net position, provided that it does so no later than the date of transition to IFRSs, to prevent selective designation. For similar reasons, the Board prohibited hedge accounting in the opening IFRS balance sheet for any hedging relationship of a type that does not qualify for hedge accounting in accordance with IAS 39 (see paragraph B5 of the IFRS).

BC80 Some respondents to ED 1 suggested that an entity adopting IFRSs for the first time in 2005 could not meet IAS 39's documentation and effectiveness criteria by the date of transition to IFRSs (1 January 2004 for many entities). Some requested an exemption from these criteria until the beginning of the latest period covered by the first IFRS financial statements (1 January 2005 for many entities). However, for the following reasons, the Board did not create an exemption in this area:

(a) The Board's primary objective is comparability within a first-time adopter's first IFRS financial statements and between different first-time adopters switching to IFRSs at the same time (paragraph BC10).

(b) The continuation of previous GAAP hedge accounting practices could permit the non-recognition of derivatives or the recognition of deferred debits and credits that are not assets and liabilities.

(c) The Board's benchmark for cost-benefit assessments was an entity that has planned the transition to IFRSs and is able to collect the necessary information at, or very soon after, the date of transition to IFRSs (paragraph BC27). Entities should not be 'rewarded'

[*] In IAS 39, as revised in 2003, paragraph 133 was replaced by paragraphs 84 and AG101.

by concessions if they failed to plan for transition, nor should that failure be allowed to undermine the integrity of their opening IFRS balance sheet. Entities switching to IFRSs in 2005 need to have their hedge accounting systems in place by the beginning of 2004. In the Board's view, that is a challenging but achievable timetable. Entities preparing to switch to IFRSs in 2004 should have been aware of the implications of IAS 39 already and the exposure draft of improvements to IAS 39, published in June 2002, proposed very few changes in this area, so delayed transition is not justified for these entities either.

Available-for-sale financial assets

BC81 Retrospective application of IAS 39 to available-for-sale financial assets requires a first-time adopter to recognise the cumulative fair value changes in a separate component of equity in the opening IFRS balance sheet, and transfer those fair value changes to the income statement on subsequent disposal or impairment of the asset. This could allow, for example, selective classification of assets with cumulative gains as available for sale (with subsequent transfers to the income statement on disposal) and assets with cumulative losses as held for trading (with no transfers on disposal).

BC82 IAS 39 confirmed the proposal in the exposure draft of June 2002 to give an entity that already applies IFRSs an option to designate any financial asset as at fair value through profit or loss when it first applies the proposed improvements. Although this requirement could increase the risk of selective classification by first-time adopters of the kind discussed in the previous paragraph, the Board noted that an entity could achieve a similar result by selective disposal of some assets before the date of transition to IFRSs. Therefore, the Board concluded that it should treat first-time adopters in the same way as entities that already apply IFRSs by requiring retrospective application.

BC83 Some respondents to ED 1 commented that the cost of determining the amount to be included in a separate component of equity would exceed the benefits. However, the Board noted that these costs would be minimal if a first-time adopter carried the available-for-sale financial assets in accordance with previous GAAP at cost or the lower of cost and market value. These costs might be more significant if it carried them at fair value, but in that case it might well classify the assets as held for trading. Therefore, the Board made no changes to ED 1's proposal that a first-time adopter should apply IAS 39 retrospectively to available-for-sale financial assets.

BC83A IFRS 1 originally required retrospective application of the 'day 1' gain or loss recognition requirements in IAS 39 paragraph AG76. After the revised IAS 39 was issued, constituents raised concerns that retrospective application would diverge from the requirements of US GAAP, would be difficult and expensive to implement, and might require subjective assumptions about what was observable and what was not. In response to these concerns, the Board decided to permit entities to apply the requirements in the last sentence of IAS 39 paragraph AG76 and in paragraph AG76A, in any one of the following ways:

(a) retrospectively;

(b) prospectively to transactions entered into after 25 October 2002; or

(c) prospectively to transactions entered into after 1 January 2004.

In 2010 the Board was asked to reconsider whether the fixed dates of 25 October 2002 and 1 January 2004 continued to be appropriate for first-time adopters. Constituents were concerned that, as time passes, these fixed dates become more remote and increasingly less relevant to the financial reports as additional jurisdictions adopt IFRSs. The Board accepted that the cost of reconstructing transactions back in time to 25 October 2002 or 1 January 2004 was likely to outweigh the benefit to be achieved in doing so. It therefore amended the fixed dates included in paragraph D20 of IFRS 1 to permit a first-time adopter to apply the 'day 1' gain or loss recognition requirement in IAS 39 paragraphs AG76 and AG76A prospectively from 'the date of transition to IFRSs'.*

* IFRS 9 *Financial Instruments* issued in October 2010 incorporated the guidance from paragraphs AG76 and AG76A of IAS 39 into paragraphs B5.4.8 and B5.4.9 of IFRS 9 respectively.

Estimates

BC84 An entity will have made estimates in accordance with previous GAAP at the date of transition to IFRSs. Events between that date and the reporting date for the entity's first IFRS financial statements might suggest a need to change those estimates. Some of those events might qualify as adjusting events in accordance with IAS 10 *Events after the Balance Sheet Date*.* However, if the entity made those estimates on a basis consistent with IFRSs, the Board concluded that it would be more helpful to users—and more consistent with IAS 8—to recognise the revision of those estimates as income or expense in the period when the entity made the revision, rather than in preparing the opening IFRS balance sheet (paragraphs 14–17 of the IFRS).

Presentation and disclosure

Comparative information

BC85 IAS 1 requires an entity to disclose comparative information (in accordance with IFRSs) for the previous period. Some suggested that a first-time adopter should disclose comparative information for more than one previous period. For entities that already apply IFRSs, users normally have access to financial statements prepared on a comparable basis for several years. However, this is not the case for a first-time adopter.

BC86 Nevertheless, the Board did not require a first-time adopter to present more comparative information than IAS 1 requires, because such a requirement would impose costs out of proportion to the benefits to users, and increase the risk that preparers might need to make arbitrary assumptions in applying hindsight.

BC87 ED 1 proposed that if the first IFRS financial statements include more than one year of comparative information, the additional comparative information should comply with IFRSs. Some respondents to ED 1 noted that some regulators require entities to prepare more than two years of comparatives. They argued the following:

(a) A requirement to restate two years of comparatives would impose excessive costs and lead to arbitrary restatements that might be biased by hindsight.

(b) Consider an entity adopting IFRSs in 2005 and required by its regulator to give two years of comparatives. Its date of transition to IFRSs would be 1 January 2003—several months before the publication of the IFRS and of the standards resulting from the improvements project. This could contradict the Board's assertion in paragraph BC27 above that most preparers could gather most information they need for their opening IFRS balance sheet at, or soon after, the date of transition to IFRSs.

BC88 In response to these comments, the Board deleted this proposal. Instead, if a first-time adopter elects to give more than one year of comparative information, the additional comparative information need not comply with IFRSs, but the IFRS requires the entity:

(a) to label previous GAAP information prominently as not being prepared in accordance with IFRSs.

(b) to disclose the nature of the main adjustments that would make it comply with IFRSs (paragraph 22 of the IFRS).

* In September 2007 the IASB amended the title of IAS 10 *Events after the Balance Sheet Date* to *Events after the Reporting Period* as a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007.

BC89 Some respondents to ED 1 suggested that it would be onerous to prepare comparative information in accordance with IAS 32 and IAS 39 about financial instruments. They suggested that an entity should be able to apply IAS 39 prospectively from the beginning of the year of its first IFRS financial statements (eg 1 January 2005 for many first-time adopters). They noted that US companies were not required to restate comparatives on the introduction of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*. However, given the Board's emphasis on comparability within the first IFRS financial statements (paragraph BC10) and the assumption of timely planning (paragraph BC27), the Board introduced no general exemption in this area.

BC89A Nevertheless, the Board noted that the revised IAS 32 and IAS 39 were not issued until December 2003. Additionally, the Board's decision to re-expose its proposals for portfolio hedges of interest rate risk had the effect that some of the requirements will not be finalised until early 2004. The Board was sympathetic to concerns that entities that will be required to comply with IFRSs for the first time in 2005 could not make a timely transition to IFRSs because IAS 39 will not be issued in final form until after the start of 2004. Therefore, the Board decided to exempt entities adopting IFRSs for the first time before 1 January 2006 from producing comparative information that complies with IAS 32 and IAS 39, as revised in 2003, in their first IFRS financial statements.

Historical summaries

BC90 Some entities choose, or are required, to present in their financial statements historical summaries of selected data covering periods before the first period for which they present full comparative information. Some argued that an entity should present this information in accordance with IFRSs, to ensure comparability over time. However, the Board concluded that such a requirement would cause costs out of proportion to the benefit to users. The IFRS requires disclosure of the nature of the main adjustments needed to make historical summaries included in financial statements or interim financial reports comply with IFRSs (paragraph 22 of the IFRS). Historical summaries published outside financial statements or interim financial reports are beyond the scope of the IFRS.

Explanation of transition to IFRSs

BC91 The IFRS requires disclosures about the effect of the transition from previous GAAP to IFRSs. The Board concluded that such disclosures are essential, in the first (annual) IFRS financial statements as well as in interim financial reports (if any), because they help users understand the effect and implications of the transition to IFRSs and how they need to change their analytical models to make the best use of information presented using IFRSs. The required disclosures relate to both:

(a) the most recent information published in accordance with previous GAAP, so that users have the most up-to-date information; and

(b) the date of transition to IFRSs. This is an important focus of attention for users, preparers and auditors because the opening IFRS balance sheet is the starting point for accounting in accordance with IFRSs.

BC92 Paragraph 24(a) and (b) of the IFRS requires reconciliations of equity and total comprehensive income. The Board concluded that users would also find it helpful to have information about the other adjustments that affect the opening IFRS balance sheet but do not appear in these reconciliations. Because a reconciliation could be voluminous, the IFRS requires disclosure of narrative information about these adjustments, as well as about adjustments to the cash flow statement (paragraph 25 of the IFRS).

BC92A The Board decided to require a first-time adopter to include in its first IFRS financial statements a reconciliation of total comprehensive income (or, if an entity did not report such a total, profit or loss) in accordance with previous GAAP to total comprehensive income in accordance with IFRSs for the latest period reported in accordance with previous GAAP.

BC92B The Board observed that the amendments to IAS 1 in 2007 regarding the presentation of income and expense might result in users having to change their analytical models to include both income and expense that are recognised in profit or loss and those recognised outside profit or loss. Accordingly, the Board concluded that it would be helpful to those users to provide information on the effect and implication of the transition to IFRSs on all items of income and expense, not only those recognised in profit or loss.

BC92C The Board acknowledged that GAAP in other jurisdictions might not have a notion of total comprehensive income. Accordingly, it decided that an entity should reconcile to total comprehensive income in accordance with IFRSs from the previous GAAP equivalent of total comprehensive income. The previous GAAP equivalent might be profit or loss.

BC93 Paragraph 26 of the IFRS states that the reconciliations should distinguish changes in accounting policies from the correction of errors. Some respondents to ED 1 argued that complying with this requirement could be difficult or costly. However, the Board concluded that both components are important and their disclosure should be required because:

(a) information about changes in accounting policies helps explain the transition to IFRSs.

(b) information about errors helps users assess the reliability of financial information. Furthermore, a failure to disclose the effect of material errors would obscure the 'results of the stewardship of management, or the accountability of management for the resources entrusted to it' (*Framework*, paragraph 14[*]).

BC94 For impairment losses (and reversals) recognised in preparing the opening IFRS balance sheet, paragraph 24(c) of the IFRS requires the disclosures that IAS 36 would require if those impairment losses (and reversals) were recognised during the period beginning with the date of transition to IFRSs. The rationale for this requirement is that there is inevitably subjectivity about impairment losses. This disclosure provides transparency about impairment losses recognised on transition to IFRSs. These losses might otherwise receive less attention than impairment losses recognised in earlier or later periods.

BC95 Paragraph 30 of the IFRS requires disclosures about the use of fair value as deemed cost. Although the adjustment arising from the use of this exemption appears in the reconciliations discussed above, this more specific disclosure highlights it. Furthermore, this exemption differs from the other exemptions that might apply for property, plant and equipment (previous GAAP revaluation or event-driven fair value measurement). The latter two exemptions do not lead to a restatement on transition to IFRSs because they apply only if the measurement was already used in previous GAAP financial statements.

Interim financial reports

BC96 IAS 34 *Interim Financial Reporting* states that the interim financial report is 'intended to provide an update on the latest complete set of annual financial statements' (paragraph 6). Thus, IAS 34 requires less disclosure in interim financial statements than IFRSs require in annual financial statements. However, an entity's interim financial report in accordance with IAS 34 is less helpful to users if the entity's latest annual financial statements were prepared using previous GAAP than if they were prepared in accordance with IFRSs. Therefore, the Board concluded that a first-time adopter's first interim financial report in accordance with IAS 34 should include sufficient information to enable users to understand how the transition to IFRSs affected previously reported annual, as well as interim, figures (paragraphs 32 and 33 of the IFRS).

[*] superseded by Chapter 1 of the *Conceptual Framework*.

Accounting policy changes in the year of adoption

BC97 In *Improvements to IFRSs* issued in May 2010, the Board clarified unclear wording concerning how changes in accounting policies should be addressed by a first-time adopter when those changes occur after the publication of the entity's first interim financial report. The Board decided that a first-time adopter is exempt from all the requirements of IAS 8 for the interim financial report it presents in accordance with IAS 34 for part of the period covered by its first IFRS financial statements and for its first IFRS financial statements. The Board concluded that to comply with IFRS 1's requirement to explain its transition to IFRSs, an entity should be required to explain any changes in its accounting policies or the IFRS 1 exemptions it applied between its first IFRS interim financial report and its first IFRS financial statements. The Board decided that the most useful information it could require was updated reconciliations between previous GAAP and IFRSs.

HKFRS 1 IG (Revised)
Revised February ~~2010~~2012

Effective for annual periods
beginning on or after 1 July 2009

Guidance on Implementing
Hong Kong Financial Reporting Standards 1(Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

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

CONTENTS

LIST OF EXAMPLES *after paragraph*

Guidance on implementing IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This guidance accompanies, but is not part of, IFRS 1.

Introduction

IG1 This implementation guidance:

(a) explains how the requirements of the IFRS interact with the requirements of some other IFRSs (paragraphs IG2–IG62, IG64 and IG65). This explanation addresses those IFRSs that are most likely to involve questions that are specific to first-time adopters.

(b) includes an illustrative example to show how a first-time adopter might disclose how the transition to IFRSs affected its reported financial position, financial performance and cash flows, as required by paragraphs 24(a) and (b), 25 and 26 of the IFRS (paragraph IG63).

IAS 10 *Events after the Reporting Period*

IG2 Except as described in paragraph IG3, an entity applies IAS 10 in determining whether:

(a) its opening IFRS statement of financial position reflects an event that occurred after the date of transition to IFRSs; and

(b) comparative amounts in its first IFRS financial statements reflect an event that occurred after the end of that comparative period.

IG3 Paragraphs 14–17 of the IFRS require some modifications to the principles in IAS 10 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of transition to IFRSs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 14–17 of the IFRS do not require modifications to the principles in IAS 10.

(a) Case 1—Previous GAAP required estimates of similar items for the date of transition to IFRSs, using an accounting policy that is consistent with IFRSs. In this case, the estimates in accordance with IFRSs need to be consistent with estimates made for that date in accordance with previous GAAP, unless there is objective evidence that those estimates were in error (see IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). The entity reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of transition to IFRSs.

(b) Case 2—Previous GAAP required estimates of similar items for the date of transition to IFRSs, but the entity made those estimates using accounting policies that are not consistent with its accounting policies in accordance with IFRSs. In this case, the estimates in accordance with IFRSs need to be consistent with the estimates required in accordance with previous GAAP for that date (unless there is objective evidence that those estimates were in error), after adjusting for the difference in accounting policies. The opening IFRS statement of financial position reflects those adjustments for the difference in accounting policies. As in case 1, the entity reports later revisions to those estimates as events of the period in which it makes the revisions.

For example, previous GAAP may have required an entity to recognise and measure provisions on a basis consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous GAAP measurement was on an undiscounted basis. In this example, the entity uses the estimates in accordance with previous GAAP as inputs in making the discounted measurement required by IAS 37.

(c) Case 3—Previous GAAP did not require estimates of similar items for the date of transition to IFRSs. Estimates in accordance with IFRSs for that date reflect conditions existing at that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of transition to IFRSs reflect market conditions at that date. This is consistent with the distinction in IAS 10 between adjusting events after the reporting period and non-adjusting events after the reporting period.

IG Example 1 Estimates

Background

Entity A's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for one year. In its previous GAAP financial statements for 31 December 20X3 and 20X4, entity A:

(a) made estimates of accrued expenses and provisions at those dates;

(b) accounted on a cash basis for a defined benefit pension plan; and

(c) did not recognise a provision for a court case arising from events that occurred in September 20X4. When the court case was concluded on 30 June 20X5, entity A was required to pay CU1,000[*] and paid this on 10 July 20X5.

In preparing its first IFRS financial statements, entity A concludes that its estimates in accordance with previous GAAP of accrued expenses and provisions at 31 December 20X3 and 20X4 were made on a basis consistent with its accounting policies in accordance with IFRSs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity A concludes that its estimates were reasonable and that, therefore, no error had occurred. As a result, accounting for those overestimates and underestimates involves the routine adjustment of estimates in accordance with IAS 8.

Application of requirements

In preparing its opening IFRS statement of financial position at 1 January 20X4 and in its comparative statement of financial position at 31 December 20X4, entity A:

(a) does not adjust the previous estimates for accrued expenses and provisions; and

(b) makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan in accordance with IAS 19 *Employee Benefits*. Entity A's actuarial assumptions at 1 January 20X4 and 31 December 20X4 do not reflect conditions that arose after those dates. For example, entity A's:

continued…

[*] In this guidance monetary amounts are denominated in 'currency units (CU)'.

… continued

IG Example 1 Estimates

(i) discount rates at 1 January 20X4 and 31 December 20X4 for the pension plan and for provisions reflect market conditions at those dates; and

(ii) actuarial assumptions at 1 January 20X4 and 31 December 20X4 about future employee turnover rates do not reflect conditions that arose after those dates—such as a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan in 20X5.

The treatment of the court case at 31 December 20X4 depends on the reason why entity A did not recognise a provision in accordance with previous GAAP at that date.

Assumption 1 – Previous GAAP was consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions in accordance with IFRSs are consistent with its assumptions in accordance with previous GAAP. Therefore, entity A does not recognise a provision at 31 December 20X4.

Assumption 2 – Previous GAAP was not consistent with IAS 37. Therefore, entity A develops estimates in accordance with IAS 37. Under IAS 37, an entity determines whether an obligation exists at the end of the reporting period by taking account of all available evidence, including any additional evidence provided by events after the reporting period. Similarly, in accordance with IAS 10 *Events after the Reporting Period*, the resolution of a court case after the reporting period is an adjusting event after the reporting period if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 20X4 (when the events occurred that gave rise to the court case). Therefore, entity A recognises a provision at 31 December 20X4. Entity A measures that provision by discounting the CU1,000 paid on 10 July 20X5 to its present value, using a discount rate that complies with IAS 37 and reflects market conditions at 31 December 20X4.

IG4 Paragraphs 14–17 of the IFRS do not override requirements in other IFRSs that base classifications or measurements on circumstances existing at a particular date. Examples include:

(a) the distinction between finance leases and operating leases (see IAS 17 *Leases*);

(b) the restrictions in IAS 38 *Intangible Assets* that prohibit capitalisation of expenditure on an internally generated intangible asset if the asset did not qualify for recognition when the expenditure was incurred; and

(c) the distinction between financial liabilities and equity instruments (see IAS 32 *Financial Instruments: Presentation*).

IAS 12 *Income Taxes*

IG5 An entity applies IAS 12 to temporary differences between the carrying amount of the assets and liabilities in its opening IFRS statement of financial position and their tax bases.

IG6 In accordance with IAS 12, the measurement of current and deferred tax reflects tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period. An entity accounts for the effect of changes in tax rates and tax laws when those changes are enacted or substantively enacted.

IAS 16 *Property, Plant and Equipment*

IG7 If an entity's depreciation methods and rates in accordance with previous GAAP are acceptable in accordance with IFRSs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 14 and 15 of the IFRS and paragraph 61 of IAS 16). However, in some cases, an entity's depreciation methods and rates in accordance with previous GAAP may differ from those that would be acceptable in accordance with IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening IFRS statement of financial position retrospectively so that it complies with IFRSs.

IG8 An entity may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:

(a) fair value at the date of transition to IFRSs (paragraph D5 of the IFRS), in which case the entity gives the disclosures required by paragraph 30 of the IFRS;

(b) a revaluation in accordance with previous GAAP that meets the criteria in paragraph D6 of the IFRS;

(c) fair value at the date of an event such as a privatisation or initial public offering (paragraph D8 of the IFRS); ~~or~~

(d) an allocation of an amount determined under previous GAAP that meets the criteria in paragraph D8A of the IFRS~~.~~; or

(e) the carrying amount under previous GAAP of an item of property, plant and equipment that is used, or was previously used, in operations subject to rate regulation (paragraph D8B of the IFRS).

IG9 Subsequent depreciation is based on that deemed cost and starts from the date for which the entity established the deemed cost.

IG10 If an entity chooses as its accounting policy the revaluation model in IAS 16 for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of equity. The revaluation surplus at the date of transition to IFRSs is based on a comparison of the carrying amount of the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of transition to IFRSs, the entity gives the disclosures required by paragraph 30 of the IFRS.

IG11 If revaluations in accordance with previous GAAP did not satisfy the criteria in paragraph D6 or D8 of the IFRS, an entity measures the revalued assets in its opening statement of financial position on one of the following bases:

(a) cost (or deemed cost) less any accumulated depreciation and any accumulated impairment losses under the cost model in IAS 16;

(b) deemed cost, being the fair value at the date of transition to IFRSs (paragraph D5 of the IFRS); or

(c) revalued amount, if the entity adopts the revaluation model in IAS 16 as its accounting policy in accordance with IFRSs for all items of property, plant and equipment in the same class.

IG12 IAS 16 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. However, IAS 16 does not prescribe the unit of measure for recognition of an asset, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances (see IAS 16 paragraphs 9 and 43).

IG13 In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site on which the asset stands. An entity applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in recognising and measuring any resulting provision. The entity applies IAS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the liability and the amount included in the carrying amount of the asset. An entity accounts for changes in such liabilities in accordance with IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. However, paragraph D21 of IFRS 1 provides an exemption for changes that occurred before the date of transition to IFRSs, and prescribes an alternative treatment where the exemption is used. An example of the first-time adoption of IFRIC 1, which illustrates the use of this exemption, is given at paragraphs IG201–IG203.

IAS 17 *Leases*

IG14 At the date of transition to IFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (IAS 17, paragraph 13). In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification in accordance with IAS 17 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.

IG15 When IAS 17 was revised in 1997, the net cash investment method for recognising finance income of lessors was eliminated. IAS 17 permits finance lessors to eliminate this method prospectively. However, the transitional provisions in IAS 17 do not apply to an entity's opening IFRS statement of financial position (paragraph 9 of the IFRS). Therefore, a finance lessor measures finance lease receivables in its opening IFRS statement of financial position as if the net cash investment method had never been permitted.

IG16 SIC-15 *Operating Leases—Incentives* applies to lease terms beginning on or after 1 January 1999. However, a first-time adopter applies SIC-15 to all leases, whether they started before or after that date.

IAS 18 *Revenue*

IG17 If an entity has received amounts that do not yet qualify for recognition as revenue in accordance with IAS 18 (for example, the proceeds of a sale that does not qualify for revenue recognition), the entity recognises the amounts received as a liability in its opening IFRS statement of financial position and measures that liability at the amount received.

IAS 19 *Employee Benefits*

IG18 At the date of transition to IFRSs, an entity applies IAS 19 in measuring net employee benefit assets or liabilities under defined benefit plans, but it may elect to recognise all cumulative actuarial gains or losses from the inception of the plan until the date of transition to IFRSs even if its accounting policy in accordance with IAS 19 will involve leaving some later actuarial gains and losses unrecognised (paragraph D10 of the IFRS). The transitional provisions in IAS 19 do not apply to an entity's opening IFRS statement of financial position (paragraph 9 of the IFRS).

IG19 An entity's actuarial assumptions at the date of transition to IFRSs are consistent with actuarial assumptions made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 14 of the IFRS). The impact of any later revisions to those assumptions is an actuarial gain or loss of the period in which the entity makes the revisions.

IG20 An entity may need to make actuarial assumptions at the date of transition to IFRSs that were not necessary in accordance with its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to IFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to IFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to IFRSs about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of transition to IFRSs (paragraph 16 of the IFRS).

IG21 In many cases, an entity's first IFRS financial statements will reflect measurements of employee benefit obligations at three dates: the end of the first IFRS reporting period, the date of the comparative statement of financial position and the date of transition to IFRSs. IAS 19 encourages an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. To minimise costs, an entity may request a qualified actuary to carry out a detailed actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19 paragraph 57).

IAS 21 *The Effects of Changes in Foreign Exchange Rates*

IG21A An entity may, in accordance with previous GAAP, have treated 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 as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. If so, the entity is permitted to apply prospectively the requirements of paragraph 47 of IAS 21 to all acquisitions occurring after the date of transition to IFRSs.

IFRS 3 *Business Combinations*

IG22 The following examples illustrate the effect of Appendix C of the IFRS, assuming that a first-time adopter uses the exemption.

IG Example 2 Business combination

Background

Entity B's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for 20X4 only. On 1 July 20X1, entity B acquired 100 per cent of subsidiary C. In accordance with its previous GAAP, entity B:

(a) classified the business combination as an acquisition by entity B.

(b) measured the assets acquired and liabilities assumed at the following amounts in accordance with previous GAAP at 31 December 20X3 (date of transition to IFRSs):

   (i) identifiable assets less liabilities for which IFRSs require cost-based measurement at a date after the business combination: CU200 (with a tax base of CU150 and an applicable tax rate of 30 per cent).

   (ii) pension liability (for which the present value of the defined benefit obligation measured in accordance with IAS 19 *Employee Benefits* is CU130 and the fair value of plan assets is CU100): nil (because entity B used a pay-as-you-go cash method of accounting for pensions in accordance with its previous GAAP). The tax base of the pension liability is also nil.

   (iii) goodwill: CU180.

(c) did not, at the acquisition date, recognise deferred tax arising from temporary differences associated with the identifiable assets acquired and liabilities assumed.

Application of requirements

In its opening (consolidated) IFRS statement of financial position, entity B:

(a) classifies the business combination as an acquisition by entity B even if the business combination would have qualified in accordance with IFRS 3 as a reverse acquisition by subsidiary C (paragraph C4(a) of the IFRS).

(b) does not adjust the accumulated amortisation of goodwill. Entity B tests the goodwill for impairment in accordance with IAS 36 *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to IFRSs. If no impairment exists, the carrying amount of the goodwill remains at CU180 (paragraph C4(g) of the IFRS).

(c) for those net identifiable assets acquired for which IFRSs require cost-based measurement at a date after the business combination, treats their carrying amount in accordance with previous GAAP immediately after the business combination as their deemed cost at that date (paragraph C4(e) of the IFRS).

(d) does not restate the accumulated depreciation and amortisation of the net identifiable assets in (c), unless the depreciation methods and rates in accordance with previous GAAP result in amounts that differ materially from those required in accordance with IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life in accordance with IFRSs). If no such restatement is made, the carrying amount of those assets in the opening IFRS statement of financial position equals their carrying amount in accordance with previous GAAP at the date of transition to IFRSs (CU200) (paragraph IG7).

continued...

…continued

IG Example 2 Business combination

(e) if there is any indication that identifiable assets are impaired, tests those assets for impairment, based on conditions that existed at the date of transition to IFRSs (see IAS 36).

(f) recognises the pension liability, and measures it, at the present value of the defined benefit obligation (CU130) less the fair value of the plan assets (CU100), giving a carrying amount of CU30, with a corresponding debit of CU30 to retained earnings (paragraph C4(d) of the IFRS). However, if subsidiary C had already adopted IFRSs in an earlier period, entity B would measure the pension liability at the same amount as in subsidiary C's financial statements (paragraph D17 of the IFRS and IG Example 9).

(g) recognises a net deferred tax liability of CU6 (CU20 at 30 per cent) arising from:

(i) the taxable temporary difference of CU50 (CU200 less CU150) associated with the identifiable assets acquired and non-pension liabilities assumed, less

(ii) the deductible temporary difference of CU30 (CU30 less nil) associated with the pension liability.

The entity recognises the resulting increase in the deferred tax liability as a deduction from retained earnings (paragraph C4(k) of the IFRS). If a taxable temporary difference arises from the initial recognition of the goodwill, entity B does not recognise the resulting deferred tax liability (paragraph 15(a) of IAS 12 *Income Taxes*).

IG Example 3 Business combination—restructuring provision

Background

Entity D's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for 20X4 only. On 1 July 20X3, entity D acquired 100 per cent of subsidiary E. In accordance with its previous GAAP, entity D recognised an (undiscounted) restructuring provision of CU100 that would not have qualified as an identifiable liability in accordance with IFRS 3. The recognition of this restructuring provision increased goodwill by CU100. At 31 December 20X3 (date of transition to IFRSs), entity D:

(a) had paid restructuring costs of CU60; and

(b) estimated that it would pay further costs of CU40 in 20X4, and that the effects of discounting were immaterial. At 31 December 20X3, those further costs did not qualify for recognition as a provision in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Application of requirements

In its opening IFRS statement of financial position, entity D:

(a) does not recognise a restructuring provision (paragraph C4(c) of the IFRS).

(b) does not adjust the amount assigned to goodwill. However, entity D tests the goodwill for impairment in accordance with IAS 36 *Impairment of Assets*, and recognises any resulting impairment loss (paragraph C4(g) of the IFRS).

(c) as a result of (a) and (b), reports retained earnings in its opening IFRS statement of financial position that are higher by CU40 (before income taxes, and before recognising any impairment loss) than in the statement of financial position at the same date in accordance with previous GAAP.

IG Example 4 Business combination—intangible assets

Background

Entity F's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for 20X4 only. On 1 July 20X1 entity F acquired 75 per cent of subsidiary G. In accordance with its previous GAAP, entity F assigned an initial carrying amount of CU200 to intangible assets that would not have qualified for recognition in accordance with IAS 38 *Intangible Assets*. The tax base of the intangible assets was nil, giving rise to a deferred tax liability (at 30 per cent) of CU60.

On 31 December 20X3 (the date of transition to IFRSs) the carrying amount of the intangible assets in accordance with previous GAAP was CU160, and the carrying amount of the related deferred tax liability was CU48 (30 per cent of CU160).

Application of requirements

Because the intangible assets do not qualify for recognition as separate assets in accordance with IAS 38, entity F transfers them to goodwill, together with the related deferred tax liability (CU48) and non-controlling interests (paragraph C4(g)(i) of the IFRS). The related non-controlling interests amount to CU28 (25 per cent of [CU160 – CU48 = CU112]). Thus, the increase in goodwill is CU84—intangible assets (CU160) less deferred tax liability (CU48) less non-controlling interests (CU28).

Entity F tests the goodwill for impairment in accordance with IAS 36 *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to IFRSs (paragraph C4(g)(ii) of the IFRS).

IG Example 5 Business combination—goodwill deducted from equity and treatment of related intangible assets

Background

Entity H acquired a subsidiary before the date of transition to IFRSs. In accordance with its previous GAAP, entity H:

(a) recognised goodwill as an immediate deduction from equity;

(b) recognised an intangible asset of the subsidiary that does not qualify for recognition as an asset in accordance with IAS 38 *Intangible Assets*; and

(c) did not recognise an intangible asset of the subsidiary that would qualify in accordance with IAS 38 for recognition as an asset in the financial statements of the subsidiary. The subsidiary held the asset at the date of its acquisition by entity H.

Application of requirements

In its opening IFRS statement of financial position, entity H:

(a) does not recognise the goodwill, as it did not recognise the goodwill as an asset in accordance with previous GAAP (paragraph C4(g)–(i) of the IFRS).

(b) does not recognise the intangible asset that does not qualify for recognition as an asset in accordance with IAS 38. Because entity H deducted goodwill from equity in accordance with its previous GAAP, the elimination of this intangible asset reduces retained earnings (paragraph C4(c)(ii) of the IFRS).

(c) recognises the intangible asset that qualifies in accordance with IAS 38 for recognition as an asset in the financial statements of the subsidiary, even though the amount assigned to it in accordance with previous GAAP in entity H's consolidated financial statements was nil (paragraph C4(f) of the IFRS). The recognition criteria in IAS 38 include the availability of a reliable measurement of cost (paragraphs IG45–IG48) and entity H measures the asset at cost less accumulated depreciation and less any impairment losses identified in accordance with IAS 36 *Impairment of Assets*. Because entity H deducted goodwill from equity in accordance with its previous GAAP, the recognition of this intangible asset increases retained earnings (paragraph C4(c)(ii) of the IFRS). However, if this intangible asset had been subsumed in goodwill recognised as an asset in accordance with previous GAAP, entity H would have decreased the carrying amount of that goodwill accordingly (and, if applicable, adjusted deferred tax and non-controlling interests) (paragraph C4(g)(i) of the IFRS).

IG Example 6 Business combination—subsidiary not consolidated in accordance with previous GAAP

Background

Parent J's date of transition to IFRSs is 1 January 20X4. In accordance with its previous GAAP, parent J did not consolidate its 75 per cent subsidiary K, acquired in a business combination on 15 July 20X1. On 1 January 20X4:

(a) the cost of parent J's investment in subsidiary K is CU180.

(b) in accordance with IFRSs, subsidiary K would measure its assets at CU500 and its liabilities (including deferred tax in accordance with IAS 12 *Income Taxes*) at CU300. On this basis, subsidiary K's net assets are CU200 in accordance with IFRSs.

Application of requirements

Parent J consolidates subsidiary K. The consolidated statement of financial position at 1 January 20X4 includes:

(a) subsidiary K's assets at CU500 and liabilities at CU300;

(b) non-controlling interests of CU50 (25 per cent of [CU500 – CU300]); and

(c) goodwill of CU30 (cost of CU180 less 75 per cent of [CU500 – CU300]) (paragraph C4(j) of the IFRS). Parent J tests the goodwill for impairment in accordance with IAS 36 *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to IFRSs (paragraph C4(g)(ii) of the IFRS).

IG Example 7 Business combination—finance lease not capitalised in accordance with previous GAAP

Background

Parent L's date of transition to IFRSs is 1 January 20X4. Parent L acquired subsidiary M on 15 January 20X1 and did not capitalise subsidiary M's finance leases. If subsidiary M prepared financial statements in accordance with IFRSs, it would recognise finance lease obligations of 300 and leased assets of 250 at 1 January 20X4.

Application of requirements

In its consolidated opening IFRS statement of financial position, parent L recognises finance lease obligations of CU300 and leased assets of CU250, and charges CU50 to retained earnings (paragraph C4(f)).

IAS 23 *Borrowing Costs*

IG23 On first adopting IFRSs, an entity begins capitalising borrowing costs (IAS 23 as revised in 2007). In accordance with paragraph D23 of the IFRS, an entity:

(a) capitalises borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009 or the date of transition to IFRSs (whichever is later);

(b) may elect to designate any date before 1 January 2009 or the date of transition to IFRSs (whichever is later) and to capitalise borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

IG24 IAS 23 requires disclosure of interest capitalised during the period. Neither IAS 23 nor the IFRS requires disclosure of the cumulative amount capitalised.

IG25 [Deleted]

IAS 27 *Consolidated and Separate Financial Statements*

IG26 A first-time adopter consolidates all subsidiaries (as defined in IAS 27), unless IAS 27 requires otherwise.

IG27 If a first-time adopter did not consolidate a subsidiary in accordance with previous GAAP, then:

(a) in its consolidated financial statements, the first-time adopter measures the subsidiary's assets and liabilities at the same carrying amounts as in the IFRS financial statements of the subsidiary, after adjusting for consolidation procedures and for the effects of the business combination in which it acquired the subsidiary (paragraph D17 of the IFRS). If the subsidiary has not adopted IFRSs in its financial statements, the carrying amounts described in the previous sentence are those that IFRSs would require in those financial statements (paragraph C4(j) of the IFRS).

(b) if the parent acquired the subsidiary in a business combination before the date of transition to IFRS, the parent recognises goodwill, as explained in IG Example 6.

(c) if the parent did not acquire the subsidiary in a business combination because it created the subsidiary, the parent does not recognise goodwill.

IG28 When a first-time adopter adjusts the carrying amounts of assets and liabilities of its subsidiaries in preparing its opening IFRS statement of financial position, this may affect non-controlling interests and deferred tax.

IG29 IG Examples 8 and 9 illustrate paragraphs D16 and D17 of the IFRS, which address cases where a parent and its subsidiary become first-time adopters at different dates.

IG Example 8 Parent adopts IFRSs before subsidiary

Background

Parent N presents its (consolidated) first IFRS financial statements in 20X5. Its foreign subsidiary O, wholly owned by parent N since formation, prepares information in accordance with IFRSs for internal consolidation purposes from that date, but subsidiary O does not present its first IFRS financial statements until 20X7.

Application of requirements

If subsidiary O applies paragraph D16(a) of the IFRS, the carrying amounts of its assets and liabilities are the same in both its opening IFRS statement of financial position at 1 January 20X6 and parent N's consolidated statement of financial position (except for adjustments for consolidation procedures) and are based on parent N's date of transition to IFRSs.

Alternatively, subsidiary O may, in accordance with paragraph D16(b) of the IFRS, measure all its assets or liabilities based on its own date of transition to IFRSs (1 January 20X6). However, the fact that subsidiary O becomes a first-time adopter in 20X7 does not change the carrying amounts of its assets and liabilities in parent N's consolidated financial statements.

IG Example 9 Subsidiary adopts IFRSs before parent

Background

Parent P presents its (consolidated) first IFRS financial statements in 20X7. Its foreign subsidiary Q, wholly owned by parent P since formation, presented its first IFRS financial statements in 20X5. Until 20X7, subsidiary Q prepared information for internal consolidation purposes in accordance with parent P's previous GAAP.

Application of requirements

The carrying amounts of subsidiary Q's assets and liabilities at 1 January 20X6 are the same in both parent P's (consolidated) opening IFRS statement of financial position and subsidiary Q's financial statements (except for adjustments for consolidation procedures) and are based on subsidiary Q's date of transition to IFRSs. The fact that parent P becomes a first-time adopter in 20X7 does not change those carrying amounts (paragraph D17 of the IFRS).

IG30 Paragraphs D16 and D17 of the IFRS do not override the following requirements:

(a) to apply Appendix C of the IFRS to assets acquired, and liabilities assumed, in a business combination that occurred before the acquirer's date of transition to IFRSs. However, the acquirer applies paragraph D17 to new assets acquired, and liabilities assumed, by the acquiree after that business combination and still held at the acquirer's date of transition to IFRSs.

(b) to apply the rest of the IFRS in measuring all assets and liabilities for which paragraphs D16 and D17 are not relevant.

(c) to give all disclosures required by the IFRS as of the first-time adopter's own date of transition to IFRSs.

IG31 Paragraph D16 of the IFRS applies if a subsidiary becomes a first-time adopter later than its parent, for example if the subsidiary previously prepared a reporting package in accordance with IFRSs for consolidation purposes but did not present a full set of financial statements in accordance with IFRSs. This may be relevant not only when a subsidiary's reporting package complies fully with the recognition and measurement requirements of IFRSs, but also when it is adjusted centrally for matters such as review of events after the reporting period and central allocation of pension costs. For the disclosure required by paragraph 26 of the IFRS, adjustments made centrally to an unpublished reporting package are not corrections of errors. However, paragraph D16 does not permit a subsidiary to ignore misstatements that are immaterial to the consolidated financial statements of its parent but material to its own financial statements.

IAS 29 *Financial Reporting in Hyperinflationary Economies*

IG32 An entity complies with IAS 21 *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency and presentation currency. When the entity prepares its opening IFRS statement of financial position, it applies IAS 29 to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.

IG33 An entity may elect to use the fair value of an item of property, plant and equipment at the date of transition to IFRSs as its deemed cost at that date (paragraph D5 of the IFRS), in which case it gives the disclosures required by paragraph 30 of the IFRS.

IG34 If an entity elects to use the exemptions in paragraphs D5-D8 of the IFRS, it applies IAS 29 to periods after the date for which the revalued amount or fair value was determined.

IAS 32 *Financial Instruments: Presentation*

IG35 In its opening IFRS statement of financial position, an entity applies the criteria in IAS 32 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32 (paragraphs 15 and 30), without considering events after that date (other than changes to the terms of the instruments).

IG36 For compound instruments outstanding at the date of transition to IFRSs, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (IAS 32 paragraph 30). An entity determines those carrying amounts using the version of IAS 32 effective at the end of its first IFRS reporting period. If the liability component is no longer outstanding at the date of transition to IFRSs, a first-time adopter need not separate the initial equity component of the instrument from the cumulative interest accreted on the liability component (paragraph D18 of the IFRS).

IAS 34 *Interim Financial Reporting*

IG37 IAS 34 applies if an entity is required, or elects, to present an interim financial report in accordance with IFRSs. Accordingly, neither IAS 34 nor the IFRS requires an entity:

(a) to present interim financial reports that comply with IAS 34; or

(b) to prepare new versions of interim financial reports presented in accordance with previous GAAP. However, if an entity does prepare an interim financial report in accordance with IAS 34 for part of the period covered by its first IFRS financial statements, the entity restates the comparative information presented in that report so that it complies with IFRSs.

IG38 An entity applies the IFRS in each interim financial report that it presents in accordance with IAS 34 for part of the period covered by its first IFRS financial statements. In particular, paragraph 32 of the IFRS requires an entity to disclose various reconciliations (see IG Example 10).

IG Example 10 Interim financial reporting

Background

Entity R's first IFRS financial statements are for a period that ends on 31 December 20X5, and its first interim financial report in accordance with IAS 34 is for the quarter ended 31 March 20X5. Entity R prepared previous GAAP annual financial statements for the year ended 31 December 20X4, and prepared quarterly reports throughout 20X4.

Application of requirements

In each quarterly interim financial report for 20X5, entity R includes reconciliations of:

(a) its equity in accordance with previous GAAP at the end of the comparable quarter of 20X4 to its equity in accordance with IFRSs at that date; and

(b) its total comprehensive income (or, if it did not report such a total, profit or loss) in accordance with previous GAAP for the comparable quarter of 20X4 (current and year to date) to its total comprehensive income in accordance with IFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by IAS 34, entity R's interim financial report for the first quarter of 20X5 includes reconciliations of (or a cross-reference to another published document that includes these reconciliations):

(a) its equity in accordance with previous GAAP at 1 January 20X4 and 31 December 20X4 to its equity in accordance with IFRSs at those dates; and

(b) its total comprehensive income (or, if it did not report such a total, profit or loss) for 20X4 in accordance with previous GAAP to its total comprehensive income for 20X4 in accordance with IFRSs.

Each of the above reconciliations gives sufficient detail to enable users to understand the material adjustments to the statement of financial position and statement of comprehensive income. Entity R also explains the material adjustments to the statement of cash flows.

If entity R becomes aware of errors made in accordance with previous GAAP, the reconciliations distinguish the correction of those errors from changes in accounting policies.

If entity R did not, in its most recent annual financial statements in accordance with previous GAAP, disclose information material to an understanding of the current interim period, its interim financial reports for 20X5 disclose that information or include a cross-reference to another published document that includes it (paragraph 33 of the IFRS).

IAS 36 *Impairment of Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

IG39 An entity applies IAS 36 in:

(a) determining whether any impairment loss exists at the date of transition to IFRSs; and

(b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date. An entity's first IFRS financial statements include the disclosures that IAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs (paragraph 24(c) of the IFRS).

IG40 The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to IFRSs are consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraphs 14 and 15 of the IFRS). The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.

IG41 In assessing whether it needs to recognise an impairment loss or provision (and in measuring any such impairment loss or provision) at the date of transition to IFRSs, an entity may need to make estimates for that date that were not necessary in accordance with its previous GAAP. Such estimates and assumptions do not reflect conditions that arose after the date of transition to IFRSs (paragraph 16 of the IFRS).

IG42 The transitional provisions in IAS 36 and IAS 37 do not apply to an entity's opening IFRS statement of financial position (paragraph 9 of the IFRS).

IG43 IAS 36 requires the reversal of impairment losses in some cases. If an entity's opening IFRS statement of financial position reflects impairment losses, the entity recognises any later reversal of those impairment losses in profit or loss (except when IAS 36 requires the entity to treat that reversal as a revaluation). This applies to both impairment losses recognised in accordance with previous GAAP and additional impairment losses recognised on transition to IFRSs.

IAS 38 *Intangible Assets*

IG44 An entity's opening IFRS statement of financial position:

(a) excludes all intangible assets and other intangible items that do not meet the criteria for recognition in accordance with IAS 38 at the date of transition to IFRSs; and

(b) includes all intangible assets that meet the recognition criteria in IAS 38 at that date, except for intangible assets acquired in a business combination that were not recognised in the acquirer's consolidated statement of financial position in accordance with previous GAAP and also would not qualify for recognition in accordance with IAS 38 in the separate statement of financial position of the acquiree (see paragraph C4(f) of the IFRS).

IG45 The criteria in IAS 38 require an entity to recognise an intangible asset if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

IAS 38 supplements these two criteria with further, more specific, criteria for internally generated intangible assets.

IG46 In accordance with paragraphs 65 and 71 of IAS 38, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met. IAS 38 does not permit an entity to use hindsight to conclude retrospectively that these recognition criteria are met. Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits from an internally generated intangible asset is probable and the entity is able to reconstruct the costs reliably, IAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:

(a) concludes, based on an assessment made and documented at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and

(b) has a reliable system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

IG47 If an internally generated intangible asset qualifies for recognition at the date of transition to IFRSs, an entity recognises the asset in its opening IFRS statement of financial position even if it had recognised the related expenditure as an expense in accordance with previous GAAP. If the asset does not qualify for recognition in accordance with IAS 38 until a later date, its cost is the sum of the expenditure incurred from that later date.

IG48 The criteria discussed in paragraph IG45 also apply to an intangible asset acquired separately. In many cases, contemporaneous documentation prepared to support the decision to acquire the asset will contain an assessment of the future economic benefits. Furthermore, as explained in paragraph 26 of IAS 38, the cost of a separately acquired intangible asset can usually be measured reliably.

IG49 For an intangible asset acquired in a business combination before the date of transition to IFRSs, its carrying amount in accordance with previous GAAP immediately after the business combination is its deemed cost in accordance with IFRSs at that date (paragraph C4(e) of the IFRS). If that carrying amount was zero, the acquirer does not recognise the intangible asset in its consolidated opening IFRS statement of financial position, unless it would qualify in accordance with IAS 38, applying the criteria discussed in paragraphs IG45-IG48, for recognition at the date of transition to IFRSs in the statement of financial position of the acquiree (paragraph C4(f) of the IFRS). If those recognition criteria are met, the acquirer measures the asset on the basis that IAS 38 would require in the statement of financial position of the acquiree. The resulting adjustment affects goodwill (paragraph C4(g)(i) of the IFRS).

IG50 A first-time adopter may elect to use the fair value of an intangible asset at the date of an event such as a privatisation or initial public offering as its deemed cost at the date of that event (paragraph D8 of the IFRS), provided that the intangible asset qualifies for recognition in accordance with IAS 38 (paragraph 10 of the IFRS). In addition, if, and only if, an intangible asset meets both the recognition criteria in IAS 38 (including reliable measurement of original cost) and the criteria in IAS 38 for revaluation (including the existence of an active market), a first-time adopter may elect to use one of the following amounts as its deemed cost (paragraph D7 of the IFRS):

(a) fair value at the date of transition to IFRSs (paragraph D5 of the IFRS), in which case the entity gives the disclosures required by paragraph 30 of the IFRS; or

(b) a revaluation in accordance with previous GAAP that meets the criteria in paragraph D6 of the IFRS.

IG51 If an entity's amortisation methods and rates in accordance with previous GAAP would be acceptable in accordance with IFRSs, the entity does not restate the accumulated amortisation in its opening IFRS statement of financial position. Instead, the entity accounts for any change in estimated useful life or amortisation pattern prospectively from the period when it makes that change in estimate (paragraph 14 of the IFRS and paragraph 104 of IAS 38). However, in some cases, an entity's amortisation methods and rates in accordance with previous GAAP may differ from those that would be acceptable in accordance with IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts the accumulated amortisation in its opening IFRS statement of financial position retrospectively so that it complies with IFRSs (paragraph 14 of the IFRS). However, if an entity uses the exemption in paragraph D8B, it uses the carrying amount of the intangible asset at the date of transition to IFRSs as deemed cost as if it had acquired an intangible asset with the same remaining service potential for that amount at the date of transition to IFRSs. Subsequent amortisation is based on that deemed cost and starts from the date of transition to IFRSs.

IAS 39 *Financial Instruments: Recognition and Measurement*

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening IFRS statement of financial position in accordance with IAS 39, except as specified in paragraphs B2-B6 of the IFRS, which address derecognition and hedge accounting.

Recognition

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with IAS 39 and have not yet qualified for derecognition in accordance with IAS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised in accordance with previous GAAP before ~~1 January 2004~~the date of transition to IFRSs, to which the entity does not choose to apply paragraph B3 (see paragraphs B2 and B3 of the IFRS). For example, an entity that does not apply paragraph B3 does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred before ~~1 January 2004~~the date of transition to IFRSs if those transactions qualified for derecognition in accordance with previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after ~~1 January 2004~~the date of transition to IFRSs, those further transfers qualify for derecognition only if they meet the derecognition criteria of IAS 39.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition in accordance with IAS 39, or have already qualified for derecognition in accordance with IAS 39.

Embedded derivatives

IG55 When IAS 39 requires an entity to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39 paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats the entire combined contract as a financial instrument held for trading (IAS 39 paragraph 12). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39 paragraph 46(c)), with changes in fair value recognised in profit or loss.

Measurement

IG56 In preparing its opening IFRS statement of financial position, an entity applies the criteria in IAS 39 to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. In particular:

(a) to comply with IAS 39 paragraph 51, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying IAS 39 reflecting the entity's intention and ability at the date of transition to IFRSs. It follows that sales or transfers of held-to-maturity investments before the date of transition to IFRSs do not trigger the 'tainting' rules in IAS 39, paragraph 9.

(b) to comply with IAS 39 paragraph 9, the category of 'loans and receivables' refers to the circumstances when the financial asset first satisfied the recognition criteria in IAS 39.

(c) in accordance with IAS 39 paragraph 9, derivative financial assets and derivative financial liabilities are always deemed held for trading (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument). The result is that an entity measures at fair value all derivative financial assets and derivative financial liabilities that are not financial guarantee contracts.

(d) to comply with IAS 39 paragraph 50, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening IFRS statement of financial position as at fair value through profit or loss only if the asset or liability was:

(i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

(ii) at the date of transition to IFRSs, part of a portfolio of identified financial instruments that were managed together and for which there was evidence of a recent actual pattern of short-term profit-taking; or

(iii) designated as at fair value through profit or loss at the date of transition to IFRSs, for an entity that presents its first IFRS financial statements for an annual period beginning on or after 1 January 2006.

(iv) designated as at fair value through profit or loss at the start of its first IFRS reporting period, for an entity that presents its first IFRS financial statements for an annual period beginning before 1 January 2006 and applies paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 of IAS 39. If the entity restates comparative information for IAS 39 it shall restate the comparative information only if the financial assets or financial liabilities designated at the start of its first IFRS reporting period would have met the criteria for such designation in paragraph 9(b)(i), 9(b)(ii) or 11A of IAS 39 at the date of transition to IFRSs or, if acquired after the date of transition to IFRSs, would have met the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A at the date of initial recognition. For groups of financial assets, financial liabilities or both that are designated in accordance with paragraph 9(b)(ii) of IAS 39 at the start of the first IFRS reporting period, the comparative financial statements should be restated for all the financial assets and financial liabilities within the groups at the date of transition to IFRSs even if individual financial assets or liabilities within a group were derecognised during the comparative period.

(e) to comply with IAS 39 paragraph 9, available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale and those non-derivative financial assets that are not in any of the previous categories.

IG57 For those financial assets and financial liabilities measured at amortised cost in the opening IFRS statement of financial position, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IAS 39. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount in accordance with previous GAAP immediately following the business combination is their deemed cost in accordance with IFRSs at that date (paragraph C4(e) of the IFRS).

IG58 An entity's estimates of loan impairments at the date of transition to IFRSs are consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 14 of the IFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in IAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

Transition adjustments

IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to IFRSs only to the extent that it results from adopting IAS 39. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which IAS 39 is initially applied (other than for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

IG58B IAS 8 (as revised in 2003) applies to adjustments resulting from changes in estimates. If an entity is unable to determine whether a particular portion of the adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate in accordance with IAS 8, with appropriate disclosures (IAS 8 paragraphs 32-40).

IG59 An entity may, in accordance with its previous GAAP, have measured investments at fair value and recognised the revaluation gain outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-IAS 39 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of IAS 39. If, on initial application of IAS 39, an investment is classified as available for sale, then the pre-IAS 39 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the available-for-sale financial asset in other comprehensive income and accumulates the cumulative gains and losses in that separate component of equity until the investment is impaired, sold, collected or otherwise disposed of. On subsequent derecognition or impairment of the available-for-sale financial asset, the entity reclassifies to profit or loss the cumulative gain or loss remaining in equity (IAS 39 paragraph 55(b)).

Hedge accounting

IG60 Paragraphs B4-B6 of the IFRS deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of transition to IFRSs if the hedge relationship is to qualify for hedge accounting from that date. Hedge accounting can be applied prospectively only from the date that the hedge relationship is fully designated and documented.

IG60A An entity may, in accordance with its previous GAAP, have deferred or not recognised gains and losses on a fair value hedge of a hedged item that is not measured at fair value. For such a fair value hedge, an entity adjusts the carrying amount of the hedged item at the date of transition to IFRSs. The adjustment is the lower of:

(a) that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognised in accordance with previous GAAP; and

(b) that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, in accordance with previous GAAP, was either (i) not recognised or (ii) deferred in the statement of financial position as an asset or liability.

IG60B An entity may, in accordance with its previous GAAP, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of transition to IFRSs, the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognised in equity. Any net cumulative gain or loss that has been reclassified to equity on initial application of IAS 39 remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from equity to profit or loss. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge in accordance with IAS 39, hedge accounting is no longer appropriate starting from the date of transition to IFRSs.

IAS 40 *Investment Property*

IG61 An entity that adopts the fair value model in IAS 40 measures its investment property at fair value at the date of transition to IFRSs. The transitional requirements of IAS 40 do not apply (paragraph 9 of the IFRS).

IG62 An entity that adopts the cost model in IAS 40 applies paragraphs IG7-IG13 on property, plant and equipment.

Explanation of transition to IFRSs

IG63 Paragraphs 24(a) and (b), 25 and 26 of the IFRS require a first-time adopter to disclose reconciliations that give sufficient detail to enable users to understand the material adjustments to the statement of financial position, statement of comprehensive income and, if applicable, statement of cash flows. Paragraph 24(a) and (b) requires specific reconciliations of equity and total comprehensive income. IG Example 11 shows one way of satisfying these requirements.

IG Example 11 Reconciliation of equity and total comprehensive income

Background

An entity first adopted IFRSs in 20X5, with a date of transition to IFRSs of 1 January 20X4. Its last financial statements in accordance with previous GAAP were for the year ended 31 December 20X4.

Application of requirements

The entity's first IFRS financial statements include the reconciliations and related notes shown below.

Among other things, this example includes a reconciliation of equity at the date of transition to IFRSs (1 January 20X4). The IFRS also requires a reconciliation at the end of the last period presented in accordance with previous GAAP (not included in this example).

In practice, it may be helpful to include cross-references to accounting policies and supporting analyses that give further explanation of the adjustments shown in the reconciliations below.

If a first-time adopter becomes aware of errors made in accordance with previous GAAP, the reconciliations distinguish the correction of those errors from changes in accounting policies (paragraph 26 of the IFRS). This example does not illustrate disclosure of a correction of an error.

Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)

Note		*Previous GAAP* *CU*	*Effect of transition to IFRSs* *CU*	*IFRSs* *CU*
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	520	13,718
	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	0	748
	Total current assets	7,753	831	8,584
	Total assets	20,951	1,351	22,302

continued…

…continued

IG Example 11 Reconciliation of equity and total comprehensive income

	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	579	460	1,039
	Total liabilities	14,391	276	14,667
	Total assets less total liabilities	6,560	1,075	7,635
	Issued capital	1,500	0	1,500
3	Revaluation surplus	0	294	294
5	Hedging reserve	0	302	302
9	Retained earnings	5,060	479	5,539
	Total equity	6,560	1,075	7,635

Notes to the reconciliation of equity at 1 January 20X4:

1 Depreciation was influenced by tax requirements in accordance with previous GAAP, but in accordance with IFRSs reflects the useful life of the assets. The cumulative adjustment increased the carrying amount of property, plant and equipment by CU100.

2 Intangible assets in accordance with previous GAAP included CU150 for items that are transferred to goodwill because they do not qualify for recognition as intangible assets in accordance with IFRSs.

3 Financial assets are all classified as available for sale in accordance with IFRSs and are carried at their fair value of CU3,891. They were carried at cost of CU3,471 in accordance with previous GAAP. The resulting gains of CU294 (CU420, less related deferred tax of CU126) are included in the revaluation surplus.

4 Inventories include fixed and variable production overhead of CU400 in accordance with IFRSs, but this overhead was excluded in accordance with previous GAAP.

5 Unrealised gains of CU431 on unmatured forward foreign exchange contracts are recognised in accordance with IFRSs, but were not recognised in accordance with previous GAAP. The resulting gains of CU302 (CU431, less related deferred tax of CU129) are included in the hedging reserve because the contracts hedge forecast sales.

continued…

…continued

IG Example 11 Reconciliation of equity and total comprehensive income

6 A pension liability of CU66 is recognised in accordance with IFRSs, but was not recognised in accordance with previous GAAP, which used a cash basis.

7 A restructuring provision of CU250 relating to head office activities was recognised in accordance with previous GAAP, but does not qualify for recognition as a liability in accordance with IFRSs.

8 The above changes increased the deferred tax liability as follows:

	CU
Revaluation surplus (note 3)	126
Hedging reserve (note 5)	129
Retained earnings	205
Increase in deferred tax liability	460

Because the tax base at 1 January 20X4 of the items reclassified from intangible assets to goodwill (note 2) equalled their carrying amount at that date, the reclassification did not affect deferred tax liabilities.

9 The adjustments to retained earnings are as follows:

	CU
Depreciation (note 1)	100
Production overhead (note 4)	400
Pension liability (note 6)	(66)
Restructuring provision (note 7)	250
Tax effect of the above	(205)
Total adjustment to retained earnings	479

Reconciliation of total comprehensive income for 20X4

Note		*Previous GAAP CU*	*Effect of transition to IFRSs CU*	*IFRSs CU*
	Revenue	20,910	0	20,910
1,2,3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530

continued…

…continued

IG Example 11 Reconciliation of equity and total comprehensive income

1	Distribution costs	(1,907)	(30)	(1,937)
1,4	Administrative expenses	(2,842)	(300)	(3,142)
	Finance income	1,446	0	1,446
	Finance costs	(1,902)	0	(1,902)
	Profit before tax	422	(427)	(5)
5	Tax expense	(158)	128	(30)
	Profit (loss) for the year	264	(299)	(35)
6	Available-for-sale financial assets	0	150	150
7	Cash flow hedges	0	(40)	(40)
8	Tax relating to other comprehensive income	0	(29)	(29)
	Other comprehensive income	0	81	81
	Total comprehensive income	264	(218)	46

Notes to the reconciliation of total comprehensive income for 20X4:

1 A pension liability is recognised in accordance with IFRSs, but was not recognised in accordance with previous GAAP. The pension liability increased by CU130 during 20X4, which caused increases in cost of sales (CU50), distribution costs (CU30) and administrative expenses (CU50).

2 Cost of sales is higher by CU47 in accordance with IFRSs because inventories include fixed and variable production overhead in accordance with IFRSs but not in accordance with previous GAAP.

3 Depreciation was influenced by tax requirements in accordance with previous GAAP, but reflects the useful life of the assets in accordance with IFRSs. The effect on the profit for 20X4 was not material.

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…continued

IG Example 11 Reconciliation of equity and total comprehensive income

4 A restructuring provision of CU250 was recognised in accordance with previous GAAP at 1 January 20X4, but did not qualify for recognition in accordance with IFRSs until the year ended 31 December 20X4. This increases administrative expenses for 20X4 in accordance with IFRSs.

5 Adjustments 1–4 above lead to a reduction of CU128 in deferred tax expense.

6 Available-for-sale financial assets carried at fair value in accordance with IFRSs increased in value by CU180 during 20X4. They were carried at cost in accordance with previous GAAP. The entity sold available-for-sale financial assets during the year, recognising a gain of CU40 in profit or loss. Of that realised gain CU30 had been included in the revaluation surplus as at 1 January 20X4 and is reclassified from revaluation surplus to profit or loss (as a reclassification adjustment).

7 The fair value of forward foreign exchange contracts that are effective hedges of forecast transactions decreased by CU40 during 20X4.

8 Adjustments 6 and 7 above lead to an increase of CU29 in deferred tax expense.

Explanation of material adjustments to the statement of cash flows for 20X4:

Income taxes of CU133 paid during 20X4 are classified as operating cash flows in accordance with IFRSs, but were included in a separate category of tax cash flows in accordance with previous GAAP. There are no other material differences between the statement of cash flows presented in accordance with IFRSs and the statement of cash flows presented in accordance with previous GAAP.

IFRS 2 *Share-based Payment*

IG64 A first-time adopter is encouraged, but not required, to apply IFRS 2 *Share-based Payment* to equity instruments that were granted after 7 November 2002 that vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005.

IG65 For example, if an entity's date of transition to IFRSs is 1 January 2004, the entity applies IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not yet vested at 1 January 2005. Conversely, if an entity's date of transition to IFRSs is 1 January 2010, the entity applies IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not yet vested at 1 January 2010.

[Paragraphs IG66–IG200 reserved for possible guidance on future standards]

IFRIC Interpretations

IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

IG201 IAS 16 requires the cost of an item of property, plant and equipment to include the initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located. IAS 37 requires the liability, both initially and subsequently, to be measured at the amount required to settle the present obligation at the end of the reporting period, reflecting a current market-based discount rate.

IG202 IFRIC 1 requires that, subject to specified conditions, changes in an existing decommissioning, restoration or similar liability are added to or deducted from the cost of the related asset. The resulting depreciable amount of the asset is depreciated over its useful life, and the periodic unwinding of the discount on the liability is recognised in profit or loss as it occurs.

IG203 Paragraph D21 of IFRS 1 provides a transitional exemption. Instead of retrospectively accounting for changes in this way, entities can include in the depreciated cost of the asset an amount calculated by discounting the liability at the date of transition to IFRSs back to, and depreciating it from, when the liability was first incurred. IG Example 201 illustrates the effect of applying this exemption, assuming that the entity accounts for its property, plant and equipment using the cost model.

IG Example 201 Changes in existing decommissioning, restoration and similar liabilities

Background

An entity's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for 20X4 only. Its date of transition to IFRSs is therefore 1 January 20X4.

The entity acquired an energy plant on 1 January 20X1, with a life of 40 years.

As at the date of transition to IFRSs, the entity estimates the decommissioning cost in 37 years' time to be 470, and estimates that the appropriate risk-adjusted discount rate for the liability is 5 per cent. It judges that the appropriate discount rate has not changed since 1 January 20X1.

Application of requirements

The decommissioning liability recognised at the transition date is CU77 (CU470 discounted for 37 years at 5 per cent).

Discounting this liability back for a further three years to 1 January 20X1 gives an estimated liability at acquisition, to be included in the cost of the asset, of CU67. Accumulated depreciation on the asset is CU67 × 3/40 = CU5.

The amounts recognised in the opening IFRS statement of financial position on the date of transition to IFRSs (1 January 20X4) are, in summary:

	CU
Decommissioning cost included in cost of plant	67
Accumulated depreciation	(5)
Decommissioning liability	(77)
Net assets/retained earnings	(15)

IFRIC 4 *Determining whether an Arrangement contains a Lease*

IG204 IFRIC 4 specifies criteria for determining, at the inception of an arrangement, whether the arrangement contains a lease. It also specifies when an arrangement should be reassessed subsequently.

IG205 Paragraph D9 of the IFRS provides a transitional exemption. Instead of determining retrospectively whether an arrangement contains a lease at the inception of the arrangement and subsequently reassessing that arrangement as required in the periods before transition to IFRSs, entities may determine whether arrangements in existence on the date of transition to IFRSs contain leases by applying paragraphs 6–9 of IFRIC 4 to those arrangements on the basis of facts and circumstances existing on that date.

IG Example 202 Determining whether an arrangement contains a lease

Background

An entity's first IFRS financial statements are for a period that ends on 31 December 20Y7 and include comparative information for 20Y6 only. Its date of transition to IFRSs is therefore 1 January 20Y6.

On 1 January 20X5 the entity entered into a take-or-pay arrangement to supply gas. On 1 January 20Y0, there was a change in the contractual terms of the arrangement.

Application of requirements

On 1 January 20Y6 the entity may determine whether the arrangement contains a lease by applying the criteria in paragraphs 6–9 of IFRIC 4 on the basis of facts and circumstances existing on that date. Alternatively, the entity applies those criteria on the basis of facts and circumstances existing on 1 January 20X5 and reassesses the arrangement on 1 January 20Y0. If the arrangement is determined to contain a lease, the entity follows the guidance in paragraphs IG14–IG16.

IG206 Paragraph D9A of IFRS 1 provides a transitional exemption in addition to that discussed in paragraph IG205. The exemption in paragraph D9A applies only to arrangements that were assessed in the same manner as required by IFRIC 4. If arrangements exist at the date of transition to IFRSs that an entity did not assess under previous GAAP in the same manner as required by IFRIC 4 to determine whether they contain a lease, the entity may apply the transition exemption discussed in paragraph IG205.

Table of Concordance

This table shows how the contents of the superseded version of HKFRS 1 and the revised version of HKFRS 1 correspond.

Superseded HKFRS 1 paragraph	Revised HKFRS 1 paragraph
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
10	10
11	11
12	12
13	D1
14	19
15	None
16	D5
17	D6
18	D7
19	D8
20	D10
20A	D11
21	D12
22	D13
23	D18
23A	D14
23B	D15
24	D16
25	D17
25A	D19
25B	D2
25C	D3
25D	D4
25E	D21
25F	D9
25G	D20
25H	D22
25I	D23

Superseded HKFRS 1 paragraph	Revised HKFRS 1 paragraph
26	B1
27	B2
27A	B3
28	B4
29	B5
30	B6
31	14
32	15
33	16
34	17
34A	None
34B	None
34C	B7
35	20
36	21
36A	None
36B	None
36C	None
37	22
38	23
39	24
40	25
41	26
42	27
43	28
43A	29
44	30
44A	31
45	32
46	33
47	34
47A	None
47B	None
47C	None
47D	None
47E	None
47F	None

Superseded HKFRS 1 paragraph	Revised HKFRS 1 paragraph
47G	35
47H	None
47I	36
47J	37
47K	38
47L	39
Appendix A	Appendix A
Appendix B	Appendix C
None	13
None	18
None	40

HKFRS 3 (Revised)
Revised ~~May 2010~~February 2012

Effective for annual periods
beginning on or after 1 July 2009

Hong Kong Financial Reporting Standard 3 (Revised)

Business Combinations

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

Hong Kong Financial Reporting Standard 3 *Business Combinations* (HKFRS 3) is set out in paragraphs 1 – 68 and Appendices A – C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the HKFRS. HKFRS 3 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for ~~the Preparation and Presentation of~~ Financial Reporting~~Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This revised Standard was issued in March 2008. It supersedes HKFRS 3 issued in 2004, as amended in 2005 and 2007.

Applying the acquisition method

IN6 A business combination must be accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control. One of the parties to a business combination can always be identified as the acquirer, being the entity that obtains control of the other business (the acquiree). Formations of a joint venture or the acquisition of an asset or a group of assets that does not constitute a business are not business combinations.

IN7 The HKFRS establishes principles for recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Any classifications or designations made in recognising these items must be made in accordance with the contractual terms, economic conditions, acquirer's operating or accounting policies and other factors that exist at the acquisition date.

IN8 Each identifiable asset and liability is measured at its acquisition-date fair value. ~~Any~~ ~~n~~Non-controlling interests in an acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation ~~is~~ are measured at either fair value or ~~as~~ the present ownership instruments' ~~non-controlling interest's~~ proportionate share in the recognised amounts of the acquiree's net identifiable assets. All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by HKFRSs.

IN9 The HKFRS provides limited exceptions to these recognition and measurement principles:

(a) Leases and insurance contracts are required to be classified on the basis of the contractual terms and other factors at the inception of the contract (or when the terms have changed) rather than on the basis of the factors that exist at the acquisition date.

(b) Only those contingent liabilities assumed in a business combination that are a present obligation and can be measured reliably are recognised.

(c) Some assets and liabilities are required to be recognised or measured in accordance with other HKFRSs, rather than at fair value. The assets and liabilities affected are those falling within the scope of HKAS 12 *Income Taxes*, HKAS 19 *Employee Benefits*, HKFRS 2 *Share-based Payment* and HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

(d) There are special requirements for measuring a reacquired right.

(e) Indemnification assets are recognised and measured on a basis that is consistent with the item that is subject to the indemnification, even if that measure is not fair value.

IN10 The HKFRS requires the acquirer, having recognised the identifiable assets, the liabilities and any non-controlling interests, to identify any difference between:

(a) the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree; and

(b) the net identifiable assets acquired.

The difference will, generally, be recognised as goodwill. If the acquirer has made a gain from a bargain purchase that gain is recognised in profit or loss.

IN11 The consideration transferred in a business combination (including any contingent consideration) is measured at fair value.

and any non-controlling interest in the acquiree; and

(d) recognising and measuring goodwill or a gain from a bargain purchase.

Identifying the acquirer

6 **For each business combination, one of the combining entities shall be identified as the acquirer.**

7 The guidance in HKAS 27 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—the entity that obtains *control* of the acquiree. If a business combination has occurred but applying the guidance in HKAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

Determining the acquisition date

8 **The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.**

9 The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

10 **As of 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. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

Recognition conditions

11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*[*] at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other HKFRSs.

12 In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former *owners*) exchanged in the business combination transaction rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 51–53 to determine which assets acquired or liabilities assumed are part of the exchange for the acquiree and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable HKFRSs.

* *Framework for the Preparation and Presentation of Financial Statements* was replaced by the *Conceptual Framework for Financial Reporting* in October 2010.

13 The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

14 Paragraphs B28–B40 provide guidance on recognising operating leases and intangible assets. Paragraphs 22–28 specify the types of identifiable assets and liabilities that include items for which this HKFRS provides limited exceptions to the recognition principle and conditions.

Classifying or designating identifiable assets acquired and liabilities assumed in a business combination

15 At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other HKFRSs subsequently. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.

16 In some situations, HKFRSs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

(a) classification of particular financial assets and liabilities as a financial asset or liability at fair value through profit or loss, or as a financial asset available for sale or held to maturity, in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*;

(b) designation of a derivative instrument as a hedging instrument in accordance with HKAS 39; and

(c) assessment of whether an embedded derivative should be separated from the host contract in accordance with HKAS 39 (which is a matter of 'classification' as this HKFRS uses that term).

17 This HKFRS provides two exceptions to the principle in paragraph 15:

(a) classification of a lease contract as either an operating lease or a finance lease in accordance with HKAS 17 *Leases*; and

(b) classification of a contract as an insurance contract in accordance with HKFRS 4 *Insurance Contracts*.

The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

Measurement principle

18 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

19 For each business combination, the acquirer shall measure <u>at the acquisition date components of</u> ~~any~~ non-controlling interest<u>s</u> in the acquiree <u>that are present ownership interests and entitles their holders to a proportionate share of the entity's net assets in the event of liquidation at</u> either<u>:</u> ~~at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets~~

<u>(a) fair value; or</u>

(b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by HKFRSs.

20 Paragraphs B41-B45 provide guidance on measuring the fair value of particular identifiable assets and a non-controlling interest in an acquiree. Paragraphs 24–31 specify the types of identifiable assets and liabilities that include items for which this HKFRS provides limited exceptions to the measurement principle.

Exceptions to the recognition or measurement principles

21 This HKFRS provides limited exceptions to its recognition and measurement principles. Paragraphs 22-31 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 22-31, which will result in some items being:

(a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other HKFRSs, with results that differ from applying the recognition principle and conditions.

(b) measured at an amount other than their acquisition-date fair values.

Exception to the recognition principle

Contingent liabilities

22 HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines a contingent liability as:

(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.

23 The requirements in HKAS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to HKAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

Exceptions to both the recognition and measurement principles

Income taxes

24 The acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with HKAS 12 *Income Taxes*.

25 The acquirer shall account for the potential tax effects of temporary differences and carryforwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with HKAS 12.

Employee benefits

26 The acquirer shall recognise and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with HKAS 19 *Employee Benefits*.

Indemnification assets

27 The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph B41 provides related application guidance).

28 In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingent liability that is not recognised at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an employee benefit, that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset shall be recognised and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 57 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the measurement principle

Reacquired rights

29 The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract regardless of whether market participants would consider potential contractual renewals in determining its fair value. Paragraphs B35 and B36 provide related application guidance.

Share-based payment ~~awards~~transactions

30 The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment ~~awards~~ transactions with share-based payment ~~awards~~ transactions of the acquirer in accordance with the method in HKFRS 2 *Share-based Payment* at the acquisition date. (This HKFRS refers to the result of that method as the 'market-based measure' of the ~~award~~share-based payment transaction.)

Assets held for sale

31 The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* at fair value less costs to sell in accordance with paragraphs 15-18 of that HKFRS.

60 To meet the objective in paragraph 59, the acquirer shall disclose the information specified in paragraphs B64-B66.

61 The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.

62 To meet the objective in paragraph 61, the acquirer shall disclose the information specified in paragraph B67.

63 If the specific disclosures required by this and other HKFRSs do not meet the objectives set out in paragraphs 59 and 61, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Effective date and transition

Effective date

64 This HKFRS shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted. However, this HKFRS shall be applied only at the beginning of an annual reporting period that begins on or after 30 June 2007. If an entity applies this HKFRS before 1 July 2009, it shall disclose that fact and apply HKAS 27 (as amended in 2008) at the same time.

64A [This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]

64B *Improvements to HKFRSs* issued in May 2010 amended paragraphs 19, 30 and B56 and added paragraphs B62A and B62B. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. Application should be prospective from the date when the entity first applied this HKFRS.

64C Paragraphs 65A–65E were added by *Improvements to HKFRSs* issued in May 2010. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. The amendments shall be applied to contingent consideration balances arising from business combinations with an acquisition date prior to the application of this HKFRS, as issued in 2008.

Transition

65 Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this HKFRS shall not be adjusted upon application of this HKFRS.

65A Contingent consideration balances arising from business combinations whose acquisition dates preceded the date when an entity first applied this HKFRS as issued in 2008 shall not be adjusted upon first application of this HKFRS. Paragraphs 65B–65E shall be applied in the subsequent accounting for those balances. Paragraphs 65B–65E shall not apply to the accounting for contingent consideration balances arising from business combinations with acquisition dates on or after the date when the entity first applied this HKFRS as issued in 2008. In paragraphs 65B–65E business combination refers exclusively to business combinations whose acquisition date preceded the application of this HKFRS as issued in 2008.

65B If a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably.

65C A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

65D However, when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

65E In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

66 An entity, such as a mutual entity, that has not yet applied HKFRS 3 and had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs B68 and B69.

Income taxes

67 For business combinations in which the acquisition date was before this HKFRS is applied, the acquirer shall apply the requirements of paragraph 68 of HKAS 12, as amended by this HKFRS, prospectively. That is to say, the acquirer shall not adjust the accounting for prior business combinations for previously recognised changes in recognised deferred tax assets. However, from the date when this HKFRS is applied, the acquirer shall recognise, as an adjustment to profit or loss (or, if HKAS 12 requires, outside profit or loss), changes in recognised deferred tax assets.

Withdrawal of HKFRS 3 (issued 2004)

68 This HKFRS supersedes HKFRS 3 *Business Combinations* issued in 2004 as amended in 2005 and 2007.

(g) *Formula for determining consideration* – The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.

(h) *Other agreements and issues* – The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

Acquirer share-based payment awards exchanged for awards held by the acquiree's employees (application of paragraph 52(b))

B56 An acquirer may exchange its share-based payment awards[*] (replacement awards) for awards held by employees of the acquiree. Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with HKFRS 2 *Share-based Payment*. If the acquirer ~~is obliged to~~ replaces the acquiree awards, either all or a portion of the market-based measure of the acquirer's replacement awards shall be included in measuring the consideration transferred in the business combination. Paragraphs B57-B62 provide guidance on how to allocate the market-based measure. ~~The acquirer is obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement. For example, for the purposes of applying this requirement, the acquirer is obliged to replace the acquiree's awards if replacement is required by:~~

~~(a) the terms of the acquisition agreement;~~

~~(b) the terms of the acquiree's awards; or~~

~~(c) applicable laws or regulations.~~

However, i~~I~~n ~~some~~ situations~~,~~ in which acquiree awards ~~may~~ would expire as a consequence of a business combination and~~.~~ ~~I~~ if the acquirer replaces those awards when ~~even though~~ it is not obliged to do so, all of the market-based measure of the replacement awards shall be recognised as remuneration cost in the post-combination financial statements in accordance with HKFRS 2. That is to say, none of the market-based measure of those awards shall be included in measuring the consideration transferred in the business combination. The acquirer is obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement. For example, for the purposes of applying this guidance, the acquirer is obliged to replace the acquiree's awards if replacement is required by:

(a) the terms of the acquisition agreement;

[*] In paragraphs B56-B62 the term 'share-based payment awards' refers to vested or unvested share-based payment transactions.

(b) the terms of the acquiree's awards; or

(c) applicable laws or regulations.

B57 To determine the portion of a replacement award that is part of the consideration transferred for the acquiree and the portion that is remuneration for post-combination service, the acquirer shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with HKFRS 2. The portion of the market-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to pre-combination service.

B58 The portion of the replacement award attributable to pre-combination service is the market-based measure of the acquiree award multiplied by the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the acquiree award. The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in HKFRS 2.

B59 The portion of a non-vested replacement award attributable to post-combination service, and therefore recognised as remuneration cost in the post-combination financial statements, equals the total market-based measure of the replacement award less the amount attributed to pre-combination service. Therefore, the acquirer attributes any excess of the market-based measure of the replacement award over the market-based measure of the acquiree award to post-combination service and recognises that excess as remuneration cost in the post-combination financial statements. The acquirer shall attribute a portion of a replacement award to post-combination service if it requires post-combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquisition date.

B60 The portion of a non-vested replacement award attributable to pre-combination service, as well as the portion attributable to post-combination service, shall reflect the best available estimate of the number of replacement awards expected to vest. For example, if the market-based measure of the portion of a replacement award attributed to pre-combination service is CU100 and the acquirer expects that only 95 per cent of the award will vest, the amount included in consideration transferred in the business combination is CU95. Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with HKFRS 2 in determining remuneration cost for the period in which an event occurs.

B61 The same requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with the provisions of HKFRS 2. All changes in the market-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognised in the acquirer’s post-combination financial statements in the period(s) in which the changes occur.

B62 The income tax effects of replacement awards of share-based payments shall be recognised in accordance with the provisions of HKAS 12 *Income Taxes*.

Equity-settled share-based payment transactions of the acquiree

B62A The acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquiree share-based payment transactions are part of the non-controlling interest in the acquiree and are measured at their market-based measure. If unvested, they are measured at their market-based measure as if the acquisition date were the grant date in accordance with paragraphs 19 and 30.

B62B The market-based measure of unvested share-based payment transactions is allocated to the non-controlling interest on the basis of the ratio of the portion of the vesting period completed to the greater of the total vesting period and the original vesting period of the share-based payment transaction. The balance is allocated to post-combination service.

Other HKFRSs that provide guidance on subsequent measurement and accounting (application of paragraph 54)

B63 Examples of other HKFRSs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a business combination include:

Basis for Conclusions on

Hong Kong Financial Reporting Standard 3 (Revised)

Business Combinations

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APPENDICES

be unlikely to increase appreciably the consistency with which different entities measured non-controlling interests.

BC216 The IASB reluctantly concluded that the only way the revised IFRS 3 would receive sufficient votes to be issued was if it permitted an acquirer to measure a non-controlling interest either at fair value or at its proportionate share of the acquiree's identifiable net assets, on a transaction-by-transaction basis.

Effects of the optional measurement of non-controlling interests

BC217 The IASB noted that there are likely to be three main differences in outcome that occur when the non-controlling interest is measured as its proportionate share of the acquiree's identifiable net assets, rather than at fair value. First, the amounts recognised in a business combination for non-controlling interests and goodwill are likely to be lower (and these should be the only two items affected on initial recognition). Second, if a cash-generating unit is subsequently impaired, any resulting impairment of goodwill recognised through income is likely to be lower than it would have been if the non-controlling interest had been measured at fair value (although it does not affect the impairment loss attributable to the controlling interest).

BC218 The third difference arises if the acquirer subsequently purchases some (or all) of the shares held by the non-controlling shareholders. If the non-controlling interests are acquired, presumably at fair value, the equity of the group is reduced by the non-controlling interests' share of any unrecognised changes in the fair value of the net assets of the business, including goodwill. If the non-controlling interest is measured initially as a proportionate share of the acquiree's identifiable net assets, rather than at fair value, that reduction in the reported equity attributable to the acquirer is likely to be larger. This matter was considered further in the IASB's deliberations on the proposed amendments to IAS 27.

Convergence

BC219 Both boards decided that, although they would have preferred to have a common measurement attribute for non-controlling interests, they had considered and removed as many differences between IFRS 3 and SFAS 141 as was practicable.

BC220 The boards were unable to achieve convergence of their respective requirements in several areas because of existing differences between IFRSs and US GAAP requirements outside a business combination. The boards observed that the accounting for impairments in IFRSs is different from that in US GAAP. This means that even if the boards converged on the initial measurement of non-controlling interests, and therefore goodwill, the subsequent accounting for goodwill would not have converged. Although this is not a good reason for allowing divergence in the initial measurement of non-controlling interests, it was a mitigating factor.

BC221 Because most business combinations do not involve a non-controlling interest, the boards also observed that the revised standards will align most of the accounting for most business combinations regardless of the different accounting for non-controlling interests in the revised standards.

Subsequent improvements to IFRS 3

BC221A In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that permitting the measurement choice for certain components of non-controlling interest might result in inappropriate measurement of those components in some circumstances. The Board decided to limit the choice to non-controlling interests that are present ownership instruments and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. The amendment requires the acquirer to measure all other components of non-controlling interest at the acquisition-date fair value, unless IFRSs require another measurement basis. For example, if a share-based payment transaction is classified as equity, an entity measures it in accordance with IFRS 2 *Share-based Payment*. Without this amendment, if the acquirer chose to measure non-controlling interest at its proportionate share of the acquiree's identifiable net assets, the acquirer might have measured some equity instruments at nil. In the Board's view, this would result in not recognising economic interests that other parties have in the acquiree. Therefore, the Board amended IFRS 3 to limit the scope of the measurement choice.

Measuring assets and liabilities arising from contingencies, including subsequent measurement

BC222 FASB Statement No. 5 *Accounting for Contingencies* (SFAS 5) defines a *contingency* as an existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. SFAS 141(R) refers to the assets and liabilities to which contingencies relate as *assets and liabilities arising from contingencies*. For ease of discussion, this Basis for Conclusions also uses that term to refer broadly to the issues related to contingencies, including the issues that the IASB considered in developing its requirements on recognising and measuring contingent liabilities in a business combination (paragraphs BC242–BC245 and BC272–BC278).

BC223 The revised standards require the assets and liabilities arising from contingencies that are recognised as of the acquisition date to be measured at their acquisition-date fair values. That requirement is generally consistent with the measurement requirements of IFRS 3, but it represents a change in the way entities generally applied SFAS 141. In addition, the IASB's measurement guidance on contingent liabilities carries forward the related guidance in IFRS 3, pending completion of the project to revise IAS 37 (paragraphs BC272–BC276). Accordingly, the FASB's and the IASB's conclusions on measuring assets and liabilities arising from contingencies are discussed separately.

The FASB's conclusions on measuring assets and liabilities arising from contingencies

BC224 The amount of an asset or a liability arising from a contingency recognised in accordance with SFAS 141 was seldom the acquisition-date fair value. Rather, it was often the settlement amount or a best estimate of the expected settlement amount on the basis of circumstances existing at a date after the acquisition date.

BC225 In developing the 2005 Exposure Draft, the FASB considered whether to require a strict SFAS 5 approach for the initial measurement and recognition of all contingencies in a business combination. That would mean that contingencies that did not meet the SFAS 5 'probability' criterion would be measured at zero (or at a minimum amount that qualifies as probable) rather than at fair value. Some constituents said that applying SFAS 5 in accounting for a business combination might be a practical way to reduce the costs and measurement difficulties involved in obtaining the information and legal counsel needed to measure the fair value of numerous contingencies that the acquiree had not recognised in accordance with SFAS 5.

BC226 The FASB observed that paragraph 17(a) of SFAS 5 states that 'Contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realisation.' Thus, to apply SFAS 5 in accounting for a business combination in the same way it is applied in other situations was likely to result in non-recognition of gain contingencies, including those for which all of the needed information is available at the acquisition date. The FASB concluded that that would be a step backwards; SFAS 141 already required the recognition of gain contingencies at the acquisition date and for which fair value is determinable (paragraphs 39 and 40(a) of SFAS 141). Also, in accordance with SFAS 5's requirements, contingent losses that arise outside a business combination are not recognised unless there is a high likelihood of a future outflow of resources. In addition, because goodwill is calculated as a residual, omitting an asset for an identifiable contingent gain would also result in overstating goodwill. Similarly, omitting a liability for a contingent loss would result in understating goodwill. Thus, the FASB rejected the SFAS 5 approach in accounting for a business combination.

BC227 The FASB also considered but rejected retaining existing practice based on FASB Statement No. 38 *Accounting for Preacquisition Contingencies of Purchased Enterprises* (SFAS 38), which SFAS 141 carried forward without reconsideration. For the reasons described in the preceding paragraph, the FASB concluded that continuing to permit the delayed recognition of most assets and liabilities arising from contingencies that occurred in applying SFAS 141 and the related guidance would fail to bring about needed improvements in the accounting for business combinations. The FASB decided that requiring an acquirer to measure at fair value and recognise any assets and liabilities arising from contingencies that meet the conceptual elements definition would help bring about those needed improvements, in particular, improvements in the completeness of reported financial information.

Un-replaced and voluntarily replaced share-based payment transactions

BC311A In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that there was insufficient application guidance for share-based payment transactions that are replaced in the context of a business combination. After the revised IFRS 3 was issued in 2008, some constituents raised concerns about the lack of explicit guidance with respect to share-based payment transactions of the acquiree that the acquirer chooses to replace, even though either they are unaffected by the business combination or vesting is accelerated as a consequence of the business combination. In addition, some were concerned that the measurement guidance for share-based payment transactions applies only to replacement awards but not to acquiree awards that the acquirer chooses not to replace. In response to those concerns, the Board added explicit guidance in paragraphs B56 and B62A to clarify that those awards should be accounted for in the same way as acquiree awards that the acquirer is obliged to replace.

BC311B Employee share-based payment awards might expire in the event of a business combination. When this occurs, the acquirer may choose to grant a new award to those employees voluntarily. The new award granted in such circumstances can only be for future services, because the acquirer has no obligation to the employees in respect of past services that they provided to the acquiree. Accordingly, paragraph B56 requires the whole of the market-based value of the new award to be accounted for as a post-combination expense, which is recognised in accordance with IFRS 2. This accounting treatment is different from that required in circumstances when the employee share-based payment award does not expire in the event of a business combination. When an unexpired award is replaced by the acquirer, part of the market-based value of the replacement award reflects the acquiree's obligation that remains outstanding at the date of the business combination, and is accounted for as part of the consideration transferred in the business combination. The balance of the market-based value of the replacement award is accounted for as a post-combination expense for the services to be received over the period to when the replacement award vests, in accordance with IFRS 2. The accounting for the replacement of unexpired awards is the same for awards that are replaced voluntarily by the acquirer and those that the acquirer is obliged to replace because the substance is the same in both circumstances.

acquirer's asset is the transaction in which it obtained the controlling interest in the acquiree.

Asset definition in the IASB's Framework

BC322 Paragraph 53 of the IASB's *Framework*‡ explains that 'The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity.'

BC323 The IASB concluded that core goodwill represents resources from which future economic benefits are expected to flow to the entity. In considering whether core goodwill represents a resource **controlled** by the entity, the IASB considered the assertion that core goodwill arises, at least in part, through factors such as a well-trained workforce, loyal customers and so on, and that these factors cannot be regarded as controlled by the entity because the workforce could leave and the customers could go elsewhere. However, the IASB, like the FASB, concluded that control of core goodwill is provided by means of the acquirer's power to direct the policies and management of the acquiree. Therefore, both the IASB and the FASB concluded that core goodwill meets the conceptual definition of an asset.

Relevance of information about goodwill

BC324 In developing SFAS 141, the FASB also considered the relevance of information about goodwill. Although the IASB's Basis for Conclusions on IFRS 3 did not explicitly discuss the relevance of information about goodwill, the FASB's analysis of that issue was available to the IASB members as they developed IFRS 3, and they saw no reason not to accept that analysis.

BC325 More specifically, in developing SFAS 141, the FASB considered the views of users as reported by the AICPA Special Committee* and as expressed by the Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR) in its 1993 position paper *Financial Reporting in the 1990s and Beyond*. The FASB observed that users have mixed views about whether goodwill should be recognised as an asset. Some are troubled by the lack of comparability between internally generated goodwill and acquired goodwill that results under present standards, but others do not appear to be particularly bothered by it. However, users appear to be reluctant to give up information about goodwill acquired in a business combination. In the view of the AICPA Special Committee, users want to retain the option of being able to use that information. Similarly, the FAPC said that goodwill should be recognised in financial statements.

BC326 The FASB also considered the growing use of 'economic value added' (EVA)† and similar measures, which are increasingly being employed as means of assessing performance. The FASB observed that such measures commonly incorporate goodwill, and in business combinations accounted for by the pooling method, an adjustment was commonly made to incorporate a measure of the goodwill that was not recognised under that method. As a result, the aggregate amount of goodwill is included in the base that is subject to a capital charge that is part of the EVA measure and management is held accountable for the total investment in the acquiree.

‡ now paragraph 4.8 of the *Conceptual Framework*

* AICPA Special Committee on Financial Reporting, *Improving Business Reporting–A Customer Focus* (New York: AICPA, 1994).

† EVA was developed by the consulting firm of Stern Stewart & Company (and is a registered trademark of Stern Stewart) as a financial performance measure that improves management's ability to make decisions that enhance shareholder value.

Effective date and transition for combinations of mutual entities or by contract alone

BC433 IFRS 3 excluded from its scope combinations of mutual entities and those achieved by contract alone. In developing IFRS 3, the IASB decided that these combinations should be excluded from its scope until the IASB published interpretative guidance for the application of the acquisition method to those transactions. The revised IFRS 3 provides that guidance. The effective date for combinations of mutual entities and those achieved by contract alone is the same as the effective date for all other entities applying the revised IFRS 3.

BC434 For the reasons outlined in paragraph BC180 of IFRS 3 the IASB concluded that the transitional provisions for combinations involving mutual entities only or those achieved by contract alone should be prospective. Given that these combinations were not within the scope of IFRS 3, they may have been accounted for differently from what IFRS 3 required. The transitional provisions in IFRS 3 took into consideration that entities may have used a range of alternatives in accounting for combinations in the past. The IASB concluded that the transitional provisions for these combinations should incorporate the transitional provisions in IFRS 3 for other business combinations. In addition, the IASB concluded that the transitional provisions should provide that an entity should continue to classify prior combinations in accordance with its previous accounting for such combinations. This is consistent with the prospective approach. Those provisions are contained in paragraphs B68 and B69 of the revised IFRS 3.

Transition requirements for contingent consideration from a business combination that occurred before the effective date of IFRS 3 (as revised in 2008)

BC434A In *Improvements to IFRSs* issued in May 2010, the Board addressed a perceived conflict in the guidance on accounting for contingent consideration in a business combination. The perceived conflict related to the transition guidance for contingent consideration arising from business combinations that had been accounted for in accordance with IFRS 3 (as issued in 2004). Before their deletion in January 2008, paragraph 3(c) of IFRS 7 *Financial Instruments: Disclosures*, paragraph 4(c) of IAS 32 *Financial Instruments: Presentation* and paragraph 2(f) of IAS 39 *Financial Instruments: Recognition and Measurement* excluded contingent consideration arrangements from the scope of those IFRSs. To allow the acquirer to account for contingent consideration as required by IFRS 3 (revised 2008), the Board deleted those scope exceptions in the second phase of its project on business combinations.

BC434B Some interpreted the deletion of the scope exception as meaning that IAS 39 would apply to all contingent consideration, including contingent consideration from business combinations with an acquisition date earlier than the application date of IFRS 3 (revised 2008). However, this interpretation is inconsistent with the transition guidance in paragraph 65 of IFRS 3 (revised 2008).

BC434C Therefore, the Board reproduced paragraphs 32–35 of IFRS 3 (as issued in 2004) as paragraphs 65B–65E in IFRS 3 (revised 2008) and made the conforming changes to IFRS 7, IAS 32 and IAS 39. The Board did this to clarify that the requirements in IAS 39 do not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008) and to provide guidance on how to account for such balances. The Board believes that the amendments will not cause IFRS 3 to diverge from FASB ASC Topic 805 *Business Combinations* (SFAS 141(R) *Business Combinations*).

Benefits and costs

BC435 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. However, the benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs do not necessarily fall on those who enjoy the benefits. For these reasons, it is difficult to apply a cost-benefit test in any particular case. In making its judgement, the IASB considers:

(a) the costs incurred by preparers of financial statements;

(b) the costs incurred by users of financial statements when information is not available;

(c) the comparative advantage that preparers have in developing information, when compared with the costs that users would incur to develop surrogate information; and

(d) the benefit of better economic decision-making as a result of improved financial reporting.

In the second phase of the business combinations project the IASB also considered the costs and benefits of the revised IFRS 3 relative to IFRS 3.

BC436 The IASB concluded that the revised IFRS 3 benefits both preparers and users of financial statements by converging to common high quality, understandable and enforceable accounting standards for business combinations in IFRSs and US GAAP. This improves the comparability of financial information around the world and it also simplifies and reduces the costs of accounting for entities that issue financial statements in accordance with both IFRSs and US GAAP.

Illustrative Examples and Comparison with SFAS 141(R)

Hong Kong Financial Reporting Standard 3 (Revised)

Business Combinations

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

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paragraphs

IFRS 3 *BUSINESS COMBINATIONS*

ILLUSTRATIVE EXAMPLES

IE10 Restated earnings per share for the annual period ended 31 December 20X5 is CU4.00 (calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)).

Non-controlling interest

IE11 Assume the same facts as above, except that only 56 of Entity B's 60 ordinary shares are exchanged. Because Entity A issues 2.5 shares in exchange for each ordinary share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 per cent of the issued shares of the combined entity (140 of 240 issued shares). The fair value of the consideration transferred for Entity A, the accounting acquiree, is calculated by assuming that the combination had been effected by Entity B issuing additional ordinary shares to the shareholders of Entity A in exchange for their ordinary shares in Entity A. That is because Entity A is the accounting acquirer, and paragraph~~s 37 and 38~~ B20 of IFRS 3 requires the acquirer to measure the consideration exchanged for the accounting acquiree.

IE12 In calculating the number of shares that Entity B would have had to issue, the non-controlling interest is excluded from the calculation. The majority shareholders own 56 shares of Entity B. For that to represent a 58.3 per cent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholders would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 per cent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the accounting acquiree, is CU1,600 (ie 40 shares, each with a fair value of CU40). That is the same amount as when all 60 of Entity B's shareholders tender all 60 of its ordinary shares for exchange. The recognised amount of the group's interest in Entity A, the accounting acquiree, does not change if some of Entity B's shareholders do not participate in the exchange.

IE13 The non-controlling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the non-controlling interest is 6.7 per cent. The non-controlling interest reflects the proportionate interest of the non-controlling shareholders in the pre-combination carrying amounts of the net assets of Entity B, the legal subsidiary. Therefore, the consolidated statement of financial position is adjusted to show a non-controlling interest of 6.7 per cent of the pre-combination carrying amounts of Entity B's net assets (ie CU134 or 6.7 per cent of CU2,000).

IE14 The consolidated statement of financial position at 30 September 20X6, reflecting the non-controlling interest is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400

Computer software and mask works

IE40 Computer software and program formats acquired in a business combination that are protected legally, such as by patent or copyright, meet the contractual-legal criterion for identification as intangible assets.

IE41 Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants

IE42 Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. A database acquired in a business combination and protected by copyright meets the contractual-legal criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialised information, such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion.

IE43 Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets, such as secret formulas, processes and recipes

IE44 A trade secret is 'information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (a) derives independent economic value, actual or potential, from not being generally known and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.'[*] If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

Measurement of non-controlling interest (NCI)

Illustrating the consequences of applying paragraph 19 of IFRS 3.

IE44A The following examples illustrate the measurement of components of NCI at the acquisition date in a business combination.

Measurement of NCI including preference shares

IE44B TC has issued 100 preference shares, which are classified as equity. The preference shares have a nominal value of CU1 each. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of TC, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of CU1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.

IE44C AC acquires all ordinary shares of TC. The acquisition gives AC control of TC. The acquisition-date fair value of the preference shares is CU120.

[*] Melvin Simensky and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.

IE44D Paragraph 19 of IFRS 3 states that for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either fair value or the present ownership instruments' proportionate share in the acquiree's recognised amounts of the identifiable net assets. All other components of non-controlling interest must be measured at their acquisition-date fair value, unless another measurement basis is required by IFRSs.

IE44E The non-controlling interests that relate to TC's preference shares do not qualify for the measurement choice in paragraph 19 of IFRS 3 because they do not entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. The acquirer measures the preference shares at their acquisition-date fair value of CU120.

First variation

IE44F Suppose that upon liquidation of TC, the preference shares entitle their holders to receive a proportionate share of the assets available for distribution. The holders of the preference shares have equal right and ranking to the holders of ordinary shares in the event of liquidation. Assume that the acquisition-date fair value of the preference shares is now CU160 and that the proportionate share of TC's recognised amounts of the identifiable net assets that is attributable to the preference shares is CU140.

IE44G The preference shares qualify for the measurement choice in paragraph 19 of IFRS 3. AC can choose to measure the preference shares either at their acquisition-date fair value of CU160 or at their proportionate share in the acquiree's recognised amounts of the identifiable net assets of CU140.

Second variation

IE44H Suppose also that TC has issued share options as remuneration to its employees. The share options are classified as equity and are vested at the acquisition date. They do not represent present ownership interest and do not entitle their holders to a proportionate share of TC's net assets in the event of liquidation. The market-based measure of the share options in accordance with IFRS 2 *Share-based Payment* at the acquisition date is CU200. The share options do not expire on the acquisition date and AC does not replace them.

IE44I Paragraph 19 of IFRS 3 requires such share options to be measured at their acquisition-date fair value, unless another measurement basis is required by IFRSs. Paragraph 30 of IFRS 3 states that the acquirer shall measure an equity instrument related to share-based payment transactions of the acquiree in accordance with the method in IFRS 2.

IE44J The acquirer measures the non-controlling interests that are related to the share options at their market-based measure of CU200.

Gain on a bargain purchase

Illustrating the consequences of recognising and measuring a gain from a bargain purchase by applying paragraphs 32–36 of IFRS 3.

IE45 The following example illustrates the accounting for a business combination in which a gain on a bargain purchase is recognised.

IE46 On 1 January 20X5 AC acquires 80 per cent of the equity interests of TC, a private entity, in exchange for cash of CU150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of IFRS 3. The identifiable assets are measured at CU250 and the liabilities assumed are measured at CU50. AC engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in TC is CU42.

HKFRS 7
Revised ~~December 2011~~February 2012

Effective for annual periods
beginning on or after 1 January 2007

Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

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

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Hong Kong Financial Reporting Standard 7 *Financial Instruments: Disclosures* (HKFRS 7) is set out in paragraphs 1-45 and Appendices A-~~G~~E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 7 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting~~the Preparation and Presentation of Financial Statements~~*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the HKFRS

IN1 In recent years, the techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance. In addition, many public and private sector initiatives have proposed improvements to the disclosure framework for risks arising from financial instruments.

IN2 The Hong Kong Institute of Certified Public Accountants (Institute) believes that users of financial statements need information about an entity's exposure to risks and how those risks are managed. Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows. Greater transparency regarding those risks allows users to make more informed judgements about risk and return.

IN3 Consequently, the Institute agreed that there was a need to revise and enhance the disclosures in HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and HKAS 32 *Financial Instruments: Disclosure and Presentation*. As part of this revision, the Institute removed duplicative disclosures and simplified the disclosures about concentrations of risk, credit risk, liquidity risk and market risk in HKAS 32.

Main features of the HKFRS

IN4 HKFRS 7 applies to all risks arising from all financial instruments, except those instruments listed in paragraph 3. The HKFRS applies to all entities, including entities that have few financial instruments (eg a manufacturer whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (eg a financial institution most of whose assets and liabilities are financial instruments). However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

IN5 The HKFRS requires disclosure of:

(a) the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in HKAS 32.

(b) qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

IN5A Amendments to the HKFRS, issued in March 2009, require enhanced disclosures about fair value measurements and liquidity risk. These have been made to address application issues and provide useful information to users.

IN5B *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7), issued in October 2010, amended the required disclosures to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position.

IN6 The HKFRS includes in Appendix B mandatory application guidance that explains how to apply the requirements in the HKFRS. The HKFRS is accompanied by non-mandatory Implementation Guidance that describes how an entity might provide the disclosures required by the HKFRS.

IN7 The HKFRS supersedes HKAS 30 and the disclosure requirements of HKAS 32. The presentation requirements of HKAS 32 remain unchanged.

IN8 The HKFRS is effective for annual periods beginning on or after 1 January 2007. Earlier application is encouraged.

Hong Kong Financial Reporting Standard 7

Financial Instruments: Disclosures

Objective

1 The objective of this HKFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

2 The principles in this HKFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in HKAS 32 *Financial Instruments: Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement*.

Scope

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 *Investments in Associates* or HKAS 31 *Interests in Joint Ventures*. However, in some cases, HKAS 27, HKAS 28 or HKAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, entities shall apply the requirements of this HKFRS. Entities shall also apply this HKFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in HKAS 32.

(b) employers' rights and obligations arising from employee benefit plans, to which HKAS 19 *Employee Benefits* applies.

(c) [deleted]

(d) insurance contracts as defined in HKFRS 4 *Insurance Contracts*. However, this HKFRS applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this HKFRS to *financial guarantee contracts* if the issuer applies HKAS 39 in recognising and measuring the contracts, but shall apply HKFRS 4 if the issuer elects, in accordance with paragraph 4(d) of HKFRS 4, to apply HKFRS 4 in recognising and measuring them.

(e) financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 *Share-based Payment* applies, except that this HKFRS applies to contracts within the scope of paragraphs 5-7 of HKAS 39.

(f) instruments that are required to be classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of HKAS 32.

4 This HKFRS applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of HKAS 39. Unrecognised financial instruments include some financial instruments that, although outside the scope of HKAS 39, are within the scope of this HKFRS (such as some loan commitments).

5 This HKFRS applies to contracts to buy or sell a non-financial item that are within the scope of HKAS 39 (see paragraphs 5-7 of HKAS 39).

Classes of financial instruments and level of disclosure

6 When this HKFRS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Significance of financial instruments for financial position and performance

7 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.

Statement of financial position

Categories of financial assets and financial liabilities

8 The carrying amounts of each of the following categories, as defined in HKAS 39, shall be disclosed either in the statement of financial position or in the notes:

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with HKAS 39;

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with HKAS 39; and

(f) financial liabilities measured at amortised cost.

Financial assets or financial liabilities at fair value through profit or loss

9 If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it shall disclose:

(a) the maximum exposure to *credit risk* (see paragraph 36(a)) of the loan or receivable (or group of loans or receivables) at the end of the reporting period.

(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

(c) the amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to *market risk*; or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

10 If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of HKAS 39, it shall disclose:

(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix B, paragraph B4); or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

11 The entity shall disclose:

(a) the methods used to comply with the requirements in paragraphs 9(c) and 10(a).

(b) if the entity believes that the disclosure it has given to comply with the requirements in paragraph 9(c) or 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Reclassification

12. If the entity has reclassified a financial asset (in accordance with paragraphs 51-54 of HKAS 39) as one measured:

(a) at cost or amortised cost, rather than fair value; or

(b) at fair value, rather than at cost or amortised cost,

it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.

12A. If the entity has reclassified a financial asset out of the fair value through profit or loss category in accordance with paragraph 50B or 50D of HKAS 39 or out of the available-for-sale category in accordance with paragraph 50E of HKAS 39, it shall disclose:

(a) the amount reclassified into and out of each category;

(b) for each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;

(c) if a financial asset was reclassified in accordance with paragraph 50B, the rare situation, and the facts and circumstances indicating that the situation was rare;

(d) for the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognised in profit or loss or other comprehensive income in that reporting period and in the previous reporting period;

(e) for each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income if the financial asset had not been reclassified, and the gain, loss, income and expense recognised in profit or loss; and

(f) the effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

~~**Derecognition**~~

13 [Deleted]~~An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 15-37 of HKAS 39). The entity shall disclose 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;~~

~~(c) when the entity continues to recognise all of the assets, the carrying amounts of the assets and of the associated liabilities; and~~

~~(d) when the entity continues to recognise the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.~~

Collateral

14 An entity shall disclose:

(a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 37(a) of HKAS 39; and

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

15 When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

(a) the fair value of the collateral held;

(b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and

(c) the terms and conditions associated with its use of the collateral.

Allowance account for credit losses

16 When financial assets are impaired by credit losses and the entity records the impairment in a separate account (eg an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

Compound financial instruments with multiple embedded derivatives

17 If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 28 of HKAS 32) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and breaches

18 For *loans payable* recognised at the end of the reporting period, an entity shall disclose:

(a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) the carrying amount of the loans payable in default at the end of the reporting period; and

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

19 If, during the period, there were breaches of loan agreement terms other than those described in paragraph 18, an entity shall disclose the same information as required by paragraph 18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Statement of comprehensive income

Items of income, expense, gains or losses

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) net gains or net losses on:

(i) financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with HKAS 39;

(ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;

(iii) held-to-maturity investments;

(iv) loans and receivables; and

(v) 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 at fair value through profit or loss;

(c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:

(i) financial assets or financial liabilities that are not at fair value through profit or loss; and

(ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

(d) interest income on impaired financial assets accrued in accordance with paragraph AG93 of HKAS 39; and

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

Other disclosures

Accounting policies

21 In accordance with paragraph 117 of HKAS 1 *Presentation of Financial Statements* (as revised 2007), an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Hedge accounting

22 An entity shall disclose the following separately for each type of hedge described in HKAS 39 (ie fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):

(a) a description of each type of hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and

(c) the nature of the risks being hedged.

23 For cash flow hedges, an entity shall disclose:

(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 that was recognised in other comprehensive income during the period;

(d) the amount that was reclassified from equity to profit or loss for the period, showing the amount included in each line item in the statement of comprehensive income; and

(e) the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.

24 An entity shall disclose separately:

(a) in fair value hedges, gains or losses:

(i) on the hedging instrument; and

(ii) on the hedged item attributable to the hedged risk.

(b) the ineffectiveness recognised in profit or loss that arises from cash flow hedges~~; and~~.

(c) the ineffectiveness recognised in profit or loss that arises from hedges of net investments in foreign operations.

Fair value

25 Except as set out in paragraph 29, for each class of financial assets and financial liabilities (see paragraph 6), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

26 In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.

27 An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.

27A To make the disclosures required by paragraph 27B an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:

(a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

(b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices) (Level 2); and

(c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

27B For fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments:

(a) the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 27A.

(b) any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.

(c) for fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:

  (i) total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented);

  (ii) total gains or losses recognised in other comprehensive income;

  (iii) purchases, sales, issues and settlements (each type of movement disclosed separately); and

  (iv) transfers into or out of Level 3 (eg transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(d) the amount of total gains or losses for the period in (c)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).

(e) for fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

28 If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74-AG79 of HKAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of HKAS 39 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

(a) its accounting policy for recognising that difference in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG76A of HKAS 39); and

(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

29 Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) for an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with HKAS 39 because its fair value cannot be measured reliably; or

(c) for a contract containing a discretionary participation feature (as described in HKFRS 4) if the fair value of that feature cannot be measured reliably.

30 In the cases described in paragraph 29(b) and (c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;

(b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;

(c) information about the market for the instruments;

(d) information about whether and how the entity intends to dispose of the financial instruments; and

(e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

Nature and extent of risks arising from financial instruments

31 **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.**

32 The disclosures required by paragraphs 33-42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, *liquidity risk* and market risk.

32A Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

Qualitative disclosures

33 For each type of risk arising from financial instruments, an entity shall disclose:

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and

(c) any changes in (a) or (b) from the previous period.

Quantitative disclosures

34 For each type of risk arising from financial instruments, an entity shall disclose:

(a) summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in HKAS 24 *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.

(b) the disclosures required by paragraphs 36-42, to the extent not provided in accordance with (a)~~, unless the risk is not material (see paragraphs 29-31 of HKAS 1 for a discussion of materiality)~~.

(c) concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

35 If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

Credit risk

36 An entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with HKAS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) ~~in respect of the amount disclosed in (a),~~ a description of collateral held as security and of other credit enhancements~~;~~, and their financial effect (eg a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

(c) information about the credit quality of financial assets that are neither *past due* nor impaired~~; and~~.

(d) [deleted]~~the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.~~

Financial assets that are either past due or impaired

37 An entity shall disclose by class of financial asset:

(a) an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired; and

(b) an analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired~~; and~~ .

(c) [deleted]~~for the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.~~

Collateral and other credit enhancements obtained

38 When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such assets meet the recognition criteria in other ~~Standards~~HKFRSs, an entity shall disclose for such assets held at the reporting date:

(a) the nature and carrying amount of the assets ~~obtained~~; and

(b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity risk

39 An entity shall disclose:

(a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.

(b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B).

(c) a description of how it manages the liquidity risk inherent in (a) and (b).

Market risk

Sensitivity analysis

40 Unless an entity complies with paragraph 41, it shall disclose:

(a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

(b) the methods and assumptions used in preparing the sensitivity analysis; and

(c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

41 If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 40. The entity shall also disclose:

(a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

(b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Other market risk disclosures

42 When the sensitivity analyses disclosed in accordance with paragraph 40 or 41 are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

Transfers of financial assets

42A The disclosure requirements in paragraphs 42B–42H relating to transfers of financial assets supplement the other disclosure requirements of this IFRS. An entity shall present the disclosures required by paragraphs 42B–42H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:

(a) transfers the contractual rights to receive the cash flows of that financial asset; or

(b) retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.

42B An entity shall disclose information that enables users of its financial statements:

(a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and

(b) to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.

42C For the purposes of applying the disclosure requirements in paragraphs 42E–42H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 42E–42H, the following do not constitute continuing involvement:

(a) normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;

(b) forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or

(c) an arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 19(a)–(c) of HKAS 39 are met.

Transferred financial assets that are not derecognised in their entirety

42D An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 42B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognised in their entirety:

(a) the nature of the transferred assets.

(b) the nature of the risks and rewards of ownership to which the entity is exposed.

(c) a description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.

(d) when the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).

(e) when the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.

(f) when the entity continues to recognise the assets to the extent of its continuing involvement (see paragraphs 20(c)(ii) and 30 of HKAS 39), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

Transferred financial assets that are derecognised in their entirety

42E To meet the objectives set out in paragraph 42B(b), when an entity derecognises transferred financial assets in their entirety (see paragraph 20(a) and (c)(i) of HKAS 39) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

(a) the carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised.

(b) the fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.

(c) the amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined.

(d) the undiscounted cash outflows that would or may be required to repurchase derecognised financial assets (eg the strike price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.

(e) a maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.

(f) qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

42F An entity may aggregate the information required by paragraph 42E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognised financial asset, and report it under one type of continuing involvement.

42G In addition, an entity shall disclose for each type of continuing involvement:

(a) the gain or loss recognised at the date of transfer of the assets.

(b) income and expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (eg fair value changes in derivative instruments).

(c) if the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):

(i) when the greatest transfer activity took place within that reporting period (eg the last five days before the end of the reporting period),

(ii) the amount (eg related gains or losses) recognised from transfer activity in that part of the reporting period, and

(iii) the total amount of proceeds from transfer activity in that part of the reporting period.

An entity shall provide this information for each period for which a statement of comprehensive income is presented.

Supplementary information

42H An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 42B.

Effective date and transition

43 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2007. Earlier application is encouraged. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.

44 If an entity applies this HKFRS for annual periods beginning before 1 January 2006, it need not present comparative information for the disclosures required by paragraphs 31-42 about the nature and extent of risks arising from financial instruments.

44A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 20, 21, 23(c) and (d), 27(c) and B5 of Appendix B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

44B HKFRS 3 (as revised in 2008) deleted paragraph 3(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of HKFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A–65E of HKFRS 3 (as amended in 2010).

44C An entity shall apply the amendment in paragraph 3 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1), issued in June 2008, for an earlier period, the amendment in paragraph 3 shall be applied for that earlier period.

44D Paragraph 3(a) was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 1 of HKAS 28, paragraph 1 of HKAS 31 and paragraph 4 of HKAS 32 issued in October 2008. An entity is permitted to apply the amendment prospectively.

44E *Reclassification of Financial Assets* (Amendments to HKAS 39 and HKFRS 7), issued in October 2008, amended paragraph 12 and added paragraph 12A. An entity shall apply those amendments on or after 1 July 2008.

44F *Reclassification of Financial Assets—Effective Date and Transition* (Amendments to HKAS 39 and HKFRS 7), issued in December 2008, amended paragraph 44E. An entity shall apply that amendment on or after 1 July 2008.

44G *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7), issued in March 2009, amended paragraphs 27, 39 and B11 and added paragraphs 27A, 27B, B10A and B11A–B11F. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. ~~In the first year of application, a~~An entity need not provide ~~comparative information for~~ the disclosures required by the amendments for:

(a) any annual or interim period, including any statement of financial position, presented within an annual comparative period ending before 31 December 2009, or

(b) any statement of financial position as at the beginning of the earliest comparative period as at a date before 31 December 2009.

Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.[*]

44H-44J *[These paragraphs refer to amendments with an effective date after 1 January 2012, and are therefore not included in this edition.]*

44K Paragraph 44B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

44L *Improvements to HKFRSs* issued in May 2010 added paragraph 32A and amended paragraphs 34 and 36–38. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

44M *Disclosures—Transfers of Financial Assets* (Amendments to HKFRS 7), issued in October 2010, deleted paragraph 13 and added paragraphs 42A–42H and B29–B39. An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendments from an earlier date, it shall disclose that fact. An entity need not provide the disclosures required by those amendments for any period presented that begins before the date of initial application of the amendments.

Withdrawal of HKAS 30

45 This HKFRS supersedes HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

[*] Paragraph 44G was amended as a consequence of *Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters* (Amendment to HKFRS 1) issued in February 2010. The HKICPA amended paragraph 44G to clarify its conclusions and intended transition for *Improving Disclosures about Financial Instruments* (Amendments to HKFRS 7).

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.
loans payable	Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: **currency risk**, **interest rate risk** and **other price risk**.
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from **interest rate risk** or **currency risk**), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.
past due	A financial asset is past due when a counterparty has failed to make a payment when contractually due.

The following terms are defined in paragraph 11 of HKAS 32 or paragraph 9 of HKAS 39 and are used in the HKFRS with the meaning specified in HKAS 32 and HKAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- financial asset or financial liability at fair value through profit or loss
- financial asset or financial liability held for trading

- financial guarantee contract
- financial instrument
- financial liability
- forecast transaction
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale

Appendix B
Application guidance

This appendix is an integral part of the HKFRS.

Classes of financial instruments and level of disclosure (paragraph 6)

B1 Paragraph 6 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in HKAS 39 (which determine how financial instruments are measured and where changes in fair value are recognised).

B2 In determining classes of financial instrument, an entity shall, at a minimum:

(a) distinguish instruments measured at amortised cost from those measured at fair value.

(b) treat as a separate class or classes those financial instruments outside the scope of this HKFRS.

B3 An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this HKFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Significance of financial instruments for financial position and performance

Financial liabilities at fair value through profit or loss (paragraphs 10 and 11)

B4 If an entity designates a financial liability as at fair value through profit or loss, paragraph 10(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 10(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).

(c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 10(a).

Other disclosure — accounting policies (paragraph 21)

B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) for financial assets or financial liabilities designated as at fair value through profit or loss:

  (i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;

  (ii) the criteria for so designating such financial assets or financial liabilities on initial recognition; and

  (iii) how the entity has satisfied the conditions in paragraph 9, 11A or 12 of HKAS 39 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

(b) the criteria for designating financial assets as available for sale.

(c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 38 of HKAS 39).

(d) when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:

  (i) the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and

  (ii) the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 16).

(e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.

(f) the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 20(e)).

(g) when the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 36(d)).

Paragraph 122 of HKAS 1 (as revised in 2007) also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, 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.

Nature and extent of risks arising from financial instruments (paragraphs 31-42)

B6 The disclosures required by paragraphs 31-42 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

Quantitative disclosures (paragraph 34)

B7 Paragraph 34(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* discusses relevance and reliability.

B8 Paragraph 34(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

(a) a description of how management determines concentrations;

(b) a description of the shared characteristic that identifies each concentration (eg counterparty, geographical area, currency or market); and

(c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

Maximum credit risk exposure (paragraph 36(a))

B9 Paragraph 36(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

(a) any amounts offset in accordance with HKAS 32; and

(b) any impairment losses recognised in accordance with HKAS 39.

B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) entering into derivative contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.

(c) granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

(d) making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognised as a liability.

Quantitative liquidity risk disclosures (paragraphs 34(a) and 39(a) and (b))

B10A In accordance with paragraph 34(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

(a) occur significantly earlier than indicated in the data, or

(b) be for significantly different amounts from those indicated in the data (eg for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement),

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 39(a) or (b).

B11 In preparing the maturity analyses required by paragraph 39(a) and (b), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(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; and

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

B11A In complying with paragraph 39(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) financial instrument. For such an instrument, an entity shall apply paragraph 39(a).

B11B Paragraph 39(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:

(a) an interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.

(b) all loan commitments.

B11C Paragraph 39(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:

(a) when a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (eg demand deposits) are included in the earliest time band.

(b) when an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

(c) for issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

B11D The contractual amounts disclosed in the maturity analyses as required by paragraph 39(a) and (b) are the contractual undiscounted cash flows, for example:

(a) gross finance lease obligations (before deducting finance charges);

(b) prices specified in forward agreements to purchase financial assets for cash;

(c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;

(d) contractual amounts to be exchanged in a derivative financial instrument (eg a currency swap) for which gross cash flows are exchanged; and

(e) gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

B11E Paragraph 39(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 39(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (eg financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

B11F Other factors that an entity might consider in providing the disclosure required in paragraph 39(c) include, but are not limited to, whether the entity:

(a) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;

(b) holds deposits at central banks to meet liquidity needs;

(c) has very diverse funding sources;

(d) has significant concentrations of liquidity risk in either its assets or its funding sources;

(e) has internal control processes and contingency plans for managing liquidity risk;

(f) has instruments that include accelerated repayment terms (eg on the downgrade of the entity's credit rating);

(g) has instruments that could require the posting of collateral (eg margin calls for derivatives);

(h) has instruments that allow the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or

(i) has instruments that are subject to master netting agreements.

B12-B16 [Deleted]

Market risk — sensitivity analysis (paragraphs 40 and 41)

B17 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph B3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

(a) an entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.

(b) an entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

B18 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable (eg prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:

(a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on profit or loss and equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on profit or loss (ie interest expense) for the current year if interest rates had varied by reasonably possible amounts.

(b) entities are not required to disclose the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

B19 In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

(a) the economic environments in which it operates. A reasonably possible change should not include remote or "worst case" scenarios or "stress tests". Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 per cent and an entity determines that a fluctuation in interest rates of ±50 basis points is reasonably possible. It would disclose the effect on profit or loss and equity if interest rates were to change to 4.5 per cent or 5.5 per cent. In the next period, interest rates have increased to 5.5 per cent. The entity continues to believe that interest rates may fluctuate by ±50 basis points (ie that the rate of change in interest rates is stable). The entity would disclose the effect on profit or loss and equity if interest rates were to change to 5 per cent or 6 per cent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by ±50 basis points, unless there is evidence that interest rates have become significantly more volatile.

(b) the time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

B20 Paragraph 41 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 41(a) by disclosing the type of value-at-risk model used (eg whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (eg the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

B21 An entity shall provide sensitivity analyses for the whole of its business, but may provide different types of sensitivity analysis for different classes of financial instruments.

Interest rate risk

B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the statement of financial position (eg loans and receivables and debt instruments issued) and on some financial instruments not recognised in the statement of financial position (eg some loan commitments).

Currency risk

B23 *Currency risk* (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency, ie in a currency other than the functional currency in which they are measured. For the purpose of this HKFRS, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.

B24 A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

Other price risk

B25 *Other price risk* arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 40, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.

B26 Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.

B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments classified as at fair value through profit or loss and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of equity (that arises, for example, from instruments classified as available for sale).

B28 Financial instruments that an entity classifies as equity instruments are not remeasured. Neither profit or loss nor equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

Derecognition (paragraphs 42C–42H)

Continuing involvement (paragraph 42C)

B29 The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 42E–42H is made at the level of the reporting entity. For example, if a subsidiary transfers to an unrelated third party a financial asset in which the parent of the subsidiary has continuing involvement, the subsidiary does not include the parent's involvement in the assessment of whether it has continuing involvement in the transferred asset in its separate or individual financial statements (ie when the subsidiary is the reporting entity). However, a parent would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its subsidiary in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (ie when the reporting entity is the group).

B30 An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future.

B31 Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferred financial assets that are not derecognised in their entirety (paragraph 42D)

B32 Paragraph 42D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognise the transferred financial assets, regardless of when the transfers occurred.

Types of continuing involvement (paragraphs 42E–42H)

B33 Paragraphs 42E–42H require qualitative and quantitative disclosures for each type of continuing involvement in derecognised financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity's exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (eg guarantees or call options) or by type of transfer (eg factoring of receivables, securitisations and securities lending).

Maturity analysis for undiscounted cash outflows to repurchase transferred assets (paragraph 42E(e))

B34 Paragraph 42E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognised financial assets or other amounts payable to the transferee in respect of the derecognised financial assets, showing the remaining contractual maturities of the entity's continuing involvement. This analysis distinguishes cash flows that are required to be paid (eg forward contracts), cash flows that the entity may be required to pay (eg written put options) and cash flows that the entity might choose to pay (eg purchased call options).

B35 An entity shall use its judgement to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 42E(e). For example, an entity might determine that the following maturity time bands are appropriate:

(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 six months;

(d) later than six months and not later than one year;

(e) later than one year and not later than three years;

(f) later than three years and not later than five years; and

(g) more than five years.

B36 If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

Qualitative information (paragraph 42E(f))

B37 The qualitative information required by paragraph 42E(f) includes a description of the derecognised financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

(a) a description of how the entity manages the risk inherent in its continuing involvement in the derecognised financial assets.

(b) whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (ie its continuing involvement in the asset).

(c) a description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or loss on derecognition (paragraph 42G(a))

B38 Paragraph 42G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of the previously recognised asset (ie the interest in the asset derecognised and the interest retained by the entity) were different from the fair value of the previously recognised asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 27A.

Supplementary information (paragraph 42H)

B39 The disclosures required in paragraphs 42D–42G may not be sufficient to meet the disclosure objectives in paragraph 42B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

Appendix C
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2007. If an entity applies the HKFRS for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Appendix ~~E~~D
Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Amendments to HKFRS 9 *Financial Instruments* and HKFRS 7 *Financial Instruments: Disclosures* – Mandatory Effective Date of HKFRS 9 and Transition Disclosures (issued in December 2011)

Paragraph 44I of HKFRS 7 is amended.

44I When an entity first applies HKFRS 9, it shall disclose for each class of financial assets <u>and financial liabilities</u> at the date of initial application:

(a) the original measurement category and carrying amount determined in accordance with HKAS 39;

(b) the new measurement category and carrying amount determined in accordance with HKFRS 9;

(c) the amount of any financial assets <u>and financial liabilities</u> in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that HKFRS 9 requires an entity to reclassify and those that an entity elects to reclassify.

An entity shall present these quantitative disclosures in tabular format unless another format is more appropriate.

Paragraphs 44S–44W of HKFRS 7 are added.

44S When an entity first applies the classification and measurement requirements of HKFRS 9, it shall present the disclosures set out in paragraphs 44T–44W of this HKFRS if it elects to, or is required to, provide these disclosures in accordance with HKFRS 9 (see paragraph 8.2.12 of HKFRS 9 (2009) and paragraph 7.2.14 of HKFRS 9 (2010)).

44T If required by paragraph 44S, at the date of initial application of HKFRS 9 an entity shall disclose the changes in the classifications of financial assets and financial liabilities, showing separately:

(a) the changes in the carrying amounts on the basis of their measurement categories in accordance with HKAS 39 (ie not resulting from a change in measurement attribute on transition to HKFRS 9); and

(b) the changes in the carrying amounts arising from a change in measurement attribute on transition to HKFRS 9.

The disclosures in this paragraph need not be made after the annual period in which HKFRS 9 is initially applied.

44U In the reporting period in which HKFRS 9 is initially applied, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortised cost as a result of the transition to HKFRS 9:

(a) the fair value of the financial assets or financial liabilities at the end of the reporting period;

(b) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets or financial liabilities had not been reclassified;

(c) the effective interest rate determined on the date of reclassification; and

(d) the interest income or expense recognised.

If an entity treats the fair value of a financial asset or a financial liability as its amortised cost at the date of initial application (see paragraph 8.2.10 of HKFRS 9 (2009) and paragraph 7.2.10 of HKFRS 9 (2010)), the disclosures in (c) and (d) of this paragraph shall be made for each reporting period following reclassification until derecognition. Otherwise, the disclosures in this paragraph need not be made after the reporting period containing the date of initial application.

44V If an entity presents the disclosures set out in paragraphs 44S–44U at the date of initial application of HKFRS 9, those disclosures, and the disclosures in paragraph 28 of HKAS 8 during the reporting period containing the date of initial application, must permit reconciliation between:

(a) the measurement categories in accordance with HKAS 39 and HKFRS 9; and

(b) the line items presented in the statements of financial position.

44W If an entity presents the disclosures set out in paragraphs 44S–44U at the date of initial application of HKFRS 9, those disclosures, and the disclosures in paragraph 25 of this HKFRS at the date of initial application, must permit reconciliation between:

(a) of the measurement categories presented in accordance with HKAS 39 and HKFRS 9; and

(b) the class of financial instrument at the date of initial application.

Appendix ~~G~~E

Amendments to HKFRS 7 *Disclosures – Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2013

The following sets out amendments required for this Standard resulting from amendments to HKFRS 7 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Introduction, paragraph IN9 is added.

IN9 *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7), issued in December 2011, amended the required disclosures to include information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

After paragraph 13, a heading and paragraphs 13A–13F are added.

Offsetting financial assets and financial liabilities

13A The disclosures in paragraphs 13B–13E supplement the other disclosure requirements of this HKFRS and are required for all recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. These disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 42 of HKAS 32.

13B An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A.

13C To meet the objective in paragraph 13B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope of paragraph 13A:

(a) the gross amounts of those recognised financial assets and recognised financial liabilities;

(b) the amounts that are set off in accordance with the criteria in paragraph 42 of HKAS 32 when determining the net amounts presented in the statement of financial position;

(c) the net amounts presented in the statement of financial position;

(d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b), including:

(i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of HKAS 32; and

(ii) amounts related to financial collateral (including cash collateral); and

(e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

13D The total amount disclosed in accordance with paragraph 13C(d) for an instrument shall be limited to the amount in paragraph 13C(c) for that instrument.

13E An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 13C(d), including the nature of those rights.

13F If the information required by paragraphs 13B–13E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

Effective date and transition

Paragraph 44R is added.

44R *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to HKFRS 7), issued in December 2011, added paragraphs IN9, 13A–13F and B40–B53. An entity shall apply those amendments for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. An entity shall provide the disclosures required by those amendments retrospectively.

After paragraph B39, headings and paragraphs B40–B53 are added.

Offsetting financial assets and financial liabilities (paragraphs 13A–13F)

Scope (paragraph 13A)

B40 The disclosures in paragraphs 13B–13E are required for all recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 13B–13E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with paragraph 42 of HKAS 32.

B41 The similar agreements referred to in paragraphs 13A and B40 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph B40 include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 13A are loans and customer deposits at the same institution (unless they are set off in the statement of financial position), and financial instruments that are subject only to a collateral agreement.

Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)

B42 Financial instruments disclosed in accordance with paragraph 13C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognised amounts and describe any resulting measurement differences in the related disclosures.

Disclosure of the gross amounts of recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C(a))

B43 The amounts required by paragraph 13C(a) relate to recognised financial instruments that are set off in accordance with paragraph 42 of HKAS 32. The amounts required by paragraph 13C(a) also relate to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 13C(a) do not relate to any amounts recognised as a result of collateral agreements that do not meet the offsetting criteria in paragraph 42 of HKAS 32. Instead, such amounts are required to be disclosed in accordance with paragraph 13C(d).

Disclosure of the amounts that are set off in accordance with the criteria in paragraph 42 of HKAS 32 (paragraph 13C(b))

B44 Paragraph 13C(b) requires that entities disclose the amounts set off in accordance with paragraph 42 of HKAS 32 when determining the net amounts presented in the statement of financial position. The amounts of both the recognised financial assets and the recognised financial liabilities that are subject to set-off under the same arrangement will be disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognised derivative asset and a recognised derivative liability that meet the offsetting criteria in paragraph 42 of HKAS 32. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with paragraph 13C(a)) and the entire amount of the derivative liability (in accordance with paragraph 13C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 13C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 13C(b)) that is equal to the amount of the derivative liability.

Disclosure of the net amounts presented in the statement of financial position (paragraph 13C(c))

B45 If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 13A), but that do not meet the offsetting criteria in paragraph 42 of HKAS 32, the amounts required to be disclosed by paragraph 13C(c) would equal the amounts required to be disclosed by paragraph 13C(a).

B46 The amounts required to be disclosed by paragraph 13C(c) must be reconciled to the individual line item amounts presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 13C(c) back to the individual line item amounts presented in the statement of financial position.

Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))

B47 Paragraph 13C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b). Paragraph 13C(d)(i) refers to amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of HKAS 32 (for example, current rights of set-off that do not meet the criterion in paragraph 42(b) of HKAS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

B48 Paragraph 13C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 13C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognised to return or receive back such collateral.

Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)

B49 When disclosing amounts in accordance with paragraph 13C(d), an entity must take into account the effects of over-collateralisation by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 13C(d)(i) from the amount disclosed in accordance with paragraph 13C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 13C(d)(ii) to the remaining amount in paragraph 13C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D.

Description of the rights of set-off subject to enforceable master netting arrangements and similar agreements (paragraph 13E)

B50 An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 13C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 42 of HKAS 32, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is restricted).

Disclosure by type of financial instrument or by counterparty

B51 The quantitative disclosures required by paragraph 13C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).

B52 Alternatively, an entity may group the quantitative disclosures required by paragraph 13C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 13C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 13C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

Other

B53 The specific disclosures required by paragraphs 13C–13E are minimum requirements. To meet the objective in paragraph 13B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity’s financial position.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 7

Financial Instruments: Disclosures

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

Basis for Conclusions
HKFRS 7 *Financial Instruments: Disclosures*

HKFRS 7 is based on IFRS 7 *Financial Instruments: Disclosures*. In approving HKFRS 7, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 7. Accordingly, there are no significant differences between HKFRS 7 and IFRS 7. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 7 referred to below generally correspond with those in HKFRS 7.

CONTENTS

Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*

This Basis for Conclusions accompanies, but is not part of, IFRS 7.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007).*

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 7 *Financial Instruments: Disclosures*. Individual Board members gave greater weight to some factors than to others.

BC2 During the late 1990s, the need for a comprehensive review of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* became apparent. The Board's predecessor, the International Accounting Standards Committee (IASC), issued a number of Standards that addressed, more comprehensively, some of the topics previously addressed only for banks in IAS 30. Also, fundamental changes were taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures, and their processes for measuring and managing those risks.

BC3 In 1999 IASC added a project to its agenda to revise IAS 30 and in 2000 it appointed a steering committee.

BC4 In 2001 the Board added this project to its agenda. To assist and advise it, the Board retained the IAS 30 steering committee, renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members had experience and expertise in banks, finance companies and insurance companies and included auditors, financial analysts, preparers and regulators. The FAAC's role was:

(a) to provide input from the perspective of preparers and auditors of financial statements of entities that have significant exposures to financial instruments; and

(b) to assist the Board in developing a standard and implementation guidance for risk disclosures arising from financial instruments and for other related disclosures.

BC5 The Board published its proposals in July 2004 as ED 7 *Financial Instruments: Disclosures*. The deadline for comments was 27 October 2004. The Board received 105 comment letters. After reviewing the responses, the Board issued IFRS 7 in August 2005.

BC5A In October 2008 the Board published an exposure draft *Improving Disclosures about Financial Instruments* (proposed amendments to IFRS 7). The aim of the proposed amendments was to enhance disclosures about fair value and liquidity risk. The Board received 89 comment letters. After reviewing the responses, the Board issued amendments to IFRS 7 in March 2009. The Board decided to require application of the amendments for periods beginning on or after 1 January 2009. The Board noted that, although the effective date of IFRSs and amendments to IFRSs is usually 6–18 months after issue, the urgent need for enhanced disclosures about financial instruments demanded earlier application.

Scope (paragraphs 3-5)

The entities to which the IFRS applies

BC6 Although IFRS 7 arose from a project to revise IAS 30 (a Standard that applied only to banks and similar financial institutions), it applies to all entities that have financial instruments. The Board observed that the reduction in regulatory barriers in many countries and increasing competition between banks, non-bank financial services firms, and financial conglomerates have resulted in many entities providing financial services that were traditionally provided only by entities regulated and supervised as banks. The Board concluded that this development would make it inappropriate to limit this project to banks and similar financial institutions.

BC7 The Board considered whether entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit-taking, lending and securities activities, face unique risks that would require a standard specific to them. However, the Board decided that the scope of this project should include disclosures about risks arising from financial instruments in all entities for the following reasons:

(a) disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities.

(b) the Board found it could not satisfactorily define deposit-taking, lending, and securities activities. In particular, it could not satisfactorily differentiate an entity with securities activities from an entity holding a portfolio of financial assets for investment and liquidity management purposes.

(c) responses to the Exposure Draft of Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation*, published in June 2002, indicated that IAS 32's risk disclosure requirements, applicable to all entities, could be improved.

(d) the exclusion of some financial instruments would increase the danger that risk disclosures could be incomplete and possibly misleading. For example, a debt instrument issued by an entity could significantly affect its exposures to liquidity risk, interest rate risk and currency risk even if that instrument is not held as part of deposit-taking, lending and securities activities.

(e) users of financial statements need to be able to compare similar activities, transactions and events of different entities on a consistent basis. Hence, the disclosure principles that apply to regulated entities should not differ from those that apply to non-regulated, but otherwise similar, entities.

BC8 The Board decided that the scope of the IFRS should be the same as that of IAS 32 with one exception. The Board concluded that the IFRS should not apply to derivatives based on interests in subsidiaries, associates or joint ventures if the derivatives meet the definition of an equity instrument in IAS 32. This is because equity instruments are not remeasured and hence:

(a) they do not expose the issuer to balance sheet and income statement risk; and

(b) the disclosures about the significance of financial instruments for financial position and performance are not relevant to equity instruments.

Although these instruments are excluded from the scope of IFRS 7, they are within the scope of IAS 32 for the purpose of determining whether they meet the definition of equity instruments.

Exemptions considered by the Board

Insurers

BC9 The Board considered whether the IFRS should apply to entities that both have financial instruments and issue insurance contracts. The Board did not exempt these entities because financial instruments expose all entities to risks regardless of what other assets and liabilities they have. Accordingly, an entity that both issues insurance contracts and has financial instruments applies IFRS 4 *Insurance Contracts* to its insurance contracts and IFRS 7 to its financial assets and financial liabilities. However, many of the disclosure requirements in IFRS 4 were applications of, or relatively straightforward analogies with, existing requirements in IAS 32. Therefore, the Board also updated the disclosures required by IFRS 4 to make them consistent with IFRS 7, with modifications that reflect the interim nature of IFRS 4.

Small and medium-sized entities

BC10 The Board considered whether it should exempt small and medium-sized entities from the scope of the IFRS. The Board noted that the extent of disclosures required by the IFRS will depend on the extent to which the entity uses financial instruments and the extent to which it has assumed associated risks. The IFRS requires entities with few financial instruments and few risks to give few disclosures. Also, many of the requirements in the IFRS are based on information provided internally to the entity's key management personnel. This helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to exempt such entities from the scope of IFRS 7. However, it will keep this decision under review in its project on financial reporting for small and medium-sized entities.

Subsidiaries

BC11 Some respondents to ED 7 stated that there is little public interest in the financial statements of some entities, such as a wholly-owned subsidiary whose parent issues publicly available financial statements. These respondents stated that such subsidiaries should be exempt from some of the requirements of IFRS 7 in their individual financial statements. However, deciding whether such an entity should prepare general purpose financial statements is a matter for the entity and local legislators and regulators. If such an entity prepares financial statements in accordance with IFRSs, users of those statements should receive information of the same quality as users of any general purpose financial statements prepared in accordance with IFRSs. The Board confirmed its view that no exemptions from the general requirements of any Standard should be given for the financial statements of subsidiaries.

Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7-30, B4 and B5)

BC12 The Board relocated disclosures from IAS 32 to IFRS 7, so that all disclosure requirements for financial instruments are in one Standard. Many of the disclosure requirements about the significance of financial instruments for an entity's financial position and performance were previously in IAS 32. For these disclosures, the relevant paragraphs from the Basis for Conclusions on IAS 32 have been incorporated into this Basis for Conclusions. This Basis for Conclusions does not discuss requirements that the Board did not reconsider either in revising IAS 32 in 2003 or in developing IFRS 7.

The principle (paragraph 7)

BC13 The Board decided that the disclosure requirements of IFRS 7 should result from the explicit disclosure principle in paragraph 7. The Board also decided to specify disclosures to satisfy this principle. In the Board's view, entities could not satisfy the principle in paragraph 7 unless they disclose the information required by paragraphs 8-30.

Balance sheet disclosures (paragraphs 8-19 and B4)

Categories of financial assets and financial liabilities (paragraph 8)

BC14 Paragraph 8 requires entities to disclose financial assets and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. The Board concluded that the disclosure for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.

BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss is useful because such designation is at the discretion of the entity.

Financial assets or financial liabilities at fair value through profit or loss (paragraphs 9-11, B4 and B5)

BC16 IAS 39 permits entities to designate a non-derivative financial liability as at fair value through profit or loss, if specified conditions are met. If entities do so, they are required to provide the disclosures in paragraphs 10 and 11. The Board's reasons for these disclosures are set out in the Basis for Conclusions on IAS 39, paragraphs BC87-BC92.

BC17 The requirements in paragraphs 9, 11 and B5(a) are related to the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option*, issued in June 2005. The reasons for those requirements are discussed in the Basis for Conclusions on those Amendments.

BC18 Paragraph 10(a) requires disclosure of the change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the liability's credit risk. The Board previously considered this disclosure in its deliberations on the fair value measurement of financial liabilities in IAS 39.

BC19 Although quantifying such changes might be difficult in practice, the Board concluded that disclosure of such information would be useful to users of financial statements and would help alleviate concerns that users may misinterpret the profit or loss effects of changes in credit risk, especially in the absence of disclosures. Therefore, in finalising the revisions to IAS 32 in 2003, it decided to require disclosure of the change in fair value of the financial liability that is not attributable to changes in a benchmark interest rate. The Board believed that this is often a reasonable proxy for the change in fair value that is attributable to changes in the liability's credit risk, in particular when such changes are large, and would provide users with information with which to understand the profit or loss effect of such a change in credit risk.

BC20 However, some respondents to ED 7 stated that they did not agree that the IAS 32 disclosure provided a reasonable proxy, except for straightforward debt instruments. In particular, there could be other factors involved in the change in an instrument's fair value unrelated to the benchmark interest rate, such as the effect of an embedded derivative. Respondents also cited difficulties for unit-linked insurance contracts, for which the amount of the liability reflects the performance of a defined pool of assets. The Board noted that the proxy that was developed in IAS 32 assumed that it is not practicable for entities to determine directly the change in fair value arising from changes in credit risk. However, the Board acknowledged and shared these concerns.

BC21 As a result, the Board amended this requirement to focus directly on the objective of providing information about the effects of changes in credit risk:

(a) by permitting entities to provide a more faithful representation of the amount of change in fair value that is attributable to changes in credit risk if they could do so. However, such entities are also required to disclose the methods used and provide their justification for concluding that those methods give a more faithful representation than the proxy in paragraph 10(a)(i).

(b) by amending the proxy disclosure to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. For example, some entities may be able to identify part of the change in the fair value of the liability as attributable to a change in an index. In these cases, the proxy disclosure would exclude the amount of change attributable to a change in an index. Similarly, excluding the amount attributable to a change in an internal or external investment fund makes the proxy more suitable for unit-linked insurance contracts.

BC22 The Board decided that when an entity has designated a financial liability as at fair value through profit or loss, it should disclose the difference between the carrying amount and the amount the entity would contractually be required to pay at maturity to the holders of the liability (see paragraph 10(b)). The fair value may differ significantly from the settlement amount, in particular for financial liabilities with a long duration when an entity has experienced a significant deterioration in creditworthiness since their issue. The Board concluded that knowledge of this difference would be useful to users of financial statements. Also, the settlement amount is important to some financial statement users, particularly creditors.

Reclassification (paragraphs 12 and 12A)

BC23 IAS 32 required disclosure of the reason for reclassification of financial assets at cost or amortised cost rather than at fair value. The Board extended this requirement to include disclosure of the reason for reclassifications and of the amount reclassified into and out of each category. As noted in paragraph BC14, the Board regards such information as useful because the categorisation of financial instruments has a significant effect on their measurement.

BC23A In October and November 2008 the Board amended IAS 39 to permit reclassification of particular financial assets in some circumstances. The Board decided to require additional disclosures about the situations in which any such reclassification is made, and the effects on the financial statements. The Board regards such information as useful because the reclassification of a financial asset can have a significant effect on the financial statements.

~~Derecognition (paragraph 13)~~

~~BC24~~ [Deleted]~~An entity may have transferred financial assets in such a way that part or all of them do not qualify for derecognition (see paragraphs 15-37 of IAS 39). If the entity either continues to recognise all of the assets or continues to recognise the assets to the extent of its continuing involvement, paragraph 13 requires disclosure of the~~

~~nature of the financial assets, the extent of the entity's continuing involvement, and any associated liabilities. Such disclosure helps users of the financial statements evaluate the significance of the risks retained.~~

Collateral (paragraphs 14 and 15)

BC25 Paragraph 15 requires disclosures about collateral that the entity holds if it is permitted to sell or repledge the collateral in the absence of default by the owner. Some respondents to ED 7 argued for an exemption from this disclosure if it is impracticable to obtain the fair value of the collateral held. However, the Board concluded that it is reasonable to expect an entity to know the fair value of collateral that it holds and can sell even if there is no default.

Allowance account for credit losses (paragraph 16)

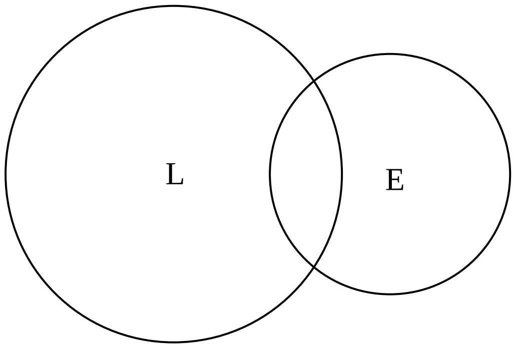
BC26 When a separate account is used to record impairment losses (such as an allowance account or similar account used to record a collective impairment of assets), paragraph 16 requires a reconciliation of that account to be disclosed. The Board was informed that analysts and other users find this information useful in assessing the adequacy of the allowance for impairment losses for such entities and when comparing one entity with another. However, the Board decided not to specify the components of the reconciliation. This allows entities flexibility in determining the most appropriate format for their needs.

BC27 Respondents to ED 7 asked the Board to require entities to provide equivalent information if they do not use an allowance account. The Board decided not to add this disclosure in finalising the IFRS. It concluded that, for virtually all entities, IAS 39's requirement to consider impairment on a group basis would necessitate the use of an allowance or similar account. The accounting policy disclosures required by paragraph B5(d) also include information about the use of direct adjustments to carrying amounts of financial assets.

Compound financial instruments with multiple embedded derivatives (paragraph 17)

BC28 IAS 32 requires the separation of the liability and equity components of a compound financial instrument. The Board notes that this is more complicated for compound financial instruments with multiple embedded derivative features whose values are interdependent (for example, a convertible debt instrument that gives the issuer a right to call the instrument back from the holder, or the holder a right to put the instrument back to the issuer) than for those without such features. If the embedded equity and non-equity derivative features are interdependent, the sum of the separately determined values of the liability and equity components will not equal the value of the compound financial instrument as a whole.

BC29 For example, the values of an embedded call option feature and an equity conversion option feature in a callable convertible debt instrument depend in part on each other if the holder's equity conversion option is extinguished when the entity exercises the call option or vice versa. The following diagram illustrates the joint value arising from the interaction between a call option and an equity conversion option in a callable convertible bond. Circle L represents the value of the liability component, ie the value of the straight debt and the embedded call option on the straight debt, and Circle E represents the value of the equity component, ie the equity conversion option on the straight debt. The total area of the two circles represents the value of the callable convertible bond. The difference between the value of the callable convertible bond as a whole and the sum of the separately determined values for the liability and equity components is the joint value attributable to the interdependence between the call option feature and the equity conversion feature. It is represented by the intersection between the two circles.



BC30 Under the approach in IAS 32, the joint value attributable to the interdependence between multiple embedded derivative features is included in the liability component. A numerical example is set out as Illustrative Example 10 accompanying IAS 32.

BC31 Even though this approach is consistent with the definition of equity as a residual interest, the Board recognises that the allocation of the joint value to either the liability component or the equity component is arbitrary because it is, by its nature, joint. Therefore, the Board concluded that it is important to disclose the existence of issued compound financial instruments with multiple embedded derivative features that have interdependent values. Such disclosure highlights the effect of multiple embedded derivative features on the amounts recognised as liabilities and equity.

Defaults and breaches (paragraphs 18 and 19)

BC32 Paragraphs 18 and 19 require disclosures about defaults and breaches of loans payable and other loan agreements. The Board concluded that such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.

Income statement and equity (paragraph 20)

Items of income, expenses, gains or losses (paragraph 20(a))

BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement categories in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC14). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39.

BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities held for trading and others do not. To assist users in comparing income arising from financial instruments across different entities, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets or financial liabilities held for trading include interest and dividend income (see Appendix B, paragraph B5(e)).

Fee income and expense (paragraph 20(c))

BC35 Paragraph 20(c) requires disclosure of fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities and from trust and other fiduciary activities that result in the entity holding or placing assets on behalf of individuals, trusts, retirement benefit plans, and other institutions. This information indicates the level of such activities and helps users to estimate possible future income of the entity.

Other disclosures—fair value (paragraphs 25-30)

BC36 Many entities use fair value information internally in determining their overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets about the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of why they are held and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. The Board decided that when an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it should provide fair value information through supplementary disclosures to assist users to compare entities on a consistent basis.

BC37 Disclosure of fair value is not required for investments in unquoted equity instruments and derivatives linked to such equity instruments if their fair value cannot be measured reliably. Similarly, IFRS 4 does not specify the accounting required for contracts containing a discretionary participation feature pending phase II of the Board's project on insurance contracts. Accordingly, disclosure of fair value is not required for contracts containing a discretionary participation feature, if the fair value of that feature cannot be measured reliably. For all other financial assets and financial liabilities, it is reasonable to expect that fair value can be determined with sufficient reliability within constraints of timeliness and cost. Therefore, the Board concluded that there should be no other exception from the requirement to disclose fair value information for financial assets or financial liabilities.

BC38 To provide users of financial statements with a sense of the potential variability of fair value estimates, the Board decided that information about the use of valuation techniques should be disclosed, in particular the sensitivities of fair value estimates to the main valuation assumptions. In forming this conclusion, the Board considered the view that disclosure of sensitivities could be difficult, particularly when there are many assumptions to which the disclosure would apply and these assumptions are interdependent. However, the Board noted that a detailed quantitative disclosure of sensitivity to all assumptions is not required (only those that could result in a significantly different estimate of fair value are required) and that the disclosure does not require the entity to reflect interdependencies between assumptions when making the disclosure. Additionally, the Board considered whether this disclosure might imply that a fair value established by a valuation technique is less reliable than one established by other means. However, the Board noted that fair values estimated by valuation techniques are more subjective than those established from an observable market price, and concluded that users need information to help them assess the extent of this subjectivity.

BC39 Paragraph 28 requires disclosure about the difference that arises if the transaction price differs from the fair value of a financial instrument that is determined in accordance with paragraph AG76 of IAS 39. Those disclosures relate to matters addressed in the December 2004 amendment to IAS 39 *Transition and Initial Recognition of Financial Assets and Financial Liabilities*. That amendment does not specify how entities should account for those initial differences in subsequent periods. The disclosures required by paragraph 28 inform users about the amount of gain or loss that will be recognised in profit or loss in future periods. The Board noted that the information required to provide these disclosures would be readily available to the entities affected.

BC39A Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) issued by the US Financial Accounting Standards Board requires disclosures that are based on a three-level fair value hierarchy for the inputs used in valuation techniques to measure fair value. The Board was asked by some users of financial statements to include similar disclosure requirements in IFRS 7 to provide more information about the relative reliability of the inputs to fair value measurements. The Board concluded that such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRSs and US generally accepted accounting principles (GAAP). Therefore, the Board decided to require disclosures for financial instruments on the basis of a fair value hierarchy.

BC39B Because its own fair value measurement project was not yet completed, the Board decided not to propose a fair value hierarchy for measurement, but only for disclosures. The fair value hierarchy for disclosures is the same as that in SFAS 157 but uses IFRS language pending completion of the fair value measurement project. Although the implicit fair value hierarchy for measurement in IAS 39 is different from the fair value hierarchy in SFAS 157, the Board recognised the importance of using a three-level hierarchy for disclosures that is the same as that in SFAS 157.

BC39C The Board noted the following three-level measurement hierarchy implicit in IAS 39:

(a) financial instruments quoted in an active market;

(b) financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets; and

(c) financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (ie without modification or repackaging) and not based on available observable market data.

BC39D For example, the Board acknowledged that some financial instruments that for measurement purposes are considered to have an active market in accordance with paragraphs AG71–AG73 of IAS 39 might be in Level 2 for disclosure purposes. Also, the application of paragraph AG76A of IAS 39 might result in no gain or loss being recognised on the initial recognition of a financial instrument that is in Level 2 for disclosure purposes.

BC39E The introduction of the fair value disclosure hierarchy does not affect any measurement or recognition requirements of other standards. In particular, the Board noted that the recognition of gains or losses at inception of a financial instrument (as required by paragraph AG76 of IAS 39) would not change as a result of the fair value disclosure hierarchy.

BC39F The Board decided to require additional disclosures for instruments with fair value measurements that are in Level 3 of the fair value hierarchy. These disclosures inform users of financial statements about the effects of those fair value measurements that use the most subjective inputs.

BC39G After reviewing comments received on the exposure draft, the Board decided not to require disclosure by level of the fair value hierarchy for financial instruments that are not measured at fair value in the statement of financial position. The Board noted that paragraphs 25 and 27 of IFRS 7, which require the disclosure of the fair value of each class of assets and liabilities in a way that permits it to be compared with its carrying amount, and the methods and assumptions applied in determining fair values, were retained.

Disclosures about the nature and extent of risks arising from financial instruments (paragraphs 31-42 and B6-B28)

BC40 The Board was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed, and the techniques used to identify, measure, monitor and control those risks. Therefore, the Board decided to require disclosure of this information. The Board also decided to balance two objectives:

(a) consistent requirements should apply to all entities so that users receive comparable information about the risks to which entities are exposed.

(b) the disclosures provided should depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks. Entities with many financial instruments and related risks should provide more disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks may provide less extensive disclosure.

BC41 The Board decided to balance these two objectives by developing an IFRS that sets out principles and minimum requirements applicable to all entities, supported by guidance on implementing the IFRS. The requirements in paragraphs 33-42 combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way in which management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments. The extent of disclosure depends on the extent of the entity's exposure to risks arising from financial instruments. The guidance on implementing the IFRS illustrates how an entity might apply the IFRS. This guidance is consistent with the disclosure requirements for banks developed by the Basel Committee (known as Pillar 3), so that banks can prepare, and users receive, a single co-ordinated set of disclosures about financial risk.

BC42 The Board noted that because entities view and manage risk in different ways, disclosures based on how an entity manages risk are unlikely to be comparable between entities. In addition, for an entity that undertakes limited management of risks arising from financial instruments, such disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify disclosures about risk exposures applicable to all entities. These disclosures provide a common benchmark for financial statement users when comparing risk exposures across different entities and are expected to be relatively easy for entities to prepare. Entities with more developed risk management systems would provide more detailed information.

Interaction between qualitative and quantitative disclosures (paragraph 32A)

BC42A In *Improvements to IFRSs* issued in May 2010, the Board addressed a perceived lack of clarity in the intended interaction between the qualitative and quantitative disclosures of the nature and extent of risks arising from financial instruments. The Board emphasised the interaction between qualitative and quantitative disclosures about the nature and extent of risks arising from financial instruments. This enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The Board concluded that an explicit emphasis on the interaction between qualitative and quantitative disclosures will contribute to disclosure of information in a way that better enables users to evaluate an entity's exposure.

Location of disclosures of risks arising from financial instruments (paragraph B6)

BC43 Many respondents to ED 7 argued that disclosures about risks in paragraphs 31-42 should not be part of the financial statements for the following reasons:

(a) the information would be difficult and costly to audit.

(b) the information is different from information generally included in financial statements because it is subjective, forward-looking and based on management's judgement. Thus, the information does not meet the criteria of comparability, faithful representation and completeness.

(c) inclusion of such information in a management commentary section outside the financial statements would be consistent with practice in other jurisdictions, including the US. Having this information in the financial statements would put IFRS preparers at a disadvantage relative to their US peers.

BC44 Respondents raised concerns that the disclosure of sensitivity analysis in particular should not be part of the financial statements. Respondents stated that sensitivity analysis cannot be prepared with the degree of reliability expected of information in the financial statements, and that the subjectivity in the sensitivity analysis and the hypothetical alternative values could undermine the credibility of the fair values recognised in the financial statements.

BC45 The Board considered whether the disclosures should be part of the information provided by management outside the financial statements. The Board noted that respondents generally regarded the disclosures proposed in ED 7 as useful, even if they did not agree that they should be located in the financial statements. The Board's view is that financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments. Hence, it concluded that such disclosures should be part of the financial statements. The Board rejected the argument that increased transparency puts an entity at a disadvantage; greater certainty on the part of investors can provide a significant advantage by lowering the entity's cost of capital.

BC46 The Board also noted that some entities might prefer to present the information required by the IFRS together with material such as a management commentary or risk report that is not part of the financial statements. Some entities might be required by regulatory authorities to provide in a separate report information similar to that required by the IFRS. Accordingly, the Board decided these disclosures should be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time.

Quantitative disclosures (paragraphs 34-42 and B7-B28)

Information based on how the entity manages risk (paragraphs 34 and B7)

BC47 The Board concluded that disclosures about an entity's exposure to risks arising from financial instruments should be required, and should be based on how the entity views and manages its risks, ie using the information provided to key management personnel (for example, its board of directors or chief executive officer). This approach:

(a) provides a useful insight into how the entity views and manages risk;

(b) results in information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity's ability to react to adverse situations;

(c) is more effective in adapting to changes in risk measurement and management techniques and developments in the external environment;

(d) has practical advantages for preparers of financial statements, because it allows them to use the data they use in managing risk; and

(e) is consistent with the approach used in IAS 14 *Segment Reporting.*[*]

BC47A In *Improvements to IFRSs* issued in May 2010, the Board removed the reference to materiality from paragraph 34(b) of IFRS 7. The Board noted that the reference could imply that disclosures in IFRS 7 are required even if those disclosures are not material, which was not the Board's intention.

Information on averages

BC48 The Board considered whether it should require quantitative information about average risk exposures during the period. It noted that information about averages is more informative if the risk exposure at the reporting date is not typical of the exposure during the period. However, information about averages is also more onerous to prepare. On balance, the Board decided to require disclosure of the exposures at the reporting date in all cases and to require additional information only if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.

Credit risk (paragraphs 36-38, B9 and B10)

Maximum exposure to credit risk (paragraphs 36(a), B9 and B10)

BC49 Paragraph 36(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date. Some respondents to ED 7 stated that these disclosures would not provide useful information when there are no identified problems in a loan portfolio, and it is not likely that collateral would be called on. However, the Board disagreed because it believes that such information:

(a) provides users of financial statements with a consistent measure of an entity's exposure to credit risk; and

(b) takes into account the possibility that the maximum exposure to loss may differ from the amount recognised in the balance sheet.

[*] In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

BC49A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that the disclosure requirement in paragraph 36(a) applies only to financial assets whose carrying amounts do not show the reporting entity's maximum exposure to credit risk. Such an approach is consistent with the approach taken in paragraph 29(a), which states that disclosure of fair value is not required when the carrying amount is a reasonable approximation of fair value. Moreover, the Board concluded that the requirement might be duplicative for assets that are presented in the statement of financial position because the carrying amount of these assets often represents the maximum exposure to credit risk. In the Board's view, the disclosure requirement should focus on the entity's exposure to credit risk that is not already reflected in the statement of financial position.

BC50 Some respondents to ED 7 questioned whether the maximum exposure to credit risk for a derivative contract is its carrying amount because fair value does not always reflect potential future exposure to credit risk (see paragraph B10(b)). However, the Board noted that paragraph 36(a) requires disclosure of the amount that best represents the maximum exposure to credit risk *at the reporting date*, which is the carrying amount.

Collateral held as security and other credit enhancements (paragraphs 36(b) and 37(c))

BC51 ED 7 proposed that, unless impracticable, the entity should disclose the fair value of collateral held as security and other credit enhancements, to provide information about the loss the entity might incur in the event of default. However, many respondents to ED 7 disagreed with this proposal on cost/benefit grounds. Respondents indicated that fair value information might not be available for:

(a) small entities and entities other than banks, which may find it onerous to acquire information about collateral;

(b) banks that collect precise information on the value of collateral only on origination, for loans whose payments are made on time and in full (for example a mortgage portfolio secured by properties, for which valuations are not kept up to date on an asset-by-asset basis);

(c) particular types of collateral, such as a floating charge on all the assets of an entity; and

(d) insurers that hold collateral for which fair value information is not readily available.

BC52 The Board also noted respondents' concerns that an aggregate disclosure of the fair value of collateral held would be misleading when some loans in a portfolio are over-collateralised, and other loans have insufficient collateral. In these circumstances, netting the fair value of the two types of collateral would under-report the amount of credit risk. The Board agreed with respondents that the information useful to users is not the total amount of credit exposure less the total amount of collateral, but rather is the amount of credit exposure that is left after available collateral is taken into account.

BC53 Therefore, the Board decided not to require disclosure of the fair value of collateral held, but to require disclosure of only a description of collateral held as security and other credit enhancements. The Board noted that such disclosure does not require an entity to establish fair values for all its collateral (in particular when the entity has determined that the fair value of some collateral exceeds the carrying amount of the loan) and, thus, would be less onerous for entities to provide than fair values.

Credit quality of financial assets that are neither past due nor impaired (paragraph 36(c))

BC54 The Board noted that information about credit quality gives a greater insight into the credit risk of assets and helps users assess whether such assets are more or less likely to become impaired in the future. Because this information will vary between entities, the Board decided not to specify a particular method for giving this information, but rather to allow each entity to devise a method that is appropriate to its circumstances.

Financial assets with renegotiated terms (paragraph 36(d))

BC54A In *Improvements to IFRSs* issued in May 2010, the Board addressed a practical concern relating to the disclosure requirements for renegotiated financial assets. The Board deleted the requirement in paragraph 36(d) to disclose the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated. The Board considered the difficulty in identifying financial assets whose terms have been renegotiated to avoid becoming past due or impaired (rather than for other commercial reasons). The Board noted that the original requirement was unclear about whether the requirement applies only to financial assets that were renegotiated in the current reporting period or whether past negotiations of those assets should be considered. Moreover, the Board was informed that commercial terms of loans are often renegotiated regularly for reasons that are not related to impairment. In practice it is difficult, especially for a large portfolio of loans, to ascertain which loans were renegotiated to avoid becoming past due or impaired.

Financial assets that are either past due or impaired (paragraph 37)

BC55 The Board decided to require separate disclosure of financial assets that are past due or impaired to provide users with information about financial assets with the greatest credit risk (paragraph 37). This includes:

(a) an analysis of the age of financial assets, including trade receivables, that are past due at the reporting date, but not impaired (paragraph 37(a)). This information provides users with information about those financial assets that are more likely to become impaired and helps users to estimate the level of future impairment losses.

(b) an analysis of financial assets that are individually determined to be impaired at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 37(b)). The Board concluded that an analysis of impaired financial assets by factors other than age (eg nature of the counterparty, or geographical analysis of impaired assets) would be useful because it helps users to understand why the impairment occurred.

BC55A In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that the disclosure of the fair value of collateral was potentially misleading. Within a class of assets some might be over-collateralised while others might be under-collateralised. Hence, aggregate disclosure of the fair value might be misleading. Therefore, the Board removed from paragraph 37(c) the requirement to disclose the fair value of collateral and other credit enhancements. However, the Board believes that information on the financial effect of such assets is useful to users. Hence, the Board included in paragraph 36(b) a requirement to disclose a description of collateral held as security and of other credit enhancements and to disclose their financial effect.

Collateral and other credit enhancements obtained (paragraph 38)

BC56 Paragraph 38 requires the entity to disclose the nature and carrying amount of assets obtained by taking possession of collateral held as security or calling on other credit enhancements and its policy for disposing of such assets. The Board concluded that this information is useful because it provides information about the frequency of such activities and the entity's ability to obtain and realise the value of the collateral. ED 7 had proposed that the entity should disclose the fair value of the assets obtained less the cost of selling them, rather than the carrying amount. The Board noted that this amount might be more relevant in the case of collateral obtained that is expected to be sold. However, it also noted that such an amount would be included in the impairment calculation that is reflected in the amount recognised in the balance sheet and the purpose of the disclosure is to indicate the amount recognised in the balance sheet for such assets.

BC56A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that paragraph 38 requires entities to disclose the amount of foreclosed collateral held at the reporting date. This is consistent with the objective in IFRS 7 to disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

Liquidity risk (paragraphs 34(a), 39, B10A and B11A-B11F)

BC57 The Board decided to require disclosure of a maturity analysis for financial liabilities showing the remaining earliest contractual maturities (paragraph 39(a) and paragraphs B11-B16 of Appendix B[*]). Liquidity risk, ie the risk that the entity will encounter difficulty in meeting commitments associated with financial liabilities, arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities earlier than expected. The Board decided to require disclosure based on the earliest contractual maturity date because this disclosure shows a worst case scenario.

BC58 Some respondents expressed concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities, which, for some entities—eg banks with many demand deposits—may be very different. They suggested that a contractual maturity analysis alone does not provide information about the conditions expected in normal circumstances or how the entity manages deviations from expected maturity. Therefore, the Board decided to require a description of how the entity manages the liquidity risk portrayed by the contractual maturity analysis.

BC58A In March 2009 the Board amended the disclosure requirements on the nature and extent of liquidity risk by:

(a) amending the definition of liquidity risk to clarify that paragraph 39 applies only to financial liabilities that will result in the outflow of cash or another financial asset. This clarifies that the disclosure requirements would not apply to financial liabilities that will be settled in the entity's own equity instruments and to liabilities within the scope of IFRS 7 that are settled with non-financial assets.

(b) emphasising that an entity must provide summary quantitative data about its exposure to liquidity risk based on information provided internally to key management personnel of the entity as required by paragraph 34(a). This reinforces the principles of IFRS 7.

(c) amending the requirement in paragraph 39 to disclose a contractual maturity analysis.

[*] Amendments to IFRS 7 issued in March 2009 amended paragraph 39 and paragraphs B11-B16. The paragraph references in paragraph BC57 have not been amended as a result of these amendments.

BC58B The requirements in paragraph 39(a) and (b) relate to minimum benchmark disclosures as set out in paragraph 34(b) and are expected to be relatively easy to apply. However, the Board noted that the requirement to provide disclosures based on the remaining contractual maturities was difficult to apply for some derivative financial liabilities and did not always result in information that reflects how many entities manage liquidity risk for such instruments. Hence, for some circumstances the Board eliminated the previous requirement to disclose contractual maturity information for derivative financial liabilities. However, the Board retained minimum contractual maturity disclosures for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and for some derivative financial liabilities.

BC58C The Board noted that for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and some derivative financial liabilities, contractual maturities are essential for an understanding of the timing of cash flows associated with the liabilities. Therefore, this information is useful to users of financial statements. The Board concluded that disclosures based on the remaining contractual maturities of these financial liabilities should continue to be required.

BC58D The Board also emphasised the existing requirement to disclose a maturity analysis for financial assets held for managing liquidity risk, if that information is required to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Board also emphasised that an entity must explain the relationship between qualitative and quantitative disclosures about liquidity risk so that users of financial statements can evaluate the nature and extent of liquidity risk.

Market risk (paragraphs 40-42 and B17-B28)

BC59 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 40) because:

(a) users have consistently emphasised the fundamental importance of sensitivity analysis;

(b) a sensitivity analysis can be disclosed for all types of market risk and by all entities, and is relatively easy to understand and calculate; and

(c) it is suitable for all entities—including non-financial entities—that have financial instruments. It is supported by disclosures of how the entity manages the risk. Thus, it is a simpler and more suitable disclosure than other approaches, including the disclosures of terms and conditions and the gap analysis of interest rate risk previously required by IAS 32.

The Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. This is because the methodologies used to prepare the sensitivity analysis and the resulting disclosures would vary according to the nature of the entity and the complexity of its risk management systems.

BC60 The Board acknowledged that a simple sensitivity analysis that shows a change in only one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or the effects of interdependencies between variables. The Board decided to meet the first concern by requiring additional disclosure when the sensitivity analysis is unrepresentative of a risk inherent in a financial instrument (paragraph 42). The Board noted that it could meet the second concern by requiring a more complex sensitivity analysis that takes into account the interdependencies between risks. Although more informative, such an analysis is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure as an alternative to the minimum requirement when it is used by management to manage risk.

BC61 Respondents to ED 7 noted that a value-at-risk amount would not show the effect on profit or loss or equity. However, entities that manage on the basis of value at risk would not want to prepare a separate sensitivity analysis solely for the purpose of this disclosure. The Board's objective was to require disclosures about sensitivity, not to mandate a particular form of sensitivity disclosure. Therefore, the Board decided not to require disclosure of the effects on profit or loss and equity if an alternative disclosure of sensitivity is made.

BC62 Respondents to ED 7 requested the Board to provide more guidance and clarification about the sensitivity analysis, in particular:

(a) what is a reasonably possible change in the relevant risk variable?

(b) what is the appropriate level of aggregation in the disclosures?

(c) what methodology should be used in preparing the sensitivity analysis?

BC63 The Board concluded that it would not be possible to provide comprehensive guidance on the methodology to be used in preparing the sensitivity analysis. The Board noted that more comparable information would be obtained if it imposed specific requirements about the inputs, process and methodology of the analysis, for example disclosure of the effects of a parallel shift of the yield curve by 100 basis points. However, the Board decided against such a specific requirement because a reasonably possible change in a relevant risk variable (such as interest rates) in one economic environment may not be reasonably possible in another (such as an economy with higher inflation). Moreover, the effect of a reasonably possible change will vary depending on the entity's risk exposures. As a result, entities are required to judge what those reasonably possible changes are.

BC64 However, the Board decided that it would provide high level application guidance about how the entity should assess what is a reasonably possible change and on the appropriate level of aggregation in the disclosures. In response to comments received on ED 7, the Board also decided to clarify that:

(a) an entity should not aggregate information about material exposures to risk from significantly different economic environments. However, if it has exposure to only one type of market risk in only one economic environment, it might not show disaggregated information.

(b) the sensitivity analysis does not require entities to determine what the profit or loss for the period would have been had the relevant risk variable been different. The sensitivity analysis shows the effect on current period profit or loss and equity if a reasonably possible change in the relevant risk variable had been applied to the risk exposures in existence at the balance sheet date.

(c) a reasonably possible change is judged relative to the economic environments in which the entity operates, and does not include remote or "worst case" scenarios or "stress tests".

(d) entities are required to disclose only the effects of the changes at the limits of the reasonably possible range of the relevant risk variable, rather than all reasonably possible changes.

(e) the time frame for which entities should make an assessment about what is reasonably possible is the period until the entity next presents these disclosures, usually its next annual reporting period.

The Board also decided to add a simple example of what a sensitivity analysis might look like.

Operational risk

BC65 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that the definition and measurement of operational risk are in their infancy and are not necessarily related to financial instruments. It also decided that such disclosures would be more appropriately located outside the financial statements. Therefore, the Board decided to defer this issue to its research project on management commentary.

Disclosures relating to transfers of financial assets

Background

BC65A In March 2009, in conjunction with the Memorandum of Understanding between the IASB and the US Financial Accounting Standards Board (FASB) to improve and achieve convergence of IFRS and US standards for derecognition, the IASB published an exposure draft to replace the derecognition requirements of IAS 39* and to improve the disclosure requirements in IFRS 7 relating to the transfer of financial assets and liabilities. In response to feedback received on the exposure draft the IASB developed more fully the alternative model described in the exposure draft and the boards discussed the alternative model.

BC65B In May 2010 the boards reconsidered their strategies and plans for the derecognition project in the light of:

(a) their joint discussions of the alternative derecognition model described in the exposure draft;

(b) the June 2009 amendments to the US GAAP derecognition guidance by the FASB, which reduced the differences between IFRSs and US GAAP by improving requirements relating to derecognition of financial assets and liabilities; and

(c) the feedback the IASB received from national standard-setters on the largely favourable effects of the IFRS derecognition requirements during the financial crisis.

BC65C As a result, in June 2010 the IASB and the FASB agreed that their near-term priority was on increasing the transparency and comparability of their standards by improving and aligning the disclosure requirements in IFRSs and US GAAP for financial assets transferred to another entity. The boards also decided to conduct additional research and analysis, including a post-implementation review of some of the FASB's recently amended requirements, as a basis for assessing the nature and direction of any further efforts to improve or align IFRSs and US GAAP.

BC65D As a result, the Board decided to finalise the derecognition disclosures and related objectives, proposed in the exposure draft. Accordingly, in October 2010 the Board issued *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7), requiring disclosures to help users of financial statements:

(a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and

(b) to evaluate the nature of and risks associated with the entity's continuing involvement in derecognised financial assets.

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

Transferred financial assets that are not derecognised in their entirety

BC65E When financial assets are transferred but not derecognised, there has been an exchange transaction that is not reflected as such in the financial statements as a result of the accounting requirements. The Board concluded that in those situations, users of financial statements need to understand the relationship between those transferred financial assets and the associated liabilities that an entity recognises. Understanding that relationship helps users of financial statements in assessing an entity's cash flow needs and the cash flows available to the entity from its assets.

BC65F The Board observed that IFRS 7 required disclosures about transferred financial assets that are not derecognised in their entirety. The Board decided to continue requiring those disclosures because they provide information that is useful in understanding the relationship between transferred financial assets that are not derecognised and associated liabilities.

BC65G However, the Board also decided that the following additional disclosures were necessary:

(a) a qualitative description of the nature of the relationship between transferred assets and associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets; and

(b) a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position when the counterparty to the associated liabilities has recourse only to the transferred assets.

BC65H The Board concluded that these disclosures would provide information that is useful in assessing the extent to which the economic benefits generated by assets of an entity cannot be used in an unrestricted manner, as is implied when assets are recognised in an entity's statement of financial position. In addition, the disclosures would provide information about liabilities that will be settled entirely from the proceeds received from the transferred assets, and thus identify liabilities for which the counterparties do not have claims on the assets of the entity in general. For those assets for which the underlying cash flows are committed to be used to satisfy related liabilities, the Board noted that a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position (in addition to showing the cash flow relationship between those assets and liabilities) also provides a means of understanding the net exposure of an entity following a transfer transaction that fails derecognition.

Transferred financial assets that are derecognised in their entirety

BC65I The Board was asked by users of financial statements, regulators and others to review the disclosure requirements for what are often described as 'off balance sheet' activities. Transfers of financial assets, particularly securitisation of financial assets, were identified as forming part of such activities.

BC65J The Board concluded that when an entity retains continuing involvement in financial assets that it has derecognised, users of financial statements would benefit from information about the risks to which the entity remains exposed. Such information is relevant in assessing the amount, timing and uncertainty of the entity's future cash flows.

BC65K The Board observed that IFRS 7 already requires certain disclosures by class of financial instrument or by type of risk. However, the IFRS requires the information at an aggregated level, so information specific to derecognition transactions is often not available. In response to requests from users and others the Board concluded that disclosures specific to derecognition transactions were necessary.

BC65L The Board concluded that the disclosures should focus on the risk exposure of an entity, and should provide information about the timing of the return and the cash outflow that would or may be required to repurchase the derecognised financial assets in the future. The Board reasoned that a combination of disclosures about the strike price or repurchase price to repurchase assets, the fair value of its continuing involvement, the maximum exposure to loss and qualitative information about an entity's obligations to provide financial support are relevant in understanding an entity's exposure to risks.

BC65M In addition, the Board concluded that information about an entity's gain or loss on derecognition and the timing of recognition of that gain or loss provides information about the proportion of an entity's profit or loss that arises from transferring financial assets in which the entity also retains continuing involvement. Such information is useful in assessing the extent to which an entity generates profits from transferring financial assets while retaining some form of continuing involvement and thus exposure to risk.

BC65N The Board observed that the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period may not be evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period). The Board decided that if transfer activity is concentrated around the end of reporting periods, disclosure of this fact provides an indication of whether transfer transactions are undertaken for the purpose of altering the appearance of the statement of financial position rather than for an ongoing commercial or financing purpose. In such cases, the amendments require disclosure of when the greatest transfer activity took place within that reporting period, the amount recognised from the transfer activity in that part of the reporting period, and the total amount of proceeds from transfer activity in that part of the reporting period.

Effective date and transition (paragraphs 43 and 44)

BC66 The Board is committed to maintaining a "stable platform" of substantially unchanged Standards for annual periods beginning on or before 1 January 2005, when many entities will adopt IFRSs for the first time. In addition, some preparers will need time to make the system changes necessary to comply with the IFRS. Therefore, the Board decided that the effective date of IFRS 7 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.

BC67 The Board noted that entities that apply IFRS 7 only when it becomes mandatory will have sufficient time to prepare comparative information. This conclusion does not apply to entities that apply IFRS 7 early. In particular, the time would be extremely short for those entities that would like to apply IFRS 7 when they first adopt IFRSs in 2005, to avoid changing from local GAAP to IAS 32 and IAS 30 when they adopt IFRSs and then changing again to IFRS 7 only one or two years later. Therefore, the Board gave an exemption from providing comparative disclosure in the first year of application of IFRS 7 to any entity that both (a) is a first-time adopter of IFRSs and (b) applies IFRS 7 before 1 January 2006. The Board noted that such an exemption for first-time adopters exists in IAS 32 and IFRS 4 and that the reasons for providing the exemption apply equally to IFRS 7.

BC68 The Board also considered whether it should provide an exemption from presenting all or some of the comparative information to encourage early adoption of IFRS 7 by entities that already apply IFRSs.

BC69 The Board noted that IFRS 7 contains two types of disclosures: accounting disclosures (in paragraphs 7-30) that are based on requirements previously in IAS 32 and new risk disclosures (in paragraphs 31-42). The Board concluded that existing users of IFRSs already will have complied with the requirements of IAS 32 and will not encounter difficulty in providing comparative information for the accounting disclosures.

BC70 The Board noted that most of the risk disclosures, in particular those about market risk, are based on information collected at the end of the reporting period. The Board concluded that although IFRS 7 was published in August 2005, it will still be possible for entities to collect the information that they require to comply with IFRS 7 for accounting periods beginning in 2005. However, it would not always be possible to collect the information needed to provide comparative information about accounting periods that began in 2004. As a result, the Board decided that entities that apply IFRS 7 for accounting periods beginning in 2005 (ie before 1 January 2006) need not present comparative information about the risk disclosures.

BC71 The Board also noted that comparative disclosures about risk are less relevant because these disclosures are intended to have predictive value. As a result information about risk loses relevance more quickly than other types of disclosure, and any disclosures required by previous GAAP are unlikely to be comparable with those required by IFRS 7. Accordingly, the Board decided that an entity that is not a first-time adopter and applies IFRS 7 for annual periods beginning before 1 January 2006 need not present comparative disclosures about the nature and extent of risks arising from financial instruments. In reaching this conclusion, the Board noted that the advantages of encouraging more entities to apply IFRS 7 early outweighed the disadvantage of the reduced information provided.

BC72 The Board considered and rejected arguments that it should extend the exemption:

(a) from providing comparative information to first-time adopters that applied IFRS 7 before 1 January 2007 (rather than only those that applied IFRS 7 before 1 January 2006). The Board concluded that an entity that intends to adopt IFRSs for the first time on or after 1 January 2006 will have sufficient time to collect information for its accounting period beginning on or after 1 January 2005 and, thus, should not have difficulty in providing the comparative disclosures for accounting periods beginning on or after 1 January 2006.

(b) from providing comparative disclosures about the significance of financial instruments to all entities adopting the IFRS for annual periods beginning before 1 January 2006 (rather than only to first-time adopters). The Board concluded that only first-time adopters warranted special relief so that they would be able to adopt IFRS 7 early without first having to adopt IAS 32 and IAS 30 for only one period. Entities that are not first-time adopters already apply IAS 32 and IAS 30 and have no particular need to adopt IFRS 7 before 1 January 2007.

(c) from providing comparative disclosures about risk to periods beginning before 1 January 2007 (rather than 2006). The Board noted that entities adopting IFRS 7 after 1 January 2006 would have a full calendar year to prepare after the publication of the IFRS.

Summary of main changes from the exposure draft

BC73 The main changes to the proposals in ED 7 are:

(a) ED 7 proposed disclosure of the amount of change in the fair value of a financial liability designated as at fair value through profit or loss that is not attributable to changes in a benchmark interest rate as a proxy for the amount of change in fair value attributable to changes in the instrument's credit risk. The IFRS permits entities to determine the amount of change in fair value attributable to changes in the instrument's credit risk using an alternative method if the entity believes that its alternative method gives more faithful representation. The proxy disclosure has been amended to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. As a result, entities may exclude factors other than a change in a benchmark interest rate when calculating the proxy.

(b) a requirement has been added for disclosures about the difference between the transaction price at initial recognition (used as fair value in accordance with paragraph AG76 of IAS 39) and the results of a valuation technique that will be used for subsequent measurement.

(c) no disclosure is required of the fair value of collateral pledged as security and other credit enhancements as was proposed in ED 7.

(d) the sensitivity analysis requirements have been clarified.

(e) the exemption from presenting comparatives has been widened.

(f) the capital disclosures are a stand-alone amendment to IAS 1, rather than part of the IFRS. No disclosure is required of whether the entity has complied with capital targets set by management and of the consequences of any non-compliance with those targets.

(g) the amendments to IFRS 4 related to IFRS 7 have been modified to reduce systems changes for insurers.

APPENDIX A
Amendments to Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 7. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the relevant Basis for Conclusions.

Appendix ~~D~~B

Amendments to Basis for Conclusions on IFRS 7 *Disclosures – Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2013

The following sets out amendments required for this Basis for Conclusions resulting from amendments to IFRS 7 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

After paragraph BC5A, paragraph BC5B is added.

BC5B In January 2011 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. This was in response to requests from users of financial statements and recommendations from the Financial Stability Board to achieve convergence of the boards' requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The proposals in the exposure draft would have replaced the requirements for offsetting financial assets and financial liabilities and would have established a common approach with the FASB. After considering the responses to the exposure draft, the boards decided to maintain their respective offsetting models. However, to meet the needs of users of financial statements, the boards agreed jointly on additional disclosures to enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) was issued in December 2011 and is effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods.

After paragraph BC24, headings and paragraphs BC24A–BC24AL are added.

Offsetting financial assets and financial liabilities

Background

BC24A Following requests from users of financial statements and recommendations from the Financial Stability Board, in June 2010 the IASB and the FASB added a project to their respective agendas to improve and potentially achieve convergence of the requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.

BC24B Consequently, in January 2011 the IASB and the FASB published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. The exposure draft proposed common offsetting requirements for IFRSs and US GAAP and proposed disclosures about financial assets and financial liabilities that are subject to rights of set-off and related arrangements.

BC24C Most respondents to the exposure draft supported the boards' efforts towards achieving convergence, but their responses to the proposals varied. Many IFRS preparers agreed with the proposals, stating that the underlying principle and proposed criteria were similar to those in IAS 32 and reflect an entity's credit and liquidity exposure to such instruments. Some US GAAP preparers indicated that offsetting in the statement of financial position in accordance with the proposed criteria provided more relevant information than the current model, except for derivatives and repurchase or reverse repurchase agreements.

BC24D There was no consensus among users of financial statements regarding if, or when, to present gross or net information in the statement of financial position. However, there was consensus that both gross and net information are useful and necessary for analysing financial statements. Users of financial statements supported achieving convergence of the IFRS and US GAAP requirements, and also supported improving disclosures so that financial statements prepared in accordance with IFRSs and US GAAP would be more comparable. Comparable information is important to investors for calculating their ratios and performing their analyses.

BC24E As a result of the feedback received on the exposure draft, the IASB and the FASB decided to maintain their respective offsetting models. However, the boards noted that requiring common disclosures of gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position, would be helpful for users of financial statements. Accordingly, the boards agreed on common disclosure requirements by amending and finalising the disclosures initially proposed in the exposure draft.

Scope (paragraph 13A)

BC24F The disclosures in the exposure draft would have applied to all recognised financial assets and recognised financial liabilities subject to a right of set-off, and/or for which an entity had either received or pledged cash or other financial instruments as collateral.

BC24G Respondents to the exposure draft noted that paragraphs 14, 15 and 36(b) of IFRS 7 already require disclosures of financial instrument collateral received and pledged and other credit enhancements. US GAAP has similar disclosure requirements. Consequently, if an entity has no financial assets or financial liabilities subject to a right of set-off (other than collateral agreements or credit enhancements), the boards concluded that there would be no incremental value in providing additional disclosure information for such instruments.

BC24H For example, some respondents were concerned that providing disclosure of conditional rights to set off loans and customer deposits at the same financial institution would be a significant operational burden. Such rights are often a result of statute, and entities do not typically manage their credit risk related to such amounts based on these rights of set-off. In addition, entities that have contractual rights to set off customer deposits with loans only in situations such as events of default see these rights as a credit enhancement and not as the primary source of credit mitigation. Respondents argued that the cost of including these amounts in the amended disclosures would outweigh the benefit because users of financial statements did not request information related to these instruments when discussing the offsetting disclosure requirements.

BC24I The boards agreed and decided to limit the scope of the disclosures to all financial instruments that meet the boards' respective offsetting models and recognised financial assets and recognised financial liabilities that are subject to an enforceable master netting arrangement or a similar agreement. The boards specifically excluded loans and customer deposits with the same financial institution from the scope of these requirements (except in the limited cases when the respective offsetting model is satisfied). This reduced scope still responds to the needs of users of financial statements for information about amounts that have been set off in accordance with IFRSs and amounts that have been set off in accordance with US GAAP. The types of instruments that fall within the scope of these disclosures include the instruments that cause significant differences between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP.

BC24J If there is an associated collateral agreement for such instruments, an entity would disclose amounts subject to such agreements in order to provide full information about its exposure in the normal course of business, as well as in the events of default and insolvency or bankruptcy.

BC24K Other respondents requested that the scope of the proposed disclosures be further amended to exclude financial instruments for which the lender has the right to set off the related non-financial collateral in the event of default. Although non-financial collateral agreements may exist for some financial instruments, those preparers do not necessarily manage the credit risk related to such financial instruments on the basis of the non-financial collateral held.

BC24L The disclosures focus on the effects of recognised financial instruments and financial instrument set-off agreements on an entity's financial position. The boards also noted that a comprehensive reconsideration of credit risk disclosures was not within the scope of this project. They therefore restricted the scope of the disclosures to exclude financial instruments with rights of set-off only for non-financial collateral.

BC24M A few respondents were concerned that the proposals seem to be designed for financial institutions and would impose requirements on non-financial institutions. They questioned the benefit that such disclosures would provide to investors in non-financial entities.

BC24N Although the boards acknowledged that financial institutions would be among those most affected, they did not agree that the disclosures are only relevant for financial institutions. Other industries have similar financial instrument activities and use enforceable master netting arrangements and similar agreements to mitigate exposure to credit risks. Consequently, the boards concluded that the required disclosures provide useful information about an entity's arrangements, irrespective of the nature of the entity's business.

Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)

BC24O The boards understood that recognised financial instruments included in the disclosure requirements in paragraph 13C of IFRS 7 may be subject to different measurement requirements. For example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative asset or derivative liability subject to the same disclosure requirements (for example, in paragraph 13C(a) of IFRS 7) will be measured at fair value. In addition, the fair value amount of any financial instrument collateral received or pledged and subject to paragraph 13C(d)(ii) of IFRS 7 should be included in the disclosures to provide users of financial statements with the best information about an entity's exposure. Consequently, a financial asset or financial liability disclosure table may include financial instruments measured at different amounts. To provide users of financial statements with the information they need to evaluate the amounts disclosed in accordance with paragraph 13C of IFRS 7, the boards decided that an entity should describe any resulting measurement differences in the related disclosures.

Disclosure of the net amounts presented in the statement of financial position (paragraph 13C(c))

BC24P When providing feedback on the proposals in the exposure draft, users of financial statements emphasised that information in the notes should be clearly reconciled back to the amounts in the statement of financial position. The boards therefore decided that if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information when disclosing amounts in accordance with paragraph 13C of IFRS 7, the entity must still reconcile the amounts disclosed in paragraph 13C(c) of IFRS 7 back to the individual line item amounts in the statement of financial position.

Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))

BC24Q Paragraph 13C(d)(i) of IFRS 7 requires disclosure of amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of IAS 32. This may include current rights of set-off that do not meet the criterion in paragraph 42(b) of IAS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties. Although such rights do not qualify for set-off in accordance with IAS 32, users of financial statements are interested in arrangements that an entity has entered into that mitigate the entity's exposure to such financial instruments in the normal course of business and/or in the events of default and insolvency or bankruptcy.

BC24R Paragraph 13C(d)(ii) of IFRS 7 requires disclosure of amounts of cash and financial instrument collateral (whether recognised or unrecognised) that do not meet the criteria for offsetting in the statement of financial position but that relate to financial instruments within the scope of these disclosure requirements. Depending on the terms of the collateral arrangement, collateral will often reduce an entity's exposure in the events of default and insolvency or bankruptcy of a counterparty to the contract. Collateral received or pledged against financial assets and financial liabilities may often be liquidated immediately upon an event of default. Consequently, the boards concluded that the amounts of collateral that are not set off in the statement of financial position but that are associated with other netting arrangements should be included in the amounts disclosed as required by paragraph 13C(d)(ii) of IFRS 7.

Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)

BC24S The boards concluded that an aggregate disclosure of the amount of cash collateral and/or the fair value of collateral in the form of other financial instruments would be misleading when some financial assets and financial liabilities are over-collateralised and others have insufficient collateral. To prevent an entity from inappropriately obscuring under-collateralised financial instruments with others that are over-collateralised, paragraph 13D of IFRS 7 restricts the amounts of cash and/or financial instrument collateral to be disclosed in respect of a recognised financial instrument to more accurately reflect an entity's exposure. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D of IFRS 7. At no point in time should under-collateralisation be obscured.

Disclosure by type of financial instrument or by counterparty

BC24T The exposure draft proposed disclosures by class of financial instrument. An entity would have been required to group financial assets and financial liabilities separately into classes that were appropriate to the nature of the information disclosed, taking into account the characteristics of those financial instruments and the applicable rights of set-off. Many preparers were concerned that the cost of disclosing amounts related to rights of set-off in the events of default and insolvency or bankruptcy by class of financial instrument would outweigh the benefit. They also indicated that they often manage credit exposure by counterparty and not necessarily by class of financial instrument.

BC24U Many users of financial statements indicated that disclosure of recognised amounts subject to enforceable master netting arrangements and similar agreements (including financial collateral) that were not set off in the statement of financial position would be useful irrespective of whether the amounts are disclosed by counterparty or by type or by class of financial instrument, as long as they can reconcile these amounts back to the statement of financial position. In evaluating whether the disclosures should be provided by type or by class of financial instrument or by counterparty, the boards noted that the objective of these disclosures (paragraph 13B of IFRS 7) is that an entity should disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position.

BC24V The boards decided to reduce the burden on preparers by requiring disclosure by type of financial instrument rather than by class. Disclosure by type of financial instrument may (or may not) differ from the class of financial instrument used for other disclosures in IFRS 7, but is appropriate in circumstances where a difference would better achieve the objective of the disclosures required by these amendments. The boards also decided to provide flexibility as to whether the information required by paragraph 13C(c)–(e) of IFRS 7 is presented by type of financial instrument or by counterparty. This would allow preparers to present the disclosures in the same way that they manage their credit exposure.

BC24W The Board also noted that paragraph 31 of IFRS 7 requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period. In addition, paragraph 34 of IFRS 7 requires the disclosure of concentrations of risk for each type of risk. Consequently, the Board noted that, irrespective of whether the disclosures were required to be provided by type or by class of financial instrument or by counterparty, entities are already required to disclose information about risks and how they are managed, including information about concentrations of credit risk.

Other considerations

Reconciliation between IFRSs and US GAAP

BC24X Some users of financial statements asked for information to help them reconcile between the amounts set off in accordance with IFRSs and the amounts set off in accordance with US GAAP. The boards recognised that the amounts disclosed in accordance with paragraph 13C(b), (c) and (d) of IFRS 7 will probably be different for financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP. However, the amounts disclosed in accordance with paragraph 13C(a) and (e) of IFRS 7 are generally not affected by the offsetting criteria applied in the statement of financial position. These amounts are important for users of financial statements to understand the effects of netting arrangements on an entity's financial position in the normal course of business and in the events of default and insolvency or bankruptcy.

BC24Y Consequently, while the amended disclosure requirements do not directly reconcile the IFRS and US GAAP amounts, they provide both gross and net information on a comparable basis. The boards considered that requiring a full reconciliation between IFRSs and US GAAP was unnecessary, particularly given the relative costs and benefits. Such reconciliation would have required preparers to apply two sets of accounting requirements and to track any changes to the related accounting standards and to contracts in the related jurisdictions.

Tabular information

BC24Z The disclosures require amounts to be presented in a tabular format (ie a table) unless another format is more appropriate. The boards believe that a tabular format best conveys an overall understanding of the effect of any rights of set-off and other related arrangements on an entity's financial position and improves the transparency of such information.

Transition and effective date

BC24AA The boards identified two transition approaches in the exposure draft—prospective and retrospective.

BC24AB Prospective transition is generally appropriate only in situations where it is not practicable to apply a standard to all prior periods. The boards did not believe that this was the case with the proposed disclosure requirements. Retrospective transition would require an entity to apply the new requirements to all periods presented. This would maximise consistency of financial information between periods. Retrospective transition would enable analysis and understanding of comparative accounting information among entities. In addition, the scope of the disclosures was reduced and the disclosures amended to require less detailed information than originally proposed, which would make them less burdensome for preparers to apply retrospectively.

BC24AC The exposure draft did not propose an effective date, but instead asked respondents for information about the time and effort that would be involved in implementing the proposed requirements. The boards indicated that they would use such feedback, as well as the responses in their *Request for Views on Effective Dates and Transition Methods*, and the timing of other planned accounting and reporting standards, to determine an appropriate effective date for the proposals in the exposure draft.

BC24AD Some respondents suggested that the offsetting proposals should have the same effective date as the other components of the IASB's project to replace IAS 39 with IFRS 9 *Financial Instruments*. If an earlier date was required, it was suggested that application should be restricted only to the accounting period being presented, rather than providing comparative information, because of the potential burden of applying the proposed disclosure requirements.

BC24AE At the time the amended disclosure requirements were issued (December 2011), IFRS 9 was not yet mandatorily effective. However, the Board did not believe that the IFRS 9 project would change the offsetting disclosures. Aligning the effective date of these amendments with the effective date of the financial instruments project could result in postponing the effective date of the common disclosure requirements, which would mean a delay in providing users of financial statements the information that they need. For users of financial statements to benefit from the increased comparability, and because the offsetting and IFRS 9 projects are independent of one another, the boards decided that common disclosures should be effective as early as possible.

BC24AF In addition, the boards did not think that a long transition period was needed, because the amended disclosures had a reduced scope and less detailed information than originally proposed in the exposure draft and were related to the presentation of instruments that entities have already recognised and measured. The boards therefore decided that the effective date for the amended disclosures should be for annual periods beginning on or after 1 January 2013, and interim periods within those annual periods.

BC24AG As described in greater detail in other sections of this Basis for Conclusions, the disclosures required by paragraphs 13B–13E of IFRS 7 are a result of requests from users of financial statements for information to enable them to compare statements of financial position prepared in accordance with IFRSs with statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.

BC24AH The information required in paragraphs 13B–13E of IFRS 7 will enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position for financial statements presented in accordance with IFRSs and those presented in accordance with US GAAP.

BC24AI The Board noted that paragraph 10(f) of IAS 1 *Presentation of Financial Statements* requires an entity to provide a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. In the case of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), because the change relates only to disclosures and there is no associated change in accounting policy, or a resulting restatement or reclassification, it was noted that paragraph 10(f) of IAS 1 does not apply for these amendments to IFRS 7.

Cost-benefit considerations

BC24AJ Before issuing an IFRS or an amendment to an IFRS, the Board seeks to ensure that it will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. As described in greater detail in other sections of this Basis for Conclusions on *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), the Board considered that there is significant benefit to market participants in providing these disclosures. The disclosures address a significant difference between the amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The disclosures therefore make the amounts presented in accordance with both sets of standards more comparable.

BC24AK During redeliberations, the Board considered feedback related to the costs of providing the disclosures proposed in the exposure draft. As described in greater detail in other sections of this Basis for Conclusions, the Board decided to limit the scope of the disclosures because these changes would reduce the cost to preparers while still providing the information that users of financial statements had requested.

BC24AL On the basis of the considerations described in the Basis for Conclusions on these amendments, and summarised in paragraphs BC24AJ and BC24AK, the Board concluded that the benefits of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) outweigh the costs to preparers of applying these amendments.

Guidance on Implementing
Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

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

CONTENTS

Guidance on Implementing IFRS 7 *Financial Instruments: Disclosures*

This guidance accompanies, but is not part of, IFRS 7.

Introduction

IG1 This guidance suggests possible ways to apply some of the disclosure requirements in IFRS 7. The guidance does not create additional requirements.

IG2 For convenience, each disclosure requirement in the IFRS is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

~~Materiality~~

IG3-IG4[Deleted]~~IAS 1 *Presentation of Financial Statements* notes that a specific disclosure requirement in an IFRS need not be satisfied if the information is not material. IAS 1 defines materiality as follows:~~

> ~~Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.~~

~~IG4 IAS 1 also explains that definition as follows:~~

> ~~Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states in paragraph 25 that "users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence." Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.~~

Classes of financial instruments and level of disclosure (paragraphs 6 and B1-B3)

IG5 Paragraph B3 states that "an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics." To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.

IG6 Paragraph 17(c) of IAS 1 requires an entity to "provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

Significance of financial instruments for financial position and performance (Paragraphs 7-30, B4 and B5)

Financial liabilities at fair value through profit or loss (paragraphs 10(a)(i) and B4)

IG7 The following example illustrates the calculation that an entity might perform in accordance with paragraph B4 of Appendix B of the IFRS.

IG8 On 1 January 20X1, an entity issues a 10-year bond with a par value of CU150,000[+] and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.

IG9 The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:

(a) LIBOR has decreased to 4.75 per cent.

(b) the fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.[*]

IG10 The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.

IG11 The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

[paragraph B4(a)] First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.	At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent. Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.
[paragraph B4(b)] Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph B4(a).	The contractual cash flows of the instrument at the end of the period are: • interest: CU12,000[(a)] per year for each of years 2-10. • principal: CU150,000 in year 10. The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period LIBOR rate, plus the 3 per cent instrument-specific component. This gives a present value of CU152,367.[(b)]
	continued…

[+] In this guidance monetary amounts are denominated in "currency units (CU)".

[*] This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

…continued	
[paragraph B4(c)]	
The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed	The market price of the liability at the end of the period is CU153,811.[(c)] Thus, the entity discloses CU1,444, which is CU153,811-CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.

(a) CU150,000x8% = CU12,000

(b) PV= $[CU12{,}000x(1-(1+0.0775)^{-9})/0.0775]+CU150{,}000x(1+0.0775)^{-9}$

(c) market price = $[CU12{,}000x(1-(1+0.076)^{-9})/0.076]+CU150{,}000x(1+0.076)^{-9}$

Defaults and breaches (paragraphs 18 and 19)

IG12 Paragraphs 18 and 19 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with IAS 1.

Total interest expense (paragraph 20(b))*

IG13 Total interest expense disclosed in accordance with paragraph 20(b) is a component of finance costs, which paragraph 82(b) of IAS 1 requires to be presented separately in the statement of comprehensive income. The line item for finance costs may also include amounts associated with non-financial liabilities.

Fair value (paragraphs 27-28)

IG13A IFRS 7 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorised for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 27B(a). (Disclosure of comparative information is also required, but is not included in the following example.)

* In *Improvements to IFRSs* issued in May 2008, the Board amended paragraph IG13 and removed 'total interest income' as a component of finance costs. This amendment removed an inconsistency with paragraph 32 of IAS 1 *Presentation of Financial Statements*, which precludes the offsetting of income and expenses (except when required or permitted by an IFRS).

Assets measured at fair value		Fair value measurement at the end of the reporting period using:		
		Level 1	Level 2	Level 3
Description	**31 Dec 20X2**	**CU million**	**CU million**	**CU million**
Financial assets at fair value through profit or loss				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Available-for-sale financial assets				
Equity investments	75	30	40	5
Total	214	87	115	12

(Note: For liabilities, a similar table might be presented.)

IG13B IFRS 7 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 27B(c). (Disclosure of comparative information is also required, but is not included in the following example.)

Assets measured at fair value based on Level 3				
	Fair value measurement at the end of the reporting period:			
	Financial assets at fair value through profit or loss		**Available-for-sale financial assets**	**Total**
	Trading securities CU million	Trading derivatives CU million	Equity investments CU million	CU million
Opening balance	6	5	4	15
Total gains or losses				
in profit or loss	(2)	(2)	-	(4)
in other comprehensive income	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(1)	(1)	-	(2)

(Note: For liabilities, a similar table might be presented.)

Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:

	Trading income
Total gains or losses included in profit or loss for the period	(4)
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(2)

(Note: For liabilities, a similar table might be presented.)

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG76 of IAS 39. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IAS 39 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG76A of IAS 39). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IAS 39, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IAS 39, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognised in profit or loss are as follows:

	31 Dec X2 CU million	**31 Dec X1 CU million**
Balance at beginning of year	5.3	5.0
New transactions	-	1.0
Amounts recognised in profit or loss during the year	(0.7)	(0.8)
Other increases	-	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	4.5	5.3

Nature and extent of risks arising from financial instruments (paragraphs 31-42 and B6-B28)

Qualitative disclosures (paragraph 33)

IG15 The type of qualitative information an entity might disclose to meet the requirements in paragraph 33 includes, but is not limited to, a narrative description of:

(a) the entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.

(b) the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:

(i) the structure and organisation of the entity's risk management function(s), including a discussion of independence and accountability;

(ii) the scope and nature of the entity's risk reporting or measurement systems;

(iii) the entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and

(iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

(c) the entity's policies and procedures for avoiding excessive concentrations of risk.

IG16 Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

IG17 In accordance with paragraph 33(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative disclosures (paragraphs 34-42 and B7-B28)

IG18 Paragraph 34 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

(a) industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.

(b) credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.

(c) geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.

(d) a limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realise liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

IG19 In accordance with paragraph B8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.

IG20 When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 35 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest and average exposures.

Credit risk (paragraphs 36-38, B9 and B10)

IG21 Paragraph 36 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

Collateral and other credit enhancements pledged (paragraph 36(b))

IG22 Paragraph 36(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:

(a) the policies and processes for valuing and managing collateral and other credit enhancements obtained;

(b) a description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with IAS 32);

(c) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(d) information about risk concentrations within the collateral or other credit enhancements.

Credit quality (paragraph 36(c))

IG23 Paragraph 36(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:

(a) an analysis of credit exposures using an external or internal credit grading system;

(b) the nature of the counterparty;

(c) historical information about counterparty default rates; and

(d) any other information used to assess credit quality.

IG24 When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the amounts of credit exposures for each external credit grade;

(b) the rating agencies used;

(c) the amount of an entity's rated and unrated credit exposures; and

(d) the relationship between internal and external ratings.

IG25 When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the internal credit ratings process;

(b) the amounts of credit exposures for each internal credit grade; and

(c) the relationship between internal and external ratings.

Financial assets that are either past due or impaired (paragraph 37)

IG26 A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.

IG27 When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.

IG28 Paragraph 37(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) not more than three months;

(b) more than three months and not more than six months;

(c) more than six months and not more than one year; and

(d) more than one year.

IG29 Paragraph 37(b) requires an analysis of impaired financial assets by class. This analysis might include:

(a) the carrying amount, before deducting any impairment loss;

(b) the amount of any related impairment loss; and

(c) the nature and fair value of collateral available and other credit enhancements obtained.

IG30-IG31 [Deleted]

Market risk (paragraphs 40-42 and B17-B28)

IG32 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (ie the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (eg a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

(a) the yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.

(b) foreign exchange rates.

(c) prices of equity instruments.

(d) market prices of commodities.

IG33 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

(a) prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan; or

(b) currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34 For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

(a) interest income and expense;

(b) other line items of profit or loss (such as trading gains and losses); and

(c) when applicable, equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

IG35 Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

Interest rate risk

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1–CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other comprehensive income would have been CU2.8 million (20X1–CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1–CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, and other comprehensive income would have been CU3.0 million (20X1–CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).[(a)]

Foreign currency exchange rate risk

At 31 December 20X2, if the CU had weakened 10 per cent against the US dollar with all other variables held constant, post-tax profit for the year would have been CU2.8 million (20X1–CU6.4 million) lower, and other comprehensive income would have been CU1.2 million (20X1–CU1.1 million) higher. Conversely, if the CU had strengthened 10 per cent against the US dollar with all other variables held constant, post-tax profit would have been CU2.8 million (20X1–CU6.4 million) higher, and other comprehensive income would have been CU1.2 million (20X1–CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in profit in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Equity is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 39(a) requires disclosure of a maturity analysis of liabilities.

Other market risk disclosures (paragraph 42)

IG37 Paragraph 42 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

(a) a financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis, eg options that remain out of (or in) the money for the chosen change in the risk variable;

(b) financial assets are illiquid, eg when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty; or

(c) an entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38 In the situation in paragraph IG37(a), additional disclosure might include:

(a) the terms and conditions of the financial instrument (eg the options);

(b) the effect on profit or loss if the term or condition were met (ie if the options were exercised); and

(c) a description of how the risk is hedged.

For example, an entity may acquire a zero-cost interest rate collar that includes an out-of-the-money leveraged written option (eg the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39 In the situation described in paragraph IG37(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40 In the situation described in paragraph IG37(c), additional disclosure might include:

(a) the nature of the security (eg entity name);

(b) the extent of holding (eg 15 per cent of the issued shares);

(c) the effect on profit or loss; and

(d) how the entity hedges the risk.

Derecognition (paragraphs 42D and 42E)

IG40A The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 42D and 42E.

IG40B The following examples illustrate how an entity that has adopted IFRS 9 *Financial Instruments* might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety

Illustrating the application of paragraph 42D(d) and (e)

	Financial assets at fair value through profit or loss		**Financial assets at amortised cost**		**Financial assets at fair value through other comprehensive income**
	CU million		CU million		CU million
	Trading assets	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Financial assets at fair value through profit or loss**	**Financial assets at fair value through other comprehensive income**	**Financial liabilities at fair value through profit or loss**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG40C The following examples illustrate how an entity that has not adopted IFRS 9 might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety

Illustrating the application of paragraph 42D(d) and (e)

	Financial assets at fair value through profit or loss		**Loans and receivables**		**Available-for-sale financial assets**
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Held for trading**	**Available-for-sale financial assets**	**Financial liabilities at fair value through profit or loss**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

Transition (paragraph 44)

IG41 The following table summarises the effect of the exemption from presenting comparative accounting and risk disclosures for accounting periods beginning before 1 January 2006, before 1 January 2007, and on or after 1 January 2007. In this table:

(a) a **first-time adopter** is an entity preparing its first IFRS financial statements (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

(b) an **existing IFRS user** is an entity preparing its second or subsequent IFRS financial statements.

	Accounting disclosures (paragraphs 7-30)	**Risk disclosures (paragraphs 31-42)**
Accounting periods beginning before 1 January 2006		
First-time adopter not applying IFRS 7 early	*Applies IAS 32 but exempt from providing IAS 32 comparative information*	*Applies IAS 32 but exempt from providing IAS 32 comparative information*
First-time adopter applying IFRS 7 early	**Exempt from presenting IFRS 7 comparative information**	**Exempt from presenting IFRS 7 comparative information**
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	**Exempt from presenting IFRS 7 comparative information**[(a)]
		continued …

Accounting periods beginning on or after 1 January 2006 and before 1 January 2007		
First-time adopter not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
First-time adopter applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Accounting periods beginning on or after 1 January 2007 (mandatory application of IFRS 7)		
First-time adopter	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
(a) See paragraph 44 of IFRS 7		

APPENDIX A
Amendments to guidance on other IFRSs

This appendix contains amendments to guidance on IFRSs other than IFRS 4 that are necessary in order to ensure consistency with IFRS 7. Amendments to the Guidance on Implementing IFRS 4 will be published at a later date. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Implementation Guidance was issued have been incorporated into the relevant Implementation Guidance.

Appendix ~~D~~B

Amendments to guidance on implementing IFRS 7 *Disclosures – Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2013

The following sets out amendments required for this Implementation Guidance resulting from amendments to IFRS 7 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

After paragraph IG40C, a heading and paragraph IG40D are added.

Disclosures (paragraphs 13A–13F and B40–B53)

IG40D The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 13C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 13B–13E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognised financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 13A.

Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 42 of IAS 32, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

continued...

...continued

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralised borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralized borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralised lending. The fair value of the financial assets (bonds) received as collateral (and not recognised in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralised lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the application of paragraph 13C(a)–(e) by type of financial instrument

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial liabilities set off in the statement of financial position**	**Net amounts of financial assets presented in the statement of financial position**	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral received**	**Net amount**
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Other financial instruments	-	-	-	-	-	-
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Description						
Derivatives	160	(80)	80	(80)	-	-
Repurchase, securities lending and similar agreements	80	-	80	(80)	-	-
Other financial instruments	-	-	-	-	-	-
Total	240	(80)	160	(160)	-	-

Illustrating the application of paragraph 13C(a)–(c) by type of financial instrument and paragraph 13C(c)–(e) by counterparty

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial liabilities set off in the statement of financial position**	**Net amounts of financial assets presented in the statement of financial position**
Description			
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	-	90
Other financial instruments	-	-	-
Total	290	(80)	210

Net financial assets subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial assets presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral received**	**Net amount**
Counterparty A	20	-	(10)	10
Counterparty B	100	(80)	(20)	-
Counterparty C	90	(90)	-	-
Other	-	-	-	-
Total	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
	Gross amounts of recognised financial liabilities	**Gross amounts of recognised financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**
Description			
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	-	80
Other financial instruments	-	-	-
Total	240	(80)	160

Net financial liabilities subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Counterparty A	-	-	-	-
Counterparty B	80	(80)	-	-
Counterparty C	80	(80)	-	-
Other	-	-	-	-
Total	160	(160)	-	-