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

MEMBERS' HANDBOOK

Update No. 47

(Issued December 2007)

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

The amendments to the following Standards, Basis for Conclusions and Implementation Guidance are set out in the Appendix of the Standards that created these amendments. The Institute has taken this opportunity to update the amendments in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

PREFACE AND FRAMEWORK

Preface to Hong Kong Financial Reporting Standards	Insert the revised pages 2 and 9. Discard the replaced page 2	Amendments due to - HKAS 1 (Revised)
Framework for the Preparation and Presentation of Financial Statements	Insert the revised pages 1 and 21. Discard the replaced page 1	Amendments due to - HKAS 1 (Revised)

HONG KONG ACCOUNTING STANDARDS (HKAS)

HKAS 1 *Presentation of Financial Statements*	Insert the revised pages 3-4, 14, 16, 16A, 17, 19-20, 22-23, 27, 27A, 45-47, 55, 55A- 55D, 63 and 63A-63C. Discard the replaced pages 3-4, 14, 16, 17, 19-20, 22-23, 27, 45-47, 55, 63 and 65-67	Amendments due to - HKAS 1 Amendment *Capital Disclosures* - HKAS 19 Amendment - HKFRS 5 - HKFRS 7
HKAS 1 Amendment *Capital Disclosures*	Discard the existing Amendment	Effects are already shown above

HKAS 2 *Inventories*	Insert the revised pages 2, 13 and 13A. Discard the replaced pages 2 and 13	Amendments due to - HKFRS 8
HKAS 7 *Cash Flow Statements*	Insert the revised pages 2 and 20. Discard the replaced page 2	Amendments due to - HKFRS 8 - HKAS 23 (Revised) - HKAS 1 (Revised)
HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	Insert the revised pages 3, 17-30, 30A, 37A and 43A. Discard the replaced pages 3 and 17-30	Amendments due to - HKAS 23 (Revised) - HKAS 1 (Revised)
HKAS 10 *Events after the Balance Sheet Date*	Insert the revised pages 2, 8, 11-12, 12A and 13A. Discard the replaced pages 2, 8 and 11-12	Amendments due to - HKFRS 5 - HKAS 1 (Revised)
HKAS 11 *Construction Contracts*	Insert the revised pages 2 and 13A. Discard the replaced page 2	Amendments due to - HKAS 23 (Revised) - HKAS 1 (Revised)
HKAS 12 *Income Taxes*	Insert the revised pages 3 and 54-57. Discard the replaced page 3	Amendments due to - HKAS 1 (Revised)
HKAS 14 *Segment Reporting*	Insert the revised pages 2, 8-9, 11, 14 and 25. Discard the replaced pages 2, 8-9, 11 and 14	Amendments due to - HKFRS 7 - HKAS 1 (Revised)
HKAS 16 *Property, Plant and Equipment*	Insert the revised pages 3-5, 14-15, 17, 19, 19A, 21-35 and 35A-35B. Discard the replaced pages 3-5, 14-15, 17, 19, 19A and 21-35	Amendments due to - HKFRS 2 - HKFRS 3 - HKFRS 5 - HKFRS 6 - HKAS 23 (Revised) - HKAS 1 (Revised)
HKAS 17 *Leases*	Insert the revised pages 7-12 and 15 and discard the replaced pages 7-12 and 15	Amendments due to - HKFRS 7
HKAS 19 *Employee Benefits* (Standard)	Insert the revised pages 2-3. 3A, 10-11,11A, 15-16, 23-27, 30-31, 31A-31B, 36, 39-42, 42A-42B, 43-48 and 50-54. Discard the replaced pages 2-3, 10-11, 15-16, 23-27, 30-31, 36 and 39-48	Amendments due to - HKAS 19 Amendment - HKFRS 8 - HKAS 1 (Revised)

HKAS 19 *Employee Benefits* (Basis for Conclusions)	Insert the revised pages 1-5, 5A-5C, 15, 15A-15D, 25, 25A and 26-28. Discard the replaced pages 1-5,15 and 25-27	
HKAS 19 Amendment *Actuarial Gains and Losses, Group Plans and Disclosures*	Discard the existing Amendment	Effects are already shown above
HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*	Insert the revised pages 2 and 7A. Discard the replaced page 2	Amendments due to - HKAS 1 (Revised)
HKAS 21 *The Effects of Changes in Foreign Exchange Rates*	Insert the revised pages 3, 7, 10, 15, 18-21, 21A-21C, 22 and 26-30. Discard the replaced pages 3, 7, 10, 15, 18-22 and 26-27	Amendments due to - HKAS 21 Amendment - HKAS 1 (Revised)
HKAS 21 Amendment *Net Investment in a Foreign Operation*	Discard the existing Amendment	Effects are already shown above
HKAS 23 (Revised) *Borrowing Costs*	Insert the revised pages 9-10 and 18-20. Discard the replaced pages 9-10 and 18-20	Amendments due to - Update of Appendix as amendments contained in the Appendix when this Standard was issued have been incorporated into the relevant Standards
HKAS 24 *Related Party Disclosures*	Insert the revised pages 2, 7, 8 and 8A. Discard the replaced pages 2, 7, and 8	Amendments due to - HKAS 19 Amendment - HKAS 1 (Revised)
HKS 27 *Consolidated and Separate Financial Statements*	Insert the revised pages 2-3, 6, 9-12, 12A-12B and 16A. Discard the replaced pages 2-3, 6 and 9-12	Amendments due to - Companies (Amendment) Ordinance 2005 - HKFRS 8 - HKAS 1 (Revised)
HKAS 28 *Investments in Associates*	Insert the revised pages 2, 4, 6-11, 11A, 13, 13A-13B and 16. Discard the replaced pages 2, 4, 6-11, 13 and 16	Amendments due to - HKFRS 3 - HKFRS 5 - HKAS 1 (Revised)

HKAS 29 *Financial Reporting in Hyperinflationary Economies*	Insert the revised pages 2 and 12-14. Discard the replaced pages 2 and 12-13	Amendments due to - HKAS 1 (Revised)
HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*	Discard the existing HKAS 30	Amendments due to - HKAS 30 has been superseded by HKFRS 7 for annual periods beginning on or after 1 January 2007
HKAS 31 *Interests in Joint Ventures*	Insert the revised page 12. Discard the replaced page 12	Amendments due to - Update of Appendix as amendments contained in the Appendix when this Standard was issued have been incorporated into the relevant Standards
HKAS 32 *Financial Instruments: Presentation*	Insert the revised pages 1-8, 8A, 9, 16-31, 31A, 33-34, 37, 42-44, 50-53, 55, 55A and 76A. Discard the replaced pages 1-9, 16-31, 33-34, 37, 42-44, 50-53 and 55	Amendments due to - HKAS 39 and HKFRS 4 Amendments - HKFRS 2 - HKFRS 3 - HKFRS 4 - HKFRS 7 - HKAS 1 (Revised)
HKAS 33 *Earnings Per Share*	Insert the revised pages 3, 8, 12-15, 17, 24, 24A-24B, 28, 33-34 and 39. Discard the replaced pages 3, 8, 12-15, 17, 24, 28, 33-34 and 39	Amendments due to - HKFRS 2 - HKFRS 3 - HKFRS 7 - HKFRS 8 - HKAS 1 (Revised)
HKAS 34 *Interim Financial Reporting*	Insert the revised pages 2, and 19-22. Discard the replaced page 2	Amendments due to - HKFRS 8 - HKAS 1 (Revised)
HKAS 36 *Impairment of Assets*	Insert the revised pages 4, 45-50, 51A-51B, 54, 116, 116A, 117 and 147A. Discard the replaced pages 4, 45-50, 54 and 116-117	Amendments due to - HKFRS 8 - HKAS 1 (Revised)
HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	Insert the revised pages 3, 22 and 27. Discard the replaced pages 3 and 22	Amendments due to - HKAS 39 and HKFRS 4 Amendments - HKAS 1 (Revised)

HKAS 38 *Intangible Assets*	Insert the revised pages 4, 9, 33 and 33A. Discard the replaced pages 4, 9 and 33	Amendments due to - HKFRS 6 - HKAS 23 (Revised) - HKAS 1 (Revised)
HKAS 39 *Financial Instruments: Recognition and Measurement*	Insert the revised pages 2-13A, 21-23A, 28, 34-34D, 36-39, 41-45, 59-63, 64A-67, 74-88, 90-92, 101-106, 144-145 and 147A-147C Discard the replaced pages 2-13, 21-23, 28, 34, 34A, 36-39, 41-45, 59-63, 65-67, 74-88, 90-92, 101-106 and 144-145	Amendments due to - HKAS 39 Amendment *Transition and Initial Recognition of Financial Assets and Financial Liabilities* - HKAS 39 Amendment *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* - HKAS 39 Amendment *The Fair Value Option* - HKAS 39 & HKFRS 4 Amendments *Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts* - HKFRS 2 - HKFRS 3 - HKFRS 4 - HKFRS 7 - HK(IFRIC)-Int 5 - HKAS 1 (Revised)
HKAS 39 *Financial Instruments: Recognition and Measurement* (Implementation Guidance)	Insert the revised pages 4-5, 10, 77, 99 and 179-185 Discard the replaced pages 4-5, 10, 77, 99 and 179	
HKAS 39 Amendment *Transition and Initial Recognition of Financial Assets and Financial Liabilities*	Discard the existing Amendment	Effects are already shown above
HKAS 39 Amendment *Cash Flow Hedge Accounting of Forecast Intragroup Transactions*	Discard the existing Amendment	Effects are already shown above
HKAS 39 Amendment *The Fair Value Option*	Discard the existing Amendment	Effects are already shown above

HKAS 39 & HKFRS 4 Amendments *Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts*	Discard the existing Amendment	Effects are already shown above
HKAS 40 *Investment Property*	Insert the revised pages 2, 16A, 20-34. Discard the replaced pages 2 and 20-33	Amendments due to - HKAS 1 (Revised) - IASB Editorial corrections (13 March 2007)
HKAS 41 *Agriculture* (Standard)	Insert the revised pages 2 and 16A. Discard the replaced page 2	Amendments due to - HKFRS 7 - HKAS 1 (Revised)
HKAS 41 *Agriculture* (Basis for Conclusions)	Insert the revised pages 2 and 14-15. Discard the replaced pages 2 and 14-15	

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*	Insert the revised pages 3, 6-8, 13-16, 25-26, 26A-26D, 28, 46, 50A-50B, 52, 59, 74-75 and 82-85. Discard the replaced pages 3, 6-8, 13-16, 25-26, 28, 46, 52, 59 and 74-75	Amendments due to - HKFRS 8 - HK(IFRIC)-Int 12 - HKAS 23 (Revised) - HKAS 1 (Revised)
HKFRSs 1 & 6 Amendments *First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources*	Discard the existing Amendment	Amendments already reflected in above
HKFRS 2 *Share-based Payment* (Standard)	Insert the revised pages 32-40. Discard the replaced pages 32-40	Amendments due to - HKAS 1 (Revised)
HKFRS 2 *Share-based Payment* (Implementation Guidance)	Insert the revised pages 2 and 31. Discard the replaced page 2	
HKFRS 3 *Business Combinations*	Insert the revised pages 10, 13, 24, 26-27 and 36-55. Discard the replaced pages 10, 13, 24, 26-27 and 36-55	Amendments due to - Companies (Amendment) Ordinance 2005

HKFRS 4 *Insurance Contracts* (Standard)	Insert the revised pages 3, 6-7, 14-16, 16A, 17, 22-24, 27-35 and 37. Discard the replaced pages 3, 6-7, 14-17, 22-24 and 27-35	Amendments due to - HKAS 39 and HKFRS 4 Amendments - HKFRS 7 - HKFRS 8 - HKAS 1 (Revised)
HKFRS 4 *Insurance Contracts* (Basis for Conclusions)	Insert the revised pages 3, 18-21, 54, 54A-54B, 55-56 and 64. Discard the replaced pages 3, 18-21 and 54-56	
HKFRS 4 *Insurance Contracts* (Implementation Guidance)	Insert the revised pages 3, 6-8 and 39-40. Discard the replaced pages 3 and 6-8	
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Standard)	Insert the revised pages 2, 17-27 and 29-30. Discard the replaced pages 2 and 17-27	Amendments due to - HKFRS 8 - HKAS 1 (Revised)
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Basis for Conclusions)	Insert the revised pages 2 and 21. Discard the replaced page 2	
HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (Implementation Guidance)	Insert the revised pages 2 and 14. Discard the replaced page 2	
HKFRS 6 *Exploration for and Evaluation of Mineral Resources* (Standard)	Insert the revised pages 2, 6, 10 and 12. Discard the replaced pages 2, 6 and 10	Amendments due to - HKFRS 1 and 6 Amendments - HKFRS 8 - HKAS 1 (Revised)
HKFRS 6 *Exploration for and Evaluation of Mineral Resources* (Basis for Conclusions)	Insert the revised pages 1, 11 and 13. Discard the replaced pages 1 and 11	
HKFRS 7 *Financial Instruments: Disclosures* (Standard)	Insert the revised pages 3, 6, 18, 26-31 and 33-34. Discard the replaced pages 3, 6, 18 and 26-31	Amendments due to - HKAS 39 and HKFRS 4 Amendments - HKFRS 8 - HKAS 1 (Revised)
HKFRS 7 *Financial Instruments: Disclosures* (Basis for Conclusions)	Insert the revised pages 3 and 20-23. Discard the replaced pages 3 and 20-22	

HKFRS 7 *Financial Instruments: Disclosures* (Implementation Guidance)	Insert the revised pages 2 and 15-17. Discard the replaced pages 2 and 15-16	
HKFRS 8 *Operating Segments* (Standard)	Insert the revised pages 2 and 16-20. Discard the replaced pages 2 and 16-19	Amendments due to - HKAS 1 (Revised)
HKFRS 8 *Operating Segments* (Basis for Conclusions)	Insert the revised pages 32-33. Discard the replaced pages 32-33	
HKFRS 8 *Operating Segments* (Implementation Guidance)	Insert the revised page 8. Discard the replaced page 8	

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

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to December 2007)

		Issue/(Review date)
HKAS 29	Financial Reporting in Hyperinflationary Economies	3/04(12/07)
HKAS 31	Interests in Joint Ventures	12/04(12/07)
HKAS 32	Financial Instruments: Presentation	11/04(12/07)
HKAS 33	Earnings Per Share	3/04(12/07)
HKAS 34	Interim Financial Reporting	10/04(12/07)
HKAS 36	Impairment of Assets	8/04(12/07)
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets	11/04(12/07)
HKAS 38	Intangible Assets	8/04(12/07)
HKAS 39	Financial Instruments: Recognition and Measurement	1/06(12/07)
HKAS 40	Investment Property	11/05(12/07)
HKAS 41	Agriculture	12/04(12/07)

HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)

Contents

Preface to Hong Kong Financial Report Standards

Appendix

Amendments resulting from other HKFRSs

The following sets out amendments required for this Preface 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 Preface and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 10, 15 and 18 are amended as follows:

10 A complete set of financial statements includes a ~~balance sheet~~ statement of financial position, ~~an income statement~~ a statement of comprehensive income, a statement ~~showing either all~~ of changes in equity ~~or changes in equity other than those arising from capital transactions with owners and distributions to owners~~, a statement of cash flows ~~statement~~, and accounting policies and explanatory notes. When a separate income statement is presented in accordance with HKAS 1 *Presentation of Financial Statements* (as revised in 2007), it is part of that complete set. In the interest …

15. Entities shall apply interpretations if their financial statements are described as being prepared in accordance with HKFRSs (see paragraph 16 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007)).

18 HKAS 1 (as revised in 2007) includes the following requirement:

> An entity whose financial statements comply with HKFRSs shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe ~~F~~financial statements ~~shall not be described~~ as complying with HKFRSs unless they comply with all the requirements of HKFRSs.

> This requirement extends to HKFRSs currently in issue.

FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

(Issued June 1997; revised May 2003, ~~and~~ September 2004 (name change) and December 2007)

Introduction

Purpose and status

1. This Framework sets out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the Framework is to:

   (a) assist the Council of the Hong Kong Institute of Certified Public Accountants (HKICPA) (formerly known as Hong Kong Society of Accountants (HKSA)) (hereafter referred to as "Council") in the development of future Statements of Standard Accounting Practice and Accounting Guidelines and in its review of existing Statements of Standard Accounting Practice and Accounting Guidelines;

   (b) [Not used]

   (c) [Not used]

   (d) assist preparers of financial statements in applying Statements of Standard Accounting Practice and Accounting Guidelines and in dealing with topics that have yet to form the subject of a Statement of Standard Accounting Practice or an Accounting Guideline;

   (e) assist auditors in forming an opinion as to whether financial statements conform with Statements of Standard Accounting Practice;

   (f) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Statements of Standard Accounting Practice and Accounting Guidelines; and

   (g) provide those who are interested in the work of Council with information about its approach to the formulation of Statements of Standard Accounting Practice and Accounting Guidelines.

2. This Framework is not a Statement of Standard Accounting Practice or an Accounting Guideline and hence does not define standards for any particular measurement or disclosure issue. Nothing in this Framework overrides any specific Statement of Standard Accounting Practice or Guideline.

3. Council recognises that in a limited number of cases there may be a conflict between the Framework and a Statement of Standard Accounting Practice or Guideline. In those cases where there is a conflict, the requirements of the Statement of Standard Accounting Practice or Guideline prevail over those of the Framework. As, however, Council will be guided by the Framework in the development of future Statements or Guidelines and in its review of existing Statements or Guidelines, the number of cases of conflict between the Framework and Statements of Standard Accounting Practice and Accounting Guidelines will diminish through time.

4. The Framework will be revised from time to time on the basis of Council's experience of working with it.

APPENDIX B

Amendments resulting from other HKFRSs

The following sets out amendments required for this Framework 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 Framework and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Rubric preceding the 'Introduction' section is added as follows:

> *The Framework has not been amended to reflect the changes made by HKAS 1* Presentation of Financial Statements (as revised in 2007).

Hong Kong Accounting Standard 1 *Presentation of Financial Statements* (HKAS 1) is set out in paragraphs 1-128 and the Appendix. All the paragraphs have equal authority. HKAS 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 *Framework for 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.

Hong Kong Accounting Standard 1

Presentation of Financial Statements

Objective

1. The objective of this Standard is to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The recognition, measurement and disclosure of specific transactions and other events are dealt with in other Standards and in Interpretations.

Scope

2. This Standard shall be applied to all general purpose financial statements prepared and presented in accordance with Hong Kong Financial Reporting Standards (HKFRSs).

3. General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs[*]. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus. This Standard does not apply to the structure and content of condensed interim financial statements prepared in accordance with HKAS 34 *Interim Financial Reporting*. However, paragraphs 13-41 apply to such financial statements. This Standard applies equally to all entities and whether or not they need to prepare consolidated financial statements or separate financial statements, as defined in HKAS 27 *Consolidated and Separate Financial Statements*.

4[ϕ]. ~~HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* specifies additional requirements for banks and similar financial institutions that are consistent with the requirements of this Standard.~~[Deleted]

5. This Standard uses terminology that is suitable for profit-oriented entities, including public sector business entities. Entities with not-for-profit activities in the private sector, public sector or government seeking to apply this Standard may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves.

6. Similarly, entities that do not have equity as defined in HKAS 32 *Financial Instruments: Disclosure and Presentation* (eg some mutual funds) and entities whose share capital is not equity (eg some co-operative entities) may need to adapt the presentation in the financial statements of members' or unitholders' interests.

[*] An example of tailored reports are those accounts prepared by certain private companies taking advantage of the exemptions granted by Section 141D of the Companies Ordinance.

[ϕ] Effective for annual periods beginning on or after 1 January 2007.

55. In applying paragraph 51, an entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and is more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.

56. Information about expected dates of realisation of assets and liabilities is useful in assessing the liquidity and solvency of an entity. ~~HKAS 32~~ HKFRS 7 *Financial Instruments: Disclosure*[*] requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions is also useful, whether or not assets and liabilities are classified as current or non-current. For example, an entity discloses the amount of inventories that are expected to be recovered more than twelve months after the balance sheet date.

Current Assets

57. An asset shall be classified as current when it satisfies any of the following criteria:

(a) it is expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle;

(b) it is held primarily for the purpose of being traded;

(c) it is expected to be realised within twelve months after the balance sheet date; or

(d) it is cash or a cash equivalent (as defined in HKAS 7 **Cash Flow Statements*****) unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date.***

All other assets shall be classified as non-current.

58. This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

59. The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the balance sheet date. Current assets also include assets held primarily for the purpose of being traded (financial assets within this category are classified as held for trading in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*) and the current portion of non-current financial assets.

Current Liabilities

60. A liability shall be classified as current when it satisfies any of the following criteria:

(a) it is expected to be settled in the entity's normal operating cycle;

(b) it is held primarily for the purpose of being traded;

---

[*] Effective for annual periods beginning on or after 1 January 2007.

67. In respect of loans classified as current liabilities, if the following events occur between the balance sheet date and the date the financial statements are authorised for issue, those events qualify for disclosure as non-adjusting events in accordance with HKAS 10 *Events after the Balance Sheet Date*:

(a) refinancing on a long-term basis;

(b) rectification of a breach of a long-term loan agreement; and

(c) the receipt from the lender of a period of grace to rectify a breach of a long-term loan agreement ending at least twelve months after the balance sheet date.

Information to be Presented on the Face of the Balance Sheet

68. As a minimum, the face of the balance sheet shall include line items that present the following amounts to the extent that they are not presented in accordance with paragraph 68A:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

(d) financial assets (excluding amounts shown under (e), (h) and (i));

(e) investments accounted for using the equity method;

(f) biological assets;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

(j) trade and other payables;

(k) provisions;

(l) financial liabilities (excluding amounts shown under (j) and (k));

(m) liabilities and assets for current tax, as defined in HKAS 12 **Income Taxes*****;***

(n) deferred tax liabilities and deferred tax assets, as defined in HKAS 12;

(o) minority interest, presented within equity; and

(p) issued capital and reserves attributable to equity holders of the parent.

68A. The face of the balance sheet shall also include line items that present the following amounts:

(a) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations; and

(b) liabilities included in disposal groups classified as held for sale in accordance with HKFRS 5.

69. Additional line items, headings and subtotals shall be presented on the face of the balance sheet when such presentation is relevant to an understanding of the entity's financial position.

70. When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).

71. This Standard does not prescribe the order or format in which items are to be presented. Paragraph 68 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation on the face of the balance sheet. In addition:

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

(b) the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position. For example, a ~~bank~~ financial institution may amend~~s~~ the above descriptions to provide information that is relevant to the operations of a financial institution ~~apply the more specific requirements in HKAS 30~~.

72. The judgement on whether additional items are presented separately is based on an assessment of:

(a) the nature and liquidity of assets;

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

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

73. The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that they should be presented as separate line items. For example, different classes of property, plant and equipment can be carried at cost or revalued amounts in accordance with HKAS 16 *Property, Plant and Equipment*.

Information to be Presented either on the Face of the Balance Sheet or in the Notes

74. An entity shall disclose, either on the face of the balance sheet or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity's operations.

75. The detail provided in subclassifications depends on the requirements of HKFRSs and on the size, nature and function of the amounts involved. The factors set out in paragraph 72 also are used to decide the basis of subclassification. The disclosures vary for each item, for example:

(a) items of property, plant and equipment are disaggregated into classes in accordance with HKAS 16;

(b) receivables are disaggregated into amounts receivable from trade customers, receivables from related parties, prepayments and other amounts;

(c) inventories are subclassified, in accordance with HKAS 2 *Inventories*, into classifications such as merchandise, production supplies, materials, work in progress and finished goods;

remeasuring available-for-sale financial assets (see HKAS 39).

Information to be Presented on the Face of the Income Statement

81. As a minimum, the face of the income statement shall include line items that present the following amounts for the period:

(a) revenue[*];

(b) finance costs;

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(d) ~~pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations~~ tax expense;

(e) ~~tax expense; and~~ a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and

(f) profit or loss.

82. The following items shall be disclosed on the face of the income statement as allocations of profit or loss for the period:

(a) profit or loss attributable to minority interest; and

(b) profit or loss attributable to equity holders of the parent.

83. Additional line items, headings and subtotals shall be presented on the face of the income statement when such presentation is relevant to an understanding of the entity's financial performance.

84. Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists in an understanding of the financial performance achieved and in making projections of future results. Additional line items are included on the face of the income statement, and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of financial performance. Factors to be considered include materiality and the nature and function of the components of income and expenses. For example, a ~~bank~~ financial institution may amend~~s~~ the descriptions to provide information that is relevant to the operations of a financial institution.~~apply the more specific requirements in HKAS 30.~~ Income and expense items are not offset unless the criteria in paragraph 32 are met.

85. An entity shall not present any items of income and expense as extraordinary items, either on the face of the income statement or in the notes.

Information to be Presented either on the Face of the Income Statement or in the Notes

86. When items of income and expense are material, their nature and amount shall be disclosed separately.

[*] Hong Kong incorporated companies are required to disclose turnover for the financial year and the method by which it is arrived at (HKCO Tenth Sch. para 16). Turnover should consist of revenue arising from the principal activities of the entity and therefore should not usually include those items of revenue and gains that arise incidentally.

87. Circumstances that would give rise to the separate disclosure of items of income and expense include:

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) disposals of items of property, plant and equipment;

(d) disposals of investments;

(e) discontinu~~ing~~ed operations;

(f) litigation settlements; and

(g) other reversals of provisions.

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

89. Entities are encouraged to present the analysis in paragraph 88 on the face of the income statement.

90. Expenses are subclassified to highlight components of financial performance that may differ in terms of frequency, potential for gain or loss and predictability. This analysis is provided in one of two forms.

91. The first form of analysis is the nature of expense method. Expenses are aggregated in the income statement according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and are not reallocated among various functions within the entity. This method may be simple to apply because no allocations of expenses to functional classifications are necessary. An example of a classification using the nature of expense method is as follows:

Revenue		X
Other income		X
Changes in inventories of finished goods and work in progress	X	
Raw materials and consumables used	X	
Employee benefits costs	X	
Depreciation and amortisation expense	X	
Other expenses	X	
Total expenses		(X)
Profit		X

(c) ***total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest; and***

(d) ***for each component of equity, the effects of changes in accounting policies and corrections of errors recognised in accordance with HKAS 8.***

~~A statement of changes in equity that comprises only these items shall be titled a statement of recognised income and expense.~~

97. ***An entity shall also present, either on the face of the statement of changes in equity or in the notes:***

(a) ***the amounts of transactions with equity holders acting in their capacity as equity holders, showing separately distributions to equity holders;***

(b) ***the balance of retained earnings (ie accumulated profit or loss) at the beginning of the period and at the balance sheet date, and the changes during the period; and***

(c) ***a reconciliation between the carrying amount of each class of contributed equity and each reserve at the beginning and the end of the period, separately disclosing each change.***

98. Changes in an entity's equity between two balance sheet dates reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with equity holders acting in their capacity as equity holders (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expenses, including gains and losses, generated by the entity's activities during that period (whether those items of income and expenses are recognised in profit or loss or directly as changes in equity).

99. This Standard requires all items of income and expense recognised in a period to be included in profit or loss unless another Standard or an Interpretation requires otherwise. Other Standards require some gains and losses (such as revaluation increases and decreases, particular foreign exchange differences, gains or losses on remeasuring available-for-sale financial assets, and related amounts of current tax and deferred tax) to be recognised directly as changes in equity. Because it is important to consider all items of income and expense in assessing changes in an entity's financial position between two balance sheet dates, this Standard requires the presentation of a statement of changes in equity that highlights an entity's total income and expenses, including those that are recognised directly in equity.

100. HKAS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transitional provisions in another Standard or an Interpretation require otherwise. HKAS 8 also requires that restatements to correct errors are made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are made to the balance of retained earnings, except when a Standard or an Interpretation requires retrospective adjustment of another component of equity. Paragraph 96(d) requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting, separately, from changes in accounting policies and from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

101. The requirements in paragraphs 96 and 97 may be met in various ways. One example is a columnar format that reconciles the opening and closing balances of each element within equity. An alternative is to present only the items set out in paragraph 96 in the statement of changes in equity. Under this approach, the items described in paragraph 97 are shown in the notes.

Cash Flow Statement

102. Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. HKAS 7 *Cash Flow Statements* sets out requirements for the presentation of the cash flow statement and related disclosures.

Notes

Structure

103. The notes shall:

- ***(a) present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 108-115;***
- ***(b) disclose the information required by HKFRSs that is not presented on the face of the balance sheet, income statement, statement of changes in equity or cash flow statement; and***
- ***(c) provide additional information that is not presented on the face of the balance sheet, income statement, statement of changes in equity or cash flow statement, but is relevant to an understanding of any of them.***

104. Notes shall, as far as practicable, be presented in a systematic manner. Each item on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement shall be cross-referenced to any related information in the notes.

105. Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

- (a) a statement of compliance with HKFRSs (see paragraph 14);
- (b) a summary of significant accounting policies applied (see paragraph 108);
- (c) supporting information for items presented on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement, in the order in which each statement and each line item is presented; and
- (d) other disclosures, including:
  - (i) contingent liabilities (see HKAS 37) and unrecognised contractual commitments; and
  - (ii) non-financial disclosures, eg the entity's financial risk management objectives and policies (see ~~HKAS 32~~HKFRS 7).

124. The disclosure of some of the key assumptions that would otherwise be required in accordance with paragraph 116 is required by other Standards. For example, HKAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. HKAS 32 requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value. HKAS 16 requires disclosure of significant assumptions applied in estimating fair values of revalued items of property, plant and equipment.

Capital

124A An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

124B To comply with paragraph 124A, the entity discloses the following:

(a) qualitative information about its objectives, policies and processes for managing capital, including (but not limited to):

(i) a description of what it manages as capital;

(ii) when an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and

(iii) how it is meeting its objectives for managing capital.

(b) summary quantitative data about what it manages as capital. Some entities regard some financial liabilities (eg some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (eg components arising from cash flow hedges).

(c) any changes in (a) and (b) from the previous period.

(d) whether during the period it complied with any externally imposed capital requirements to which it is subject.

(e) when the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

These disclosures shall be based on the information provided internally to the entity's key management personnel.

124C An entity may manage capital in a number of ways and be subject to a number of different capital requirements. For example, a conglomerate may include entities that undertake insurance activities and banking activities, and those entities may also operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity shall disclose separate information for each capital requirement to which the entity is subject.

Other Disclosures

125. An entity shall disclose in the notes:

(a) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to equity holders during the period [*]***, and the related amount per share; and***

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

126. An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

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

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

(c) the name of the parent and the ultimate parent of the group.

Effective Date

127. An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

127A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

127B. An entity shall apply the requirements of paragraphs 124A–124C for annual periods beginning on or after 1 January 2007. Earlier application is encouraged.

Withdrawal of Other Pronouncements

128. This Standard supersedes SSAP 1 *Presentation of Financial Statements* revised in 2001 and Interpretation 8 *Presentation of Financial statements – Current Assets: Classification of Restricted and Appropriated Cash Balance*.

[*] Hong Kong incorporated companies are required to show the aggregate amount which is recommended for distribution by way of dividend under a separate heading(s) in their balance sheet (HKCO Tenth Sch., para 9(1)(e)).

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003:~~

~~(a) references to 'net profit or loss' are amended to 'profit or loss';~~

~~(b) references to 'notes to the financial statements' are amended to 'notes'; and~~

~~(c) references to 'equity capital' are amended to 'contributed equity'.~~

~~A2. In the *Preface to Hong Kong Financial Reporting Standards*, paragraph 16 is amended to read as follows:~~

~~16. HKAS 1 *Presentation of Financial Statements* includes the following requirement:~~

~~"An entity whose financial statements comply with HKFRSs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with HKFRSs unless they comply with all the requirements of HKFRSs."~~

~~A3. Paragraphs 69 and 70 of HKAS 12 *Income Taxes* are deleted.~~

~~A4. In HKAS 19 *Employee Benefits*, paragraph 23 is amended to read as follows:~~

~~23. Although this Standard does not require specific disclosures about short-term employee benefits, other Standards may require disclosures. For example, HKAS 24 *Related Party Disclosures* requires disclosures about employee benefits for key management personnel. HKAS 1 *Presentation of Financial Statements* requires disclosure of employee benefits expense.~~

~~A5. In Appendix B to HKAS 19, in the section headed Employee Benefit Obligations, the reference to "Total, included in 'staff costs'" is amended to "Total, included in 'employee benefits expense'".~~

~~A6. HKAS 34 *Interim Financial Reporting* is amended as described below.~~

~~Paragraph 5 is amended to read as follows:~~

~~5. HKAS 1 defines a complete set of financial statements as including the following components:~~

~~(a) a balance sheet;~~

~~(b) an income statement;~~

~~(c) a statement of changes in equity showing either:~~

~~(i) all changes in equity, or~~

~~(ii) changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;~~

~~(d) a cash flow statement; and~~

~~(e) notes, comprising a summary of significant accounting policies and other explanatory notes.~~

~~Paragraph 12 is amended to read as follows:~~

~~12. HKAS 1 provides guidance on the structure of financial statements. The Implementation Guidance for HKAS 1 illustrates ways in which the balance sheet, income statement and statement of changes in equity may be presented.~~

~~Paragraph 13 is amended to read as follows:~~

~~13. HKAS 1 requires a statement of changes in equity to be presented as a separate component of an entity's financial statements, and permits information about changes in equity arising from transactions with equity holders acting in their capacity as equity holders (including distributions to equity holders) to be shown either on the face of the statement or in the notes. An entity follows the same format in its interim statement of changes in equity as it did in its most recent annual statement.~~

~~A7. Paragraphs 39 and 40 of HKAS 35 *Discontinuing Operations* are amended to read as follows:~~

~~39. The disclosures required by paragraphs 27-37, except for the disclosure of the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation in accordance with paragraph 31(a), may be presented either in the notes or on the face of the balance sheet, income statement or statement of changes in equity.~~

~~40. HKAS 1 *Presentation of Financial Statements* requires the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations to be presented on the face of the income statement. The disclosures required by paragraph 27(f) and (g) are~~

~~encouraged to be presented on the face of the income statement and cash flow statement, respectively.~~

~~A8. In Appendix A to HKAS 35:~~

~~(a) in the illustrative income statement presented in paragraph 6, the total 'Profit (loss) from ordinary activities after taxes' is amended to 'Profit (loss)';~~

~~(b) in the illustrative income statement presented in paragraph 7, the total 'Profit (loss) from ordinary activities' is amended to 'Profit (loss)'; and~~

~~(c) in the illustrative income statement presented in paragraph 13, the total 'Profit from ordinary activities' is amended to 'Profit (loss)'.~~

~~A9. HKAS 41 *Agriculture* is amended as described below.~~

~~Paragraph 39 is deleted.~~

~~Paragraph 53 is amended to read as follows:~~

~~53. Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of income or expense, the nature and amount of that item are disclosed in accordance with HKAS 1 *Presentation of Financial Statements*. Examples of such an event include an outbreak of a virulent disease, a flood, a severe drought or frost, and a plague of insects.~~

~~A10. In HKAS-Int-29 *Disclosure—Service Concession Arrangements*, paragraph 10 of the Basis for Conclusions should be read as follows:~~

~~[The original text has been marked up to reflect the revision of HKAS 1 in 2003: new text is underlined and deleted text is struck through.]~~

~~10. HKAS 1.91103(c) requires the an entity's notes to the financial statements of an enterprise to provide additional information which that is not presented on the face of the financial statements balance sheet, income statement, statement of changes in equity or cash flow statement, but that is necessary for a fair presentation relevant to an understanding of any of them. HKAS 1.93 The definition of notes in HKAS 1.11 indicates that the notes to the financial statements include provide narrative descriptions or more detailed analyses disaggregations of amounts shown on the face of items disclosed in the balance sheet, income statement, statement of changes in equity and cash flow statement and statement of changes in equity, as well as additional information such as contingent liabilities and commitments about items that do not qualify for recognition in those statements.~~

balance sheet date, even though future market prices could be different. The objective of fair value measurement is to reflect fair value at the measurement date, not to predict a future value.

BC37. The revised Standard does not prescribe the particular form or detail of the disclosures. Circumstances differ from entity to entity, and the nature of estimation uncertainty at the balance sheet date has many facets. The revised Standard limits the scope of the disclosures to items that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities *within the next financial year*. The longer the future period to which the disclosures relate, the greater the range of items that would qualify for disclosure, and the less specific the disclosures that could be made about particular assets or liabilities. A period longer than the next financial year might obscure the most relevant information with other disclosures.

Criterion for Exemption from Requirements

BC38. The previous version of IAS 1 specified that when the presentation or classification of items in the financial statements is amended, comparative amounts should be reclassified unless it is impracticable to do so (paragraph 40). Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

BC39. The Exposure Draft proposed a different criterion for exemption from particular requirements. For the reclassification of comparative amounts, and its proposed new requirement to disclose key assumptions and other sources of estimation uncertainty at the balance sheet date (discussed in paragraphs BC32-BC37), the Exposure Draft proposed that the criterion for exemption should be that applying the requirements would give rise to undue cost or effort.

BC40. In the light of comments received on the Exposure Draft, the Board decided that an exemption based on management's assessment of undue cost or effort is too subjective to be applied consistently by different entities. Moreover, the Board decided that balancing costs and benefits is a task for the Board when it sets accounting requirements rather than for entities when they apply those requirements. Therefore, the Board decided to retain the "impracticability" criterion for exemption set out in the previous version of IAS 1. This affects the exemptions set out in paragraphs 38-40 and 122 of the revised Standard. Impracticability is the only basis on which specific exemptions are provided in Standards and Interpretations from applying particular requirements when the effect of applying them is material.

Disclosures about capital

BC41 In July 2004, the Board published an Exposure Draft ED 7 *Financial Instruments: Disclosures*. As part of that project, the Board considered whether it should require disclosures about capital.

BC42 The level of an entity's capital and how it manages capital are important factors for users to consider in assessing the risk profile of an entity and its ability to withstand unexpected adverse events. The level of capital might also affect the entity's ability to pay dividends. Consequently, ED 7 proposed disclosures about capital.

BC43 In ED 7, the Board decided that it should not limit its requirements for disclosures about capital to entities that are subject to external capital requirements (eg regulatory capital requirements established by legislation or other regulation). The Board believes that information about capital is useful for all entities, as is evidenced by the fact that some entities set internal capital requirements and norms have been established for some industries. The Board noted that the capital disclosures are not intended to replace disclosures required by regulators. The Board also noted that the financial statements should not be regarded as a substitute for disclosures to regulators (which may not be available to all users) because the function of disclosures made to regulators may differ from those to other users. Therefore, the Board decided that information about capital should be required of all entities because it is useful to users of general purpose financial statements. Accordingly, the Board did not distinguish between the requirements for regulated and non-regulated entities.

BC44 Some respondents to ED 7 questioned the relevance of the capital disclosures in a Standard dealing with disclosures relating to financial instruments. The Board noted that an entity's capital does not relate solely to financial instruments and, thus, capital disclosures have more general relevance. Accordingly, the Board included these disclosures in IAS 1, rather than IFRS 7 *Financial Instruments: Disclosures*, the Standard resulting from ED 7.

BC45 The Board also decided that an entity's decision to adopt the amendments to IAS 1 should be independent of the entity's decision to adopt IFRS 7. The Board noted that issuing a separate amendment facilitates separate adoption decisions.

Objectives, policies and processes for managing capital

BC46 The Board decided that disclosure about capital should be placed in the context of a discussion of the entity's objectives, policies and processes for managing capital. This is because the Board believes that such a discussion both communicates important information about the entity's capital strategy and provides the context for other disclosures.

BC47 The Board considered whether an entity can have a view of capital that differs from what IFRSs define as equity. The Board noted that, although for the purposes of this disclosure capital would often equate with equity as defined in IFRSs, it might also include or exclude some components. The Board also noted that this disclosure is intended to give entities the opportunity to describe how they view the components of capital they manage, if this is different from what IFRSs define as equity.

Externally imposed capital requirements

BC48 The Board considered whether it should require disclosure of any externally imposed capital requirements. Such a capital requirement could be:

(a) an industry-wide requirement with which all entities in the industry must comply; or

(b) an entity-specific requirement imposed on a particular entity by its prudential supervisor or other regulator.

BC49 The Board noted that some industries and countries have industry-wide capital requirements, and others do not. Thus, the Board concluded that it should not require disclosure of industry-wide requirements, or compliance with such requirements, because such disclosure would not lead to comparability between different entities or between similar entities in different countries.

BC50 The Board concluded that disclosure of the existence and level of entity-specific capital requirements is important information for users, because it informs them about the risk assessment of the regulator. Such disclosure improves transparency and market discipline.

BC51 However, the Board noted the following arguments against requiring disclosure of externally imposed entity-specific capital requirements.

(a) Users of financial statements might rely primarily on the regulator's assessment of solvency risk without making their own risk assessment.

(b) The focus of a regulator's risk assessment is for those whose interests the regulations are intended to protect (eg depositors or policyholders). This emphasis is different from that of a shareholder. Thus, it could be misleading to suggest that the regulator's risk assessment could, or should, be a substitute for independent analysis by investors.

(c) The disclosure of entity-specific capital requirements imposed by a regulator might undermine that regulator's ability to impose such requirements. For example, the information could cause depositors to withdraw funds, a prospect that might discourage regulators from imposing requirements. Furthermore, an entity's regulatory dialogue would become public, which might not be appropriate in all circumstances.

(d) Because different regulators have different tools available, for example formal requirements and moral suasion, a requirement to disclose entity-specific capital requirements could not be framed in a way that would lead to the provision of information that is comparable across entities.

(e) Disclosure of capital requirements (and hence, regulatory judgements) could hamper clear communication to the entity of the regulator's assessment by creating incentives to use moral suasion and other informal mechanisms.

(f) Disclosure requirements should not focus on entity-specific capital requirements in isolation, but should focus on how entity-specific capital requirements affect how an entity manages and determines the adequacy of its capital resources.

(g) A requirement to disclose entity-specific capital requirements imposed by a regulator is not part of Pillar 3 of the Basel II Framework developed by the Basel Committee on Banking Supervision.

BC52 Taking into account all of the above arguments, the Board decided not to require quantitative disclosure of externally imposed capital requirements. Rather, it decided to require disclosures about whether the entity complied with any externally imposed capital requirements during the period and, if not, the consequences of non-compliance. This retains confidentiality between regulators and the entity, but alerts users to breaches of capital requirements and their consequences.

BC53 Some respondents to ED 7 did not agree that breaches of externally imposed capital requirements should be disclosed. They argued that disclosure about breaches of externally imposed capital requirements and the associated regulatory measures subsequently imposed could be disproportionately damaging to entities. The Board was not persuaded by these arguments because it believes that such concerns indicate that information about breaches of externally imposed capital requirements may often be material by its nature. The *Framework* states that 'Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.' Similarly, the Board decided not to provide an exemption for temporary non-compliance with regulatory requirements during the year. Information that an entity is sufficiently close to its limits to breach them, even on a temporary basis, is useful for users.

Internal capital targets

BC54 The Board proposed in ED 7 that the requirement to disclose information about breaches of capital requirements should apply equally to breaches of internally imposed requirements, because it believed the information is also useful to a user of the financial statements.

BC55 However, this proposal was criticised by respondents to ED 7 for the following reasons:

(a) The information is subjective and, thus, not comparable between entities. In particular, different entities will set internal targets for different reasons, so a breach of a requirement might signify different things for different entities. In contrast, a breach of an external requirement has similar implications for all entities required to comply with similar requirements.

(b) Capital targets are not more important than other internally set financial targets, and to require disclosure only of capital targets would provide users with incomplete, and perhaps misleading, information.

(c) Internal targets are estimates that are subject to change by the entity. It is not appropriate to require the entity's performance against this benchmark to be disclosed.

(d) An internally set capital target can be manipulated by management. The disclosure requirement could cause management to set the target so that it would always be achieved, providing little useful information to users and potentially reducing the effectiveness of the entity's capital management.

BC56 As a result, the Board decided not to require disclosure of the capital targets set by management, whether the entity has complied with those targets, or the consequences of any non-compliance. However, the Board confirmed its view that when an entity has policies and processes for managing capital, qualitative disclosures about these policies and processes are useful. The Board also concluded that these disclosures, together with disclosure of the components of equity and their changes during the year (required by paragraphs 96-101), would give sufficient information about entities that are not regulated or subject to externally imposed capital requirements.

Dissenting Opinion

The following dissent opinion was noted.

DO1 An IASB Board Member dissents from the amendments to IAS 1 Presentation of Financial Statements–*Capital Disclosures.* That member disagrees with the assertion in paragraph BC43 that the information required by this amendment is useful for all entities. He notes that nothing would prohibit an entity making these disclosures if specific circumstances suggested the disclosures were particularly useful. Therefore that member would not impose the disclosure requirements of paragraphs 124A-124C on entities that are not subject to external capital requirements.

XYZ GROUP - STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 20-2

(in thousands of currency units)

	20-2	**20-1**
Gain/(loss) on revaluation of properties	(X)	X
Available-for-sale investments:		
Valuation gains/(losses) taken to equity	(X)	(X)
Transferred to profit or loss on sale	X	(X)
Cash flow hedges:		
Gains/(losses) taken to equity	X	X
Transferred to profit or loss for the period	(X)	X
Transferred to the initial carrying amount of hedged items	(X)	(X)
Exchange differences on translation of foreign operations	(X)	(X)
Actuarial gains (losses) on defined benefit plans	X	(X)
Tax on items taken directly to or transferred from equity	X	(X)
Net income recognised directly in equity	(X)	X
Profit for the period	X	X
Total recognised income and expense for the period	X	X
Attributable to:		
Equity holders of the parent	X	X
Minority interest	X	X
	X	X
Effect of changes in accounting policy:		
Equity holders of the parent		(X)
Minority interest		(X)
		(X)

The above example illustrates an approach that presents changes in equity representing income and expense in a separate component of the financial statements. Under this approach, a reconciliation of opening and closing balances of share capital, reserves and accumulated profit, as illustrated on the previous page, is given in the notes.

Illustrative examples of capital disclosures (paragraphs 124A-124C)

An entity that is not a regulated financial institution

IG5 The following example illustrates the application of paragraphs 124A and 124B for an entity that is not a financial institution and is not subject to an externally imposed capital requirement. In this example, the entity monitors capital using a debt-to-adjusted capital ratio. Other entities may use different methods to monitor capital. The example is also relatively simple. An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of paragraphs 124A and 124B.

Facts

Group A manufactures and sells cars. Group A includes a finance subsidiary that provides finance to customers, primarily in the form of leases. Group A is not subject to any externally imposed capital requirements.

Example disclosure

The Group's objectives when managing capital are:

- to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and
- to provide an adequate return to shareholders by pricing products and services commensurately with the level of risk.

The Group sets the amount of capital in proportion to risk. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or sell assets to reduce debt.

Consistently with others in the industry, the Group monitors capital on the basis of the debt-to-adjusted capital ratio. This ratio is calculated as net debt ÷ adjusted capital. Net debt is calculated as total debt (as shown in the balance sheet) less cash and cash equivalents. Adjusted capital comprises all components of equity (ie share capital, share premium, minority interest, retained earnings, and revaluation reserve) other than amounts recognised in equity relating to cash flow hedges, and includes some forms of subordinated debt.

continued…

…continued

During 20X4, the Group's strategy, which was unchanged from 20X3, was to maintain the debt-to-adjusted capital ratio at the lower end of the range 6:1 to 7:1, in order to secure access to finance at a reasonable cost by maintaining a BB credit rating. The debt-to-adjusted capital ratios at 31 December 20X4 and at 31 December 20X3 were as follows:

	31 Dec X4 **CU million**	**31 Dec X3** **CU million**
Total debt	1,000	1,100
Less: cash and cash equivalents	(90)	(150)
Net debt	910	950
Total equity	110	105
Add: subordinated debt instruments	38	38
Less: amounts recognised in equity relating to cash flow hedges	(10)	(5)
Adjusted capital	138	138
Debt-to-adjusted capital ratio	6.6	6.9

The decrease in the debt-to-adjusted capital ratio during 20X4 resulted primarily from the reduction in net debt that occurred on the sale of subsidiary Z. As a result of this reduction in net debt, improved profitability and lower levels of managed receivables, the dividend payment was increased to CU2.8 million for 20X4 (from CU2.5 million for 20X3).

An entity that has not complied with externally imposed capital requirements

IG6 The following example illustrates the application of paragraph 124B(e) when an entity has not complied with externally imposed capital requirements during the period. Other disclosures would be provided to comply with the other requirements of paragraphs 124A and 124B.

Facts

Entity A provides financial services to its customers and is subject to capital requirements imposed by Regulator B. During the year ended 31 December 20X7, Entity A did not comply with the capital requirements imposed by Regulator B. In its financial statements for the year ended 31 December 20X7, Entity A provides the following disclosure relating to its non-compliance.

…continued

continued …

Example disclosure

Entity A filed its quarterly regulatory capital return for 30 September 20X7 on 20 October 20X7. At that date, Entity A's regulatory capital was below the capital requirement imposed by Regulator B by CU1 million. As a result, Entity A was required to submit a plan to the regulator indicating how it would increase its regulatory capital to the amount required. Entity A submitted a plan that entailed selling part of its unquoted equities portfolio with a carrying amount of CU11.5 million in the fourth quarter of 20X7. In the fourth quarter of 20X7, Entity A sold its fixed interest investment portfolio for CU12.6 million and met its regulatory capital requirement.

Contents

Hong Kong Accounting Standard 2

Inventories

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. In HKAS 14 *Segment Reporting*, paragraph 22 is amended to read as follows:~~

> ~~22. Some guidance for cost allocation can be found in other Standards. For example, paragraphs 11-20 of HKAS 2 *Inventories* provide guidance on attributing and allocating costs to inventories, and paragraphs 16-21 of HKAS 11 *Construction Contracts* provide guidance on attributing and allocating costs to contracts. That guidance may be useful in attributing or allocating costs to segments.~~

~~A2. In HKAS 34 *Interim Financial Reporting*, paragraphs 25 and 27 of Appendix B and paragraph 1 of Appendix C are amended to read as follows:~~

> ~~**Appendix B**~~
>
> ~~Inventories~~
>
> ~~25. Inventories are measured for interim financial reporting by the same principles as at financial year-end. HKAS 2 *Inventories* establishes standards for recognising and measuring inventories. Inventories pose particular problems at any financial reporting date because of the need to determine inventory quantities, costs, and net realisable values. Nonetheless, the same measurement principles are applied for interim inventories. To save cost and time, entities often use estimates to measure inventories at interim dates to a greater extent than at annual reporting dates. Following are examples of how to apply the net realisable value test at an interim date and how to treat manufacturing variances at interim dates.~~
>
> ~~27. [Deleted]~~
>
> ~~**Appendix C**~~
>
> ~~1. **Inventories**: Full stock-taking and valuation procedures may not be required for inventories at interim dates, although it may be done at financial year-end. It may be sufficient to make estimates at interim dates based on sales margins.~~

~~A3. [Not used]~~

~~A4. [Not used]~~

Appendix

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 26 and 29 are amended as follows:

26 For example, inventories used in one ~~business~~ operating segment may have a use to the entity different from the same type of inventories used in another ~~business~~ operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

29 Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular ~~industry or geographical~~ operating segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

Contents

Hong Kong Accounting Standard 7

Cash Flow Statements

Hong Kong Accounting Standard 7 *Cash Flow Statements* (HKAS 7) is set out in paragraphs 1-53. All the paragraphs have equal authority. HKAS 7 should be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix C

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.

HKFRS 8 Operating Segments (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 50 is amended as follows:

50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:

...

(d) the amount of the cash flows arising from the operating, investing and financing activities of each ~~reported industry and geographical~~ reportable segment (see ~~HKAS 14 Segment Reporting~~ HKFRS 8 Operating Segments).

HKAS 23 Borrowing Costs (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 32 is amended as follows:

32 The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with ~~the allowed alternative treatment in~~ HKAS 23 *Borrowing Costs*.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

The title is amended to '*Statement of Cash Flows*'.

The title (as amended) above the Objective is footnoted as follows: 'As a consequence of the revision of HKAS 1 *Presentation of Financial Statements* in December 2007, the title of HKAS 7 was amended from Cash Flow Statements to Statement of Cash Flows.'

In paragraph 32, 'the income statement' is amended to 'profit or loss'.

Appendix A accompanying HKAS 7 is amended as described below:

The table heading '**Consolidated income statement for the period ended 20X2**' is amended to '**Consolidated statement of comprehensive income for the period ended 20X2**' and footnoted as follows: 'The entity did not recognise any components of other comprehensive income in the period ended 20X2'.

In note C (**Cash and cash equivalents**), 'balance sheet amounts' is amended to 'amounts in the statement of financial position'.

APPENDIX:

Comparison with International Accounting Standards

Amendments to Other Pronouncements

Amendments resulting from other HKFRSs

BASIS FOR CONCLUSIONS

Amendments resulting from other Basis for Conclusions

IMPLEMENTATION GUIDANCE

Amendments resulting from other Implementation Guidance

TABLE OF CONCORDANCE

Hong Kong Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (HKAS 8) is set out in paragraphs 1-56 and the Appendix. All the paragraphs have equal authority. HKAS 8 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements.*

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. HKAS 7 *Cash Flow Statements* is amended as follows:~~

~~Paragraphs 29 and 30 on extraordinary items are deleted.~~

~~Appendix A, which illustrates a cash flow statement for an entity other than a financial institution, is amended to remove an extraordinary item. The revised Appendix is set out below.~~

~~**Appendix A**~~

~~**Cash Flow Statement for an Entity other than a Financial Institution**~~

~~*This appendix accompanies, but is not part of, the Standard.*~~

1. ~~The examples show only current period amounts. Corresponding amounts for the preceding period are required to be presented in accordance with HKAS 1 *Presentation of Financial Statements.*~~

2. ~~Information from the income statement and balance sheet is provided to show how the statements of cash flows under the direct method and indirect method have been derived. Neither the income statement nor the balance sheet is presented in conformity with the disclosure and presentation requirements of other Standards.~~

3. ~~The following additional information is also relevant for the preparation of the statements of cash flows:~~

   - ~~all of the shares of a subsidiary were acquired for 590. The fair values of assets acquired and liabilities assumed were as follows:~~

~~Inventories~~	~~100~~
~~Accounts receivable~~	~~100~~
~~Cash~~	~~40~~
~~Property, plant and equipment~~	~~650~~
~~Trade payables~~	~~100~~

~~Long-term debt~~	~~200~~

- ~~250 was raised from the issue of share capital and a further 250 was raised from long-term borrowings.~~
- ~~interest expense was 400, of which 170 was paid during the period. Also, 100 relating to interest expense of the prior period was paid during the period.~~
- ~~dividends paid were 1,200.~~
- ~~the liability for tax at the beginning and end of the period was 1,000 and 400 respectively. During the period, a further 200 tax was provided for. Withholding tax on dividends received amounted to 100.~~
- ~~during the period, the group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.~~
- ~~plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.~~
- ~~accounts receivable as at the end of 20-2 include 100 of interest receivable.~~

~~Consolidated Income Statement for the period ended 20-2~~

~~Sales~~	~~30,650~~
~~Cost of sales~~	~~(26,000)~~
~~Gross profit~~	~~4,650~~
~~Depreciation~~	~~(450)~~
~~Administrative and selling expenses~~	~~(910)~~
~~Interest expense~~	~~(400)~~
~~Investment income~~	~~500~~
~~Foreign exchange loss~~	~~(40)~~
~~Profit before taxation~~	~~3,350~~
~~Taxes on income~~	~~(300)~~
~~Profit~~	~~3,050~~

~~Consolidated Balance Sheet as at the end of 20-2~~

		~~20-2~~		**~~20-1~~**
~~Assets~~				
~~Cash and cash equivalents~~		~~230~~		~~160~~
~~Accounts receivable~~		~~1,900~~		~~1,200~~
~~Inventory~~		~~1,000~~		~~1,950~~
~~Portfolio investments~~		~~2,500~~		~~2,500~~
~~Property, plant and equipment at cost~~	~~3,730~~		~~1,910~~	
~~Accumulated depreciation~~	~~(1,450)~~		~~(1,060)~~	
~~Property, plant and equipment net~~		~~2,280~~		~~850~~
~~Total assets~~		~~7,910~~		~~6,660~~
~~Liabilities~~				
~~Trade payables~~		~~250~~		~~1,890~~
~~Interest payable~~		~~230~~		~~100~~
~~Income taxes payable~~		~~400~~		~~1,000~~
~~Long-term debt~~		~~2,300~~		~~1,040~~
~~Total liabilities~~		~~3,180~~		~~4,030~~
~~Shareholders' Equity~~				
~~Share capital~~		~~1,500~~		~~1,250~~
~~Retained earnings~~		~~3,230~~		~~1,380~~
~~Total shareholders' equity~~		~~4,730~~		~~2,630~~
~~Total liabilities and shareholders' equity~~		~~7,910~~		~~6,660~~

~~Direct Method Cash Flow Statement (paragraph 18a)~~

		~~20-2~~
~~Cash flows from operating activities~~		
~~Cash receipts from customers~~	~~30,150~~	
~~Cash paid to suppliers and employees~~	~~(27,600)~~	
~~Cash generated from operations~~	~~2,550~~	
~~Interest paid~~	~~(270)~~	
~~Income taxes paid~~	~~(900)~~	
~~Net cash from operating activities~~		~~1,380~~
~~Cash flows from investing activities~~		
~~Acquisition of subsidiary X, net of cash acquired (Note A)~~	~~(550)~~	
~~Purchase of property, plant and equipment (Note B)~~	~~(350)~~	
~~Proceeds from sale of equipment~~	~~20~~	
~~Interest received~~	~~200~~	
~~Dividends received~~	~~200~~	
~~Net cash used in investing activities~~		~~(480)~~
~~Cash flows from financing activities~~		
~~Proceeds from issue of share capital~~	~~250~~	
~~Proceeds from long-term borrowings~~	~~250~~	
~~Payment of finance lease liabilities~~	~~(90)~~	
~~Dividends paid*~~	~~(1,200)~~	
~~Net cash used in financing activities~~		~~(790)~~
~~Net increase in cash and cash equivalents~~		~~110~~
~~Cash and cash equivalents at beginning of period (Note C)~~		~~120~~
~~Cash and cash equivalents at end of period (Note C)~~		~~230~~

~~*This could also be shown as an operating cash flow.~~

~~Indirect Method Cash Flow Statement (paragraph 18b)~~

		~~20-2~~
~~Cash flows from operating activities~~		
~~Profit before taxation~~	~~3,350~~	
~~Adjustments for:~~		
~~Depreciation~~	~~450~~	
~~Foreign exchange loss~~	~~40~~	
~~Investment income~~	~~(500)~~	
~~Interest expense~~	~~400~~	
	~~3,740~~	
~~Increase in trade and other receivables~~	~~(500)~~	
~~Decrease in inventories~~	~~1,050~~	
~~Decrease in trade payables~~	~~(1,740)~~	
~~Cash generated from operations~~	~~2,550~~	
~~Interest paid~~	~~(270)~~	
~~Income taxes paid~~	~~(900)~~	
~~Net cash from operating activities~~		~~1,380~~
~~Cash flows from investing activities~~		
~~Acquisition of subsidiary X net of cash acquired (Note A)~~	~~(550)~~	
~~Purchase of property, plant and equipment (Note B)~~	~~(350)~~	
~~Proceeds from sale of equipment~~	~~20~~	
~~Interest received~~	~~200~~	
~~Dividends received~~	~~200~~	
~~Net cash used in investing activities~~		~~(480)~~
~~Cash flows from financing activities~~		
~~Proceeds from issue of share capital~~	~~250~~	
~~Proceeds from long-term borrowings~~	~~250~~	
~~Payment of finance lease liabilities~~	~~(90)~~	
~~Dividends paid*~~	~~(1,200)~~	
~~Net cash used in financing activities~~		~~(790)~~
~~Net increase in cash and cash equivalents~~		~~110~~
~~Cash and cash equivalents at beginning of period (Note C)~~		~~120~~
~~Cash and cash equivalents at end of period (Note C)~~		~~230~~

~~*This could also be shown as an operating cash flow.~~

~~**Notes to the Cash Flow Statement**~~
~~**(direct method and indirect method)**~~

~~**A. Acquisition of Subsidiary**~~

~~During the period the group acquired subsidiary X. The fair value of assets acquired and liabilities assumed were as follows:~~

~~Cash~~	~~40~~
~~Inventories~~	~~100~~
~~Accounts receivable~~	~~100~~
~~Property, plant and equipment~~	~~650~~
~~Trade payables~~	~~(100)~~
~~Long-term debt~~	~~(200)~~
~~Total purchase price~~	~~590~~
~~Less: Cash of X~~	~~(40)~~
~~Cash flow on acquisition net of cash acquired~~	~~(550)~~

~~**B. Property, Plant and Equipment**~~

~~During the period, the Group acquired property, plant and equipment with an aggregate cost of 1,250 of which 900 was acquired by means of finance leases. Cash payments of 350 were made to purchase property, plant and equipment.~~

~~**C. Cash and Cash Equivalents**~~

~~Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts:~~

	~~**20-2**~~	~~**20-1**~~
~~Cash on hand and balances with banks~~	~~40~~	~~25~~
~~Short-term investments~~	~~190~~	~~135~~
~~Cash and cash equivalents as previously reported~~	~~230~~	~~160~~
~~Effect of exchange rate changes~~	~~-~~	~~(40)~~
~~Cash and cash equivalents as restated~~	~~230~~	~~120~~

~~Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a subsidiary that are not freely remissible to the holding company because of currency exchange restrictions.~~

~~The Group has undrawn borrowing facilities of 2,000, of which 700 may be used only for future expansion.~~

~~**D. Segment Information**~~

	~~Segment A~~	~~Segment B~~	~~Total~~
~~Cash flows from:~~			
~~Operating activities~~	~~1,520~~	~~(140)~~	~~1,380~~
~~Investing activities~~	~~(640)~~	~~160~~	~~(480)~~
~~Financing activities~~	~~(570)~~	~~(220)~~	~~(790)~~
	~~310~~	~~(200)~~	~~110~~

~~**Alternative Presentation (indirect method)**~~

~~As an alternative, in an indirect method cash flow statement, operating profit before working capital changes is sometimes presented as follows:~~

~~Revenues excluding investment income~~	~~30,650~~	
~~Operating expense excluding depreciation~~	~~(26,910)~~	
~~Operating profit before working capital changes~~		~~3,740~~

~~A2. HKAS 12 *Income Taxes* is amended as described below.~~

~~Paragraph 62(b) is amended to read as follows:~~

~~(b) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error (see HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).~~

~~Paragraph 80(h) is amended to read as follows:~~

~~(h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with HKAS 8, because they cannot be accounted for retrospectively.~~

~~Paragraphs 81(b) and 83 are deleted.~~

~~A3. HKAS 14 *Segment Reporting* is amended as described below.~~

~~The definition of accounting policies in paragraph 8 is amended to read as follows:~~

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

~~Paragraph 60 is amended to read as follows:~~

~~60. HKAS 1 requires that when items of income and expense are material, their nature and amount shall be disclosed separately. HKAS 1 offers a number of examples, including write-downs of inventories and property, plant, and equipment, provisions for restructurings, disposals of property, plant, and equipment and long-term investments, discontinuing operations, litigation settlements, and reversals of provisions. Paragraph 59 is not intended to change the classification of any such items or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the entity level to the segment level.~~

~~Paragraphs 77 and 78 are amended to read as follows:~~

~~77. Changes in accounting policies applied by the entity are dealt with in HKAS 8. HKAS 8 requires that changes in accounting policy shall be made only if required by a Standard or Interpretation, or if the change will result in reliable and more relevant information about transactions, other events or conditions in the financial statements of the entity.~~

~~78. Changes in accounting policies applied at the entity level that affect segment information are dealt with in accordance with HKAS 8. Unless a new Standard or Interpretation specifies otherwise, HKAS 8 requires that:~~

~~(a) a change in accounting policy shall be applied retrospectively and prior period information restated unless it is impracticable to determine either the cumulative effect or the period-specific effects of the change;~~

~~(b) if retrospective application is not practicable for all periods presented, the new accounting policy shall be applied retrospectively from the earliest practicable date; and~~

~~(c) if it is impracticable to determine the cumulative effect of applying the new accounting policy at the start of the current period, the policy shall be applied prospectively from the earliest date practicable.~~

~~The following changes are made to remove references to extraordinary items:~~

~~(a) in paragraph 16, in the definition of segment revenue, subparagraph (a) is deleted.~~

~~(b) in paragraph 16, in the definition of segment expense, subparagraph (a) is deleted.~~

~~(c) in Appendix B, Schedule A, the line items 'Profit from ordinary activities' and 'Extraordinary loss: uninsured earthquake damage to factory' are deleted, and 'Net profit' is amended to 'Profit'. The profit for 20x1 is amended from 14 to 17.~~

~~(d) in Appendix B, the final paragraph is deleted.~~

~~A4. HKAS 19 *Employee Benefits* is amended as described below.~~

~~Paragraph 131 is amended to read as follows:~~

~~131. Although this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures, for example, when the expense resulting from such benefits is material and so would require disclosure in accordance with HKAS 1 *Presentation of Financial Statements*. When required by HKAS 24 *Related Party Disclosures*, an entity discloses information about other long-term employee benefits for key management personnel.~~

~~Paragraph 142 is amended to read as follows:~~

~~142. As required by HKAS 1, an entity discloses the nature and amount of an expense if it is material. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.~~

~~Paragraph 160 is amended to read as follows:~~

~~160. HKAS 8 applies when an entity changes its accounting policies to reflect the changes specified in paragraphs 159 and 159A. In applying those changes retrospectively, as required by HKAS 8, the entity treats those changes as if they had been applied at the same time as the rest of this Standard.~~

~~A5. In HKAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraphs 20-22 are amended to read as follows:~~

~~***20. A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised as income of the period in which it becomes receivable.***~~

~~21. In some circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an entity rather than as an incentive to undertake specific expenditures. Such grants may be confined to an individual entity and may not be available to a whole class of beneficiaries. These circumstances may warrant recognising a grant as income in the period in which the entity qualifies to receive it, with disclosure to ensure that its~~

~~effect is clearly understood.~~

~~22. A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised as income of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood.~~

~~A6. In HKAS 22 *Business Combinations*, paragraph 100 is deleted.~~

~~A7. In HKAS 23 *Borrowing Costs*, paragraph 30 is amended to read as follows:~~

~~***30. When the adoption of this Standard constitutes a change in accounting policy, an entity is encouraged to adjust its financial statements in accordance with HKAS 8*** **Accounting Policies, Changes in Accounting Estimates and Errors*****. Alternatively, entities shall capitalise only those borrowing costs incurred after the effective date of the Standard that meet the criteria for capitalisation.***~~

~~A8. HKAS 34 *Interim Financial Reporting* is amended as described below.~~

~~Paragraph 17 is amended to read as follows:~~

~~17. Examples of the kinds of disclosures that are required by paragraph 16 are set out below. Individual Standards and Interpretations provide guidance regarding disclosures for many of these items:~~

~~(a) the write-down of inventories to net realisable value and the reversal of such a write-down;~~

~~(b) recognition of a loss from the impairment of property, plant and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;~~

~~(c) the reversal of any provisions for the costs of restructuring;~~

~~(d) acquisitions and disposals of items of property, plant and equipment;~~

~~(e) commitments for the purchase of property, plant and equipment;~~

~~(f) litigation settlements;~~

~~(g) corrections of prior period errors;~~

~~(h) [deleted];~~

~~(i) any loan default or breach of a loan agreement that has not been remedied on or before the balance sheet date; and~~

~~(j) related party transactions.~~

~~Paragraphs 24, 25 and 27 are amended to read as follows:~~

~~24. HKAS 1 *Presentation of Financial Statements* and HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* define an item as material if its omission or misstatement could~~

~~influence the economic decisions of users of the financial statements. HKAS 1 requires separate disclosure of material items, including (for example) discontinuing operations, and HKAS 8 requires disclosure of changes in accounting estimates, errors and changes in accounting policies. The two Standards do not contain quantified guidance as to materiality.~~

~~25. While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.~~

~~27. HKAS 8 requires disclosure of the nature and (if practicable) the amount of a change in estimate that either has a material effect in the current period or is expected to have a material effect in subsequent periods. Paragraph 16(d) of this Standard requires similar disclosure in an interim financial report. Examples include changes in estimate in the final interim period relating to inventory write-downs, restructurings, or impairment losses that were reported in an earlier interim period of the financial year. The disclosure required by the preceding paragraph is consistent with the HKAS 8 requirement and is intended to be narrow in scope—relating only to the change in estimate. An entity is not required to include additional interim period financial information in its annual financial statements.~~

~~Paragraphs 43 and 44 are amended to read as follows:~~

~~***43. A change in accounting policy, other than one for which the transition is specified by a new Standard or Interpretation, shall be reflected by:***~~

~~***(a) restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with HKAS 8; or***~~

~~***(b) when it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years to apply the new accounting policy prospectively from the earliest date practicable.***~~

~~44. One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. Under HKAS 8, a change in accounting policy is reflected by retrospective application, with~~

~~restatement of prior period financial data as far back as is practicable. However, if the cumulative amount of the adjustment relating to prior financial years is impracticable to determine, then under HKAS 8 the new policy is applied prospectively from the earliest date practicable. The effect of the principle in paragraph 43 is to require that within the current financial year any change in accounting policy is applied either retrospectively or, if that is not practicable, prospectively, from no later than the beginning of the financial year.~~

~~A9. In HKAS 35 *Discontinuing Operations*, paragraphs 41, 42 and 50 are deleted.~~

~~A10. In HKAS 36 *Impairment of Assets*, paragraphs 120 and 121 are deleted.~~

~~A11. In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 94 is deleted.~~

~~A12. In HKAS 38 *Intangible Assets*, paragraph 120 is deleted.~~

~~A13. [Not used]~~

~~A14. [Not used]~~

~~A15. In HKAS-Int-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*, the effective date paragraph is amended to read as follows:~~

~~**Effective Date:** This consensus becomes effective on 1 January 2003. Changes in accounting policies shall be accounted for in accordance with HKAS 8.~~

~~A16. In HKAS-Int-22 *Business Combinations—Subsequent Adjustment of Fair Values and Goodwill Initially Reported*, paragraph 11 of the Basis for Conclusions should be read as follows:~~

~~[The original text has been marked up to reflect the revision of HKAS 8 in 2003: new text is underlined and deleted text is struck through.]~~

~~11. HKAS 22.93 requires disclosure if the fair values of identifiable assets and liabilities can only be determined on a provisional basis. This implies that in such circumstances, the entity enterprise is aware that reliable estimates cannot yet be made and therefore the adjustment is not accounted for as a change in estimate in accordance with addressed in paragraphs .23 through .30 of HKAS 8.~~

~~A17. In HKAS-Int-25 *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders*, the effective date paragraph is amended to read as follows:~~

~~**Effective Date:** This consensus becomes effective on 15 July 2000. Changes in accounting policies shall be accounted for in accordance with HKAS 8.~~

~~A18. In HKAS-Int-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*, the effective date paragraph is amended to read as follows:~~

~~**Effective Date**: This Interpretation becomes effective on 29 June 2001. Changes in accounting policies shall be accounted for in accordance with HKAS 8.~~

~~A19. In HKAS-Int-31 *Revenue – Barter Transactions Involving Advertising Services*, the effective date paragraph is amended to read as follows:~~

~~**Effective Date**: This Interpretation becomes effective on 25 June 2002. Changes in accounting policies shall be accounted for in accordance with HKAS 8.~~

~~A20. In HKFRS 1 *First-time Adoption of International Financial Reporting Standards*, the definition of Hong Kong Financial Reporting Standards in Appendix A is amended to read as follows:~~

~~**Hong Kong Financial Reporting Standards (HKFRSs)**~~

~~Standards and Interpretations issued by the Hong Kong Society of Accountants (HKSA). They comprise:~~

~~(a) Hong Kong Financial Reporting Standards;~~

~~(b) Hong Kong Accounting Standards (HKASs); and~~

~~(c) Interpretations~~

~~A21. The rubric of HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended to read as follows:~~

~~Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1-47 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 Standard. 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 *Framework for 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.~~

~~A22. The rubrics of all other Hong Kong Accounting Standards are replaced by a new rubric in the following form:~~

~~Hong Kong Accounting Standard X *Title in Words* (HKAS X) is set out in paragraphs 1-000 [and Appendices A-C]*. All the paragraphs have equal authority. HKAS X should be read in the context of [its objective and the Basis for Conclusions,]† the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.~~

~~* used only for those appendices that are part of the Standard.~~
~~† used only where the Standard contains an objective or is accompanied by a Basis for Conclusions.~~

~~A23. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003, references to the current version of SSAP 2 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* are amended to HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*~~

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 5 is amended as follows:

- in the definition of ***Material***, '**of users taken**' is amended to '**that users make**'.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

In paragraph BC29, 'a Standard or an Interpretation' is amended to 'an IFRS'.

In paragraphs BC29 and BC30, 'Standard or Interpretation' is amended to 'IFRS'.

In paragraphs BC14, BC17, BC24 and the heading above paragraph BC30, 'Standards and Interpretations' is amended to 'IFRSs'.

Paragraphs BC20 and BC22 are amended as follows:

> BC20 The Standard … includes a definition of material omissions or misstatements, which is based on the description of materiality in ~~the previous version of~~ IAS 1 *Presentation of Financial Statements* (<u>as issued in 1997</u>) and in the *Framework*.
>
> BC22 The application of the concept of materiality is set out in two Standards. ~~The revised~~ IAS 1 ~~*Presentation of Financial Statements*~~ <u>(as revised in 2007)</u> continues to specify its application to disclosures. IAS 8 …

In paragraph BC24, the last sentence is footnoted as follows:

> In 2006 the IASB issued IFRS 8 *Operating Segments*. As explained in paragraphs BC46 and BC47 of the Basis for Conclusions on IFRS 8, that IFRS includes an exemption from some requirements if the necessary information is not available and the cost to develop it would be excessive.

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 23 Revised *Borrowing Costs* (issued in June 2007) – effective for annual periods beginning on or after 1 January 2009

In the Guidance on Implementing HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, Example 2 is deleted.

Contents

Hong Kong Accounting Standard 10

Events after the Balance Sheet Date

20. In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the balance sheet date, even when the information does not affect the amounts that it recognises in its financial statements. One example of the need to update disclosures is when evidence becomes available after the balance sheet date about a contingent liability that existed at the balance sheet date. In addition to considering whether it should recognise or change a provision under HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity updates its disclosures about the contingent liability in the light of that evidence.

Non-adjusting Events after the Balance Sheet Date

21. If non-adjusting events after the balance sheet date are material, non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the balance sheet date:

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

22. The following are examples of non-adjusting events after the balance sheet date that would generally result in disclosure:

(a) a major business combination after the balance sheet date (HKAS 22 *Business Combinations* requires specific disclosures in such cases) or disposing of a major subsidiary;

(b) announcing a plan to discontinue an operation. ~~disposing of assets or settling liabilities attributable to a discontinuing operation or entering into binding agreements to sell such assets or settle such liabilities (see HKAS 35 *Discontinuing Operations*);~~

(c) ~~major purchases and disposals of assets, or expropriation of major assets by government;~~ major purchases of assets, classification of assets as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, other disposals of assets, or expropriation of major assets by government.

(d) the destruction of a major production plant by a fire after the balance sheet date;

(e) announcing, or commencing the implementation of, a major restructuring (see HKAS 37);

(f) major ordinary share transactions and potential ordinary share transactions after the balance sheet date (HKAS 33 *Earnings per Share* requires an entity to disclose a description of such transactions, other than when such transactions involve capitalisation or bonus issues, share splits or reverse share splits all of which are required to be adjusted under HKAS 33);

(g) abnormally large changes after the balance sheet date in asset prices or foreign exchange rates;

(h) changes in tax rates or tax laws enacted or announced after the balance sheet date that have a significant effect on current and deferred tax assets and liabilities (see HKAS 12 *Income Taxes*);

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied e for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. In HKAS 22 *Business Combinations*, paragraph 97 is amended to read as follows:~~

> ~~97. Business combinations effected after the balance sheet date and before the date on which the financial statements of one of the combining entities are authorised for issue are disclosed if they are material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements (see HKAS 10 *Events after the Balance Sheet Date*).~~

~~A2. In HKAS 35 *Discontinuing Operations*, paragraph 32 is amended to read as follows:~~

> ~~32. The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period. In accordance with HKAS 10 *Events after the Balance Sheet Date*, if some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into after the balance sheet date but before the board approves the financial statements for issue, the financial statements include the disclosures required by paragraph 31 if the effects are material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements.~~

~~A3. In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 75 are amended to read as follows and paragraph 96 is deleted:~~

> ~~75. A management or board decision to restructure taken before the balance sheet date does not give rise to a constructive obligation at the balance sheet date unless the entity has, before the balance sheet date:~~
>
> ~~(a) started to implement the restructuring plan; or~~
>
> ~~(b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.~~

~~If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the balance sheet date, disclosure is required under HKAS 10 *Events after the Balance Sheet Date*, if the restructuring is material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements.~~

~~96. [Deleted]~~

~~A4. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations in issue at December 2003, references to the current version of SSAP 9 *Events After the Balance Sheet Date* are amended to HKAS 10 *Events after the Balance Sheet Date.*~~

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

The title is amended to '*Events after the Reporting Period*'.

The title (as amended) above the Objective is footnoted as follows:

> 'As a consequence of the revision of HKAS 1 Presentation of Financial Statements in December 2007, the title of HKAS 10 was amended from Events after the Balance Sheet Date to Events after the Reporting Period'

In paragraph 21, 'of users taken' is amended to 'that users make'.

Appendix
Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The title is amended to **'Basis for Conclusions on IAS 10 *Events after the Reporting Period*'** and footnoted as follows:

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

Paragraph BC4 is footnoted as follows:

> BC4 For this limited clarification of IAS 10 the main change made is in paragraphs 12 and 13 (paragraphs 11 and 12 of the previous version of IAS 10). As revised, those paragraphs state that if dividends are declared after the balance sheet date,* an entity shall not recognise those dividends as a liability at the balance sheet date. …

> * IAS 1 *Presentation of Financial Statements* (as revised in 2007) replaced the term 'balance sheet date' with 'end of the reporting period'.

Contents

Hong Kong Accounting Standard 11

Construction Contracts

Hong Kong Accounting Standard 11 *Construction Contracts* (HKAS 11) is set out in paragraphs 1-46. All the paragraphs have equal authority. HKAS 11 shall be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix

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.

HKAS 23 *Borrowing Costs* (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

The last sentence of paragraph 18 is amended as follows:

18 Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs ~~when the contractor adopts the allowed alternative treatment in HKAS 23 Borrowing Costs~~.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 26, 28 and 38, 'the income statement' is amended to 'profit or loss'.

D. Amendments resulting from other HKFRSs

E. Amendments resulting from other Implementation Guidance

Hong Kong Accounting Standard 12 *Income Taxes* (HKAS 12) is set out in paragraphs 1-91. All the paragraphs have equal authority. HKAS 12 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix 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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as follows:

> Hong Kong Accounting Standard 12 *Income Taxes* (HKAS 12) is set out in paragraphs ~~1–91~~ <u>1–92</u>. All the paragraphs …

The third paragraph of the '**Objective**' in HKAS 12 is amended as follows:

> '… For transactions and other events recognised <u>outside profit or loss (either in other comprehensive income or</u> directly in equity<u>)</u>, any related tax effects are also recognised <u>outside profit or loss (either in other comprehensive income or</u> directly in equity<u>, respectively</u>).

In paragraphs 22(b), 59, 60 and 65, 'the income statement' is amended to 'profit or loss', and in paragraph 81(g)(ii) '**the income statement**' is amended to '**profit or loss**'.

Paragraph 23 is amended as follows:

> 23 … In accordance with paragraph 61<u>A</u>, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in <u>profit or loss</u> ~~the income statement~~ as deferred tax expense (income).

In paragraph 52, in the notes at the end of Example B and Example C, '*paragraph 61'* is amended to '*paragraph 61A*' and '*charged directly to equity*' is amended to '*recognised in other comprehensive income*'.

The heading above paragraph 58 and paragraph 58 are amended as follows:

~~Income statement~~ <u>Items recognised in profit or loss</u>

> **58 Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:**
>
> **(a) a transaction or event which is recognised, in the same or a different period, <u>outside profit or loss, either in other comprehensive income or</u> directly in equity (see paragraphs 61<u>A</u> to 65); …**

In paragraph 60, 'charged or credited to equity' is amended to 'recognised outside profit or loss'.

In the heading above paragraph 61, '**credited or charged directly to equity**' is amended to '**recognised outside profit or loss**'.

Paragraph 61 is deleted and paragraph 61A is added as follows:

> **61A Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:**

(a) **in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).**

(b) **directly in equity, shall be recognised directly in equity (see paragraph 62A).**

Paragraphs 62 and 63 are amended and paragraph 62A is added as follows:

62 Hong Kong Financial Reporting Standards require or permit ~~certain~~ particular items to be ~~credited or charged directly to equity~~ recognised in other comprehensive income. Examples of such items are:

(a) a change in carrying amount arising from the revaluation of property, plant and equipment (see HKAS 16); and

(b) [deleted] ~~an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error (see HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*);~~

(c) exchange differences arising on the translation of the financial statements of a foreign operation (see HKAS 21)~~; and~~.

(d) [deleted] ~~amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 23).~~

62A Hong Kong Financial Reporting Standards require or permit particular items to be credited or charged directly to equity. Examples of such items are:

(a) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error (see HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*); and

(b) amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 23).

63 In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items ~~credited or charged to equity~~ recognised outside profit or loss (either in other comprehensive income or directly in equity). This may be the case, for example, when:

(a) …

(b) a change in the tax rate … to an item that was previously recognised outside profit or loss ~~charged or credited to equity~~; or

(c) an entity … and the deferred tax asset relates (in whole or in part) to an item that was previously recognised outside profit or loss ~~charged or credited to equity~~.

In such cases, the current and deferred tax related to items that are recognised outside profit or loss are ~~credited or charged to equity is~~ based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

In paragraph 65, 'credited or charged to equity' is amended to 'recognised in other comprehensive income'.

Paragraph 68C is amended as follows:

68C As noted … (a) a transaction or event ~~which~~ that is recognised, in the same or a different period, ~~directly in equity~~ outside profit or loss, or (b) a business combination. …

Paragraph 77 is amended and paragraph 77A is added as follows:

77 The tax expense (income) related to profit or loss from ordinary activities shall be presented in ~~on the face of~~ the ~~income~~ statement of comprehensive income.

77A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007), it presents the tax expense (income) related to profit or loss from ordinary activities in that separate statement.

Paragraph 81 is amended as follows:

81 The following shall also be disclosed separately:

(a) the aggregate current and deferred tax relating to items that are charged or credited directly to equity (see paragraph 62A);

(ab) the amount of income tax relating to each component of other comprehensive income (see paragraph 62 and HKAS 1 (as revised in 2007));

(b) [deleted]; ...

Paragraph 92 is added as follows:

92 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 23, 52, 58, 60, 62, 63, 65, 68C, 77 and 81, deleted paragraph 61 and added paragraphs 61A, 62A and 77A. 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.

Appendix E

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Appendix A accompanying HKAS 12 is amended as described below.

In the headings above paragraph 1 of Section A and above paragraph 1 of Section B, '**the income statement**' is amended to '**profit or loss**'.

In paragraph 11 of Section A, '*paragraph 61*' is amended to '*paragraph 61*A' and '*charged directly to equity*' is amended to '*recognised in other comprehensive income*'.

Paragraph 18 of Section A is amended as follows:

18 Non-monetary assets … (*notes: (1) the deferred tax is ~~charged in the income statement~~ <u>recognised in profit or loss;</u> and (2) if, in addition to the restatement, the non-monetary assets are also revalued, the deferred tax relating to the revaluation is ~~charged to equity~~ <u>recognised in other comprehensive income</u> and the deferred tax relating to the restatement is ~~charged~~ <u>recognised</u> in ~~the income statement~~ <u>profit or loss</u>*).

Appendix B accompanying HKAS 12 is amended as described below.

In the rubric below the heading, '*income statements and balance sheets*' is replaced by '*statements of financial position and statements of comprehensive income*'.

In the last paragraph and table in Example 1, 'income statement is as follows' is amended to 'statement of comprehensive income includes the following' and 'Net profit for the period' is amended to 'Profit for the period'.

In the section of Example 2 headed **Illustrative disclosure**, the heading '**Aggregate current and deferred tax relating to items charged or credited to equity (paragraph 81(a))**' is amended to '**Income tax relating to the components of other comprehensive income (paragraph 81(ab))**'.

At the end of Example 2, 'the income statement' is amended to 'profit or loss' (twice).

The last paragraph of Example 3 is amended as follows:

If A expects … A ~~credits or charges~~ <u>recognises</u> the deferred tax <u>in other comprehensive income</u> ~~to equity~~ to the extent that the deferred tax results from foreign exchange translation differences <u>that</u> ~~which~~ have been <u>recognised in other comprehensive income</u> ~~charged or credited directly to equity~~ (paragraph 61<u>A</u> of the Standard). A discloses separately:

(a) the amount of deferred tax <u>that</u> ~~which~~ has been <u>recognised in other comprehensive income</u> ~~charged or credited directly to equity~~ (paragraph 81(a<u>b</u>) of the Standard); and …

The last paragraph of Example 4 is amended as follows:

Subsequent changes in the deferred tax liability are recognised in ~~the income statement~~ <u>profit or loss</u> as tax income (see paragraph 23 of the Standard). Therefore, the entity's ~~income statement is as follows~~ <u>profit or loss includes the following</u>:

Contents

Hong Kong Accounting Standard 14 *Segment Reporting* (HKAS 14) is set out in paragraphs 1-84A. All the paragraphs have equal authority. HKAS 14 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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. HKAS 14 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2009. HKFRS 8 issued in March 2007 is applicable for annual periods beginning on or after 1 January 2009 and supersedes HKAS 14.

Identifying Reportable Segments

Primary and Secondary Segment Reporting Formats

26. The dominant source and nature of an entity's risks and returns shall govern whether its primary segment reporting format will be business segments or geographical segments. If the entity's risks and rates of return are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information shall be business segments, with secondary information reported geographically. Similarly, if the entity's risks and rates of return are affected predominantly by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information shall be geographical segments, with secondary information reported for groups of related products and services.

27. An entity's internal organisational and management structure and its system of internal financial reporting to key management personnel (for example, *[*]* ***the board of directors and the chief executive officer)*** *[*]* ***shall normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the entity and, therefore, for determining which reporting format is primary and which is secondary, except as provided in subparagraphs (a) and (b) below:***

(a) if an entity's risks and rates of return are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a "matrix approach" to managing the company and to reporting internally to ~~the board of directors and the chief executive officer~~ key management personnel *[*]****, then the entity shall use business segments as its primary segment reporting format and geographical segments as its secondary reporting format; and***

(b) if an entity's internal organisational and management structure and its system of internal financial reporting to ~~the board of directors and the chief executive officer~~ key management personnel *[*]* ***are based neither on individual products or services or on groups of related products/services nor on geography, ~~the directors and management~~ key management personnel*** *[*]* ***of the entity shall determine whether the entity's risks and returns are related more to the products and services it produces or more to the geographical areas in which it operates and, as a consequence, shall choose either business segments or geographical segments as the entity's primary segment reporting format, with the other as its secondary reporting format.***

28. For most entities, the predominant source of risks and returns determines how the entity is organised and managed. An entity's organisational and management structure and its internal financial reporting system normally provide the best evidence of the entity's predominant source of risks and returns for purpose of its segment reporting. Therefore, except in rare circumstances, an entity will report segment information in its financial statements on the same basis as it reports internally to key management personnel ~~top management~~[*]. Its predominant source of risks and returns becomes its primary segment reporting format. Its secondary source of risks and returns becomes its secondary segment reporting format.

29. A "matrix presentation" — both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis --- often will provide useful information if an entity's risks and rates of return are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. This Standard does not require, but does not prohibit, a "matrix presentation".

30. In some cases, an entity's organisation and internal reporting may have developed along lines unrelated either to differences in the types of products and services they produce or to the geographical areas in which they operate. For instance, internal reporting may be organised solely by legal entity, resulting in internal segments composed of groups of unrelated products and services. In those unusual cases, the internally reported segment data will not meet the objective of this Standard. Accordingly, paragraph 27(b) requires ~~the directors and management~~key management personnel[*] of the entity to determine whether the entity's risks and returns are more product/service driven or geographically driven and to choose either

[*] Effective for annual periods beginning on or after 1 January 2007.

business segments or geographical segments as the entity's primary basis of segment reporting. The objective is to achieve a reasonable degree of comparability with other entities, enhance understandability of the resulting information, and meet the expressed needs of investors, creditors, and others for information about product/service-related and geographically-related risks and returns.

Business and Geographical Segments

31. An entity's business and geographical segments for external reporting purposes shall be those organisational units for which information is reported to ~~the board of directors and to the chief executive officer~~ key management personnel[*] for the purpose of evaluating the unit's past performance and for making decisions about future allocations of resources, except as provided in paragraph 32.

32. If an entity's internal organisational and management structure and its system of internal financial reporting to ~~the board of directors and the chief executive officer~~ key management personnel[*] are based neither on individual products or services or on groups of related products/services nor on geography, paragraph 27(b) requires that the directors and management of the entity shall choose either business segments or geographical segments as the entity's primary segment reporting format based on their assessment of which reflects the primary source of the entity's risks and returns, with the other its secondary reporting format. In that case, ~~the directors and management~~ key management personnel[*] of the entity must determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions in paragraph 9 of this Standard, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:

(a) if one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions in paragraph 9 but others are not, subparagraph (b) below shall be applied only to those internal segments that do not meet the definitions in paragraph 9 (that is, an internally reported segment that meets the definition shall not be further segmented);

(b) for those segments reported internally to the directors and management that do not satisfy the definitions in paragraph 9, management of the entity shall look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions in paragraph 9; and

(c) if such an internally reported lower-level segment meets the definition of business segment or geographical segment based on the factors in paragraph 9, the criteria in paragraphs 34 and 35 for identifying reportable segments shall be applied to that segment.

33. Under this Standard, most entities will identify their business and geographical segments as the organisational units for which information is reported to key management personnel ~~the board of directors (particularly the supervisory non-management directors, if any) and to the chief executive officer (~~, or[*] the senior operating decision maker, which in some cases may be a group of ~~several~~[*] people, ~~)~~[*] for the purpose of evaluating each unit's past performance and for making decisions about future allocations of resources. And even if an entity must apply paragraph 32 because its internal segments are not along product/service or geographical lines, it will look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines rather than construct segments solely for external reporting purposes. This approach of looking to an entity's organisational and management structure and its internal financial reporting system to identify the entity's business and geographical segments for external reporting purposes is sometimes called the "management approach", and the organisational components for which information is reported internally are sometimes called "operating segments".

Reportable Segments

34. Two or more internally reported business segments or geographical segments that are substantially similar may be combined as a single business segment or geographical segment. Two or more business segments or geographical segments are substantially similar only if:

(a) they exhibit similar long-term financial performance; and

[*] Effective for annual periods beginning on or after 1 January 2007.

43. If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, prior period segment data that is presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent thresholds in the prior period, unless it is impracticable to do so.

Segment Accounting Policies

44. Segment information shall be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity.

45. There is a presumption that the accounting policies that the directors and management of an entity have chosen to use, in preparing its consolidated or entity-wide financial statements, are those that the directors and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help users of financial statements better understand and make more informed judgements about the entity as a whole, this Standard requires the use, in preparing segment information, of the accounting policies that the directors and management have chosen. That does not mean, however, that the consolidated or entity accounting policies are to be applied to reportable segments as if the segments were separate stand-alone reporting entities. A detailed calculation done in applying a particular accounting policy at the entity-wide level may be allocated to segments if there is a reasonable basis for doing so. Pension calculations, for example, often are done for an entity as a whole, but the entity-wide figures may be allocated to segments based on salary and demographic data for the segments.

46. This Standard does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the consolidated or entity financial statements provided that (a) the information is reported internally to ~~the board of directors and the chief executive officer~~key management personnel* for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described.

47. Assets that are jointly used by two or more segments shall be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

48. The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that shall be adopted by all entities. Nor is it appropriate to force allocation of enterprise asset, liability, revenue, and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary or difficult to understand. At the same time, the definitions of segment revenue, segment expense, segment assets, and segment liabilities are interrelated, and the resulting allocations shall be consistent. Therefore, jointly used assets are allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments. For example, an asset is included in segment assets if, and only if, the related depreciation or amortisation is deducted in measuring segment result.

Disclosure

49. Paragraphs 50-67 specify the disclosures required for reportable segments for an entity's *primary* segment reporting format. Paragraphs 68-72 identify the disclosures required for an entity's *secondary* reporting format. Entities are encouraged to present all of the primary-segment disclosures identified in paragraphs 50-67 for each reportable secondary segment, although paragraphs 68-72 require considerably less disclosure on the secondary basis. Paragraphs 74-83 address several other segment disclosure matters. Appendix B to this Standard illustrates application of these disclosure standards.

Primary Reporting Format

50. The disclosure requirements in paragraphs 51-67 shall be applied to each reportable segment based on an entity's primary reporting format.

* Effective for annual periods beginning on or after 1 January 2007.

70. If an entity's primary format for reporting segment information is geographical segments (whether based on location of assets or location of customers), it shall also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of total entity revenue from sales to all external customers or whose segment assets are 10 per cent or more of the total assets of all business segments:

(a) segment revenue from external customers;

(b) the total carrying amount of segment assets; and

(c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets).

71. If an entity's primary format for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the entity shall also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 per cent or more of total entity revenue from sales to all external customers.

72. If an entity's primary format for reporting segment information is geographical segments that are based on location of customers, and if the entity's assets are located in different geographical areas from its customers, then the entity shall also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more of related consolidated or total entity amounts:

(a) the total carrying amount of segment assets by geographical location of the assets; and

(b) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment, and intangible assets) by location of the assets.

Illustrative Segment Disclosures

73. Appendix B to this Standard presents an illustration of the disclosures for primary and secondary reporting formats that are required by this Standard.

Other Disclosure Matters

74. If a business segment or geographical segment for which information is reported to ~~the board of directors and chief executive officer~~key management personnel[*] is not a reportable segment because it earns a majority of its revenue from sales to other segments, but nonetheless its revenue from sales to external customers is 10 per cent or more of total entity revenue from sales to all external customers, the entity shall disclose that fact and the amounts of revenue from (a) sales to external customers and (b) internal sales to other segments.

75. In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers shall be measured on the basis that the entity actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein shall be disclosed in the financial statements.

76. Changes in accounting policies adopted for segment reporting that have a material effect on segment information shall be disclosed, and prior period segment information presented for comparative purposes shall be restated unless it is impracticable to do so. Such disclosure shall include a description of the nature of the change, the reasons for the change, the fact that comparative information has been restated or that it is impracticable to do so, and the financial effect of the change, if it is reasonably determinable. If an entity changes the identification of its segments and it does not restate prior period segment information on the new basis because it is impracticable to do so, then for the purpose of comparison the entity shall report segment data for both the old and the new bases of segmentation in the year in which it changes the identification of its segments.

[*] Effective for annual periods beginning on or after 1 January 2007.

Appendix E

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as described below.

> Hong Kong Accounting Standard 14 *Segment Reporting* (HKAS 14) is set out in paragraphs ~~1–84~~ 1–85. All the paragraphs …

Paragraphs 2, 52A and 54 are amended as follows:

2 A complete set of financial statements includes a ~~balance sheet~~ statement of financial position, ~~income~~ a statement of comprehensive income, ~~cash flow~~ a statement of cash flows, a statement ~~showing~~ of changes in equity, and notes, as provided in HKAS 1 *Presentation of Financial Statements* (as revised in 2007). When a separate income statement is presented in accordance with HKAS 1, it is part of that complete set.

52A An entity ...all operations that had been classified as discontinued at the ~~balance sheet date~~ end of the latest reporting period presented.

54 An example of a measure of segment performance above segment result ~~on~~ in the ~~income~~ statement of comprehensive income is gross margin on sales. Examples of measures of segment performance below segment result ~~on~~ in the ~~income~~ statement of comprehensive income are profit or loss from ordinary activities (either before or after income taxes) and profit or loss.

Paragraph 85 is added as follows:

85 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 2. An entity shall apply HKAS 1 (revised 2007) 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.

APPENDIX:

Comparison with International Accounting Standards

Amendments to Other Pronouncements

Amendments resulting from other HKFRSs

BASIS FOR CONCLUSIONS

TABLE OF CONCORDANCE

Hong Kong Accounting Standard 16 *Property, Plant and Equipment* (HKAS 16) is set out in paragraphs 1-83 and the Appendix. All the paragraphs have equal authority. HKAS 16 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Reporting Standards* and the *Framework for 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.

Hong Kong Accounting Standard 16

Property, Plant and Equipment

Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

2. This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.

3. This Standard does not apply to:

   (a) property, plant and equipment classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

   (~~a~~b) biological assets related to agricultural activity (see HKAS 41 *Agriculture*); ~~or~~

   (c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6 *Exploration for and Evaluation of Mineral Resources*); or

   (~~b~~d) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

   However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in ~~(a)~~(b) and ~~(b)~~(d).

4. Other Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, HKAS 17 *Leases* requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

5. An entity shall apply this Standard to property that is being constructed or developed for future use as investment property but does not yet satisfy the definition of 'investment property' in HKAS 40 *Investment Property*. Once the construction or development is complete, the property becomes investment property and the entity is required to apply HKAS 40. HKAS 40 also applies to investment property that is being redeveloped for continued future use as investment property. An entity using the cost model for investment property in accordance with HKAS 40 shall use the cost model in this Standard.

Definitions

6. ***The following terms are used in this Standard with the meanings specified:***

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

~~***Cost is the amount of cash or cash equivalents paid and the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.***~~ ***Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other HKFRSs, e.g. HKFRS 2*** **Share-based Payment.**

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

Recoverable amount is the higher of an asset's net selling price and its value in use.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

55. Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. ~~Depreciation of an asset ceases when the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal unless the asset is fully depreciated.~~ Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

56. The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

57. The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.

58. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

59. If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation Method

60. The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

61. The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.

62. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

Impairment

63. To determine whether an item of property, plant and equipment is impaired, an entity applies HKAS 36 *Impairment of Assets*. That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

~~64.~~ ~~HKAS 22 *Business Combinations* explains how to account for an impairment loss recognised before the end of the first annual accounting period beginning after a business combination that is an acquisition.~~ [Deleted].

Compensation for Impairment

65. Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

66. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

(a) impairments of items of property, plant and equipment are recognised in accordance with HKAS 36;

(b) derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;

(c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and *(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and*

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) ~~disposals;~~ assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;

(iii) acquisitions through business combinations;

(iv) increases or decreases resulting from revaluations under paragraphs 31, 39 and 40 and from impairment losses recognised or reversed directly in equity in accordance with HKAS 36;

(v) impairment losses recognised in profit or loss in accordance with HKAS 36;

(vi) impairment losses reversed in profit or loss in accordance with HKAS 36;

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

(ix) other changes.

74. ***The financial statements shall also disclose:***

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(d) if it is not disclosed separately on the face of the income statement, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

(a) the carrying amount of temporarily idle property, plant and equipment;

(b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;

(c) ~~the carrying amount of property, plant and equipment retired from active use and held for disposal; and~~ the carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with HKFRS 5; and

(d) when the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional Provisions

80. The requirements of paragraphs 24-26 regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction shall be applied prospectively to future transactions.

80A. Enterprises which carried property, plant and equipment at revalued amounts in financial statements relating to periods ended before 30 September 1995 are not required to make regular revaluations in accordance with paragraphs 31 and 36 even if the carrying amounts of the revalued assets are materially different from the asset's fair values provided that:

(a) these enterprises do not revalue their property, plant and equipment subsequent to 1995; and

(b) disclosure of reliance of this paragraph is made in the financial statements.

80B. SSAP 17 Property, Plant and Equipment exempted charitable, government subvented and not-for-profit organisations whose long-term financial objective is other than to achieve operating profits (e.g. trade associations, clubs and retirement schemes) from compliance with its requirements. Those entities that have previously taken advantage of the exemption under SSAP 17 are permitted to deem the carrying amount of an item of property, plant and equipment immediately before applying this Standard on its effective date (or earlier) as the cost of that item. Depreciation on the deemed cost of an item of property, plant and equipment commences from the time at which this Standard is first applied. In the case where a carrying amount is used as a deemed cost for subsequent accounting, this fact and the aggregate of the carrying amounts for each class of property, plant and equipment presented shall be disclosed.

Effective Date

81. An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

81A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period(s).

Withdrawal of Other Pronouncements

82. This Standard supersedes SSAP 17 *Property, Plant and Equipment* revised in 2001.

83. This Standard supersedes the following Interpretations**:** (a) Interpretation 1 *Costs of Modifying Existing Software* and Interpretation 5 *Property, Plant and Equipment—Compensation for the Impairment or Loss of Items*

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* and its accompanying documents are amended as described below.~~

~~In the HKFRS, paragraph 24 is amended to read as follows:~~

~~24 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its individual financial statements, measure its assets and liabilities at either:~~

~~…~~

~~(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):~~

~~…~~

~~(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.~~

~~…~~

~~In the Basis for Conclusions, paragraph BC45 is amended to read as follows:~~

~~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.~~

~~In the Guidance on Implementing HKFRS 1, paragraphs IG7 and IG10-IG12 are amended to read as follows:~~

~~IG7 If an entity's depreciation methods and rates under previous GAAP are acceptable under HKFRSs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 31 and 32 of the HKFRS and paragraph 61 of HKAS 16). However, in some cases, an entity's depreciation methods and rates under previous GAAP may differ from those that would be acceptable under HKFRSs (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 HKFRS balance sheet retrospectively so that it complies with HKFRSs.~~

~~G10 If an entity chooses as its accounting policy the revaluation model in HKAS 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 HKFRSs 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 HKFRSs, the entity gives the disclosures required by paragraph 44 of the HKFRS.~~

~~IG11 If revaluations under previous GAAP did not satisfy the criteria in paragraph 17 or 19 of the HKFRS, an entity measures the revalued assets in its opening balance sheet 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 HKAS 16;~~

~~(b) deemed cost, being the fair value at the date of transition to HKFRSs (paragraph 16 of the HKFRS); or~~

~~(c) revalued amount, if the entity adopts the revaluation model in HKAS 16 as its accounting policy under HKFRSs for all items of property, plant and equipment in same class.~~

~~IG12 HKAS 16 requires each part of an item of property, plant~~

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

~~A2. In HKAS 14 *Segment Reporting*, paragraph 21 is amended to read follows:~~

~~21. Measurements of segment assets and liabilities include adjustments to the prior carrying amounts of the identifiable segment assets and segment liabilities of a company acquired a business combination accounted for as a purchase, even those adjustments are made only for the purpose of preparing consolidated financial statements and are not recorded in either the parent's separate or the subsidiary's individual financial statements. Similarly, if property, plant and equipment been revalued subsequent to acquisition in accordance with revaluation model in HKAS 16, then measurements of segment assets reflect those revaluations.~~

~~A3. In Appendix C to HKAS 34 *Interim Financial Reporting*, paragraph amended to read as follows:~~

~~7. **Revaluations and fair value accounting:** HKAS 16 *Property, Plant and Equipment* allows an entity to choose as accounting policy the revaluation model whereby items property, plant and equipment are revalued to fair value. Similarly, HKAS 40 *Investment Property* requires an entity determine the fair value of investment property. For measurements, an entity may rely on professionally qualified valuers at annual reporting dates though not at interim reporting dates.~~

~~A4. HKAS 36 *Impairment of Assets* is amended as described below.~~

~~In the Standard, paragraphs 4, 9, 37, 38, 41, 42, 59, 96 and 104 are amended to read as follows:~~

~~4. This Standard applies to assets that are carried at revalued amount (fair value) under other Standards, such as the revaluation model in HKAS 16 *Property, Plant and Equipment*. However, identifying whether a revalued asset may be impaired depends on the basis used to determine fair value:~~

~~…~~

~~***9. In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:***~~

~~**...**~~

~~***Internal sources of information***~~

~~**...**~~

~~***(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, and plans to dispose of an asset before the previously expected date; and***~~

~~***…***~~

~~***37. Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:***~~

~~***...***~~

~~***(b) future costs to add to, replace part of, or service the asset.***~~

~~38. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:~~

~~…~~

~~(b) future costs to add to, replace part of, or service the asset or the related future benefits from this future cost.~~

~~41. Until an entity incurs costs to add to, replace part of, or service the asset, estimates of future cash flows do not include the estimated future cash inflows expected to arise from this cost (see Appendix A, Example 6).~~

~~42. Estimates of future cash flows include future costs necessary for the day-to-day servicing of the asset.~~

~~***59. An impairment loss shall be recognised as an expense in the income statement immediately, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in HKAS 16*** **Property, Plant and Equipment*****). Any impairment loss of a revalued asset shall be treated as a revaluation decrease under that other Standard.***~~

~~***96. In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:***~~

~~***...***~~

~~***Internal sources of information***~~

~~***(d) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the***~~

~~***asset is used or is expected to be used. These changes include costs incurred during the period to add to, replace part of, or service the asset or a commitment to discontinue or restructure the operation to which the asset belongs; and***~~

~~**...**~~

~~***104. A reversal of an impairment loss for an asset shall be recognised as income immediately in the income statement, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in HKAS 16*** **Property, Plant and Equipment*****). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase under that other Standard.***~~

~~In Appendix A, the title of Example 6 and paragraphs A56 and A60 are amended to read as follows:~~

~~**Example 6 - Treatment of Future Costs**~~

~~A56. Management approved budgets reflect that:~~

~~(a) in 20X4, costs of 25,000 will be incurred to renew the engine of the plane; and~~

~~…~~

~~A60. The costs to renew the engine of the plane are incurred. Therefore, in determining the plane's value in use, the future benefits expected from the renewal of the engine are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. As a consequence, in accordance with paragraphs 95 and 96 of HKAS 36, the recoverable amount of the plane is recalculated at the end of 20X4.~~

~~A5. In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the footnote in paragraph 14(a) is deleted.~~

~~A6. HKAS 38 *Intangible Assets* is amended as described below.~~

~~**Standard**~~

~~In paragraph 7 the following definition is added:~~

~~***Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.***~~

~~In paragraph 7 the following definitions are amended:~~

~~***Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.***~~

~~***Cost** is the amount of cash or cash equivalents paid and the fair value of the other consideration given to acquire an asset at the time of its acquisition or production.*~~

~~***The residual value** of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.*~~

~~***Useful life** is:*~~

~~***(a)** the period over which an asset is expected to be available for use by an entity; or*~~

~~***(b)** the number of production or similar units expected to be obtained from the asset by an entity.*~~

~~Paragraph 18 and the immediately preceding heading are amended to read as follows:~~

~~**Recognition and Measurement**~~

~~18. The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:~~

~~(a) the definition of an intangible asset (see paragraphs 7-17); and~~

~~(b) the recognition criteria set out in this Standard (see paragraphs 19-55).~~

~~This is the case for costs incurred initially to acquire or internally generate an intangible asset and those incurred subsequently to add to, replace part of, or service it.~~

~~Paragraph 18A is added:~~

~~18A. The nature of intangible assets is such that, in many cases, there are no additions to an asset or replacements of part of an asset. Accordingly, most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria set out in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure — expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset — be recognised in the carrying amount of an asset. Consistently with paragraph 51, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised in profit or loss as incurred to avoid the recognition of internally generated goodwill.~~

~~Paragraph 24 is amended to read as follows:~~

~~24. The cost of an intangible asset comprises:~~

~~(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and~~

~~(b) any directly attributable cost of preparing the asset for its intended use.~~

~~Paragraphs 24A-24D are added:~~

~~24A. Examples of directly attributable costs are:~~

~~(a) costs of employee benefits (as defined in HKAS 19 *Employee Benefits*) arising directly from bringing the asset to its working condition; and~~

~~(b) professional fees.~~

~~24B. Examples of costs that are not a cost of an intangible asset are:~~

~~(a) costs of introducing a new product or service (including costs of advertising and promotional activities);~~

~~(b) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and~~

~~(c) administration and other general overhead costs.~~

~~24C. Recognition of costs in the carrying amount of an intangible asset ceases when it is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:~~

~~(a) costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and~~

~~(b) initial operating losses, such as those incurred while demand for the asset's output builds up.~~

~~24D. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.~~

~~Paragraph 34 is amended to read as follows:~~

~~34. One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all the exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.~~

~~Paragraphs 34A and 34B are added:~~

~~34A. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:~~

~~(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or~~

~~(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and~~

~~(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.~~

~~For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.~~

~~34B. Paragraph 19(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.~~

~~Paragraph 35 is deleted.~~

~~Paragraph 54 is amended to read as follows:~~

~~54. The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:~~

~~(a) costs of materials and services used or consumed in generating the intangible asset;~~

~~(b) costs of employee benefits (as defined in HKAS 19 *Employee Benefits*) arising from the generation of the intangible asset;~~

~~(c) fees to register a legal right; and~~

~~(d) amortisation of patents and licences that are used to generate the intangible asset.~~

~~HKAS 23 *Borrowing Costs* specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.~~

~~The heading preceding paragraphs 60-62 is deleted.~~

~~Paragraphs 60 and 61 are deleted.~~

~~Paragraph 62 is deleted, its content having been moved to paragraph 18A.~~

~~The heading preceding paragraph 63 is amended to read as follows:~~

~~**Measurement After Recognition**~~

~~Paragraphs 76 and 77 are amended to read as follows:~~

~~***76. If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.***~~

~~***77. If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.***~~

~~Paragraphs 79 and 80 are amended to read as follows:~~

~~***79. The depreciable amount of an intangible asset shall be allocated on a systematic basis over its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed twenty years***~~

~~***from the date when the asset is available for use. Amortisation shall begin when the asset is available for use. Amortisation shall cease when the asset is derecognised.***~~

~~80. Amortisation is recognised even if there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors are considered in determining the useful life of an intangible asset, including:~~

~~(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;~~

~~(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;~~

~~(c) technical, technological, commercial or other types of obsolescence;~~

~~(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;~~

~~(e) expected actions by competitors or potential competitors;~~

~~(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and an entity's ability and intent to reach such a level;~~

~~(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and~~

~~(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.~~

~~Paragraphs 88-90 are amended to read as follows:~~

~~***88. The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortisation charge for each period shall be recognised in profit or loss unless another Standard permits or requires it to be included in the carrying amount of another asset.***~~

~~89. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected based on the expected pattern of consumption of the future economic benefits embodied in the asset and is applied consistently from period to~~

~~period, unless there is a change in the expected pattern of consumption of those future economic benefits. There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.~~

~~90. Amortisation is usually recognised in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the amortisation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see HKAS 2 *Inventories*).~~

~~Paragraph 93 is amended to read as follows:~~

~~93. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each financial year-end. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.~~

~~Paragraph 93A is added:~~

~~93A. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortisation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.~~

~~Paragraphs 94 and 95 are amended to read as follows:~~

~~***94. The amortisation period and the amortisation method shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with HKAS 8.***~~

~~95. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.~~

~~Paragraphs 103 and 104 are amended to read as follows:~~

~~***103. An intangible asset shall be derecognised:***~~

~~***(a) on disposal; or***~~

~~***(b) when no future economic benefits are expected from its use or disposal.***~~

~~***104. The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be included in profit or loss when the asset is derecognised (unless HKAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.***~~

~~Paragraphs 104A-104C are added:~~

~~104A. The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). In determining the date of disposal of such an asset, an entity applies the criteria in HKAS 18 *Revenue* for recognising revenue from the sale of goods. HKAS 17 applies to disposal by a sale and leaseback.~~

~~104B. If under the recognition principle in paragraph 19 an entity recognises in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognises the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.~~

~~104C. The consideration receivable on disposal of an intangible asset is recognised initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with HKAS 18 reflecting the effective yield on the receivable.~~

~~Paragraph 105 is deleted.~~

~~Paragraph 106 is amended to read as follows:~~

~~106. Amortisation does not cease when the intangible asset is no longer used or is held for disposal unless the asset has been fully depreciated.~~

~~In paragraph 107, the sentence "***Comparative information is not required.*** " is deleted.~~

~~Paragraph 111(e) is amended to read as follows:~~

~~***(e) the amount of contractual commitments for the acquisition of intangible assets.***~~

~~Paragraph 113(a)(iii) is amended to read as follows:~~

~~***(iii) the carrying amount that would have been recognised had the revalued class of intangible assets been carried under the benchmark treatment in paragraph 63; and***~~

~~Paragraph 113(b) is amended to read as follows and paragraph 113(c) is added:~~

~~***(b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders; and***~~

~~***(c) the methods and significant assumptions applied in estimating the assets' fair values.***~~

~~Paragraph 121A is added:~~

~~***121A. The requirements of paragraphs 34-34B regarding the initial measurement of an intangible asset acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.***~~

~~A7. [Not used]~~

~~A8. In HKAS-Int-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*, paragraphs 3-5 are amended to read as follows:~~

~~3. The issue is how to interpret the term "recovery" in relation to an asset that is not depreciated (non-depreciable asset) and is revalued in accordance with paragraph 31 of HKAS 16.~~

~~4. This Interpretation also applies to investment properties that are carried at revalued amounts under HKAS 40.33 but would be considered non-depreciable if HKAS 16 were to be applied.~~

~~5. The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with HKAS 16.31 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived~~

~~from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.~~

~~.~~

~~A9. In HKAS-Int-22 *Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported*, the Basis for Conclusions should be read as follows:~~

~~BASIS FOR CONCLUSIONS~~

~~[The original text has been marked up to reflect the revision of HKAS 16 in 2003; new text is underlined and deleted text is struck through.]~~

~~…~~

~~10. Under HKAS 22.71, unless an adjustment to the carrying amount of identifiable assets and liabilities is appropriately recognised as an adjustment to goodwill or negative goodwill, it is recognised as income or expense. However, this does not change the accounting subsequent to the date of the acquisition under Standards which require or permit items to be credited or charged directly to equity. For example, for an adjustment made to the value initially recognised as acquired property, plant and equipment which is revalued subsequent to the date of the acquisition under HKAS 16.2931, the related revaluation surplus included in equity under paragraph 3739 of HKAS 16 is determined based on the adjusted fair value of the acquired property, plant and equipment. However, under paragraph 5 of this Interpretation, a decrease to the amount initially assigned to the asset would also result in an adjustment to decrease depreciation of the asset; this decrease would be reflected as a reduction to depreciation expense.~~

~~A10. In HKAS-Int-32 *Intangible Assets—Web Site Costs*, paragraph 9(d) is amended to read as follows:~~

~~(d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense when it is incurred unless it meets the recognition criteria in HKAS 38.19.~~

~~The Basis for Conclusions should be read as follows:~~

~~BASIS FOR CONCLUSIONS~~

~~17. Once development of a web site is complete, an enterprise begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an enterprise's own web site is recognised as an expense when incurred unless it meets the recognition criteria in HKAS 38.60. HKAS 38.61explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.*~~

~~* HKAS 16 *Property, Plant and Equipment* as revised in 2003 requires all subsequent costs to be covered by its general recognition principle and eliminated the requirement to reference the originally assessed standard of performance. HKAS 38 was amended as a consequence of the change to HKAS 16 and the paragraphs specifically referred to were eliminated. This paragraph has been struck through to avoid any confusion.~~

~~A11. In December 2002 the Financial Accounting Standards Committee invited comments on an Exposure Draft of Proposed Amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* published by the International Accounting Standards Board ("the Board"). The Board's proposed amendments to IAS 36 and IAS 38 reflect changes related to its decisions in its Business Combinations project. Because that project is still under way, those corresponding proposed changes are not reflected in the amendments to HKAS 36 and HKAS 38 included in this appendix.~~

~~A12. In July 2003 the Financial Accounting Standards Committee invited comments on ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* published by the Board in which it proposed amendments to IAS 38 and to IAS 40 *Investment Property*. Those corresponding proposed changes are not reflected in the amendments to HKAS 38 and IAS 40 included in this appendix.~~

Appendix

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.

HKAS 23 *Borrowing Costs* (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 23 is amended as follows:

23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is ~~recognised in the carrying amount of the item~~ capitalised in accordance with ~~the allowed alternative treatment in~~ HKAS 23.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 39 and 40 are amended as follows:

39 If an asset's carrying amount is increased as a result of a revaluation, the increase shall be ~~credited directly to equity~~ recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However …

40 If an asset's … However, the decrease shall be ~~debited directly to equity under the heading of revaluation surplus~~ recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

In paragraph 73(e)(iv), **'recognised or reversed directly in equity'** is amended to **'recognised or reversed in other comprehensive income'**.

Paragraph 81B is added as follows:

81B **HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 39, 40 and 73(e)(iv). 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.**

accordance with paragraphs 7-13.

16. Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

17. For a lease of land and buildings in which the amount that would initially be recognised for the land element, in accordance with paragraph 20, is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 7-13. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.

18. Separate measurement of the land and buildings elements is not required when the lessee's interest in both land and buildings is classified as an investment property in accordance with HKAS 40 and the fair value model is adopted. Detailed calculations are required for this assessment only if the classification of one or both elements is otherwise uncertain.

19. In accordance with HKAS 40, it is possible for a lessee to classify a property interest held under an operating lease as an investment property. If it does, the property interest is accounted for as if it were a finance lease and, in addition, the fair value model is used for the asset recognised. The lessee shall continue to account for the lease as a finance lease, even if a subsequent event changes the nature of the lessee's property interest so that it is no longer classified as investment property. This will be the case if, for example, the lessee:

(a) occupies the property, which is then transferred to owner-occupied property at a deemed cost equal to its fair value at the date of change in use; or

(b) grants a sublease that transfers substantially all of the risks and rewards incidental to ownership of the interest to an unrelated third party. Such a sublease is accounted for by the lessee as a finance lease to the third party, although it may be accounted for as an operating lease by the third party.

Leases in the Financial Statements of Lessees

Finance Leases

Initial Recognition

20. At the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate shall be used. Any initial direct costs of the lessee are added to the amount recognised as an asset.

21. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. Although the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating, at the inception of the lease, the fair value of the asset and the related finance charge.

22. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an entity are understated, thereby distorting financial ratios. Therefore, it is appropriate for a finance lease to be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the commencement of the lease term, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts except for any initial direct costs of the lessee that are added to the amount recognised as an asset.

23. It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets. If for the presentation of liabilities on the face of the balance sheet a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.

24. Initial direct costs are often incurred in connection with specific leasing activities, such as negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are added to the amount recognised as an asset.

Subsequent Measurement

25. Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.

26. In practice, in allocating the finance charge to periods during the lease term, a lessee may use some form of approximation to simplify the calculation.

27. A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with HKAS 16 **Property, Plant and Equipment** ***and HKAS 38*** **Intangible Assets*****. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.***

28. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term and its useful life.

29. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense. Accordingly, the asset and the related liability are unlikely to be equal in amount after the commencement of the lease term.

30. To determine whether a leased asset has become impaired, an entity applies HKAS 36 *Impairment of Assets.*

31. Lessees shall, in addition to meeting the requirements of ~~HKAS 32~~HKFRS 7 **Financial Instruments: Disclosures[*] ~~and Presentation~~*****, make the following disclosures for finance leases:***

(a) for each class of asset, the net carrying amount at the balance sheet date.

(b) a reconciliation between the total of future minimum lease payments at the balance sheet date, and their present value. In addition, an entity shall disclose the total of future minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

(i) not later than one year;

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

(iii) later than five years.

(c) contingent rents recognised as an expense in the period.

(d) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.

(e) a general description of the lessee's material leasing arrangements including, but not limited to, the following:

[*] Effective for annual periods beginning on or after 1 January 2007.

(i) ***the basis on which contingent rent payable is determined;***

(ii) ***the existence and terms of renewal or purchase options and escalation clauses; and***

(iii) ***restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.***

32. In addition, the requirements for disclosure in accordance with HKAS 16, HKAS 36, HKAS 38, HKAS 40 and HKAS 41 apply to lessees for assets leased under finance leases.

Operating Leases

33. Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.[2]

34. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

35. Lessees shall, in addition to meeting the requirements of ~~HKAS 32~~HKFRS 7[*]***, make the following disclosures for operating leases:***

(a) ***the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:***

(i) ***not later than one year;***

(ii) ***later than one year and not later than five years;***

(iii) ***later than five years.***

(b) ***the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.***

(c) ***lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.***

(d) ***a general description of the lessee's significant leasing arrangements including, but not limited to, the following:***

(i) ***the basis on which contingent rent payable is determined;***

(ii) ***the existence and terms of renewal or purchase options and escalation clauses; and***

(iii) ***restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.***

Leases in the Financial Statements of Lessors

Finance Leases

Initial Recognition

36. Lessors shall recognise assets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease.

---

[2] See also HK(SIC)-Int15 *Operating Leases – Incentives*.

[*] Effective for annual periods beginning on or after 1 January 2007.

37. Under a finance lease substantially all the risks and rewards incidental to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance income to reimburse and reward the lessor for its investment and services.

38. Initial direct costs are often incurred by lessors and include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by a sales and marketing team. For finance leases other than those involving manufacturer or dealer lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable; there is no need to add them separately. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease are excluded from the definition of initial direct costs. As a result, they are excluded from the net investment in the lease and are recognised as an expense when the selling profit is recognised, which for a finance lease is normally at the commencement of the lease term.

Subsequent Measurement

39. The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

40. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the lessor’s net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

41. Estimated unguaranteed residual values used in computing the lessor’s gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the lease term is revised and any reduction in respect of amounts accrued is recognised immediately.

41A. An asset under a finance lease that is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* shall be accounted for in accordance with that HKFRS.

42. Manufacturer or dealer lessors shall recognise selling profit or loss in the period, in accordance with the policy followed by the entity for outright sales. If artificially low rates of interest are quoted, selling profit shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or dealer lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the selling profit is recognised.

43. Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) finance income over the lease term.

44. The sales revenue recognised at the commencement of the lease term by a manufacturer or dealer lessor is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a market rate of interest. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the entity’s policy for outright sales.

45. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit is restricted to that which would apply if a market rate of interest were charged.

46. Costs incurred by a manufacturer or dealer lessor in connection with negotiating and arranging a finance lease are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.

47. Lessors shall, in addition to meeting the requirements in ~~HKAS 32~~HKFRS 7*, disclose the following for finance leases:

(a) a reconciliation between the gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

(i) not later than one year;

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

(iii) later than five years.

(b) unearned finance income.

(c) the unguaranteed residual values accruing to the benefit of the lessor.

(d) the accumulated allowance for uncollectible minimum lease payments receivable.

(e) contingent rents recognised as income in the period.

(f) a general description of the lessor's material leasing arrangements.

48. As an indicator of growth it is often useful also to disclose the gross investment less unearned income in new business added during the period, after deducting the relevant amounts for cancelled leases.

Operating Leases

49. Lessors shall present assets subject to operating leases in their balance sheets according to the nature of the asset.

50. Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.[3]

51. Costs, including depreciation, incurred in earning the lease income are recognised as expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised on a straight-line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

52. Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.

53. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with HKAS 16 and HKAS 38 .

54. To determine whether a leased asset has become impaired, an entity applies HKAS 36.

55. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

[3] See also HK(SIC)-Int 15 *Operating Leases – Incentives*.

* Effective for annual periods beginning on or after 1 January 2007.

56. Lessors shall, in addition to meeting the requirements of ~~HKAS 32~~HKFRS 7[*], disclose the following for operating leases:

(a) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:

(i) not later than one year;

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

(iii) later than five years.

(b) total contingent rents recognised as income in the period.

(c) a general description of the lessor's leasing arrangements.

57. In addition, the disclosure requirements in HKAS 16, HKAS 36, HKAS 38, HKAS 40 and HKAS 41 apply to lessors for assets provided under operating leases.

Sale and Leaseback Transactions

58. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

59. If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognised as income by a seller-lessee. Instead, it shall be deferred and amortised over the lease term.

60. If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term.

61. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss shall be recognised immediately. If the sale price is below fair value, any profit or loss shall be recognised immediately except that, if the loss is compensated for by future lease payments at below market price, it shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.

62. If the leaseback is an operating lease, and the lease payments and the sale price are at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.

63. For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately.

64. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with HKAS 36.

65. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of material leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

66. Sale and leaseback transactions may trigger the separate disclosure criteria in HKAS 1 *Presentation of Financial Statements*.

Transitional Provisions

67. Subject to paragraph 68, retrospective application of this Standard is encouraged but not required. If the Standard is not applied retrospectively, the balance of any pre-existing finance lease is deemed to have been properly determined by the lessor and shall be accounted for thereafter in accordance with the provisions of this Standard.

[*] Effective for annual periods beginning on or after 1 January 2007.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*The accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. [Not used]~~

~~A2. In the Guidance on Implementing HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*, paragraph IG14 is amended to read as follows:~~

> ~~IG14 At the date of transition to HKFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (HKAS 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 HKAS 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.~~

Contents

Hong Kong Accounting Standard 19
Employee Benefits

Hong Kong Accounting Standard 19 *Employee Benefits* (HKAS 19) is set out in paragraphs 1-160. *All the* paragraphs have equal authority. HKAS 19 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Standards*. 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 to February 2005 Amendment

IN1. The amendment to HKAS 19 *Employee Benefits* issued in February 2005, effective for annual periods beginning on or after 1 January 2006 (now incorporated in the body of this Standard) introduces an additional recognition option for actuarial gains and losses arising in post-employment defined benefit plans. Actuarial gains and losses are defined in HKAS 19 as experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred) and the effects of changes in actuarial assumptions. They include changes in the fair value of plan assets other than those explained by the expected return. Before this amendment, HKAS 19 required actuarial gains and losses to be recognised in profit or loss either in the period in which they occur, or on a deferred basis.

IN2. The Hong Kong Institute of Certified Public Accountants (Institute) has reservations about aspects of HKAS 19, including concerns about deferred recognition of actuarial gains and losses. The Institute believes that deferred recognition is inconsistent with the Institute's *Framework for the Preparation and Presentation of Financial Statements* because it results in amounts presented in the balance sheet that do not meet the definition of a liability or an asset. The Institute notes the intention of the International Accounting Standards Board (IASB) to undertake a major project on accounting for post-employment benefits.

IN3. The Institute also notes that the UK standard on post-employment benefits, FRS 17 *Retirement Benefits,* requires recognition of all actuarial gains and losses as they occur, outside profit or loss in a statement of total recognised gains and losses. The Institute does not necessarily regard this as an ideal solution, but notes that FRS 17 produces transparent information about defined benefit plans in the financial statements. The Institute believes that, pending (a) a comprehensive reconsideration of the accounting for post-employment benefits by the IASB and (b) the development of a new format for the income statement by the IASB, an option similar to the approach in FRS 17 should be available as an alternative to deferred recognition or immediate recognition in profit or loss.

IN4. The other features of the amendment are:

(a) clarification that a contractual agreement between a multi-employer plan and participating employers that determines how a surplus is to be distributed or a deficit funded will give rise to an asset or liability.

(b) accounting requirements for group defined benefit plans in the separate or individual financial statements of entities within a group.

(c) additional disclosures that:

(i) provide information about trends in the assets and liabilities in a defined benefit plan and the assumptions underlying the components of the defined benefit cost; and

(ii) bring the disclosures in HKAS 19 closer to those required by the US standard SFAS 132 *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which was revised in December 2003.

25. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. Under defined contribution plans:

(a) the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

(b) in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

26. Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through:

(a) a plan benefit formula that is not linked solely to the amount of contributions;

(b) a guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

(c) those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an entity has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.

27. Under defined benefit plans:

(a) the entity's obligation is to provide the agreed benefits to current and former employees; and

(b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

28. Paragraphs 29 to 42 below explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, state plans and insured benefits.

Multi-employer Plans

29. An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an entity shall:

(a) account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and

(b) disclose the information required by paragraph ~~123~~120A.

30. When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:

(a) account for the plan under paragraphs 44 - 46 as if it were a defined contribution plan;

(b) disclose:

(i) the fact that the plan is a defined benefit plan; and

(ii) the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and

(c) to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:

(i) ***any available information about that surplus or deficit;***

(ii) ***the basis used to determine that surplus or deficit; and***

(iii) ***the implications, if any, for the entity.***

31. One example of a defined benefit multi-employer plan is one where:

(a) the plan is financed on a pay-as-you-go basis such that: contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and

(b) employees' benefits are determined by the length of their service and the participating entities have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal. Such a plan creates actuarial risk for the entity: if the ultimate cost of benefits already earned at the balance sheet date is more than expected, the entity will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

32. Where sufficient information is available about a multi-employer plan which is a defined benefit plan, an entity accounts for its proportionate share of the defined benefit obligation, plan assets and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, in some cases, an entity may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

(a) the entity does not have access to information about the plan that satisfies the requirements of this Standard; or

(b) the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan.

In those cases, an entity accounts for the plan as if it were a defined contribution plan and discloses the additional information required by paragraph 30.

32A. There may be a contractual agreement between the multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 30 shall recognise the asset or liability that arises from the contractual agreement and the resulting income or expense in profit or loss.

Example illustrating paragraph 32A

An entity participates in a multi-employer defined benefit plan that does not prepare plan valuations on an HKAS 19 basis. It therefore accounts for the plan as if it were a defined contribution plan. A non-HKAS 19 funding valuation shows a deficit of 100 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. The entity's total contributions under the contract are 8 million.

The entity recognises a liability for the contributions adjusted for the time value of money and an equal expense in profit or loss.

32B. HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires an entity to recognise, or disclose information about, certain contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:

(a) actuarial losses relating to other participating entities because each entity that participates in a multi-employer plan shares in the actuarial risks of every other participating entity; or

(b) any responsibility under the terms of a plan to finance any shortfall in the plan if other entities cease to participate.

33. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating entities to actuarial risks associated with the current and former employees of other entities. The definitions in this Standard require an entity to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

Defined benefit plans that share risks between various entities under common control

34. Defined benefit plans that ~~pool the assets contributed by~~ share risks between various entities under common control, for example, a parent and its subsidiaries, are not multi-employer plans. ~~Therefore, an entity treats all such plans as defined benefit plans.~~

34A. An entity participating in such a plan shall obtain information about the plan as a whole measured in accordance with HKAS 19 on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with HKAS 19 to individual group entities, the entity shall, in its separate or individual financial statements, recognise the net defined benefit cost so charged. If there is no such agreement or policy, the net defined benefit cost shall be recognised in the separate or individual financial statements of the group entity that is legally the sponsoring employer for the plan. The other group entities shall, in their separate or individual financial statements, recognise a cost equal to their contribution payable for the period.

34B. Participation in such a plan is a related party transaction for each individual group entity. An entity shall therefore, in its separate or individual financial statements, make the following disclosures:

(a) the contractual agreement or stated policy for charging the net defined benefit cost or the fact that there is no such policy.

(b) the policy for determining the contribution to be paid by the entity.

(c) if the entity accounts for an allocation of the net defined benefit cost in accordance with paragraph 34A, all the information about the plan as a whole in accordance with paragraphs 120-121.

(d) if the entity accounts for the contribution payable for the period in accordance with paragraph 34A, the information about the plan as a whole required in accordance with paragraphs 120A(b)-(e), (j), (n), (o), (q) and 121. The other disclosures required by paragraph 120A do not apply.

35. ~~HKAS 37, Provisions, Contingent Liabilities and Contingent Assets, requires an entity to recognise, or disclose information about, certain contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:~~

~~(a) actuarial losses relating to other participating entities because each entity that participates in a multi-employer plan shares in the actuarial risks of every other participating entity; or~~

~~(b) any responsibility under the terms of a plan to finance any shortfall in the plan if other entities cease to participate.~~[Deleted]

(b) total of:

(i) any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 78.

58A. The application of paragraph 58 shall not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The entity shall therefore recognise immediately under paragraph 54 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):

(a) net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognised immediately under paragraph 54.

(b) net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognised immediately under paragraph 54.

58B. Paragraph 58A applies to an entity only if it has, at the beginning or end of the accounting period, a surplus* in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under paragraph 54, will increase the amount specified in paragraph 58(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 58(b)(ii), there will be an increase in the net total specified by paragraph 58(b) and, hence, a recognised gain. Paragraph 58A prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 54, to the extent that the actuarial gains reduce cumulative unrecognised actuarial losses. Paragraph 58A prohibits the recognition of a loss in these circumstances. For examples of the application of this paragraph, see Appendix C.

59. An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised. An entity recognises an asset in such cases because:

(a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;

(b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and

(c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.

60. The limit in paragraph 58(b) does not over-ride the delayed recognition of certain actuarial losses (see paragraphs 92 and 93) and certain past service cost (see paragraph 96), other than as specified in paragraph 58A. However, that limit does over-ride the transitional option in paragraph 155(b). Paragraph ~~120(c)(vi)~~120A(f)(iii) requires an entity to disclose any amount not recognised as an asset because of the limit in paragraph 58(b).

* A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

Example Illustrating Paragraph 60

A defined benefit plan has the following characteristics:

Present value of the obligation	1,100
Fair value of plan assets	(1,190)
	(90)
Unrecognised actuarial losses	(110)
Unrecognised past service cost	(70)
Unrecognised increase in the liability on initial adoption of the Standard under paragraph 155(b)	(50)
Negative amount determined under paragraph 54	(320)
Present value of available future refunds and reductions in future contributions	90

The limit under paragraph 58(b) is computed as follows:

Unrecognised actuarial losses	*110*
Unrecognised past service cost	*70*
Present value of available future refunds and reductions in future contributions	*90*
Limit	*270*

270 is less than 320. Therefore, the entity recognises an asset of 270 and discloses that the limit reduced the carrying amount of the asset by 50 (see paragraph ~~120(c)(vi)~~120A(f)(iii)).

~~Income Statement~~Profit and Loss

61. ***An entity shall recognise the net total of the following amounts ~~as expense or (subject to the limit in paragraph 58(b)) income~~in profit or loss, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:***

(a) ***current service cost (see paragraphs 63 - 91);***

(b) ***interest cost (see paragraph 82);***

(c) ***the expected return on any plan assets (see paragraphs 105 - 107) and on any reimbursement rights (see paragraph 104A);***

(d) ***actuarial gains and losses, ~~to the extent that they are recognised under~~ as required in accordance with the entity's accounting policy (see paragraphs 92 ~~and 93~~ -93D);***

(e) ***past service cost~~, to the extent that paragraph 96 requires an entity to recognise it~~ (see paragraph 96); ~~and~~***

(f) ***the effect of any curtailments or settlements (see paragraphs 109 and 110); and***

(g) ***the effect of the limit in paragraph 58(b), unless it is recognised outside profit or loss in accordance with paragraph 93C.***

62. Other Standards require the inclusion of certain employee benefit costs within the cost of assets such as inventories or property, plant and equipment (see HKAS 2, Inventories, and HKAS 16 Property, Plant and Equipment). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 61.

90. The level and frequency of claims is particularly sensitive to the age, health status and sex of employees (and their dependants) and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.

91. Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the balance sheet date (or based on any constructive obligation that goes beyond those terms). Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 83(c) and 87).

Actuarial Gains and Losses

92. In measuring its defined benefit liability ~~under~~ in accordance with paragraph 54, an entity shall, subject to paragraph 58A, recognise a portion (as specified in paragraph 93) of its actuarial gains and losses as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

(a) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and

(b) 10% of the fair value of any plan assets at that date.

These limits shall be calculated and applied separately for each defined benefit plan.

93. The portion of actuarial gains and losses to be recognised for each defined benefit plan is the excess determined ~~under~~ in accordance with paragraph 92, divided by the expected average remaining working lives of the employees participating in that plan. However, an entity may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. An entity may apply such systematic methods to actuarial gains and losses even if they ~~fall~~ are within the limits specified in paragraph 92.

93A. If, as permitted by paragraph 93, an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them outside profit or loss, in accordance with paragraphs 93B-93D, providing it does so for:

(a) all of its defined benefit plans; and

(b) all of its actuarial gains and losses.

93B. Actuarial gains and losses recognised outside profit or loss as permitted by paragraph 93A shall be presented in a statement of changes in equity titled 'statement of recognised income and expense' that comprises only the items specified in paragraph 96 of HKAS 1. The entity shall not present the actuarial gains and losses in a statement of changes in equity in the columnar format referred to in paragraph 101 of HKAS 1 or any other format that includes the items specified in paragraph 97 of HKAS 1.

93C. An entity that recognises actuarial gains and losses in accordance with paragraph 93A shall also recognise any adjustments arising from the limit in paragraph 58(b) outside profit or loss in the statement of recognised income and expense.

93D. Actuarial gains and losses and adjustments arising from the limit in paragraph 58(b) that have been recognised directly in the statement of recognised income and expense shall be recognised immediately in retained earnings. They shall not be recognised in profit or loss in a subsequent period.

94 Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:

(a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(b) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(c) the effect of changes in the discount rate; and

(d) differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 105–107).

95. In the long term, actuarial gains and losses may offset one another. Therefore, estimates of post-employment benefit obligations ~~are best~~ may be viewed as a range (or 'corridor') around the best estimate. An entity is permitted, but not required, to recognise actuarial gains and losses that fall within that range. This Standard requires an entity to recognise, as a minimum, a specified portion of the actuarial gains and losses that fall outside a 'corridor' of plus or minus 10%. [Appendix A illustrates the treatment of actuarial gains and losses, among other things] The Standard also permits systematic methods of faster recognition, provided that those methods satisfy the conditions set out in paragraph 93. Such permitted methods include, for example, immediate recognition of all actuarial gains and losses, both within and outside the 'corridor'. Paragraph 155(b)(iii) explains the need to consider any unrecognised part of the transitional liability in accounting for subsequent actuarial gains.

Past Service Cost

96. In measuring its defined benefit liability under paragraph 54, an entity shall, subject to paragraph 58A, recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognise past service cost immediately.

97. Past service cost arises when an entity introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, past service cost is recognised over that period, regardless of the fact that the cost refers to employee service in previous periods. Past service cost is measured as the change in the liability resulting from the amendment (see paragraph 64).

Example Illustrating Paragraph 97

An entity operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On 1 January 20X5 the entity improves the pension to 2.5% of final salary for each year of service starting from 1 January 20X1. At the date of the improvement, the present value of the additional benefits for service from 1 January 20X1 to 1 January 20X5 is as follows:

Employees with more than five years' service at 1/1/X5	150
Employees with less than five years' service at 1/1/X5 (average period until vesting: three years)	120
	270

The entity recognises 150 immediately because those benefits are already vested. The entity recognises 120 on a straight-line basis over three years from 1 January 20X5.

98. Past service cost excludes:

(a) the effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) under and over estimates of discretionary pension increases where an entity has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) estimates of benefit improvements that result from actuarial gains that have already been recognised in the financial statements if the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 85(b));

(d) the increase in vested benefits when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the estimated cost of benefits was recognised as current service cost as the service was rendered); and

(e) the effect of plan amendments that reduce benefits for future service (a curtailment).

99. An entity establishes the amortisation schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortisation schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an entity amends the amortisation schedule for past service cost only if there is a curtailment or settlement.

100. Where an entity reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognised as (negative) past service cost over the average period until the reduced portion of the benefits becomes vested.

101. Where an entity reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the entity treats the change as a single net change.

Recognition and Measurement: Plan Assets

Fair Value of Plan Assets

102. The fair value of any plan assets is deducted in determining the amount recognised in the balance sheet under paragraph 54. When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).

103. Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

104. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 54 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements

104A. When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In all other respects, an entity shall treat that asset in the same way as plan assets. In the income statement, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

104B. Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 7, are plan assets. An entity accounts for qualifying insurance policies in the same way as for all other plan assets and paragraph 104A does not apply (see paragraphs 39 - 42 and 104).

104C. When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 104A deals with such cases: the entity recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognised under paragraph 54; in all other respects, the entity treats that asset in the same way as plan assets. In particular, the defined benefit liability recognised under paragraph 54 is increased (reduced) to the extent that net cumulative actuarial gains (losses) on the defined benefit obligation and on the related reimbursement right remain unrecognised under paragraphs 92 and 93. Paragraph ~~120(c)(vii)~~120A(f)(iv) requires the entity to disclose a brief description of the link between the reimbursement right and the related obligation.

Example Illustrating Paragraphs 104A-C

Present value of obligation	1,241
Unrecognised actuarial gains	17
Liability recognised in balance sheet	1,258
Rights under insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of 1,092	1,092

The unrecognised actuarial gains of 17 are the net cumulative actuarial gains on the obligation and on the reimbursement rights.

104D. If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 54 (subject to any reduction required if the reimbursement is not recoverable in full).

Return on Plan Assets

105. The expected return on plan assets is one component of the expense recognised in the income statement. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10% 'corridor' specified in paragraph 92.

106. The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.

Example Illustrating Paragraph 106

At 1 January 20X1, the fair value of plan assets was 10,000 and net cumulative unrecognised actuarial gains were 760. On 30 June 20X1, the plan paid benefits of 1,900 and received contributions of 4,900. At 31 December 20X1, the fair value of plan assets was 15,000 and the present value of the defined benefit obligation was 14,792. Actuarial losses on the obligation for 20X1 were 60.

At 1 January 20X1, the reporting entity made the following estimates, based on market prices at that date:

	%
Interest and dividend income, after tax payable by the fund	9.25
Realised and unrealised gains on plan assets (after tax)	2.00
Administration costs	(1.00)
Expected rate of return	10.25

continued…

…continued

For 20X1, the expected and actual return on plan assets are as follows:

Return on 10,000 held for 12 months at 10.25%	1,025
Return on 3,000 held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	150
Expected return on plan assets for 20X1	1,175
Fair value of plan assets at 31 December 20X1	15,000
Less fair value of plan assets at 1 January 20X1	(10,000)
Less contributions received	(4,900)
Add benefits paid	*1,900*
Actual return on plan assets	*2,000*

The difference between the expected return on plan assets (1,175) and the actual return on plan assets (2,000) is an actuarial gain of 825. Therefore, the cumulative net unrecognised actuarial gains are 1,525 (760 plus 825 less 60). Under paragraph 92, the limits of the corridor are set at 1,500 (greater of: (i) 10% of 15,000 and (ii) 10% of 14,792). In the following year (20X2), the entity recognises in the income statement an actuarial gain of 25 (1,525 less 1,500) divided by the expected average remaining working life of the employees concerned.

The expected return on plan assets for 20X2 will be based on market expectations at 1/1/X2 for returns over the entire life of the obligation.

107. In determining the expected and actual return on plan assets, an entity deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

Business Combinations

108. In a business combination, an entity recognises assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see HKFRS 3 *Business Combinations*). The present value of the obligation includes all of the following, even if the acquiree had not yet recognised them at the acquisition date:

(a) actuarial gains and losses that arose before the acquisition date (whether or not they fell inside the 10% 'corridor');

(b) past service cost that arose from benefit changes, or the introduction of a plan, before the acquisition date; and

(c) amounts that, under the transitional provisions of paragraph 155(b), the acquiree had not recognised.

Disclosure

120. An entity shall disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.

120A. An entity shall disclose the following information about defined benefit plans:

(a) the entity's accounting policy for recognising actuarial gains and losses~~;~~.

(b) a general description of the type of plan~~;~~.

(c) a reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:

(i) current service cost,

(ii) interest cost,

(iii) contributions by plan participants,

(iv) actuarial gains and losses,

(v) foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency,

(vi) benefits paid,

(vii) past service cost,

(viii) business combinations,

(ix) curtailments and

(x) settlements.

(d) an analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded.

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset in accordance with paragraph 104A showing separately, if applicable, the effects during the period attributable to each of the following:

(i) expected return on plan assets,

(ii) actuarial gains and losses,

(iii) foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency,

(iv) contributions by the employer,

(v) contributions by plan participants,

(vi) benefits paid,

(vii) business combinations and

(viii) settlements.

(~~e~~f) a reconciliation of the present value of the defined benefit obligation in (c) and the fair value of the plan assets in (e) to the assets and liabilities recognised in the balance sheet, showing at least:

~~(i) the present value at the balance sheet date of defined benefit obligations that are wholly unfunded;~~

~~(ii) the present value (before deducting the fair value of plan assets) at the balance sheet date of defined benefit obligations that are wholly or partly funded;~~

~~(iii) the fair value of any plan assets at the balance sheet date;~~

(i~~iv~~) the net actuarial gains or losses not recognised in the balance sheet (see paragraph 92);

(ii~~v~~) the past service cost not ~~yet~~ recognised in the balance sheet (see paragraph 96);

(iii~~vi~~) any amount not recognised as an asset, because of the limit in paragraph 58(b);

(iv~~vii~~) the fair value at the balance sheet date of any reimbursement right recognised as an asset in accordance with paragraph 104A (with a brief description of the link between the reimbursement right and the related obligation); and

(v~~viii~~) the other amounts recognised in the balance sheet~~;~~.

~~(d) the amounts included in the fair value of plan assets for:~~

~~(i) each category of the reporting entity's own financial instruments; and~~

~~(ii) any property occupied by, or other assets used by, the reporting entity;~~

~~(e) a reconciliation showing the movements during the period in the net liability (or asset) recognised in the balance sheet;~~

(g~~f~~) the total expense recognised in ~~the income statement~~ profit or loss for each of the following, and the line item(s) ~~of the income statement~~ in which they are included:

(i) current service cost;

(ii) interest cost;

(iii) expected return on plan assets;

(iv) expected return on any reimbursement right recognised as an asset ~~under~~ in accordance with paragraph 104A;

(v) actuarial gains and losses;

(vi) past service cost; ~~and~~

(vii) the effect of any curtailment or settlement; and

(viii) the effect of the limit in paragraph 58(b).

(h) the total amount recognised in the statement of recognised income and expense for each of the following:

(i) actuarial gains and losses; and

(ii) the effect of the limit in paragraph 58(b).

(i) for entities that recognise actuarial gains and losses in the statement of recognised income and expense in accordance with paragraph 93A, the cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expense.

(j) for each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets.

(k) the amounts included in the fair value of plan assets for:

> ***(i) each category of the entity's own financial instruments; and***
>
> ***(ii) any property occupied by, or other assets used by, the entity.***

(l) a narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets.

(~~g~~m) the actual return on plan assets, as well as the actual return on any reimbursement right recognised as an asset ~~under~~ in accordance with paragraph 104A.~~; and~~

(~~h~~n) the principal actuarial assumptions used as at the balance sheet date, including, when~~re~~ applicable:

> ***(i) the discount rates;***
>
> ***(ii) the expected rates of return on any plan assets for the periods presented in the financial statements;***
>
> ***(iii) the expected rates of return for the periods presented in the financial statements on any reimbursement right recognised as an asset ~~under~~ in accordance with paragraph 104A;***
>
> ***(iv) the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);***
>
> ***(v) medical cost trend rates; and***
>
> ***(vi) any other material actuarial assumptions used.***

An entity shall disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables.

(o) the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on:

> ***(i) the aggregate of the current service cost and interest cost components of net periodic post-employment medical costs; and***
>
> ***(ii) the accumulated post-employment benefit obligation for medical costs.***

For the purposes of this disclosure, all other assumptions shall be held constant. For plans operating in a high inflation environment, the disclosure shall be the effect of a percentage increase or decrease in the assumed medical cost trend rate of a significance similar to one percentage point in a low inflation environment.

(p) ***the amounts for the current annual period and previous four annual periods of:***

(i) ***the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and***

(ii) ***the experience adjustments arising on:***

(A) ***the plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the balance sheet date and***

(B) ***the plan assets expressed either as (1) an amount or (2) a percentage of the plan assets at the balance sheet date.***

(q) ***the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the balance sheet date.***

121. Paragraph 120A(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from post-employment medical plans. The description of the plan shall include informal practices that give rise to constructive obligations included in the measurement of the defined benefit obligation in accordance with paragraph 52. Further detail is not required.

122. When an entity has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) the geographical location of the plans, for example, by distinguishing domestic plans from foreign plans; or

(b) whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from post-employment medical plans.

When an entity provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

123. Paragraph 30 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.

124. Where required by HKAS 24 *Related Party Disclosures*, an entity discloses information about:

(a) related party transactions with post-employment benefit plans; and

(b) post-employment benefits for key management personnel.

125. Where required by HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Other Long-term Employee Benefits

126. Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

Effective Date

157. ***This Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged.***

158. This Standard supersedes SSAP 34 *Employee Benefits* (revised in May 2003).

159. [Not used]

159A. [Not used]

159B. ***An entity shall apply the amendments in paragraphs 32A, 34-34B, 61 and 120-121 for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies these amendments for a period beginning before 1 January 2006, it shall disclose that fact.***

159C. ***The option in paragraphs 93A-93D may be used for annual periods ending on or after 16 December 2004 if an entity decides to early adopt this Standard for a period beginning before 1 January 2005. An entity using the option for annual periods beginning before 1 January 2006 shall also apply the amendments in paragraphs 32A, 34-34B, 61 and 120-121.***

160. HKAS 8 applies when an entity changes its accounting policies to reflect the changes specified in paragraphs 159B and 159C. In applying those changes retrospectively, as required by HKAS 8, the entity treats those changes as if they had been applied at the same time as the rest of this Standard, except that an entity may disclose the amounts required by paragraph 120A(p) as the amounts are determined for each annual period prospectively from the first annual period presented in the financial statements in which the entity first applies the amendments in paragraph 120A.

Average expected remaining working lives (years) [B]	10	10	10
Actuarial gain (loss) to be recognised [A/B]	4	-	5
Unrecognised actuarial gains (losses) at 1 January	140	107	170
Actuarial gain (loss) for year - obligation	(61)	87	(42)
Actuarial gain (loss) for year - plan assets	32	(24)	(50)
Subtotal	111	170	78
Actuarial (gain) loss recognised	(4)	-	(5)
Unrecognised actuarial gains (losses) at 31 December	107	170	73

Amounts Recognised in the Balance Sheet and ~~Income Statement~~ Profit or Loss, and Related Analyses

The final step is to determine the amounts to be recognised in the balance sheet and ~~income statement~~ profit or loss, and the related analyses to be disclosed ~~under~~ in accordance with paragraph 120A(~~c), (e),~~ (f)~~, and~~ (g) and (~~l~~m) of the Standard (the analyses required to be disclosed in accordance with paragraph 120A(c) and (e) are given in the section of this Appendix 'Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets'). These are as follows.

	20X1	*20X2*	*20X3*
Present value of the obligation	1,141	1,197	1,295
Fair value of plan assets	(1,092)	(1,109)	(1,093)
	49	88	202
Unrecognised actuarial gains (losses)	107	170	73
Unrecognised past service cost—non-vested benefits	-	(20)	(10)
Liability recognised in balance sheet	**156**	**238**	**265**
Current service cost	130	140	150
Interest cost	100	103	96
Expected return on plan assets	(120)	(121)	(114)
Net actuarial (gain) loss recognised in year	(4)	-	(5)
Past service cost—non-vested benefits	-	10	10
Past service cost—vested benefits	-	50	-
Expense recognised in ~~the income statement~~ profit or loss	**106**	**182**	**137**

~~Movements in the net liability recognised in the balance sheet, to be disclosed under paragraph 120(c):~~			
~~Opening net liability~~	~~140~~	~~156~~	~~238~~
~~Expense as above~~	~~106~~	~~182~~	~~137~~
~~Contributions paid~~	~~(90)~~	~~(100)~~	~~(110)~~
~~Closing net liability~~	~~156~~	~~238~~	~~265~~

Actual return on plan assets~~, to be disclosed under paragraph 120(g)~~			
Expected return on plan assets	120	121	114
Actuarial gain (loss) on plan assets	32	(24)	(50)
Actual return on plan assets	152	97	64

Note: see example illustrating paragraphs 104A-104C for presentation of reimbursements.

Appendix B

Illustrative Disclosures

~~*The*~~ *This appendix accompanies, but is not part of, HKAS 19. Extracts from notes show how the required disclosures may be aggregated in the case of a large multi-national group that provides a variety of employee benefits. These extracts do not necessarily conform with all the disclosure and presentation requirements of HKAS 19 and other Standards. In particular, they do not illustrate the disclosure of:*

(a) *accounting policies for employee benefits (see HKAS 1* Presentation of Financial Statements*).* ~~*Under p*~~*Paragraph 120A(a) of the Standard*~~*,*~~ *requires this disclosure to* ~~*shall*~~ *include the entity's accounting policy for recognising actuarial gains and losses.*

(b) *a general description of the type of plan (paragraph 120A(b)).*

(c) a narrative description of the basis used to determine the overall expected rate of return on assets (paragraph 120A(l)).

(d~~b~~) *employee benefits granted to directors and key management personnel (see HKAS 24* Related Party Disclosures*).*

(e) *share-based employee benefits (see HKFRS 2* Share-based Payment*).*

Employee Benefit Obligations

The amounts recognised in the balance sheet are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	**20X1**	**20X2**	**20X1**
Present value of funded obligations	20,300	17,400	-	-
Fair value of plan assets	18,420	17,280	-	-
	1,880	120	-	-
Present value of unfunded obligations	2,000	1,000	7,337	6,405
Unrecognised actuarial gains (losses)	(1,605)	840	(2,707)	(2,607)
Unrecognised past service cost	(450)	(650)	-	-
Net liability ~~in balance sheet~~	1,825	1,310	4,630	3,798
Amounts in the balance sheet:				
liabilities	1,825	1,400	4,630	3,798
assets	-	(90)	-	-
Net liability ~~in balance sheet~~	1,825	1,310	4,630	3,798

The pension plan assets include ordinary shares issued by [name of reporting entity] with a fair value of 317 (20X1: 281). Plan assets also include property occupied by [name of reporting entity] with a fair value of 200 (20X1:185).

The amounts recognised in ~~the income statement~~ profit or loss are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	**20X1**	**20X2**	**20X1**
Current service cost	850	750	479	411
Interest on obligation	950	1000	803	705
Expected return on plan assets	(900)	(650)		
Net actuarial losses (gains) recognised in year	(70)	(20)	150	140
Past service cost	200	200		
Losses (gains) on curtailments and settlements	175	(390)		
Total, included in 'employee benefits expense'	1,205	890	1,432	1,256
Actual return on plan assets	600	2,250	-	-

~~Movements in the net liability recognised in the balance sheet are as follows:~~

	~~Defined benefit pension plans~~		~~Post-employment medical benefits~~	
	~~***20X2***~~	~~***20X1***~~	~~***20X2***~~	~~***20X1***~~
~~Net liability at start of year~~	~~6,040~~	~~5,505~~	~~5,472~~	~~5,439~~
~~Net expense recognised in the income statement~~	~~2,688~~	~~1,982~~	~~999~~	~~850~~
~~Contributions~~	~~(2,261)~~	~~(1,988)~~	~~(941)~~	~~(817)~~
~~Exchange differences on foreign plan~~	~~(227)~~	~~221~~	~~-~~	~~-~~
~~Liabilities acquired in business combinations~~	~~-~~	~~320~~	~~-~~	~~-~~
~~Net liability at end of year~~	~~6,240~~	~~6,040~~	~~5,530~~	~~5,472~~

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	**20X1**	**20X2**	**20X1**
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	-		
Liabilities extinguished on settlements	-	(350)		
Liabilities assumed in a business combination	-	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension plans	
	20X2	**20X1**
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains (losses)	(300)	1,600
Assets distributed on settlements	(400)	-
Contributions by employer	700	350
Assets acquired in a business combination	-	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

The group expects to contribute 900 to its defined benefit pension plans in 20X3.

The major categories of plan assets as a percentage of total plan assets are as follows:	20X2	20X1
European equities	30%	35%
North American equities	16%	15%
European bonds	31%	28%
North American bonds	18%	17%
Property	5%	5%

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

	20X2	*20X1*
Discount rate at 31 December	5.0%	6.5%
Expected return on plan assets at 31 December	5.4%	7.0%
Future salary increases	5%	4%
Future pension increases	3%	2%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state healthcare benefits	3%	2%

Assumed healthcare cost trend rates have a significant effect on the amounts recognised in profit or loss. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase	One percentage point decrease
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

Amounts for the current and previous four periods are as follows:

Defined benefit pension plans

	20X2	20X1	20X0	20W9	20W8
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus/(deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777

Post-employment medical benefits

	20X2	20X1	20X0	20W9	20W8
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The group also participates in an industry-wide defined benefit plan ~~which~~that provides pensions linked to final salaries and is funded on a pay-as-you-go basis. It is not practicable to determine the present value of the group's obligation or the related current service cost as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting entity]'s financial statements. [describe basis] On that basis, the plan's financial statements to 30 June 20X0 show an unfunded liability of 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting entity] or their dependants. The expense recognised in the income statement, which is equal to contributions due for the year, and is not included in the above amounts, was 230 (20X1: 215). The group's future contributions may be increased substantially if other entities withdraw from the plan.

Appendix C

The appendix accompanies, but is not part of, HKAS 19.

Illustration of the application of paragraph 58A

The issue

Paragraph 58 of the Standard imposes a ceiling on the defined benefit asset that can be recognised.

58. The amount determined under paragraph 54 may be negative (an asset). An entity shall measure the resulting asset at the lower of:

(a) the amount determined under paragraph 54 *[ie the surplus/deficit in the plan plus (minus) any unrecognised losses (gains)];* ***and***

(b) the total of:

(i) any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 78.

Without paragraph 58A (see below), paragraph 58(b)(i) has the following consequence: sometimes deferring the recognition of an actuarial loss (gain) in determining the amount specified by paragraph 54 leads to a gain (loss) being recognised in the income statement.

The following example illustrates the effect of applying paragraph 58 without paragraph 58A. The example assumes that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'. (Whether the 'corridor' is used is not significant. The issue can arise whenever there is deferred recognition under paragraph 54.)

Example 1

	A	B	C	D =A+C	E =B+C	F =lower of D and E	G
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	100	0	0	100	0	0	
2	70	0	30	100	30	30	30

At the end of year 1, there is a surplus of 100 in the plan (column A in the table above), but no economic benefits are available to the entity either from refunds or reductions in future contributions[*] (column B). There are no unrecognised gains and losses under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 would be recognised, being the amount specified by paragraph 54 (column D). The asset ceiling in paragraph 58 restricts the asset to nil (column F).

In year 2 there is an actuarial loss in the plan of 30 that reduces the surplus from 100 to 70 (column A) the recognition of which is deferred under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 (column D) would be recognised. The asset ceiling without paragraph 58A would be 30 (column E). An asset of 30 would be recognised (column F), giving rise to a gain in income (column G) even though all that has happened is that a surplus from which the entity cannot benefit has decreased.

A similarly counter-intuitive effect could arise with actuarial gains (to the extent that they reduce cumulative unrecognised actuarial losses).

[*] based on the current terms of the plan.

Paragraph 58A

Paragraph 58A prohibits the recognition of gains (losses) that arise solely from past service cost and actuarial losses (gains).

58A. The application of paragraph 58 shall not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The entity shall therefore recognise immediately under paragraph 54 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):

(a) net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognised immediately under paragraph 54.

(b) net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognised immediately under paragraph 54.

Examples

The following examples illustrate the result of applying paragraph 58A. As above, it is assumed that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'. For the sake of simplicity the periodic amortisation of unrecognised gains and losses outside the corridor is ignored in the examples.

Example 1 continued – Adjustment when there are actuarial losses and no change in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	100	0	0	100	0	0	–
2	70	0	0	70	0	0	0

The facts are as in example 1 above. Applying paragraph 58A, there is no change in the economic benefits available to the entity[*] so the entire actuarial loss of 30 is recognised immediately under paragraph 54 (column D). The asset ceiling remains at nil (column F) and no gain is recognised.

In effect, the actuarial loss of 30 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	Balance sheet asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(100)	0
Year 2	70	(70)	0
Gain/(loss)	(30)	30	0

[*] The term 'economic benefits available to the entity' is used to refer to those economic benefits that qualify for recognition under paragraph 58(b)(ii).

In the above example, there is no change in the present value of the economic benefits available to the entity. The application of paragraph 58A becomes more complex when there are changes in present value of the economic benefits available, as illustrated in the following examples.

Example 2 - adjustment when there are actuarial losses and a decrease in the economic benefits available

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	30	40	100	70	70	
2	25	20	50	75	70	70	0

At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54[*] (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial loss of 35 in the plan reduces the surplus from 60 to 25 (column A). The economic benefits available to the entity fall by 10 from 30 to 20 (column B). Applying paragraph 58A, the actuarial loss of 35 is analysed as follows:

Actuarial loss equal to the reduction in economic benefits	10
Actuarial loss that exceeds the reduction in economic benefits	25

In accordance with paragraph 58A, 25 of the actuarial loss is recognised immediately under paragraph 54 (column D). The reduction in economic benefits of 10 is included in the cumulative unrecognised losses that increase to 50 (column C). The asset ceiling, therefore, also remains at 70 (column E) and no gain is recognised.

In effect, an actuarial loss of 25 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	Balance sheet asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	75	(5)	70
Gain/(loss)	(25)	25	0

[*] The application of paragraph 58A allows the recognition of some actuarial gains and losses to be deferred under paragraph 54 and, hence, to be included in the calculation of the asset ceiling. For example, cumulative unrecognised actuarial losses that have built up while the amount specified by paragraph 58(b) is not lower than the amount specified by paragraph 54 will not be recognised immediately at the point that the amount specified by paragraph 58(b) becomes lower. Instead their recognition will continue to be deferred in line with the entity's accounting policy. The cumulative unrecognised losses in this example are losses the recognition of which is deferred even though paragraph 58A applies.

Example 3 - adjustment when there are actuarial gains and a decrease in the economic benefits available to the entity

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	30	40	100	70	70	
2	110	25	40	150	65	65	(5)

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial gain of 50 in the plan increases the surplus from 60 to 110 (column A). The economic benefits available to the entity decrease by 5 (column B). Applying paragraph 58A, there is no increase in economic benefits available to the entity. Therefore, the entire actuarial gain of 50 is recognised immediately under paragraph 54 (column D) and the cumulative unrecognised loss under paragraph 54 remains at 40 (column C). The asset ceiling decreases to 65 because of the reduction in economic benefits. That reduction is not an actuarial loss as defined by HKAS 19 and therefore does not qualify for deferred recognition.

In effect, an actuarial gain of 50 is recognised immediately, but is (more than) offset by the increase in the effect of the asset ceiling.

	Balance sheet asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	150	(85)	65
Gain/(loss)	50	(55)	(5)

In both examples 2 and 3 there is a reduction in economic benefits available to the entity. However, in example 2 no loss is recognised whereas in example 3 a loss is recognised. This difference in treatment is consistent with the treatment of changes in the present value of economic benefits before paragraph 58A was introduced. The purpose of paragraph 58A is solely to prevent gains (losses) being recognised because of past service cost or actuarial losses (gains). As far as is possible, all other consequences of deferred recognition and the asset ceiling are left unchanged.

Example 4 - adjustment in a period in which the asset ceiling ceases to have an effect

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	25	40	100	65	65	
2	(50)	0	115	65	115	65	0

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits are available to the entity of 25 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 65 (column F).

In year 2, an actuarial loss of 110 in the plan reduces the surplus from 60 to a deficit of 50 (column A). The economic benefits available to the entity decrease from 25 to 0 (column B). To apply paragraph 58A it is necessary to determine how much of the actuarial loss arises while the defined benefit asset is determined in accordance with paragraph 58(b). Once the surplus becomes a deficit, the amount determined by paragraph 54 is lower than the net total under paragraph 58(b). So, the actuarial loss that arises while the defined benefit asset is determined in accordance with paragraph 58(b) is the loss that reduces the surplus to nil, ie 60. The actuarial loss is, therefore, analysed as follows:

Actuarial loss that arises while the defined benefit asset is measured under paragraph 58(b):

Actuarial loss that equals the reduction in economic benefits	25
Actuarial loss that exceeds the reduction in economic benefits	35
	60
Actuarial loss that arises while the defined benefits asset is measured under paragraph 54	50
Total actuarial loss	110

In accordance with paragraph 58A, 35 of the actuarial loss is recognised immediately under paragraph 54 (column D); 75 (25+50) of the actuarial loss is included in the cumulative unrecognised losses which increase to 115 (column C). The amount determined under paragraph 54 becomes 65 (column D) and under paragraph 58(b) becomes 115 (column E). The recognised asset is the lower of the two, ie 65 (column F), and no gain or loss is recognised (column G).

In effect, an actuarial loss of 35 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	Balance sheet asset under paragraph 54 (column D above)	Effect of the asset ceiling	Asset ceiling (column F (above)
Year 1	100	(35)	65
Year 2	65	0	65
Gain/(loss)	(35)	35	0

Notes

1 In applying paragraph 58A in situations when there is an increase in the present value of the economic benefits available to the entity, it is important to remember that the present value of the economic benefits available cannot exceed the surplus in the plan.[1]

2 In practice, benefit improvements often result in a past service cost and an increase in expected future contributions due to increased current service costs of future years. The increase in expected future contributions may increase the economic benefits available to the entity in the form of anticipated reductions in those future contributions. The prohibition against recognising a gain solely as a result of past service cost in the current period does not prevent the recognition of a gain because of an increase in economic benefits. Similarly, a change in actuarial assumptions that causes an actuarial loss may also increase expected future contributions and, hence, the economic benefits available to the entity in the form of anticipated reductions in future contributions. Again, the prohibition against recognising a gain solely as a result of an actuarial loss in the current period does not prevent the recognition of a gain because of an increase in economic benefits.

[1] The example following paragraph 60 of HKAS 19 is corrected so that the present value of available future refunds and reductions in contributions equals the surplus in the plan of 90 (rather than 100), with a further correction to make the limit 270 (rather than 280).

Appendix E

Amendments to other pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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 F

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

The example illustrating paragraph 115 is amended as follows:

Example illustrating paragraph 115
An entity discontinues ~~a business~~ an operating segment and employees of the discontinued segment will earn no further benefits...

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as described below.

> Hong Kong Accounting Standard 19 *Employee Benefits* (HKAS 19) is set out in paragraphs ~~1–160~~ 1–161. All the paragraphs …

In paragraph 69, 'at each successive balance sheet date' is amended to 'at the end of each successive reporting period'.

Paragraphs 93A–93D are amended as follows:

93A If, as permitted by paragraph 93, an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them ~~outside profit or loss~~ in other comprehensive income, in accordance with paragraphs 93B–93D, providing …

93B Actuarial gains and losses recognised ~~outside profit or loss~~ in other comprehensive income as permitted by paragraph 93A shall be presented in the ~~a~~ statement of comprehensive income. ~~changes in equity titled 'statement of recognised income and expense' that comprises only the items specified in paragraph 96 of HKAS 1. The entity shall not present the actuarial gains and losses in a statement of changes in equity in the columnar format referred to in paragraph 101 of HKAS 1 or any other format that includes the items specified in paragraph 97 of HKAS 1.~~

93C An entity that recognises actuarial gains and losses in accordance with paragraph 93A shall also recognise any adjustments arising from the limit in paragraph 58(b) in other comprehensive income ~~outside profit or loss in the statement of recognised income and expense~~.

93D Actuarial gains and losses and adjustments arising from the limit in paragraph 58(b) that have been recognised ~~directly in the statement of recognised income and expense~~ in other comprehensive income shall be recognised immediately in retained earnings. They shall not be ~~recognised in~~ reclassified to profit or loss in a subsequent period.

In paragraph 105 and in the third paragraph of the Example illustrating paragraph 106, 'the income statement' is amended to 'profit or loss'.

Paragraph 120A is amended as follows:

120A An entity shall disclose the following information about defined benefit plans: …

(h) the total amount recognised in other comprehensive income ~~the statement of recognised income and expense~~ for each of the following: …

(i) for entities that recognise actuarial gains and losses in ~~the statement of recognised income and expense~~ other comprehensive income in accordance with paragraph 93A, the cumulative amount of actuarial gains and losses recognised in ~~the statement of recognised income and expense~~ other comprehensive income.

Paragraph 161 is added as follows:

161 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 93A–93D, 106 (Example) and 120A. 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.

Appendices B and C accompanying HKAS 19 are amended as described below.

In the last paragraph of Appendix B and in the second paragraph of Appendix C, 'the income statement' is amended to 'profit or loss'.

Appendix G

Dissenting opinion (2002 amendment)

Ms O'Malley dissents from this amendment of IAS 19. In her view, the perceived problem being addressed is an inevitable result of the interaction of two fundamentally inconsistent notions in IAS 19. The corridor approach allowed by IAS 19 permits the recognition of amounts on the balance sheet that do not meet the *Framework*'s definition of assets. The asset ceiling then imposes a limitation on the recognition of some of those assets based on a recoverability notion. A far preferable limited amendment would be to delete the asset ceiling in paragraph 58. This would resolve the identified problem and at least remove the internal inconsistency in IAS 19.

It is asserted that the amendment to the standard will result in a more representationally faithful portrayal of economic events. Ms O'Malley believes that it is impossible to improve the representational faithfulness of a standard that permits recording an asset relating to a pension plan that actually has a deficiency, or a liability in respect of a plan that actually has a surplus.

Appendix H

Dissenting opinions (2004 amendment)

Dissenting opinions on December 2004 Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*

Dissent of James J Leisenring

DO1 Mr Leisenring dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.

DO2 Mr Leisenring dissents because he disagrees with the deletion of the last sentence in paragraph 34 and the addition of paragraphs 34A and 34B. He believes that group entities that give a defined benefit promise to their employees should account for that defined benefit promise in their separate or individual financial statements. He further believes that separate or individual financial statements that purport to be prepared in accordance with IFRSs should comply with the same requirements as other financial statements that are prepared in accordance with IFRSs. He therefore disagrees with the removal of the requirement for group entities to treat defined benefit plans that share risks between entities under common control as defined benefit plans and the introduction instead of the requirements of paragraph 34A.

DO3 Mr Leisenring notes that group entities are required to give disclosures about the plan as a whole but does not believe that disclosures are an adequate substitute for recognition and measurement in accordance with the requirements of IAS 19.

Dissent of Tatsumi Yamada

DO4 Mr Yamada dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.

DO5 Mr Yamada agrees that an option should be added to IAS 19 that allows entities that recognise actuarial gains and losses in full in the period in which they occur to recognise them outside profit or loss in a statement of recognised income and expense, even though under the existing IAS 19 they can be recognised in profit or loss in full in the period in which they occur. He agrees that the option provides more transparent information than the deferred recognition options commonly chosen under IAS 19. However, he also believes that all items of income and expense should be recognised in profit or loss in some period. Until they have been so recognised, they should be included in a component of equity separate from retained earnings. They should be transferred from that separate component of equity into retained earnings when they are recognised in profit or loss. Mr Yamada does not, therefore, agree with the requirements of paragraph 93D.

DO6 Mr Yamada acknowledges the difficulty in finding a rational basis for recognising actuarial gains and losses in profit or loss in periods after their initial recognition in a statement of recognised income and expense when the plan is ongoing. He also acknowledges that, under IFRSs, some gains and losses are recognised directly in a separate component of equity and are not subsequently recognised in profit or loss. However, Mr Yamada does not believe that this justifies expanding this treatment to actuarial gains and losses.

DO7 The cumulative actuarial gains and losses could be recognised in profit or loss when a plan is wound up or transferred outside the entity. The cumulative amount recognised in a separate component of equity would be transferred to retained earnings at the same time. This would be consistent with the treatment of exchange gains and losses on subsidiaries that have a measurement currency different from the presentation currency of the group.

DO8 Therefore, Mr Yamada believes that the requirements of paragraph 93D mean that the option is not an improvement to financial reporting because it allows gains and losses to be excluded permanently from profit or loss and yet be recognised immediately in retained earnings.

HKAS 19 is based on IAS 19, *Employee Benefits.* In approving HKAS 19, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's basis for conclusions on IAS 19 (as revised 2003). Accordingly, there are no significant differences between HKAS 19 and IAS 19. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IAS 19 referred to below generally correspond with those in HKAS 19.

Contents

paragraphs

International Accounting Standard 19

Basis for Conclusions on Employee Benefits

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, HKAS 19.

[The original text has been marked up to reflect the revision of IAS 39 (as revised in 2003) and subsequently IFRS 2; new text is underlined and deleted text is struck through.]

Paragraphs 9A–9D, 10A–10K, 48A–48EE and 85A–85E are added in relation to the amendment to IAS 19 issued in December 2004.

Background

1. The IASC Board (the 'Board') approved IAS 19 *Accounting for Retirement Benefits in the Financial Statements of Employers*, in 1983. Following a limited review, the Board approved a revised Standard IAS 19 *Retirement Benefit Costs* ('the old IAS 19'), in 1993. The Board began a more comprehensive review of IAS 19 in November 1994. In August 1995, the IASC Staff published an Issues Paper on *Retirement Benefit and Other Employee Benefit Costs*. In October 1996, the Board approved E54 *Employee Benefits*, with a comment deadline of 31 January 1997. The Board received more than 130 comment letters on E54 from over 20 countries. The Board approved IAS 19 *Employee Benefits* ('the new IAS 19') in January 1998.

2. The Board believes that the new IAS 19 is a significant improvement over the old IAS 19. Nevertheless, the Board believes that further improvement may be possible in due course. In particular, several Board members believe that it would be preferable to recognise all actuarial gains and losses immediately in a statement of financial performance. However, the Board believes that such a solution is not feasible for actuarial gains and losses until the Board makes further progress on various issues relating to the reporting of financial performance. When the Board makes further progress with those issues, it may decide to revisit the treatment of actuarial gains and losses.

Summary of Changes to IAS 19

3. The most significant feature of the new IAS 19 is a market based approach to measurement. The main consequences are that the discount rate is based on market yields at the balance sheet date and any plan assets are measured at fair value. In summary, the main changes from the old IAS 19 are the following:

   (a) there is a revised definition of defined contribution plans and related guidance (see paragraphs 5-6 below), including more detailed guidance than the old IAS 19 on multi-employer plans and state plans (see paragraphs 7-10 below) and on insured plans;

   (b) there is improved guidance on the balance sheet treatment of liabilities and assets arising from defined benefit plans (see paragraphs 11-14 below).

   (c) defined benefit obligations should be measured with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date (see paragraphs 15-16 below);

   (d) projected benefit methods are eliminated and there is a requirement to use the accrued benefit method known as the Projected Unit Credit Method (see paragraphs 17-22 below). The use of an accrued benefit method makes it essential to give detailed guidance on the attribution of benefit to individual periods of service (see paragraphs 23-25 below);

   (e) the rate used to discount post-employment benefit obligations and other long-term employee benefit obligations (both funded and unfunded) should be determined by reference to market yields at the balance sheet date on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds should be used. The currency and term of the corporate bonds or government bonds should be consistent with the currency and estimated term of the post-employment benefit obligations (see paragraphs 26-34 below);

(f) defined benefit obligations should consider all benefit increases that are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs 35-37 below);

(g) an entity should recognise, as a minimum, a specified portion of those actuarial gains and losses (arising from both defined benefit obligations and any related plan assets) that fall outside a 'corridor'. An entity is permitted, but not required, to adopt certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs 38-48 below);

(h) an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately, an entity should recognise past service cost immediately (see paragraphs 49-62 below);

(i) plan assets should be measured at fair value. Fair value is estimated by discounting expected future cash flows only if no market price is available (see paragraphs 66-75 below);

(j) amounts recognised by the reporting entity as an asset should not exceed the net total of:

  (i) any unrecognised actuarial losses and past service cost; and

  (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in contributions to the plan (see paragraphs 76-78 below);

(k) curtailment and settlement losses should be recognised not when it is probable that the settlement or curtailment will occur, but when the settlement or curtailment occurs (see paragraphs 79-80 below);

(l) improvements have been made to the disclosure requirements (see paragraphs 81-85 below);

(m) the new IAS 19 deals with all employee benefits, whereas IAS 19 deals only with retirement benefits and certain similar post-employment benefits (see paragraphs 86-94 below); and

(n) the transitional provisions for defined benefit plans are amended (see paragraphs 95-96 below).

The Board rejected a proposal to require recognition of an 'additional minimum liability' in certain cases (see paragraphs 63-65 below).

Summary of Changes to E54

4. The new IAS 19 makes the following principal changes to the proposals in E54:

(a) an entity should attribute benefit to periods of service following the plan's benefit formula, but the straight-line basis should be used if employee service in later years leads to a materially higher level of benefit than in earlier years (see paragraphs 23-25 below);

(b) actuarial assumptions should include estimates of benefit increases not if there is reliable evidence that they will occur, but only if the increases are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs 35-37 below);

(c) actuarial gains and losses that fall outside the 10% 'corridor' need not be recognised immediately as proposed in E54. The minimum amount that an entity should recognise for each defined benefit plan is the part that fell outside the 'corridor' as at the end of the previous reporting period, divided by the expected average remaining working lives of the employees participating in that plan. The new IAS 19 also permits certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs 38-48 below);

(d) E54 set out two alternative treatments for past service cost and indicated that the Board would eliminate one of these treatments after considering comments on the Exposure Draft. One treatment was immediate recognition of all past service cost. The other treatment was immediate recognition for former employees, with amortisation for current employees over the remaining working lives of the current employees. The new IAS 19 requires that an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately an entity should recognise past service cost immediately (see paragraphs 49-59 below);

(e) the effect of 'negative plan amendments' should not be recognised immediately (as proposed in E54) but treated in the same way as past service cost (see paragraphs 60-62 below);

(f) non-transferable securities issued by the reporting entity have been excluded from the definition of plan assets (see paragraphs 67-68 below);

(g) plan assets should be measured at fair value rather than market value, as defined in E54 (see paragraphs 69-70 below);

(h) plan administration costs (not just investment administration costs, as proposed in E54), are to be deducted in determining the return on plan assets (see paragraph 75 below);

(i) the limit on the recognition of plan assets has been changed in two respects from the proposals in E54. The limit does not over-ride the corridor for actuarial losses or the deferred recognition of past service cost. Also, the limit refers to **available** refunds or reductions in future contributions. E54 referred to the **expected** refunds or reductions in future contributions (see paragraphs 76-78 below);

(j) unlike E54, the new IAS 19 does not specify whether an income statement should present interest cost and the expected return on plan assets in the same line item as current service cost. The new IAS 19 requires an entity to disclose the line items in which they are included;

(k) improvements have been made to the disclosure requirements (see paragraphs 81-85 below);

(l) the guidance in certain areas (particularly termination benefits, curtailments and settlements, profit sharing and bonus plans and various references to constructive obligations) has been conformed to the proposals in E59, *Provisions, Contingent Liabilities and Contingent Assets*. Also, the Board has added explicit guidance on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year (see paragraphs 91-93 below); and

(m) on initial adoption of the new IAS 19, there is a transitional option to recognise an increase in defined benefit liabilities over not more than five years. The new IAS 19 is operative for financial statements covering periods beginning on or after 1 January 1999, rather than 2001 as proposed in E54 (see paragraphs 95-96 below).

Defined Contribution Plans (paragraphs 24-47 of the Standard)

5. The old IAS 19 defined:

   (a) **defined contribution plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to contributions to a fund together with investment earnings thereon; and

   (b) **defined benefit plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' remuneration and/or years of service.

   The Board considers these definitions unsatisfactory because they focus on the benefit receivable by the employee, rather than on the cost to the entity. The definitions in paragraph 7 of the new IAS 19 focus on the downside risk that the cost to the entity may increase. The definition of defined contribution plans does not exclude the upside potential that the cost to the entity may be less than expected.

6. The new IAS 19 does not change the accounting for defined contribution plans, which is straightforward because there is no need for actuarial assumptions and an entity has no possibility of any actuarial gain or loss. The new IAS 19 gives no guidance equivalent to paragraphs 20 (past service costs in defined contribution plans) and 21 (curtailment of defined contribution plans) of the old IAS 19. The Board believes that these issues are not relevant to defined contribution plans.

Multi-employer Plans and State Plans (paragraphs 29-38 of the Standard)

7. An entity may not always be able to obtain sufficient information from multi-employer plans to use defined benefit accounting. The Board considered three approaches to this problem:

   (a) use defined contribution accounting for some and defined benefit accounting for others;

   (b) use defined contribution accounting for all multi-employer plans, with additional disclosure where the multi-employer plan is a defined benefit plan; or

   (c) use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting.

8. The Board believes that there is no conceptually sound, workable, and objective way to draw a distinction so that an entity could use defined contribution accounting for some multi-employer defined benefit plans and defined benefit accounting for others. Also, the Board believes that it is misleading to use defined contribution accounting for multi-employer plans that are defined benefit plans. This is illustrated by the case of French banks that used defined contribution accounting for defined benefit pension plans operated under industry-wide collective agreements on a pay-as-you-go basis. Demographic trends made these plans unsustainable and a major reform in 1993 replaced these by defined contribution arrangements for future service. At this point, the banks were compelled to quantify their obligations. Those obligations had previously existed, but had not been recognised as liabilities.

9. The Board concluded that an entity should use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting. The Board agreed to apply the same principle to state plans. The new IAS 19 notes that most state plans are defined contribution plans.

Multi-employer plans: amendment issued by the IASB in December 2004

9A. In April 2004 the International Financial Reporting Interpretations Committee(IFRIC) published a draft Interpretation, D6 *Multi-employer Plans*, which proposed the following guidance on how multi-employer plans should apply defined benefit accounting, if possible:

(a) the plan should be measured in accordance with IAS 19 using assumptions appropriate for the plan as a whole

(b) the plan should be allocated to plan participants so that they recognise an asset or liability that reflects the impact of the surplus or deficit on the future contributions from the participant.

9B. The concerns raised by respondents to D6 about the availability of the information about the plan as a whole, the difficulties in making an allocation as proposed and the resulting lack of usefulness of the information provided by defined benefit accounting were such that the IFRIC decided not to proceed with the proposals.

9C. The International Accounting Standards Board (IASB), when discussing group plans (see paragraphs 10A-10K) noted that, if there were a contractual agreement between a multi-employer plan and its participants on how a surplus would be distributed or deficit funded, the same principle that applied to group plans should apply to multi-employer plans, ie the participants should recognise an asset or liability. In relation to the funding of a deficit, the IASB regarded this principle as consistent with the recognition of a provision in accordance with IAS 37.

9D. The IASB therefore decided to clarify in IAS 19 that, if a participant in a defined benefit multi-employer plan:

(a) accounts for that participation on a defined contribution basis in accordance with paragraph 30 of IAS 19 because it had insufficient information to apply defined benefit accounting but

(b) has a contractual agreement that determined how a surplus would be distributed or a deficit funded,

it recognises the asset or liability arising from that contractual agreement.

10. In response to comments on E54, the Board considered a proposal to exempt wholly owned subsidiaries (and their parents) participating in group defined benefit plans from the recognition and measurement requirements in their individual non-consolidated financial statements, on cost-benefit grounds. The Board concluded that such an exemption would not be appropriate.

Application of IAS 19 in the separate or individual financial statements of entities in a consolidated group: amendment issued by the IASB in December 2004

10A. Some constituents asked the IASB to consider whether entities participating in a group defined benefit plan should, in their separate or individual financial statements, either have an unqualified exemption from defined benefit accounting or be able to treat the plan as a multi-employer plan.

10B. In developing the exposure draft, the IASB did not agree that an unqualified exemption from defined benefit accounting for group defined benefit plans in the separate or individual financial statements of group entities was appropriate. In principle, the requirements of International Financial Reporting Standards (IFRSs) should apply to separate or individual financial statements in the same way as they apply to any other financial statements. Following that principle would mean amending IAS 19 to allow group entities that participate in a plan that meets the definition of a multi-employer plan, except that the participants are under common control, to be treated as participants in a multi-employer plan in their separate or individual financial statements.

10C. However, in the exposure draft, the IASB concluded that entities within a group should always be presumed to be able to obtain the necessary information about the plan as a whole. This implies that, in accordance with the requirements for multi-employer plans, defined benefit accounting should be applied if there is a consistent and reliable basis for allocating the assets and obligations of the plan.

10D. In the exposure draft, the IASB acknowledged that entities within a group might not be able to identify a consistent and reliable basis for allocating the plan that results in the entity recognising an asset or liability that reflects the extent to which a surplus or deficit in the plan would affect their future contributions. This is because there may be uncertainty in the terms of the plan about how surpluses will be used or deficits funded across the consolidated group. However, the IASB concluded that entities within a group should always be able to make at least a consistent and *reasonable* allocation, for example on the basis of a percentage of pensionable pay.

10E. The IASB then considered whether, for some group entities, the benefits of defined benefit accounting using a consistent and *reasonable* basis of allocation were worth the costs involved in obtaining the information. The IASB decided that this was not the case for entities that meet criteria similar to those in IAS 27 *Consolidated and Separate Financial Statements* for the exemption from preparing consolidated financial statements.

10F. The exposure draft therefore proposed that:

(a) entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control, and that meet the criteria set out in paragraph 34 of IAS 19 as proposed to be amended in the exposure draft, should be treated as if they were participants in a multi-employer plan. This means that if there is no consistent and reliable basis for allocating the assets and liabilities of the plan, the entity should use defined contribution accounting and provide additional disclosures.

(b) all other entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control should be required to apply defined benefit accounting by making a consistent and reasonable allocation of the assets and liabilities of the plan.

10G. Respondents to the exposure draft generally supported the proposal to extend the requirements in IAS 19 on multi-employer plans to group entities. However, many disagreed with the criteria proposed in the exposure draft, for the following reasons:

(a) the proposed amendments and the interaction with D6 were unclear.

(b) the provisions for multi-employer accounting should be extended to a listed parent company.

(c) the provisions for multi-employer accounting should be extended to group entities with listed debt.

(d) the provisions for multi-employer plan accounting should be extended to all group entities, including partly-owned subsidiaries.

(e) there should be a blanket exemption from defined benefit accounting for all group entities.

10H. The IASB agreed that the proposed requirements for group plans were unnecessarily complex. The IASB also concluded that it would be better to treat group plans separately from multi-employer plans because of the difference in information available to the participants: in a group plan information about the plan as a whole should generally be available. The IASB further noted that, if the parent wishes to comply with IFRSs in its separate financial statements or wishes its subsidiaries to comply with IFRSs in their individual financial statements, then it must obtain and provide the necessary information for the purposes of disclosure, at least.

10I. The IASB noted that, if there were a contractual agreement or stated policy on charging the net defined benefit cost to group entities, that agreement or policy would determine the cost for each entity. If there is no such contractual agreement or stated policy, the entity that is the sponsoring employer by default bears the risk relating to the plan. The IASB therefore concluded that a group plan should be allocated to the individual entities within a group in accordance with any contractual agreement or stated policy. If there is no such agreement or policy, the net defined benefit cost is allocated to the sponsoring employer. The other group entities recognise a cost equal to any contribution collected by the sponsoring employer.

10J. This approach has the advantages of (a) all group entities recognising the cost they have to bear for the defined benefit promise and (b) being simple to apply.

10K. The IASB also noted that participation in a group plan is a related party transaction. As such, disclosures are required to comply with IAS 24 *Related Party Disclosures.* Paragraph 20 of IAS 24 requires an entity to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. The IASB noted that information about each of (a) the policy on charging the defined benefit cost, (b) the policy on charging current contributions and (c) the status of the plan as a whole was required to give an understanding of the potential effect of the participation in the group plan on the entity's separate or individual financial statements.

Defined Benefit Plans

Recognition and Measurement: Balance Sheet (paragraphs 49-60 of the Standard)

11. Paragraph 54 of the new IAS 19 summarises the recognition and measurement of liabilities arising from defined benefit plans and paragraphs 55-107 of the new IAS 19 describe various aspects of recognition and measurement in greater detail. Although the old IAS 19 did not deal explicitly with the recognition of retirement benefit obligations as a liability, it is likely that most entities would recognise a liability for retirement benefit obligations at the same time under both Standards. However, the two Standards differ in the measurement of the resulting liability.

12. Paragraph 54 of the new IAS 19 is based on the definition of, and recognition criteria for, a liability in IASC's *Framework for the Preparation and Presentation of Financial Statements* (the *'Framework'*). The *Framework* defines a liability *as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits*. The *Framework* states that an item which meets the definition of a liability should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow from the entity; and

(b) the item has a cost or value that can be measured with reliability.

allowing entities to use different mechanisms, the needs of users are not likely to be compromised if faster (and systematic) recognition methods are permitted.

47. The Board noted that changes in the fair value of any plan assets are, in effect, the results of changing estimates by market participants and are, therefore, inextricably linked with changes in the present value of the obligation. Consequently, the Board decided that changes in the fair value of plan assets are actuarial gains and losses and should be treated in the same way as the changes in the related obligation.

48. The width of a 'corridor' (i.e. the point at which it becomes necessary to recognise gains and losses) is arbitrary. To enhance comparability, the Board decided that the width of the 'corridor' should be consistent with the current requirement in those countries that have already adopted a 'corridor' approach, notably the USA. The Board noted that a significantly narrower 'corridor' would suffer from the disadvantages of the 'corridor', without being large enough to generate the advantages. On the other hand, a significantly wider 'corridor' would lack credibility.

An additional option for the recognition of actuarial gains and losses: amendment adopted by the IASB in December 2004

48A. In 2004 the IASB published an exposure draft proposing an additional option for the recognition of actuarial gains and losses. The proposed option allowed an entity that recognised actuarial gains and losses in full in the period in which they occurred to recognise them outside profit or loss in a statement of recognised income and expense.

48B. The argument for immediate recognition of actuarial gains and losses is that they are economic events of the period. Recognising them when they occur provides a faithful representation of those events. It also results in a faithful representation of the plan in the balance sheet. In contrast, when recognition is deferred, the information provided is partial and potentially misleading. Furthermore, any net cumulative deferred actuarial losses can give rise to a debit item in the balance sheet that does not meet the definition of an asset. Similarly, any net cumulative deferred actuarial gains can give rise to a credit item in the balance sheet that does not meet the definition of a liability.

48C. The arguments put forward for deferred recognition of actuarial gains and losses are, as noted above:

(a) immediate recognition can cause volatile fluctuations in the balance sheet and income statement. It implies a degree of accuracy of measurement that rarely applies in practice. As a result, the volatility may not be a faithful representation of changes in the defined benefit asset or liability, but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements.

(b) in the long term, actuarial gains and losses may offset one another.

(c) whether or not the volatility resulting from immediate recognition reflects economic events of the period, it is too great to be acceptable in the financial statements. It could overwhelm the profit or loss and financial position of other business operations.

48D. The IASB does not accept arguments (a) and (b) as reasons for deferred recognition. It believes that the defined benefit asset or liability can be measured with sufficient reliability to justify its recognition. Recognition in a transparent manner of the current best estimate of the events of the period and the resulting asset and liability provides better information than non-recognition of an arbitrary amount of that current best estimate. Further, it is not reasonable to assume that existing actuarial gains and losses will be offset in future years. This implies an ability to predict future market prices.

48E. The IASB also does not accept argument (c) in relation to the balance sheet. If the post-employment benefit amounts are large and volatile, the post-employment plan must be large and risky compared with other business operations. However, the IASB accepts that requiring actuarial gains and losses to be recognised in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognised income and expense.

48F. The IASB noted that the UK standard FRS 17 *Retirement Benefits* requires recognition of actuarial gains and losses in full as they occur outside profit or loss in a statement of total recognised gains and losses.

48G. The IASB does not believe that immediate recognition of actuarial gains and losses outside profit or loss is necessarily ideal. However, it provides more transparent information than deferred recognition. The IASB therefore decided to propose such an option pending further developments on the presentation of profit or loss and other items of recognised income and expense.

48H. IAS 1 *Presentation of Financial Statements* (as revised in 2003) requires income and expense recognised outside profit or loss to be presented in a statement of changes in equity. The statement of changes in equity must present the total income and expense for the period, being the profit or loss for the period and each item of income and expense for the period that, as required or permitted by other Standards or Interpretations, is recognised directly in equity (IAS 1 paragraph 96(a)-(c)). IAS 1 also permits these items, together with the effect of changes in accounting policies and the correction of errors, to be the only items shown in the statement of changes in equity.

48I. To emphasise its view that actuarial gains and losses are items of income or expense, the IASB decided that actuarial gains and losses that are recognised outside profit or loss must be presented in the form of a statement of changes in equity that excludes transactions with equity holders acting in their capacity as equity holders. The IASB decided that this statement should be titled 'the statement of recognised income and expense'.

48J. The responses from the UK to the exposure draft strongly supported the proposed option. The responses from outside the UK were divided. The main concerns expressed were:

(a) the option is not a conceptual improvement compared with immediate recognition of actuarial gains and losses in profit or loss.

(b) the option prejudges issues relating to IAS 1 that should be resolved in the project on reporting comprehensive income.

(c) adding options to Standards is not desirable and obstructs comparability.

(d) the IASB should not tinker with IAS 19 before undertaking a comprehensive review of the Standard.

(e) the option could lead to divergence from US GAAP.

(f) deferred recognition is preferable to immediate recognition.

48K. The IASB agrees that actuarial gains and losses are items of income and expense. However, it believes that it would be premature to require their immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income. The requirement that actuarial gains and losses that are recognised outside profit or loss must be recognised in a statement of recognised income and expense does not prejudge any of the discussions the IASB is yet to have on reporting comprehensive income. Rather, the IASB is allowing an accounting treatment currently accepted by a national standard-setter (the UK ASB) to continue, pending the comprehensive review of accounting for post-employment benefits and reporting comprehensive income.

48L. The IASB also agrees that adding options to Standards is generally undesirable because of the resulting lack of comparability between entities. However, IAS 19 permits an entity to choose *any* systematic method of recognition for actuarial gains and losses that results in faster recognition than the minimum required by the Standard. Furthermore, the amount to be recognised under any deferral method will depend on when that method was first applied, ie when an entity first adopted IAS 19 or started a defined benefit plan. There is, therefore, little or no comparability because of the existing options in IAS 19.

48M. The IASB further agrees that a fundamental review of accounting for post-employment benefits is needed. However, such a review is likely to take some time to complete. In the meantime, the IASB believes that it would be wrong to prohibit a method of recognising actuarial gains and losses that is accepted by a national standard-setter and provides more transparent information about the costs and risks of running a defined benefit plan.

48N. The IASB agrees that the new option could lead to divergence from US GAAP. However, although IAS 19 and US GAAP share the same basic approach, they differ in several respects. The IASB has decided not to address these issues now. Furthermore, the option is just that. No entity is obliged to create such divergence.

48O. Lastly, as discussed above, the IASB does not agree that deferred recognition is better than immediate recognition of actuarial gains and losses. The amounts recognised under a deferral method are opaque and not representationally faithful, and the inclusion of deferral methods creates a complex difficult standard.

48P. The IASB considered whether actuarial gains and losses that have been recognised outside profit or loss should be recognised in profit or loss in a later period (ie recycled). The IASB noted that there is not a consistent policy on recycling in IFRSs and that recycling in general is an issue to be resolved in its project on reporting comprehensive income. Furthermore, it is difficult to see a rational basis on which actuarial gains and losses could be recycled. The exposure draft therefore proposed prohibiting recycling of actuarial gains and losses that have been recognised in the statement of recognised income and expense.

48Q. Most respondents supported not recycling actuarial gains and losses. However, many argued in favour of recycling, for the following reasons:

(a) all income and expense should be recognised in profit or loss at some time.

(b) a ban on recycling is a new approach in IFRSs and should not be introduced before a fundamental review of reporting comprehensive income.

(c) to ban recycling could encourage abuse in setting over-optimistic actuarial assumptions.

48R. The IASB notes that most items under IFRSs that are recognised outside profit or loss are recycled, but not all. Revaluation gains and losses on property, plant and equipment and intangibles are not recycled. The question of recycling therefore remains open in IFRSs. The IASB does not believe that a general decision on the matter should be made in the context of these amendments. The decision in these amendments not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis and does not prejudge the wider debate that will take place in the project on reporting comprehensive income.

48S. In the meantime, the IASB acknowledges the concern of some respondents that some items of income or expense will not be recognised in profit or loss in any period. The IASB has therefore required disclosure of the cumulative amounts recognised in the statement of recognised income and expense so that users of the financial statements can assess the effect of this policy.

48T. The IASB also notes the argument that to ban recycling could lead to abuse in setting over-optimistic assumptions. A lower cost could be recognised in profit or loss with resulting experience losses being recognised in the statement of recognised income and expense. Some of the new disclosures help to counter such concerns, for example, the narrative description of the basis for the expected rate of return and the five-year history of experience gains and losses. The IASB also notes that under a deferred recognition approach, if over-optimistic assumptions are used, a lower cost is recognised immediately in profit or loss and the resulting experience losses are recognised only gradually over the next 10-15 years. The incentive for such abuse is just as great under deferred recognition as it is under immediate recognition outside profit or loss.

48U. The IASB also considered whether actuarial gains and losses recognised outside profit or loss should be recognised immediately in a separate component of equity and transferred to retained earnings at a later period. Again the IASB concluded that there is no rational basis for a transfer to retained earnings in later periods. Hence, the exposure draft proposed that actuarial gains and losses that are recognised outside profit or loss should be recognised in retained earnings immediately.

48V. A small majority of the respondents supported this proposal. The arguments put forward against immediate recognition in retained earnings were:

(a) the IASB should not set requirements on the component of equity in which items should be recognised before a fundamental review of the issue.

(b) retained earnings should be the cumulative total of profit or loss less amounts distributed to owners.

(c) the volatility of the amounts means that separate presentation would be helpful.

(d) the impact on distributions needs to be considered.

(e) actuarial gains and losses are temporary in nature and hence should be excluded from retained earnings.

48W. In IFRSs, the phrase 'retained earnings' is not defined and the IASB has not discussed what it should mean. In particular, retained earnings is not defined as the cumulative total of profit or loss less amounts distributed to owners. As with recycling, practice varies under IFRSs. Some amounts that are recognised outside profit or loss are required to be presented in a separate component of equity, for example exchange gains and losses on foreign subsidiaries. Other such amounts are not, for example gains and losses on available-for-sale financial assets.

48X. The IASB does not believe that it is appropriate to introduce a definition of retained earnings in the context of these amendments to IAS 19. The proposal in the exposure draft was based on practical considerations. As with recycling, there is no rational basis for transferring actuarial gains and losses from a separate component in equity into retained earnings at a later date. As discussed above, the IASB has added a requirement to disclose the cumulative amount recognised in the statement of recognised income and expense to provide users with further information.

48Y. Consideration of the implications of IFRSs on the ability of an entity to make distributions to equity holders is not within the IASB's remit. In addition, the IASB does not agree that even if actuarial gains and losses were temporary in nature this would justify excluding them from retained earnings.

48Z. Finally, the IASB considered whether, if actuarial gains and losses are recognised when they occur, entities should be required to present separately in retained earnings an amount equal to the defined benefit asset or liability. Such a presentation is required by FRS 17. The IASB noted that such a presentation is not required by IFRSs for any other item, however significant its size or volatility, and that entities can provide the information if they wish. The IASB therefore decided not to require such a presentation.

48AA. IAS 19 limits the amount of a surplus that can be recognised as an asset ('the asset ceiling') to the present value of any economic benefits available to an entity in the form of refunds from the plan or reductions in future contributions to the plan.[*] The IASB considered whether the effect of this limit should be recognised outside profit or loss, if that is the entity's accounting policy for actuarial gains and losses, or treated as an adjustment of the other components of the defined benefit cost and recognised in profit or loss.

48BB. The IASB decided that the effect of the limit is similar to an actuarial gain or loss because it arises from a remeasurement of the benefits available to an entity from a surplus in the plan. The IASB therefore concluded that, if the entity's accounting policy is to recognise actuarial gains and losses as they occur outside profit or loss, the effect of the limit should also be recognised outside profit or loss in the statement of recognised income and expense.

48CC. Most respondents supported this proposal. The arguments opposing the proposal were:

(a) the adjustment arising from the asset ceiling is not necessarily caused by actuarial gains and losses and should not be treated in the same way.

(b) it is not consistent with FRS 17, which allocates the change in the recoverable surplus to various events and hence to different components of the defined benefit cost.

48DD. The IASB agrees that the adjustment from the asset ceiling is not necessarily caused by actuarial gains and losses. The asset ceiling effectively imposes a different measurement basis for the asset to be recognised (present value of refunds and reductions in future contributions) from that used to derive the actuarial gains and losses and other components of the defined benefit cost (fair value of plan assets less projected unit credit value of plan liabilities).

[*] The limit also includes unrecognised actuarial gains and losses and past service costs.

Changes in the recognised asset arise from changes in the present value of refunds and reductions in future contributions. Such changes can be caused by events of the same type as those that cause actuarial gains and losses, for example changes in interest rates or assumptions about longevity, or by events that do not cause actuarial gains and losses, for example trustees agreeing to a refund in exchange for benefit enhancements or a management decision to curtail the plan.

48EE. Because the asset ceiling imposes a different measurement basis for the asset to be recognised, the IASB does not believe it is possible to allocate the effect of the asset ceiling to the components of the defined benefit cost other than on an arbitrary basis. The IASB reaffirmed its view that the adjustment arising from the asset ceiling should, therefore, be regarded as a remeasurement and similar to an actuarial gain or loss. This treatment also has the advantages of (a) being simple and (b) giving transparent information because the cost of the defined benefit promise (ie the service costs and interest cost) remains unaffected by the funding of the plan.

Past Service Cost (paragraphs 96-101 of the Standard)

49. E54 included two alternative treatments for past service cost. The first approach was similar to that used in the old IAS 19 (amortisation for current employees and immediate recognition for former employees). The second approach was immediate recognition of all past service cost.

50. Those who support the first approach argue that:

(a) an entity introduces or improves employee benefits for current employees in order to generate future economic benefits in the form of reduced employee turnover, improved productivity, reduced demands for increases in cash compensation and improved prospects for attracting additional qualified employees;

(b) although it may not be feasible to improve benefits for current employees without also improving benefits for former employees, it would be impracticable to assess the resulting economic benefits for an entity and the period over which those benefits will flow to the entity; and

(c) immediate recognition is too revolutionary. It would also have undesirable social consequences because it would deter companies from improving benefits.

51. Those who support immediate recognition of all past service cost argue that:

(a) amortisation of past service cost is inconsistent with the view of employee benefits as an exchange between an entity and its employees for services rendered: past service cost relates to past events and affects the employer's present obligation arising from employees' past service. Although an entity may improve benefits in the expectation of future benefits, an obligation exists and should be recognised;

(b) deferred recognition of the liability reduces comparability; an entity that retrospectively improves benefits relating to past service will report lower liabilities than an entity that granted identical benefits at an earlier date, yet both have identical benefit obligations. Also, deferred recognition encourages entities to increase pensions instead of salaries;

(c) past service cost does not give an entity control over a resource and thus does not meet the *Framework*'s definition of an asset. Therefore, it is not appropriate to defer recognition of the expense; and

(d) there is not likely to be a close relationship between cost - the only available measure of the effect of the amendment - and any related benefits in the form of increased loyalty.

52. Under the old IAS 19, past service cost for current employees was recognised as an expense systematically over the expected remaining working lives of the employees concerned. Similarly, under the first approach set out in E54, past service cost was to be amortised over the average expected remaining working lives of the employees concerned. However, E54 also proposed that the attribution period for current service cost should end when the employee's entitlement to receive all significant benefits due under the plan is no longer conditional on further service. Some commentators on E54 felt that these two provisions were inconsistent.

82. Information about defined benefit plans is particularly important to users of financial statements because other information published by an entity will not allow users to estimate the nature and extent of defined benefit obligations and to assess the risks associated with those obligations. The disclosure requirements are based on the following principles:

(a) the most important information about employee benefits is information about the uncertainty attaching to measures of employee benefit obligations and costs and about the potential consequences of such uncertainty for future cash flows;

(b) employee benefit arrangements are often complex, and this makes it particularly important for disclosures to be clear, concise and relevant;

(c) given the wide range of views on the treatment of actuarial gains and losses and past service cost, the required disclosures should highlight their impact on the income statement and the impact of any unrecognised actuarial gains and losses and unamortised past service cost on the balance sheet; and

(d) the benefits derived from information should exceed the cost of providing it.

83. The Board agreed the following changes to the disclosure requirements proposed in E54:

(a) the description of a defined benefit plan need only be a general description of the type of plan: for example, flat salary pension plans should be distinguished from final salary plans and from post-employment medical plans. Further detail would not be required;

(b) an entity should disclose the amounts, if any, included in the fair value of plan assets not only for each category of the reporting entity's own financial instruments, but also for any property occupied by, or other assets used by, the entity;

(c) an entity should disclose not just the expected return on plan assets, but also the actual return on plan assets;

(d) an entity should disclose a reconciliation of the movements in the net liability (or asset) recognised in its balance sheet; and

(e) an entity should disclose any amount not recognised as an asset because of the new limit in paragraph 58(b) of the Standard.

84. Some commentators on E54, especially preparers, felt that the disclosures were excessive. A particular concern expressed by several respondents was aggregation: how should an entity aggregate information about many different plans in a concise, meaningful and cost-effective way? Two disclosures that seemed to cause special concern were the analysis of the overall charge in the income statement and the actuarial assumptions. In particular, a number of commentators felt that the requirement to disclose expected rates of salary increases would cause difficulties with employees. However, the Board concluded that all the disclosures were essential.

85. The Board considered whether smaller or non-public entities could be exempted from any of the disclosure requirements. However, the Board concluded that any such exemptions would either prevent disclosure of essential information or do little to reduce the cost of the disclosures.

Disclosures: amendment issued by the IASB in December 2004

85A. From a review of national standards on accounting for post-employment benefits, the IASB identified the following disclosures that it proposed should be added to IAS 19:

(a) reconciliations showing the changes in plan assets and defined benefit obligations. The IASB believed that these reconciliations give clearer information about the plan. Unlike the reconciliation previously required by IAS 19 that showed the changes in the recognised net liability or asset, the new reconciliations include amounts whose recognition has been deferred. The reconciliation previously required was eliminated.

(b) information about plan assets. The IASB believed that more information is needed about the plan assets because, without such information, users cannot assess the level of risk inherent in the plan. The exposure draft proposed:

(i) disclosure of the percentage that the major classes of assets held by the plan constitute of the total fair value of the plan assets;

(ii) disclosure of the expected rate of return for each class of asset; and

(iii) a narrative description of the basis used to determine the overall expected rate of return on assets.

(c) information about the sensitivity of defined benefit plans to changes in medical cost trend rates. The IASB believed that this is necessary because the effects of changes in a plan's medical cost trend rate are difficult to assess. The way in which healthcare cost assumptions interact with caps, cost-sharing provisions, and other factors in the plan precludes reasonable estimates of the effects of those changes. The IASB also noted that the disclosure of a change of one percentage point would be appropriate for plans operating in low inflation environments but would not provide useful information for plans operating in high inflation environments.

(d) information about trends in the plan. The IASB believed that information about trends is important so that users have a view of the plan over time, not just at the balance sheet date. Without such information, users may misinterpret the future cash flow implications of the plan. The exposure draft proposed disclosure of five-year histories of the plan liabilities, plan assets, the surplus or deficit and experience adjustments.

(e) information about contributions to the plan. The IASB believed that this will provide useful information about the entity's cash flows in the immediate future that cannot be determined from the other disclosures about the plan. It proposed the disclosure of the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the balance sheet date.

(f) information about the nature of the plan. The IASB proposed an addition to paragraph 121 of IAS 19 to ensure that the description of the plan is complete and includes all the terms of the plan that are used in the determination of the defined benefit obligation.

85B. The proposed disclosures were generally supported by respondents to the exposure draft, except for the expected rate of return for each major category of plan assets, sensitivity information about medical cost trend rates and the information about trends in the plan.

85C. In relation to the expected rate of return for each major category of plan assets, respondents argued that the problems of aggregation for entities with many plans in different geographical areas were such that this information would not be useful. The IASB accepted this argument and decided not to proceed with the proposed disclosure. However, the IASB decided to specify that the narrative description of the basis for the overall expected rate of return should include the effect of the major categories of plan assets.

85D. Respondents also expressed concerns that the sensitivity information about medical cost trend rates gave undue prominence to that assumption, even though medical costs might not be significant compared with other defined benefit costs. The IASB noted that the sensitivity information need be given only if the medical costs are material and that IAS 1 requires information to be given about all key assumptions and key sources of estimation uncertainty.

85E. Finally, some respondents argued that requiring five-year histories would give rise to information overload and was unnecessary because the information was available from previous financial statements. The IASB reconfirmed its view that the trend information was useful and noted that it was considerably easier for an entity to take the information from previous financial statements and present it in the current financial statements than it would be for users to find the figures for previous periods. However, the IASB agreed that as a transitional measure entities should be permitted to build up the trend information over time.

Benefits other than Post-Employment Benefits

Compensated Absences (paragraphs 11-16 of the Standard)

86. Some argue that an employee's entitlement to future compensated absences does not create an obligation if that entitlement is conditional on future events other than future service. However, the Board believes that an obligation arises as an employee renders service which increases the employee's entitlement (conditional or unconditional) to future compensated absences; for example, accumulating paid sick leave creates an obligation because any unused entitlement increases the employee's entitlement to sick leave in future periods. The probability that the employee will be sick in those future periods affects the measurement of that obligation, but does not determine whether that obligation exists.

87. The Board considered three alternative approaches to measuring the obligation that results from unused entitlement to accumulating compensated absences:

(a) recognise the entire unused entitlement as a liability, on the basis that any future payments are made first out of unused entitlement and only subsequently out of entitlement that will accumulate in future periods (a FIFO approach);

(b) recognise a liability to the extent that future payments for the employee group as a whole are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (a group LIFO approach); or

(c) recognise a liability to the extent that future payments for individual employees are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (an individual LIFO approach).

These methods are illustrated by the following example.

Example

An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one year. Such leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X1, the average unused entitlement is two days per employee. The entity expects, based on past experience which is expected to continue, that 92 employees will take no more than four days of paid sick leave in 20X2 and that the remaining 8 employees will take an average of six and a half days each.

Method (a) *The entity recognises a liability equal to the undiscounted amount of 200 days of sick pay (two days each, for 100 employees). It is assumed that the first 200 days of paid sick leave result from the unused entitlement.*

Method (b) *The entity recognises no liability because paid sick leave for the employee group as a whole is not expected to exceed the entitlement of five days each in 20X2.*

Method (c) *The entity recognises a liability equal to the undiscounted amount of 12 days of sick pay (one and a half days each, for 8 employees).*

88. The Board selected method (c), the individual LIFO approach, because that method measures the obligation at the present value of the additional future payments that are expected to arise solely from the accumulation feature. The new IAS 19 notes that, in many cases, the resulting liability will not be material.

Death-in-service Benefits

89. E54 gave guidance on cases where death-in-service benefits are not insured externally and are not provided through a post-employment benefit plan. The Board concluded that such cases will be rare. Accordingly, the Board agreed to delete the guidance on death-in-service benefits.

Other Long-term Employee Benefits (paragraphs 126-131 of the Standard)

90. The Board decided, for simplicity, not to permit or require a 'corridor' approach for other long-term employee benefits, as such benefits do not present measurement difficulties to the same extent as post-employment benefits. For the same reason, the Board decided to require immediate recognition of all past service cost for such benefits and not to permit any transitional option for such benefits.

Termination Benefits (paragraphs 132-143 of the Standard)

91. Under some national standards, termination benefits are not recognised until employees have accepted the offer of the termination benefits. However, the Board decided that the communication of an offer to employees (or their representatives) creates an obligation and that obligation should be recognised as a liability if there is a detailed formal plan. The detailed formal plan both makes it probable that there will be an outflow of resources embodying economic benefits and also enables the obligation to be measured reliably.

92. Some argue that a distinction should be made between:

(a) termination benefits resulting from an explicit contractual or legal requirement; and

(b) termination benefits resulting from an offer to encourage voluntary redundancy.

The Board believes that such a distinction is irrelevant; an entity offers termination benefits to encourage voluntary redundancy because the entity already has a constructive obligation. The communication of an offer enables an entity to measure the obligation reliably. E54 proposed some limited flexibility to allow that communication to take place shortly after the balance sheet date. However, in response to comments on E54, and for consistency with E59, *Provisions, Contingent Liabilities and Contingent Assets*, the Board decided to remove that flexibility.

93. Termination benefits are often closely linked with curtailments and settlements and with restructuring provisions. Therefore, the Board decided that there is a need for recognition and measurement principles to be similar. The guidance on the recognition of termination benefits (and of curtailments and settlements) has been conformed to the proposals in E59 *Provisions, Contingent Liabilities and Contingent Assets*. The Board agreed to add explicit guidance (not given in E54) on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year.

Equity Compensation Benefits (paragraphs 144-152 of the Standard)

~~94. The Board decided that the new IAS 19 should not:~~

~~(a) include recognition and measurement requirements for equity compensation benefits, in view of the lack of international consensus on the recognition and measurement of the resulting obligations and costs; or~~

~~(b) require disclosure of the fair value of employee share options, in view of the lack of international consensus on the fair value of many employee share options.~~[1]

Transition and Effective Date (paragraphs 153-158 of the Standard)

95. The Board recognises that the new IAS 19 will lead to significant changes for some entities. E54 proposed to mitigate this problem by delaying the effective date of the new IAS 19 until 3 years after its approval. In response to comments on E54, the Board introduced a transitional option to amortise an increase in defined benefit liabilities over not more than five years. In consequence, the Board decided that it was not necessary to delay the effective date.

96. E54 proposed no specific transitional provisions. Consequently, an entity applying the new IAS 19 for the first time would have been required to compute the effect of the 'corridor' retrospectively. Some commentators felt that this would be impracticable and would not generate useful information. The Board agreed with these comments. Accordingly, the new IAS 19 confirms that, on initial adoption, an entity does not compute the effect of the 'corridor' retrospectively.

[1] Paragraphs 144-152 of IAS 19 were deleted by IFRS 2 *Share-based Payment.*

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

> *[The original text has been marked up to reflect the revision of IAS 39* Financial Instruments: Recognition and Measurement *~~(as revised~~ in 2003~~)~~ and subsequently the issue of IFRS 2* Share-based Payment *in 2004; new text is underlined and deleted text is struck through. The terminology has not been amended to reflect the changes made by IAS 1* Presentation of Financial Statements *(as revised in 2007).]*
>
> ...

Paragraph 38 is footnoted as follows:

38 The Board considered five methods of accounting for actuarial gains and losses:

(a) …

(b) immediate recognition both in the balance sheet and outside the income statement in equity (IAS 1 *Presentation of Financial Statements* sets out requirements for the presentation or disclosure of such movements in equity)* (see paragraphs 40 and 41 below); …

* IAS 1 (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

Paragraph 48H is amended and footnoted as follows:

48H IAS 1 ~~*Presentation of Financial Statements*~~ (as revised in 2003) requires income and expense recognised outside profit or loss to be presented in a statement of changes in equity.* The statement of changes in equity must present the total income and expense for the period, being the profit or loss for the period and each item of income and expense for the period that, as required or permitted by other ~~Standards or Interpretations~~ IFRSs, is recognised directly in equity ~~(IAS 1 paragraph 96(a)–(c))~~. IAS 1 also permits these items, together with the effect of changes in accounting policies and the correction of errors, to be the only items shown in the statement of changes in equity.

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

Contents

Hong Kong Accounting Standard 20

Accounting for Government Grants and Disclosure of Government Assistance

Hong Kong Accounting Standard 20 *Accounting for Governments Grants and Disclosure of Government Assistance* (HKAS 20) is set out in paragraphs 1-41A. All the paragraphs have equal authority. HKAS 20 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Statements* and the *Framework for 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.

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as described below.

> Hong Kong Accounting Standard 20 *Accounting for Government Grants and Disclosure of Government Assistance* (HKAS 20) is set out in paragraphs ~~1–41~~ <u>1–42</u>. All the paragraphs …

In paragraphs 14 and 15, ‘the income statement’ is amended to ‘profit or loss’.

In paragraph 28, ‘for the purpose of balance sheet presentation’ is amended to ‘for presentation purposes in the statement of financial position’.

Paragraph 29A is added as follows:

> 29A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents grants related to income as required in paragraph 29 in that separate statement.

Paragraph 42 is added as follows:

> **42 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it added paragraph 29A. 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.**

Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) is set out in paragraphs 1-62 and the Appendix. All the paragraphs have equal authority. HKAS 21 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

14. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with HKAS 29 *Financial Reporting in Hyperinflationary Economies*. An entity cannot avoid restatement in accordance with HKAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent).

Net Investment in a Foreign Operation

15. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 32 and 33. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

15A. The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if Subsidiary A were itself a foreign operation.

Monetary Items

16. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognised as a liability. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (eg prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

Summary of the Approach Required by this Standard

17. In preparing financial statements, each entity—whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—determines its functional currency in accordance with paragraphs 9-14. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20-37 and 50.

18. Many reporting entities comprise a number of individual entities (eg a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38-50.

29. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period.

30. When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss shall be recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

31. Other Standards require some gains and losses to be recognised directly in equity. For example, HKAS 16 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised directly in equity. When such an asset is measured in a foreign currency, paragraph 23(c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognised in equity.

32. Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 15) shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in a separate component of equity and recognised in profit or loss on disposal of the net investment in accordance with paragraph 48.

33. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 28. ~~Similarly, i~~If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 28. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 28. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method). ~~However, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie they remain recognised in profit or loss).~~

56. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 55. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with Hong Kong Financial Reporting Standards and the disclosures set out in paragraph 57 are required.

57. When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 55 are not met, it shall:

(a) clearly identify the information as supplementary information to distinguish it from the information that complies with Hong Kong Financial Reporting Standards;

(b) disclose the currency in which the supplementary information is displayed; and

(c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Effective Date and Transition

58. An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

58A. Net Investment in a Foreign Operation (Amendment to HKAS 21), issued in January 2006, added paragraph 15A and amended paragraph 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

59. An entity shall apply paragraph 47 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this Standard is first applied. Retrospective application of paragraph 47 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than assets and liabilities of the foreign operation. 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 at the date of the acquisition.

60. All other changes resulting from the application of this Standard shall be accounted for in accordance with the requirements of HKAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors.**

60A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. In HKAS 7 *Cash Flow Statements*, paragraphs 25 and 26 are amended to read as follows:~~

~~***25. Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.***~~

~~***26. The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.***~~

~~A2. In HKAS 12 *Income Taxes*, paragraphs 41 and 62 are amended to read as follows:~~

~~41. The non-monetary assets and liabilities of an entity are measured in its functional currency (see HKAS 21 *The Effect of Changes in Foreign Exchange Rates*). If the entity's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in a different currency, changes in the exchange rate give rise to temporary differences that result in a recognised deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited to profit or loss (see paragraph 58).~~

~~62. Hong Kong Financial Reporting Standards require or permit certain items to be credited or charged directly to equity. Examples of such items are: …~~

~~(c) exchange differences arising on the translation of the financial statements of a foreign operation (see HKAS 21 *The Effects of Changes in Foreign Exchange Rates*); and~~

~~…~~

~~A3. [Not used]~~

~~A4. In Appendix B to HKAS 34 *Interim Financial Reporting*, paragraphs 30 and 31 are amended to read as follows:~~

~~30. HKAS 21 *The Effects of Changes in Foreign Exchange Rates* specifies how to translate the financial statements for foreign operations into the presentation currency, including guidelines for using average or closing foreign exchange rates and guidelines for recognising the resulting adjustments in profit or loss or in equity. Consistently with HKAS 21, the actual average and closing rates for the interim period are used. Entities do not anticipate some future changes in foreign exchange rates in the remainder of the current financial year in translating foreign operations at an interim date.~~

~~31. If HKAS 21 requires translation adjustments to be recognised as income or expense in the period in which they arise, that principle is applied during each interim period. Entities do not defer some foreign currency translation adjustments at an interim date if the adjustment is expected to reverse before the end of the financial year.~~

~~A5. [Not used]~~

~~A6. In HKAS 38 *Intangible Assets*, paragraph 107 is amended to read as follows:~~

~~***107. The financial statements shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:***~~

~~**…**~~

~~***(e) a reconciliation of the carrying amount at the beginning and end of the period showing:***~~

~~**…**~~

~~***(vii) net exchange differences arising on the translation of the financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and***~~

~~**…**~~

~~A7. In HKAS 41 *Agriculture*, paragraph 50 is amended to read as follows:~~

~~***50. An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:***~~

~~**…**~~

~~***(f)*** ***net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and***~~

~~…~~

~~A8. [Not used]~~

~~A9. HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~In Appendix B, paragraphs B1A and B1B are added:~~

~~B1A. 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 under previous GAAP.~~

~~B1B 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 HKAS 22, as permitted by paragraph B1 above..~~

~~In the Guidance on Implementing HKFRS 1, after paragraph IG21, a heading and paragraph IG21A are added, and paragraph IG32 is amended to read as follows:~~

~~**HKAS 21 *The Effects of Changes in Foreign Exchange Rates***~~

~~IG21A An entity may, under 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 HKAS 21 to all acquisitions occurring after the date of transition to HKFRSs.~~

~~IG32 An entity complies with HKAS 21 *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency and presentation currency. When the entity prepares its opening HKFRS balance sheet, it applies HKAS 29 to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.~~

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 7, '... a cash flow statement of cash flows arising …' is amended to '... a statement of cash flows of the cash flows arising…'.

In the heading above paragraph 23, '**Reporting at subsequent balance sheet dates**' is amended to '**Reporting at the ends of subsequent reporting periods**'.

In paragraph 27, 'reported initially in equity' is amended to 'recognised initially in other comprehensive income'.

In paragraphs 30 and 31, 'recognised directly in equity' and 'recognised in equity' are amended to 'recognised in other comprehensive income'.

In paragraph 32, '**recognised initially in a separate component of equity and recognised in profit or loss**' is amended to '**recognised initially in other comprehensive income and reclassified from equity to profit or loss**'.

In paragraph 33, 'reclassified to the separate component of equity' is amended to 'recognised in other comprehensive income'.

Paragraph 37 is amended as follows:

37 The effect … Exchange differences arising from the translation of a foreign operation previously ~~classified in equity~~ <u>recognised in other comprehensive income</u> in accordance with paragraphs 32 and 39(c) are not ~~recognised in~~ <u>reclassified from equity to</u> profit or loss until the disposal of the operation.

In paragraph 39(a), '**at the closing rate at the date of that balance sheet**' is amended to '**at the closing rate at the date of that statement of financial position**'.

In paragraph 39(b), '**each income statement**' is amended to '**each statement of comprehensive income or separate income statement presented**'.

In paragraph 39(c), '**as a separate component of equity**' is amended to '**in other comprehensive income**'.

Paragraphs 41, 45, 46, 48 and 52 are amended as follows:

41 The exchange differences referred to in paragraph 39(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. ~~Such exchange differences arise both on income and expense items recognised in profit or loss and on those recognised directly in equity.~~

...

These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation. When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, …

45 The incorporation … Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference ~~continues to be~~ is recognised in profit or loss or, if it arises from the circumstances described in paragraph 32, it is ~~classified as equity~~ recognised in other comprehensive income and accumulated in a separate component of equity until the disposal of the foreign operation.

46 When … HKAS 27 allows the use of a different ~~reporting~~ date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.

…

48 On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, ~~deferred~~ recognised in other comprehensive income and accumulated in a separate component of equity, ~~relating to that foreign operation~~ shall be ~~recognised in~~ reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised (see HKAS 1 *Presentation of Financial Statements* (as revised in 2007)).

52 An entity shall disclose: …

(b) net exchange differences ~~classified~~ recognised in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

Paragraph 60A is added as follows:

60A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 27, 30–33, 37, 39, 41, 45, 48 and 52. 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.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, HKAS 21.

Paragraph BC1 is amended and paragraphs BC25A–BC25F are added in relation to the amendment to IAS 21 issued in December 2005.

HKAS 21 is based on IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In approving HKAS 21, the Council of the Hong Kong Society of Accountants considered and agreed with the IASB's basis for conclusions on IAS 21 (as revised 2003). Accordingly, there are no significant differences between HKAS 21 and IAS 21. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IAS 21 referred to below generally correspond with those in HKAS 21.

Introduction

BC1. This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 21 *The Effects of Changes in Foreign Exchange Rates* in 2003, and on the amendment to IAS 21 *Net Investment in a Foreign Operation* in December 2005. Individual Board members gave greater weight to some factors than to others.

BC2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 21. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.

BC3. Because the Board's intention was not to reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates established by IAS 21, this Basis for Conclusions does not discuss requirements in IAS 21 that the Board has not reconsidered.

Functional Currency

BC4. The term 'reporting currency' was previously defined as "the currency used in presenting the financial statements". This definition comprises two separate notions (which were identified in SIC-19 *Reporting Currency–Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*):

- the measurement currency (the currency in which the entity measures the items in the financial statements) and
- the presentation currency (the currency in which the entity presents its financial statements).

The Board decided to revise the previous version of IAS 21 to incorporate the SIC-19 approach of separating these two notions. The Board also noted that the term 'functional currency' is more commonly used than 'measurement currency' and decided to adopt the more common term.

BC22. However, the Board decided not to adopt the SIC-30 approach for the translation of comparatives for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into a presentation currency of a non-hyperinflationary economy. The Board noted that in such a case, the SIC-30 approach requires restating the comparative amounts from those shown in last year's financial statements for both the effects of inflation and for changes in exchange rates. If exchange rates fully reflect differing price levels between the two economies to which they relate, the SIC-30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, the Board noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them. For these reasons the Board decided to require that all comparative amounts are those presented in the prior year financial statements (ie there is no adjustment for either subsequent changes in the price level or subsequent changes in exchange rates).

BC23. The Board decided to incorporate into the Standard most of the disclosure requirements of SIC-30 *Reporting Currency–Translation from Measurement Currency to Presentation Currency* that apply when a different translation method is used or other supplementary information, such as an extract from the full financial statements, is displayed in a currency other than the functional currency (see paragraph 57 of the Standard). These disclosures enable users to distinguish information prepared in accordance with IFRSs from information that may be useful to users but is not the subject of IFRSs, and also tell users how the latter information has been prepared.

Capitalisation of Exchange Differences

BC24. The previous version of IAS 21 allowed a limited choice of accounting for exchange differences that arise "from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset"[*]. The benchmark treatment was to recognise such exchange differences in profit or loss. The allowed alternative was to recognise them as an asset.

BC25. The Board noted that the allowed alternative (of recognition as an asset) was not in accordance with the *Framework for the Preparation and Presentation of Financial Statements* because exchange losses do not meet the definition of an asset. Moreover, recognition of exchange losses as an asset is neither allowed nor required by any liaison standard-setter, so its deletion would improve convergence. Finally, in many cases when the conditions for recognition as an asset are met, the asset would be restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*. Thus, to the extent that an exchange loss reflects hyperinflation, this effect is taken into account by IAS 29. For all of these reasons, the Board removed the allowed alternative treatment and the related SIC Interpretation is superseded.

[*] IAS 21 (revised 1993), paragraph 21

Net investment in a foreign operation

BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity's net investment in a foreign operation are initially recognised in a separate component of equity in the consolidated financial statements of the reporting entity. Among the revisions to IAS 21 made in 2003 was the provision of guidance on this principle that required the monetary item to be denominated in the functional currency of either the reporting entity or the foreign operation. The previous version of IAS 21 did not include such guidance.

BC25B The requirements can be illustrated by the following example. Parent P owns 100 per cent of Subsidiary S. Parent P has a functional currency of UK sterling. Subsidiary S has a functional currency of Mexican pesos. Parent P grants a loan of 100 US dollars to Subsidiary S, for which settlement is neither planned nor likely to occur in the foreseeable future. IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.

BC25C After the revised IAS 21 was issued in 2003, constituents raised the following concerns:

(a) It is common practice for a monetary item that forms part of an entity's investment in a foreign operation to be denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation. An example is a monetary item denominated in a currency that is more readily convertible than the local domestic currency of the foreign operation.

(b) An investment in a foreign operation denominated in a currency that is not the functional currency of the reporting entity or the foreign operation does not expose the group to a greater foreign currency exchange difference than arises when the investment is denominated in the functional currency of the reporting entity or the foreign operation. It simply results in exchange differences arising in the foreign operation's individual financial statements and the reporting entity's separate financial statements.

(c) It is not clear whether the term 'reporting entity' in paragraph 32 should be interpreted as the single entity or the group comprising a parent and all its subsidiaries. As a result, constituents questioned whether the monetary item must be transacted between the foreign operation and the reporting entity, or whether it could be transacted between the foreign operation and any member of the consolidated group, ie the reporting entity or any of its subsidiaries.

BC25D The Board noted that the nature of the monetary item referred to in paragraph 15 is similar to an equity investment in a foreign operation, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.

BC25E Accordingly, in 2005 the Board decided to amend IAS 21. The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements. This requirement applies irrespective of the currency of the monetary item and of whether the monetary item results from a transaction with the reporting entity or any of its subsidiaries.

BC25F The Board also proposed amending IAS 21 to clarify that an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that foreign operation. Respondents to the exposure draft disagreed with this proposal. Many respondents said that the proposed amendment added a detailed rule that was not required because the principle in paragraph 15 was clear. In redeliberations, the Board agreed with those comments and decided not to proceed with that proposed amendment.

Goodwill and Fair Value Adjustments

BC26. The previous version of IAS 21 allowed a choice of translating goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity at (a) the closing rate or (b) the historical transaction rate.

BC27. The Board agreed that, conceptually, the correct treatment depends on whether goodwill and fair value adjustments are part of:

(a) the assets and liabilities of the acquired entity (which would imply translating them at the closing rate); or

(b) the assets and liabilities of the parent (which would imply translating them at the historical rate).

BC28. The Board agreed that fair value adjustments clearly relate to the identifiable assets and liabilities of the acquired entity and should therefore be translated at the closing rate.

BC29. Goodwill is more complex, partly because it is measured as a residual. In addition, the Board noted that difficult issues can arise when the acquired entity comprises businesses that have different functional currencies (eg if the acquired entity is a multinational group). The Board discussed how to assess any resulting goodwill for impairment and, in particular, whether the goodwill would need to be 'pushed down' to the level of each different functional currency or could be accounted for and assessed at a higher level.

BC30. One view is that when the parent acquires a multinational operation comprising businesses with many different functional currencies, any goodwill may be treated as an asset of the parent/acquirer and tested for impairment at a consolidated level.

Those who support this view believe that, in economic terms, the goodwill is an asset of the parent because it is part of the acquisition price paid by the parent. Thus, they believe, it would be incorrect to allocate the goodwill to the many acquired businesses and translate it into their various functional currencies. Rather, the goodwill, being treated as an asset of the parent, is not exposed to foreign currency risks, and translation differences associated with it should not be recognised. In addition, they believe that such goodwill should be tested for impairment at a consolidated level. Under this view, allocating or 'pushing down' the goodwill to a lower level, such as each different functional currency within the acquired foreign operation, would not serve any purpose.

BC31. Others take a different view. They believe that the goodwill is part of the parent's net investment in the acquired entity. In their view, goodwill should be treated no differently from other assets of the acquired entity, in particular intangible assets, because a significant part of the goodwill is likely to comprise intangible assets that do not qualify for separate recognition. They also note that goodwill arises only because of the investment in the foreign entity and has no existence apart from that entity. Lastly, they point out that when the acquired entity comprises a number of businesses with different functional currencies, the cash flows that support the continued recognition of goodwill are generated in those different functional currencies.

BC32. The Board was persuaded by the reasons set out in the preceding paragraph and decided that goodwill is treated as an asset of the foreign operation and translated at the closing rate. Consequently, goodwill should be allocated to the level of each functional currency of the acquired foreign operation. This means that the level to which goodwill is allocated for foreign currency translation purposes may be different from the level at which the goodwill is tested for impairment. Entities follow the requirements in IAS 36 *Impairment of Assets* to determine the level at which goodwill is tested for impairment.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

This Basis for Conclusions accompanies, but is not part of, IAS 21.

Paragraph BC1 was amended and paragraphs BC25A–BC25F were added in relation to the amendment to IAS 21 issued in December 2005.

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).*

Paragraphs BC25A, BC25B, BC25D and BC25E are footnoted as follows:

BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity's net investment in a foreign operation are initially recognised in a separate component of equity* in the consolidated financial statements of the reporting entity. Among…

BC25B The requirements … IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity* in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.

BC25D The Board noted … Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity* effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board …

BC25E Accordingly … The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity* in the consolidated financial statements. This …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such differences are recognised in other comprehensive income.

Appendix
Amendments to other pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2009. If an entity applies this Standard for an earlier period, the amendments in this appendix shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~A1 HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~In the rubric, the first sentence is amended as follows:~~

~~Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1 – 47F 1-47G…~~

~~Paragraphs 9, 12 and 13 are amended, after paragraph 25H a heading and paragraph 25I are inserted, and paragraph 47G is added as follows:~~

~~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 paragraphs 25D, 25H, 25I, 34A and 34B.~~

~~12 This HKFRS establishes two categories of exceptions to the principle that an entity's opening HKFRS balance sheet shall comply with each HKFRS:~~

~~(a) paragraphs 13-25HI and 36A-36C grant exemptions from some requirements of other HKFRSs.~~

~~(b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.~~

~~13 An entity may elect to use one or more of the following exemptions:~~

~~(a) …~~

~~(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G); and~~

~~(m) a financial asset or an intangible asset accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph 25H); and~~

~~(n) borrowing costs (paragraph 25I).~~

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

~~Borrowing costs~~

~~25I A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of HKAS 23 *Borrowing Costs*, 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.~~

~~47G An entity shall apply the amendments in paragraphs 13(n) and 25I for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 23 for an earlier period, these amendments shall be applied for that earlier period.~~

~~A2 In HKAS 1 *Presentation of Financial Statements* the last sentence of paragraph 110 is deleted.~~

~~A3 In HKAS 7 *Cash Flow Statements* paragraph 32 is amended as follows:~~

~~32 The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognised as an expense in the income statement or capitalised in accordance with the allowed alternative treatment in HKAS 23 *Borrowing Costs*.~~

~~A4 In HKAS 11 *Construction Contracts* the last sentence of paragraph 18 is amended as follows:~~

~~18 Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs when the contractor adopts the allowed alternative treatment in HKAS 23 *Borrowing Costs*.~~

~~A5 In HKAS 16 *Property, Plant and Equipment* paragraph 23 is amended as follows:~~

~~23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is recognised in the carrying amount of the item capitalised in accordance with the allowed alternative treatment in HKAS 23.~~

~~A6 In HKAS 38 *Intangible Assets* paragraph 32 is amended as follows:~~

~~32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with the capitalisation treatment permitted in HKAS 23 *Borrowing Costs*.~~

~~A7 In Hong Kong (IFRIC) Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* paragraph 8 is amended as follows:~~

~~8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. The allowed alternative treatment of cCapitalisation under HKAS 23 is not permitted.~~

~~A8 In Hong Kong (IFRIC) Interpretation 12 *Service Concession Arrangements* paragraph 22 is amended as follows:~~

~~22 In accordance with HKAS 23, borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case borrowing costs attributable to the arrangement may shall be capitalised during the construction phase of the arrangement in accordance with the allowed alternative treatment under that Standard.~~

Appendix
Amendments to Basis for Conclusions on other pronouncements

This appendix contains amendments to the Basis for Conclusions on other pronouncements that are necessary in order to ensure consistency with the revised IAS 23.

* * *

The amendments contained in this appendix when this *Basis for Conclusions* was issued have been incorporated into the relevant *Basis for Conclusions*.

~~BCA1 In the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, after paragraph BC63D a heading and paragraph BC63E are added as follows:~~

~~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.~~

~~BCA2 In the Basis for Conclusions on IFRIC Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, the second sentence of paragraph BC26 is footnoted as follows:~~

~~In March 2007, IAS 23 was revised to require the previously allowed alternative treatment of capitalisation. Capitalisation of borrowing costs for a qualifying asset becomes the only accounting treatment. That revision does not affect the reasoning set out in this Basis for Conclusions.~~

~~BCA3 In the Basis for Conclusions on IFRIC Interpretation 12 *Service Concession Arrangements*, the first sentence of paragraph BC57, and paragraphs BC59 and BC77(f) are footnoted as follows:~~

~~In March 2007, IAS 23 was revised to require the previously allowed alternative treatment of capitalisation. Therefore, an entity is required to capitalise borrowing costs as part of the cost of a qualifying asset to the extent that they are directly attributable to its acquisition, construction or production until the asset is ready for its intended use or sale. That revision does not affect the reasoning set out in this Basis for Conclusions.~~

Amendments to guidance on other pronouncements

The following amendments to guidance on other pronouncements are necessary in order to ensure consistency with the revised HKAS 23. 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.

~~IGA1 In the Guidance on Implementing HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*, paragraphs IG23 and IG24 are amended as follows. Paragraph IG25 is deleted.~~

~~IG23 On first adopting HKFRSs, an entity adopts a policy of begins capitalising borrowing costs (HKAS 23 as revised in 2007) allowed alternative treatment) or not capitalising them (HKAS 23 benchmark treatment). The entity applies that policy consistently in its opening HKFRS balance sheet and in all periods presented in its first HKFRS financial statements. In accordance with paragraph 25I of the HKFRS, 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 HKFRSs (whichever is later);~~

~~(b) may elect to designate any date before 1 January 2009 or the date of transition to HKFRSs (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 Under the allowed alternative treatment, HKAS 23 requires disclosure of interest capitalised during the period. Neither HKAS 23 nor the HKFRS requires disclosure of the cumulative amount capitalised.~~

~~IG25 [Deleted] HKAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of HKAS 23 that meet the criteria for capitalisation. However, if a first-time adopter adopts the HKAS 23 allowed alternative treatment, the HKFRS requires retrospective application of that treatment, even for periods before the effective date of HKAS 23 (paragraph 9 of the HKFRS).~~

~~IGA2 In the Guidance on Implementing HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, Example 2 is deleted.~~

~~IGA3 In the Illustrative Examples accompanying Hong Kong (IFRIC) Interpretation 12 *Service Concession Arrangements*, paragraphs IE15 and IE31 are amended as follows:~~

~~IE15 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructure).~~

~~The operator estimates the fair value of its consideration received to be equal to the forecast construction costs plus 5 per cent margin. It is also assumed that, in accordance with HKAS 23 *Borrowing Costs*, the operator adopts the allowed alternative treatment in HKAS 23 *Borrowing Costs* and therefore capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:~~

~~IE31 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructure. The operator estimates the fair value of its consideration received or receivable as equal to the forecast construction costs plus 5 per cent. It is also assumed that, in accordance with HKAS 23 *Borrowing Costs*, the operator adopts the allowed alternative treatment in HKAS 23 *Borrowing Costs* and therefore capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase:~~

Contents

Hong Kong Accounting Standard 24

Related Party Disclosures

paragraphs

Hong Kong Accounting Standard 24 *Related Party Disclosures* (HKAS 24) is set out in paragraphs 1-24 and the Appendix. All the paragraphs have equal authority. HKAS 24 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

or in kind);

(h) provision of guarantees or collateral; and

(i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties (see paragraph 34B of HKAS 19).

21. Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

22. Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Effective Date

23. An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

23A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

Withdrawal of SSAP 20 (issued 1997)

24. This Standard supersedes SSAP 20 *Related Party Disclosures* (issued in 1997).

Appendix A

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at December 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 24.

The International Accounting Standard comparable with HKAS 24 is IAS 24 *Related Party Disclosures*.

There are no major textual differences between HKAS 24 and IAS 24.

Appendix B

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 19, 'on the balance sheet' is amended to 'in the statement of financial position'.

Contents

Hong Kong Accounting Standard 27

Consolidated and Separate Financial Statements

Hong Kong Accounting Standard 27 *Consolidated and Separate Financial Statements* (HKAS 27) is set out in paragraphs 1-45 and the Appendix. All the paragraphs have equal authority. HKAS 27 should be read in the context of the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Hong Kong Accounting Standard 27

Consolidated and Separate Financial Statements

Scope

1. This Standard shall be applied in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent.

2. This Standard does not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see HKFRS 3 *Business Combinations*).

3. This Standard shall also be applied in accounting for investments in subsidiaries, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements.

~~3A. This Standard defines a subsidiary as "an entity that is controlled by another entity". For this purpose, control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. This definition of subsidiary could result in an investee entity being classified as a subsidiary when it does not meet the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance.~~

~~3B. In issuing this Standard, the Hong Kong Society of Accountants has obtained legal advice on the legality of introducing a requirement in this Standard to consolidate certain entities which are not subsidiaries as defined by section 2(4) of the Companies Ordinance in group accounts of a Hong Kong incorporated company. The legal opinion states that the definitions of "subsidiary" and "holding company" in sections 2(4) and 2(7) of the Companies Ordinance are exhaustive for the purposes of group accounts as defined by section 124(1) of the Companies Ordinance. Accordingly, a Hong Kong incorporated company may not consolidate a company that does not meet the definition of a subsidiary in the Companies Ordinance.~~

~~3C. The principles laid down in this Standard are applicable to Hong Kong incorporated companies except to the extent that the legal constraints do not permit them to include in their consolidated financial statements an entity which does not meet the definition of a subsidiary in the Companies Ordinance. However, this Standard requires Hong Kong incorporated companies to disclose certain additional information to enable users of the consolidated financial statements to assess the effects as if this Standard had been fully complied with.~~

Definitions

4. The following terms are used in this Standard with the meanings specified:

<u>Consolidated financial statements</u> are the financial statements of a group presented as those of a single economic entity.

<u>Control</u> is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The <u>cost method</u> is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

A <u>group</u> is a parent and all its subsidiaries.

<u>Minority interest</u> is that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.

20. A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other entities within the group. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by HKAS 14 *Segment Reporting* help to explain the significance of different business activities within the group.

21. A parent loses control when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities. The loss of control can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when a subsidiary becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual agreement.

~~Specific provisions for Hong Kong incorporated companies~~

~~*21A. In preparing consolidated financial statements of a Hong Kong incorporated company, only companies that fall within the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance may be consolidated. Therefore, for the purposes of applying this Standard, Hong Kong incorporated companies should use the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance where it conflicts with the definition in paragraph 4 above.*~~

~~*21B. In the circumstances where a company is a subsidiary as defined by section 2(4) of the Companies Ordinance but the parent does not have unilateral control over it, it should not be dealt with in the consolidated financial statements as a subsidiary. Where a subsidiary is excluded on the grounds of lack of effective control, it should be accounted for as a jointly controlled entity in accordance with HKAS 31* **Interests in Joint Ventures** *or an associate in accordance with HKAS 28,* **Investments in Associates***, as appropriate.*~~

Consolidation Procedures

22. In preparing consolidated financial statements, an entity combines the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single economic entity, the following steps are then taken:

    (a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see HKFRS 3, which describes the treatment of any resultant goodwill);

    (b) minority interests in the profit or loss of consolidated subsidiaries for the reporting period are identified; and

    (c) minority interests in the net assets of consolidated subsidiaries are identified separately from the parent shareholders' equity in them. Minority interests in the net assets consist of:

        (i) the amount of those minority interests at the date of the original combination calculated in accordance with HKFRS 3; and

        (ii) the minority's share of changes in equity since the date of the combination.

23. When potential voting rights exist, the proportions of profit or loss and changes in equity allocated to the parent and minority interests are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights.

24. Intragroup balances, transactions, income and expenses shall be eliminated in full.

25. Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. HKAS 12 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

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

41. When separate financial statements are prepared for a parent that, in accordance with paragraph 10, elects not to prepare consolidated financial statements, those separate financial statements shall disclose:

(a) the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name and country of incorporation or residence of the entity whose consolidated financial statements that comply with Hong Kong Financial Reporting Standards or International Financial Reporting Standards have been produced for public use; and the address where those consolidated financial statements are obtainable;

(b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and

(c) a description of the method used to account for the investments listed under (b).

42. When a parent (other than a parent covered by paragraph 41), venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:

(a) the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;

(b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and

(c) a description of the method used to account for the investments listed under (b);

and shall identify the financial statements prepared in accordance with paragraph 9 of this Standard, HKAS 28 and HKAS 31 to which they relate.

~~Specific disclosures for Hong Kong incorporated companies~~

~~42A. When a Hong Kong incorporated company holds an entity which would be a subsidiary as defined in paragraph 4 but is not accounted for as a subsidiary as a result of paragraph 21A, it should disclose in the notes details of the effect on the consolidated financial statements had the exemption given in paragraph 21A not applied.~~

Effective Date

43. **~~Subject to paragraph 43B, a~~An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact and apply Hong Kong Accounting Standards Interpretation (HK(SIC)-Int 12)** ***Consolidation – Special Purpose Entities*** **at the same time.**

43A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period(s).

~~43B. An entity shall apply paragraphs 3A-3C, 21A, 21B and 42A from the time when this Standard becomes effective (or earlier) and cease to apply those paragraphs for annual periods beginning on or after 1 January 2006 as a consequence of the Companies (Amendment) Ordinance 2005. This is because the Companies (Amendment) Ordinance~~

~~2005 will remove the legal constraint that prevents a Hong Kong incorporated company from consolidating in its group accounts a subsidiary that does not meet the legal definition of subsidiary with effect for annual periods beginning on or after 1 January 2006. If an entity has applied these paragraphs for an annual period beginning before 1 January 2006, it should restate the comparative amounts for the prior periods presented in the financial statements prepared for annual periods beginning on or after 1 January 2006 as if those paragraphs had not been applied.~~

Withdrawal of Other Pronouncements

44. This Standard supersedes SSAP 32 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* (issued in 2001).

45. This Standard supersedes Interpretation 18 *Consolidation and Equity Method — Potential Voting Rights and Allocation of Ownership Interests.*

Appendix

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at 24 November 2005 ~~2004~~ and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 27.

The International Accounting Standard comparable with HKAS 27 is IAS 27 *Consolidated and Separate Financial Statements*.

There are no major textual differences between HKAS 27 and IAS 27.

~~The following sets out the major textual differences between HKAS 27 and IAS 27 and the reason for the differences.~~

~~**Differences**~~	~~**Reason for the Differences**~~
~~**Provisions for Hong Kong incorporated companies**~~ ~~Additional paragraphs are inserted:~~ ~~a. to give the background on why Hong Kong incorporated companies should use the definition of subsidiary as set out in section 2(4) of the Companies Ordinance (see paragraphs 3A to 3C);~~ ~~b. to include specific provisions for Hong Kong incorporated companies in applying this Standard (see paragraphs 21A and 21B); and~~ ~~c. to require specific disclosures for Hong Kong incorporated companies (see paragraph 42A).~~ ~~Hong Kong incorporated companies should apply these additional paragraphs from the time when this Standard becomes effective (or earlier) and should cease to apply these additional paragraphs for annual periods beginning on or after 1 January 2006.~~	~~The Standard recognises that, in preparing consolidated financial statements6, a company incorporated under the Hong Kong Companies Ordinance does may not consolidate an entity that does not meet the definition of a subsidiary under that Ordinance.The Standard also recognises thatthe above legal constraint will be removed by the Companies (Amendment) Ordinance 2005 with effect for annual periods beginning on or after 1 January 2006.~~ ~~The Standard also takes the view that in the circumstances where a company is a subsidiary as defined by the Companies Ordinance but the parent does not have unilateral control over it, it should not be dealt with in the consolidated financial statements as a subsidiary but as a jointly controlled entity.~~

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. [Not used]~~

~~A2. [Not used]~~

~~A3. [Not used]~~

~~A4. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003, references to the current version of SSAP 32 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* are amended to HKAS 27 *Consolidated and Separate Financial Statements.*~~

Appendix

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

References to HKAS 14 *Segment Reporting* are amended to HKFRS 8 *Operating Segments* in:

- paragraph 20 of HKAS 27 *Consolidated and Separate Financial Statements*

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 4, in the definition of the ***cost method***, '**accumulated profits**' is amended to '**retained earnings**'.

Paragraphs 26, 27, 30 and 40(e) are amended as follows:

26 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same ~~reporting~~ date. When the ~~reporting dates~~ end of the reporting period of the parent is different from that of ~~and~~ a subsidiary ~~are different~~, the subsidiary prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the parent unless it is impracticable to do so.

27 When … the financial statements of a subsidiary used in the preparation of consolidated financial statements are prepared as of a ~~reporting~~ date different from that of the parent, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the parent's financial statements. In any case, the difference between the ~~reporting date~~ end of the reporting period of the subsidiary and that of the parent shall be no more than three months. The length of the reporting periods and any difference between ~~in~~ the ~~reporting dates~~ ends of the reporting periods shall be the same from period to period.

30 The income … recognised in ~~equity~~ other comprehensive income in accordance with HKAS 21 *The Effects of Changes in Foreign Exchange Rates*, is ~~recognised in the~~ reclassified to consolidated ~~income statement~~ profit or loss as a reclassification adjustment as the gain or loss on the disposal of the subsidiary.

40 The following disclosures …

(e) the ~~reporting date~~ end of the reporting period of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a ~~reporting~~ date or for a period that is different from that of the parent, and the reason for using a different ~~reporting~~ date or period; …

Paragraph 43C is added as follows:

43C HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 30. 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.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC21 is footnoted as follows:

In 2006 IAS 14 *Segment Reporting* was replaced by IFRS 8 *Operating Segments*.

Contents

Hong Kong Accounting Standard 28

Investments in Associates

Hong Kong Accounting Standard 28

Investments in Associates

Scope

1. ***This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:***

   (a) venture capital organisations, or

   (b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

   that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with HKAS 39 **Financial Instruments: Recognition and Measurement.** ***Such investments shall be measured at fair value in accordance with HKAS 39, with changes in fair value recognised in profit or loss in the period of the change.***

Definitions

2. ***The following terms are used in this Standard with the meanings specified:***

   An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

   Consolidated financial statements are the financial statements of a group presented as those of a single economic entity.

   Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

   The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

   Joint control is the contractually agreed sharing of control over an economic activity~~.~~ ***, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).***

   Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

8. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or reduce another party's voting power over the financial and operating policies of another entity (ie potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

9. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential rights, except the intention of management and the financial ability to exercise or convert.

10. An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual agreement.

Equity Method

11. Under the equity method, the investment in an associate is initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the profit or loss of the investee is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognised in the investee's profit or loss. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised directly in equity of the investor.

12. When potential voting rights exist, the investor's share of profit or loss of the investee and of changes in the investee's equity is determined on the basis of present ownership interests and does not reflect the possible exercise or conversion of potential voting rights.

Application of the Equity Method

13. An investment in an associate shall be accounted for using the equity method except when:

(a) ***~~there is evidence that the investment is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer~~*** ***the investment is classified as held for sale in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations*;***

(b) ***the exception in paragraph 10 of HKAS 27, allowing a parent that also has an investment in an associate not to present consolidated financial statements, applies; or***

(c) ***all of the following apply:***

(i) ***the investor is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method;***

(ii) ***the investor's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the counter market, including local and regional markets);***

(iii) ***the investor did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of securities in a public market; and***

(iv) ***the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with Hong Kong Financial Reporting Standards or International Financial Reporting Standards.***

14. Investments described in paragraph 13(a) shall be ~~classified as held for trading and~~ accounted for in accordance with ~~HKAS 39~~HKFRS 5.

15. When an investment in an associate previously ~~accounted for in accordance with HKAS 39 is not disposed of within twelve months, it shall be accounted for using the equity method as from the date of acquisition (see HKAS 22 Business Combinations)~~ classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method as from the date of its classification as held for sale. Financial statements for the periods since ~~acquisition shall be restated~~classification as held for sale shall be amended accordingly.

16. ~~Exceptionally, an entity may have found a buyer for an associate described in paragraph 13(a), but may not have completed the sale within twelve months because of the need for approval by regulators or others. The entity is not required to apply the equity method to an investment in such an associate if the sale is in process at the balance sheet date and there is no reason to believe that it will not be completed shortly after the balance sheet date~~[Deleted].

17. The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relation to the performance of the associate. Because the investor has significant influence over the associate, the investor has an interest in the associate's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of profits or losses of such an associate. As a result, application of the equity method provides more informative reporting of the net assets and profit or loss of the investor.

18. An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with HKAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in HKAS 31.

19. The carrying amount of the investment at the date that it ceases to be an associate shall be regarded as its cost on initial measurement as a financial asset in accordance with HKAS 39.

20. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures described in HKAS 27. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.

21. A group's share in an associate is the aggregate of the holdings in that associate by the parent and its subsidiaries. The holdings of the group's other associates or joint ventures are ignored for this purpose. When an associate has subsidiaries, associates, or joint ventures, the profits or losses and net assets taken into account in applying the equity method are those recognised in the associate's financial statements (including the associate's share of the profits or losses and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 26 and 27).

22. Profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor's financial statements only to the extent of unrelated investors' interests in the associate. 'Upstream' transactions are, for example, sales of assets from an associate to the investor. 'Downstream' transactions are, for example, sales of assets from the investor to an associate. The investor's share in the associate's profits and losses resulting from these transactions is eliminated.

23. An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference ~~(whether positive or negative)~~ between the cost of the investment and the investor's share of the net fair values of the ~~net~~ associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with HKFRS 3 *Business Combinations*. Therefore: ~~of the associate is treated as goodwill (see HKAS 22)~~.

(a) goodwill relating to an associate is included in the carrying amount of the investment. However, amortisation of that goodwill is not permitted and is therefore not included in the determination of the investor's share of the associate's profits or losses.

(b) any excess of the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.

Appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are also made to account, for example, for depreciation of the depreciable assets~~,~~ based on their fair values at the ~~date of~~ acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as for goodwill or property, plant and equipment.

24. ***The most recent available financial statements of the associate are used by the investor in applying the equity method. When the reporting dates of the investor and the associate are different, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so.***

25. When, in accordance with paragraph 24, the financial statements of an associate used in applying the equity method are prepared as of a different reporting date from that of the investor, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. In any case, the difference between the reporting date of the associate and that of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.

26. The investor's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

27. If an associate uses accounting policies other than those of the investor for like transactions and events in similar circumstances, adjustments shall be made to conform the associate's accounting policies to those of the investor when the associate's financial statements are used by the investor in applying the equity method.

28. If an associate has outstanding cumulative preference shares that are held by parties other than the investor and classified as equity, the investor computes its share of profits or losses after adjusting for the dividends on such shares, whether or not the dividends have been declared.

29. If an investor's share of losses of an associate equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate. Such items may include preferred shares and long-term receivables or loans but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognised under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (ie priority in liquidation).

30. After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

Impairment Losses

31. After application of the equity method including recognising the associate's losses in accordance with paragraph 29, the investor applies the requirements of HKAS 39 to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate.

32. The investor also applies the requirements of HKAS 39 to determine whether any additional impairment loss is recognised with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of that impairment loss.

33. Because goodwill included in the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately ~~If application of the requirements in HKAS 39 indicates that the investment may be impaired, an entity applies HKAS 36 *Impairment of Assets*. In determining~~ by applying the requirements for impairment testing goodwill in HKAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested under HKAS 36 for impairment, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in HKAS 39 indicates that the investment may be impaired. In determining the value in use of the investment, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the ~~investee~~associate, including the cash flows from the operations of the ~~investee~~associate and the proceeds on the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. ~~Any resulting impairment loss for the investment is allocated in accordance with HKAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 23).~~

34. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

Separate Financial Statements

35. ***An investment in an associate shall be accounted for in the investor's separate financial statements in accordance with paragraphs 37-42 of HKAS 27.***

36. This Standard does not mandate which entities produce separate financial statements available for public use.

Disclosure

37. ***The following disclosures shall be made:***

(a) ***the fair value of investments in associates for which there are published price quotations;***

(b) ***summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss;***

(c) ***the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;***

(d) ***the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power of the investee but concludes that it does not have significant influence;***

(e) ***the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;***

(f) ***the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;***

(g) ***the unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;***

(h) ***the fact that an associate is not accounted for using the equity method in accordance with paragraph 13; and***

(i) ***summarised financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and profit or loss.***

38. ***Investments in associates accounted for using the equity method shall be classified as non-current assets. The investor's share of the profit or loss of such associates, and the carrying amount of those investments, shall be separately disclosed. The investor's share of any discontinuing operations of such associates shall also be separately disclosed.***

39. ***The investor's share of changes recognised directly in the associate's equity shall be recognised directly in equity by the investor and shall be disclosed in the statement of changes in equity required by HKAS 1*** **Presentation of Financial Statements*****.***

40. ***In accordance with HKAS 37*** **Provisions, Contingent Liabilities and Contingent Assets*****, the investor shall disclose:***

(a) ***its share of the contingent liabilities of an associate incurred jointly with other investors; and***

(b) ***those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.***

Effective Date

41. ***An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.***

41A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

Withdrawal of Other Pronouncements

42. This Standard supersedes SSAP 10 *Accounting for Investments in Associates* (revised in 2001).

43. This Standard supersedes Interpretation 18, *Consolidation and Equity Method—Potential Voting Rights and Allocation of Ownership Interests*.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003, references to the current version of SSAP 10 *Accounting for Investments in Associates* are amended to HKAS 28 *Investments in Associates*.~~

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 11, 24, 25, 37(e) and 39 are amended as follows:

11 Under the equity method … Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's <u>other comprehensive income</u> ~~equity that have not been recognised in the investee's profit or loss~~. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised ~~directly in equity~~ <u>in other comprehensive income</u> of the investor <u>(see HKAS 1 *Presentation of Financial Statements* (as revised in 2007))</u>.

24 The most recent … When the ~~reporting dates~~ <u>end of the reporting period</u> of the investor ~~and~~ <u>is different from that of</u> the associate ~~are different~~, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so.

25 When … the financial statements of an associate used in applying the equity method are prepared as of a different ~~reporting~~ date from that of the investor … In any case, the difference between the ~~reporting date~~ <u>end of the reporting period</u> of the associate and that of the investor shall be no more than three months. The length of the reporting periods and any difference <u>between</u> ~~in~~ the ~~reporting dates~~ <u>ends of the reporting periods</u> shall be the same from period to period.

37 The following disclosures ...

(e) the <u>end of the reporting period</u> ~~reporting date~~ of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a ~~reporting~~ date or for a period that is different from that of the investor, and the reason for using a different ~~reporting~~ date or different period;

39 **The investor's share of changes recognised ~~directly in the associate's equity~~ in other comprehensive income by the associate shall be recognised by the investor in other comprehensive income ~~directly in equity by the investor and shall be disclosed in the statement of changes in equity as required by HKAS 1~~ ~~*Presentation of Financial Statements*~~.**

Paragraph 41A is added as follows:

41A **HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 11 and 39. 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.**

'well-established' practice in the Exposure Draft was to emphasise that the exclusion would apply generally to those investments for which fair value is already available.

BC11. Therefore, the Board decided that the availability of the exclusion should be based only on the nature of an entity's activities and to delete the reference to 'well-established' practices. The Board understands that measurement of these investments at fair value is 'well-established' practice in these industries.

Definition of 'Venture Capital Organisations'

BC12. The Board decided not to define further those 'venture capital organisations and similar entities' excluded from the scope of the Standard. Apart from recognising the difficulties of arriving at a universally applicable definition, the Board did not want inadvertently to make it difficult for entities to measure investments at fair value. However, the Board decided to clarify that the reference to 'similar entities' in the scope exclusion includes investment-linked insurance funds.

BC13. The Board decided, however, that if an investee is a subsidiary in accordance with IAS 27, it should be consolidated. The Board concluded that if an investor controls an investee, the investee is part of a group and part of the structure through which the group operates its business and thus consolidation of the investee is appropriate.

Application of the Equity Method

Temporary Significant Influence

BC14. The Board considered whether to remove the exemption from applying the equity method when significant influence over an associate is intended to be temporary. The Board decided to consider this issue as part of a comprehensive standard dealing with asset disposals. It decided to retain an exemption from applying the equity method when there is evidence that an associate is acquired with the intention to dispose of it within twelve months and that management is actively seeking a buyer. The Board's Exposure Draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* proposes to measure and present assets held for sale in a consistent manner irrespective of whether they are held by an investor in an associate or in a subsidiary.*

Severe Long-Term Restrictions Impairing Ability to Transfer Funds to the Investor

BC15. The Board decided to remove the exemption from applying the equity method for an associate that previously applied when severe long-term restrictions impaired an associate's ability to transfer funds to the investor. It did so because such circumstances may not preclude the investor's significant influence over the associate. The Board decided that an investor should, when assessing its ability to exercise significant influence over an entity, consider restrictions on the transfer of funds from the associate to the investor. In themselves, such restrictions do not preclude the existence of significant influence.

* In March 2004, the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removes this scope exclusion and now eliminates the exemption from applying the equity method when significant influence over an associate is intended to be temporary. See IFRS 5 Basis for Conclusions for further discussion.

Contents

Hong Kong Accounting Standard 29

Financial Reporting in Hyperinflationary Economies

Appendix

Amendments to Other Pronouncements

The amendments in this appendix become effective for annual periods beginning on or after 1 January 2005. If an entity applies this Standard for an earlier period, these amendments become effective for that earlier period.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~*The accounting standard, paragraph and appendix references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made by the HKSA to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~Amendments to HKAS 12 *Income Taxes*, Appendix A (Paragraph 18)~~

~~Hyperinflation~~

~~18. Non-monetary assets are restated in terms of the measuring unit current at the balance sheet date (see HKAS 29, Financial Reporting in Hyperinflationary Economies) and no equivalent adjustment is made for tax purposes. *(notes: (1) the deferred tax is charged in the income statement; and (2) if, in addition to the restatement, the non-monetary assets are also revalued, the deferred tax relating to the revaluation is charged to equity and the deferred tax relating to the restatement is charged in the income statement).*~~

~~Amendments to HKAS 34 *Interim Financial Reporting*, Appendix B (Paragraphs 32 to 34)~~

~~Interim Financial Reporting in Hyperinflationary Economies~~

~~32. Interim financial reports in hyperinflationary economies are prepared by the same principles as at financial year end.~~

~~33. HKAS 29, Financial Reporting in Hyperinflationary Economies, requires that the financial statements of an enterprise that reports in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at balance sheet date, and the gain or loss on the net monetary position is included in net income. Also, comparative financial data reported for prior periods is restated to the current measuring unit.~~

~~34. Enterprises follow those same principles at interim dates, thereby presenting all interim data in the measuring unit as of the end of the interim period, with the resulting gain or loss on the net monetary position included in the interim period's net income. Enterprises do not annualise the recognition of the gain or loss. Nor do they use an estimated annual inflation rate in preparing an interim financial report in a hyperinflationary economy.~~

~~Amendments to HKAS 19 *Employee Benefits*, Paragraph 76~~

~~76. An enterprise determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are more reliable, for example, in a hyper-inflationary economy (see HKAS 29, Financial Reporting in Hyperinflationary Economies), or where the benefit is index-linked and there is a deep market in index-linked bonds of the same currency and term.~~

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 27, ‘income statement items’ is amended to ‘items in the statement of comprehensive income’.

In paragraph 28, ‘income statement items’ is amended to ‘income and expense items’.

In paragraph 36, ‘reporting dates’ is amended to ‘ends of the reporting periods’.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix become effective for annual periods beginning on or after 1 January 2005. If an entity applies this Standard for an earlier period, these amendments become effective for that earlier period.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~*As explained in the introduction to this Standard, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~A1. [Not used]~~

~~A2. [Not used]~~

~~A3. In International Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003, references to the current version of SSAP 21 *Accounting for Interests in Joint Ventures* are amended to HKAS 31 *Interests in Joint Ventures*.~~

Hong Kong Accounting Standard 32

Financial Instruments: ~~Disclosure and~~ Presentation

Contents

Hong Kong Accounting Standard 32

Financial Instruments: ~~Disclosure and~~ Presentation

Appendix: Application Guidance

Basis for Conclusions

Illustrative Examples

Hong Kong Accounting Standard 32 *Financial Instruments: Disclosure and Presentation* (HKAS 32) is set out in paragraphs 1-100 and the Appendix. All the paragraphs have equal authority. HKAS 32 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Hong Kong Accounting Standard 32

Financial Instruments: *~~Disclosure and~~ Presentation

Objective

1*. ~~The objective of this Standard is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.~~[Deleted].

2*. ~~This Standard contains requirements for the presentation of financial instruments and identifies the information that should be disclosed about them. The presentation requirements apply~~ The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. ~~The Standard requires disclosure of information about factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments and the accounting policies applied to those instruments. This Standard also requires disclosure of information about the nature and extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them, and management's policies for controlling those risks.~~

3*. The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in HKAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in HKFRS 7 *Financial Instruments: Disclosures*.

Scope

4*. This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with ~~under~~ 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 ~~entities shall apply this Standard to~~ an interest in a subsidiary, associate or joint venture ~~that according to HKAS 27, HKAS 28 or HKAS 31 is accounted for under~~ using HKAS 39*** ~~**Financial Instruments: Recognition and Measurement.**~~***; in those ~~In these~~ cases, entities shall apply the disclosure requirements in HKAS 27, HKAS 28 ~~and~~ or HKAS 31 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives ~~on~~ linked to interests in subsidiaries, associates or joint ventures.***

(b) employers' rights and obligations under employee benefit plans, to which HKAS 19 **Employee Benefits** ***applies.***

* Effective for annual periods beginning on or after 1 January 2007.

~~*(c) rights and obligations arising under insurance contracts. However, entities shall apply this Standard to a financial instrument that takes the form of an insurance (or reinsurance) contract as described in paragraph 6, but principally involves the transfer of financial risks described in paragraph 52. In addition, entities shall apply this Standard to derivatives that are embedded in insurance contracts (see paragraphs 10-13 of HKAS 39).*~~

(~~d~~c) contracts for contingent consideration in a business combination (see ~~paragraphs 65-67 of HKAS 22~~ HKFRS 3 Business Combinations). This exemption applies only to the acquirer.

(d) insurance contracts as defined in HKFRS 4 Insurance Contracts. However, this Standard 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 Standard 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) contracts that require a payment based on climatic, geological or other physical variables (see paragraph AG1 of HKAS 39). However, this Standard shall be applied to other types of derivatives that are embedded in such contracts (for example, if an interest rate swap is contingent on a climatic variable such as heating degree days, the interest rate swap element is an embedded derivative that is within the scope of this Standard – see paragraphs 10-13 of HKAS 39).*~~

(e) financial instruments that are within the scope of HKFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see HKAS 39).

(f) financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 Share-based Payment applies, except for

- ***(i) contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,***

- ***(ii) paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.***

~~5*.~~ ~~This Standard applies to recognised and unrecognised financial instruments. Recognised financial instruments include equity instruments issued by the entity and 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 Standard (such as some loan commitments).~~[Deleted]

~~6~~*. ~~For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (or in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and business interruption. The provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks (see paragraph 52), for example, some types of financial reinsurance and guaranteed investment contracts issued by insurance and other entities. Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting and disclosing information about such obligations.~~ [Deleted]

~~7~~*. ~~Other Standards specific to particular types of financial instrument contain additional presentation and disclosure requirements. For example, HKAS 17 *Leases* and HKAS 26 *Accounting and Reporting by Retirement Benefit Plans* incorporate specific disclosure requirements relating to finance leases and retirement benefit plan investments, respectively. In addition, some requirements of other Standards, particularly HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, apply to financial instruments.~~ [Deleted]

8. This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

9. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

* Effective for annual periods beginning on or after 1 January 2007.

(d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 8 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirement, and accordingly, whether they are within the scope of this Standard.

10. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 9(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions (see also paragraphs AG3-AG243)

11. The following terms are used in this Standard with the meanings specified:

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

A financial asset is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) ***a contract that will or may be settled in the entity's own equity instruments and is:***

(i) ***a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or***

(ii) ***a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.***

A financial liability is any liability that is:

(a) ***a contractual obligation:***

(i) ***to deliver cash or another financial asset to another entity; or***

(ii) ***to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or***

(b) ***a contract that will or may be settled in the entity's own equity instruments and is:***

(i) ***a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or***

(ii) ***a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.***

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

12. The following terms are defined in paragraph 9 of HKAS 39 and are used in this Standard with the meaning specified in HKAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness

whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

37. An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

38. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

39. The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under HKAS 1 *Presentation of Financial Statements*. The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under HKAS 12 *Income Taxes*.

40. Dividends classified as an expense may be presented in the income statement either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of HKAS 1 and HKFRS 7 ~~HKAS 30~~ ~~*Disclosures in the Financial Statements of Banks and Similar Financial Institutions*~~[*]. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the income statement. Disclosures of the tax effects are made in accordance with HKAS 12.

41. Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under HKAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately on the face of the income statement when it is relevant in explaining the entity's performance.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG38 and AG39)

42. A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

[*] Effective for annual periods beginning on or after 1 January 2007.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see HKAS 39, paragraph 36).

43. This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.

44. Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the balance sheet but also may result in recognition of a gain or loss.

45. A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

46. The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

47. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph ~~76~~36 of HKFRS 7.

48. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearinghouse in an organised financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for

the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realisation of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.

49. The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:

(a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');

(b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;

(c) financial or other assets are pledged as collateral for non-recourse financial liabilities;

(d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or

(e) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance ~~policy~~contract.

50. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph ~~76~~36 of HKFRS 7.

~~Disclosure~~ (51. to 95. [Deleted])

~~51. The purpose of the disclosures required by this Standard is to provide information to enhance understanding of the significance of financial instruments to an entity's financial position, performance and cash flows, and assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments.~~

~~52. Transactions in financial instruments may result in an entity assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information to assist users of financial statements in assessing the extent of risk related to financial instruments.~~

~~(a) *Market risk* includes three types of risk:~~

~~(i) *currency risk*—the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates.~~

~~(ii) *fair value interest rate risk*—the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.~~

~~(iii) *price risk*—the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.~~

~~Market risk embodies not only the potential for loss but also the potential for gain.~~

~~(b) *Credit risk*—the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.~~

~~(c) *Liquidity risk* (also referred to as *funding risk*)—the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.~~

~~(d) *Cash flow interest rate risk*—the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. In the case of a floating rate debt instrument, for example, such fluctuations result in a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.~~

~~Format, Location and Classes of Financial Instruments~~

~~53. This Standard does not prescribe either the format of the information required to be disclosed or its location within the financial statements. To the extent that the required information is presented on the face of the financial statements, it is unnecessary to repeat it in the notes to the financial statements. Disclosures may include a combination of narrative descriptions and quantified data, as appropriate to the nature of the instruments and their relative significance to the entity.~~

~~54. Determining the level of detail to be disclosed about particular financial instruments requires the exercise of judgement taking into account the relative significance of those instruments. 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, when an entity is party to a large number of financial instruments with similar characteristics and no single contract is individually material, a summary by classes of instruments is appropriate. On the other hand, information about an individual instrument may be important when it is, for example, a material component of an entity's capital structure.~~

~~55. The management of an entity groups financial instruments into classes that are appropriate to the nature of the information disclosed, taking into account matters such as the characteristics of the instruments and the measurement basis that has been applied. In general, classes distinguish items measured at cost or amortised cost from items measured at fair value. Sufficient information is provided to permit a reconciliation to relevant line items on the balance sheet. When an entity is a party to financial instruments not within the scope of this Standard, those instruments constitute a class or classes of financial assets or financial liabilities separate from those within the scope of this Standard. Disclosures about those financial instruments are dealt with by other IFRSs.~~

~~Risk Management Policies and Hedging Activities~~

~~***56. An entity shall describe its financial risk management objectives and policies, including its policy for hedging each main type of forecast transaction for which hedge accounting is used.***~~

~~57. In addition to providing specific information about particular balances and transactions related to financial instruments, an entity provides a discussion of the extent to which financial instruments are used, the associated risks and the business purposes served. A discussion of management's policies for controlling the risks associated with financial instruments includes policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risk. Such discussion provides a valuable additional perspective that is independent of the specific instruments held or outstanding at a particular time.~~

~~***58. An entity shall disclose the following separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation (as defined in HKAS 39):***~~

~~***(a) a description of the hedge;***~~

~~***(b) a description of the financial instruments designated as hedging instruments and their fair values at the balance sheet date;***~~

~~***(c) the nature of the risks being hedged; and***~~

~~***(d) for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss, and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur.***~~

~~***59. When a gain or loss on a hedging instrument in a cash flow hedge has been recognised directly in equity, through the statement of changes in equity, an entity shall disclose:***~~

~~***(a) the amount that was so recognised in equity during the period;***~~

~~***(b) the amount that was removed from equity and included in profit or loss for the period; and***~~

> ~~***(c)*** ***the amount that was removed from equity during the period and included in the initial measurement of the acquisition cost or other carrying amount of a non-financial asset or non-financial liability in a hedged highly probable forecast transaction.***~~

~~Terms, Conditions and Accounting Policies~~

~~***60.*** ***For each class of financial asset, financial liability and equity instrument, an entity shall disclose:***~~

> ~~***(a)*** ***information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and***~~
>
> ~~***(b)*** ***the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.***~~

~~***61.*** ***As part of the disclosure of an entity's accounting policies, an entity shall disclose, for each category of financial assets, whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see HKAS 39, paragraph 38).***~~

~~62. The contractual terms and conditions of a financial instrument affect the amount, timing and certainty of future cash receipts and payments by the parties to the instrument. When financial instruments are significant, either individually or as a class, to the financial position of an entity or its future operating results, their terms and conditions are disclosed. If no single instrument is individually significant to the future cash flows of the entity, the essential characteristics of the instruments are described by reference to appropriate groupings of like instruments.~~

~~63. When financial instruments held or issued by an entity, either individually or as a class, create a potentially significant exposure to the risks described in paragraph 52, terms and conditions that warrant disclosure include:~~

> ~~(a) the principal, stated, face or other similar amount, which, for some derivative instruments, such as interest rate swaps, might be the amount (referred to as the notional amount) on which future payments are based;~~
>
> ~~(b) the date of maturity, expiry or execution;~~
>
> ~~(c) early settlement options held by either party to the instrument, including the period in which, or date at which, the options can be exercised and the exercise price or range of prices;~~
>
> ~~(d) options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options can be exercised and the conversion or exchange ratio(s);~~
>
> ~~(e) the amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including instalment repayments and any sinking fund or similar requirements;~~

~~(f) stated rate or amount of interest, dividend or other periodic return on principal and the timing of payments;~~

~~(g) collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;~~

~~(h) in the case of an instrument for which cash flows are denominated in a currency other than the entity's functional currency, the currency in which receipts or payments are required;~~

~~(i) in the case of an instrument that provides for an exchange, information described in items (a)-(h) for the instrument to be acquired in the exchange; and~~

~~(j) any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt-to-equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).~~

~~64. When the balance sheet presentation of a financial instrument differs from the instrument's legal form, it is desirable for an entity to explain in the notes to the financial statements the nature of the instrument.~~

~~65. The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relationship between individual instruments that can significantly affect the amount, timing or certainty of the future cash flows of an entity. For example, it may be important to disclose hedging relationships such as one that might exist when an entity holds an investment in shares for which it has purchased a put option. The extent to which a risk exposure is altered by the relationship among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 63, but in some circumstances further disclosure is necessary.~~

~~66. In accordance with HKAS 1, an entity provides disclosure of all significant accounting policies, including the general principles adopted and the method of applying those principles to transactions, other events and conditions arising in the entity's business. In the case of financial instruments, such disclosure includes:~~

~~(a) the criteria applied in determining when to recognise a financial asset or financial liability and when to derecognise it;~~

~~(b) the basis of measurement applied to financial assets and financial liabilities on initial recognition and subsequently; and~~

~~(c) the basis on which income and expenses arising from financial assets and financial liabilities are recognised and measured.~~

~~Interest Rate Risk~~

~~67. For each class of financial assets and financial liabilities, an entity shall disclose information about its exposure to interest rate risk, including:~~

~~(a) contractual repricing or maturity dates, whichever dates are earlier; and~~

~~***(b) effective interest rates, when applicable.***~~

~~68. An entity provides information about its exposure to the effects of future changes in the prevailing level of interest rates. Changes in market interest rates have a direct effect on the contractually determined cash flows associated with some financial assets and financial liabilities (cash flow interest rate risk) and on the fair value of others (fair value interest rate risk).~~

~~69. Information about maturity dates (or repricing dates when they are earlier) indicates the length of time for which interest rates are fixed, and information about effective interest rates indicates the levels at which they are fixed. Disclosure of this information provides users of financial statements with a basis for evaluating the fair value interest rate risk to which an entity is exposed and, thus, the potential for gain or loss. For instruments that are repriced to a market rate of interest before maturity, disclosure of the period until the next repricing is more important for this purpose than disclosure of the period to maturity.~~

~~70. To supplement the information about contractual repricing and maturity dates, an entity may elect to disclose information about expected repricing or maturity dates when those dates differ significantly from the contractual dates. For example, such information may be particularly relevant when an entity is able to predict, with reasonable reliability, the amount of fixed rate mortgage loans that will be repaid before maturity and it uses this information as the basis for managing its interest rate risk exposure. The additional information includes disclosure that it is based on management's expectations of future events and an explanation of the assumptions made about repricing or maturity dates and how those assumptions differ from the contractual dates.~~

~~71. An entity indicates which of its financial assets and financial liabilities are:~~

~~(a) exposed to fair value interest rate risk, such as financial assets and financial liabilities with a fixed interest rate;~~

~~(b) exposed to cash flow interest rate risk, such as financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and~~

~~(c) not directly exposed to interest rate risk, such as some investments in equity instruments.~~

~~72. The requirement in paragraph 67(b) applies to bonds, notes, loans and similar financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement does not apply to financial instruments such as investments in equity instruments and derivative instruments that do not bear a determinable effective interest rate. For example, even though instruments such as interest rate derivatives (including swaps, forward rate agreements and options) are exposed to fair value or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not required. However, when providing effective interest rate information, an entity discloses the effect on its interest rate risk exposure of hedging transactions such as interest rate swaps.~~

~~73. An entity may become exposed to interest rate risk as a result of a transaction in which no financial asset or financial liability is recognised on its balance sheet. In such circumstances, the entity discloses information that permits users of its financial statements to understand the nature and extent of its exposure. For example, when an entity has a commitment to lend funds at a fixed interest rate, the disclosure normally includes the stated principal, interest rate and term to maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to interest rate risk.~~

~~74. The nature of an entity's business and the extent of its activity in financial instruments determine whether information about interest rate risk is presented in narrative form, in tables or by using a combination of the two. When an entity has a variety of financial instruments exposed to fair value or cash flow interest rate risk, it may adopt one or more of the following approaches to presenting information:~~

~~(a) The carrying amounts of financial instruments exposed to interest rate risk may be presented in tabular form, grouped by those that are contracted to mature or be repriced in the following periods after the balance sheet date:~~

~~(i) in one year or less;~~

~~(ii) in more than one year but not more than two years;~~

~~(iii) in more than two years but not more than three years;~~

~~(iv) in more than three years but not more than four years;~~

~~(v) in more than four years but not more than five years; and~~

~~(vi) in more than five years.~~

~~(b) When the performance of an entity is significantly affected by the level of its exposure to interest rate risk or changes in that exposure, more detailed information is desirable. An entity such as a bank may disclose, for example, separate groupings of the carrying amounts of financial instruments contracted to mature or be repriced:~~

~~(i) in one month or less after the balance sheet date;~~

~~(ii) in more than one month but not more than three months after the balance sheet date; and~~

~~(iii) in more than three months but not more than twelve months after the balance sheet date.~~

~~(c) Similarly, an entity may indicate its exposure to cash flow interest rate risk through a table indicating the aggregate carrying amount of groups of floating rate financial assets and financial liabilities maturing within various future time periods.~~

~~(d) Interest rate information may be disclosed for individual financial instruments. Alternatively, weighted average rates or a range of rates may be presented for each class of financial instrument. An entity may group into separate classes instruments denominated in different currencies or having substantially different credit risks when those factors result in instruments having substantially different effective interest rates.~~

~~75. In some circumstances, an entity may be able to provide useful information about its exposure to interest rate risks by indicating the effect of a hypothetical change in market interest rates on the fair value of its financial instruments and future profit or loss and cash flows. Such information may be based on, for example, an assumed one percentage point (100 basis points) change in market interest rates occurring at the balance sheet date. The effects of a change in interest rates include changes in interest income and expense relating to floating rate financial instruments and gains or losses resulting from changes in the fair value of fixed rate instruments. The reported interest rate sensitivity may be restricted to the direct effects of an interest rate change on interest-bearing financial instruments recognised at the balance sheet date because the indirect effects of a rate change on financial markets and individual entities cannot normally be predicted reliably. When disclosing interest rate sensitivity information, an entity indicates the basis on which it has prepared the information, including any significant assumptions.~~

~~Credit Risk~~

~~***76. For each class of financial assets and other credit exposures, an entity shall disclose information about its exposure to credit risk, including:***~~

~~***(a) the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event of other parties failing to perform their obligations under financial instruments; and***~~

~~***(b) significant concentrations of credit risk.***~~

~~77. An entity provides information relating to credit risk to permit users of its financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets recognised at the balance sheet date or require a cash outflow from other credit exposures (such as a credit derivative or an issued guarantee of the obligations of a third party). Such failures give rise to a loss recognised in an entity's profit or loss. Paragraph 76 does not require an entity to disclose an assessment of the probability of losses arising in the future.~~

~~78. The purposes of disclosing amounts exposed to credit risk without regard to potential recoveries from realisation of collateral ('an entity's maximum credit risk exposure') are:~~

~~(a) to provide users of financial statements with a consistent measure of the amount exposed to credit risk for financial assets and other credit exposures; and~~

~~(b) to take into account the possibility that the maximum exposure to loss may differ from the carrying amount of financial assets recognised at the balance sheet date.~~

~~79. In the case of financial assets exposed to credit risk, the carrying amount of the assets in the balance sheet, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the balance sheet date is normally the carrying amount because it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the balance sheet is necessary. On the other hand, an entity's maximum potential loss from some financial instruments may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 76(a).~~

~~80. A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the balance sheet net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 76. For example, when an entity is due to receive the proceeds from realisation of a financial asset before settlement of a financial liability of equal or greater amount against which the entity has a legal right of set-off, the entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform users of financial statements of the extent to which exposure to credit risk at a particular point in time has been reduced, the entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.~~

~~81. An entity may have entered into one or more master netting arrangements that serve to mitigate its exposure to credit loss but do not meet the criteria for offsetting. When a master netting arrangement significantly reduces the credit risk associated with financial assets not offset against financial liabilities with the same counterparty, an entity provides additional information concerning the effect of the arrangement. Such disclosure indicates that:~~

~~(a) the credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realised; and~~

~~(b) the extent to which an entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the balance sheet date because the exposure is affected by each transaction subject to the arrangement.~~

~~It is also desirable for an entity to disclose the terms of its master netting arrangements that determine the extent of the reduction in its credit risk.~~

~~82. An entity may be exposed to credit risk as a result of a transaction in which no financial asset is recognised on its balance sheet, such as for a financial guarantee or credit derivative contract. Guaranteeing an obligation of another party creates a liability and exposes the guarantor to credit risk that is taken into account in making the disclosures required by paragraph 76.~~

~~83. Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature of the business and financial position of the entity and result in a significant exposure to loss in the event of default by other parties. Identification of such concentrations requires judgement by management taking into account the circumstances of the entity and its debtors. HKAS 14 *Segment Reporting* provides guidance in identifying industry and geographical segments within which credit risk concentrations may arise.~~

~~84. Concentrations of credit risk may arise from exposures to a single debtor or to groups of debtors having such a similar characteristic that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. Characteristics that may give rise to a concentration of risk include the nature of the activities undertaken by debtors, such as the industry in which they operate, the geographical area in which activities are undertaken and the level of creditworthiness of groups of borrowers. For example, a manufacturer of equipment for the oil and gas industry will normally have trade accounts receivable from sales of its products for which the risk of non-payment is affected by economic changes in the oil and gas industry. A bank that normally lends on an international scale may have many loans outstanding to less developed nations and the bank's ability to recover them may be adversely affected by local economic conditions.~~

~~85. Disclosure of concentrations of credit risk includes a description of the shared characteristic that identifies each concentration and the amount of the maximum credit risk exposure associated with all financial assets sharing that characteristic.~~

~~Fair Value~~

~~***86. Except as set out in paragraph 90, for each class of financial assets and financial liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the balance sheet. (HKAS 39 provides guidance for determining fair value.)***~~

~~87. Fair value information is widely used for business purposes in determining an entity's 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. When an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it provides fair value information through supplementary disclosures.~~

~~88. For financial instruments such as short-term trade receivables and payables, no disclosure of fair value is required when the carrying amount is a reasonable approximation of fair value.~~

~~89. In disclosing fair values, an entity groups financial assets and financial liabilities into classes and offsets them only to the extent that their related carrying amounts are offset in the balance sheet.~~

~~***90. If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under HKAS 39 because their fair value cannot be measured reliably, that fact shall be disclosed together with a description of the financial instruments, their carrying amount, an explanation of why fair value cannot be measured reliably and, if possible, the range of estimates within which fair value is highly likely to lie. Furthermore, if financial assets whose fair value previously could not be reliably measured are sold, that fact, the carrying amount of such financial assets at the time of sale and the amount of gain or loss recognised shall be disclosed.***~~

~~91. If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under HKAS 39 because their fair values cannot be measured reliably, the information about fair value set out in paragraphs 86 and 92 is not required to be disclosed. Instead, information is provided to assist users of the financial statements in making their own judgements about the extent of possible differences between the carrying amount of such financial assets and financial liabilities and their fair value. In addition to an explanation of the principal characteristics of the financial instruments that are pertinent to their value and the reason for not disclosing fair values, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 60 may provide sufficient information. When it has a reasonable basis for doing so, management may indicate its opinion on the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value reliably.~~

~~***92. An entity shall disclose:***~~

~~***(a) the methods and significant assumptions applied in determining fair values of financial assets and financial liabilities separately for significant classes of financial assets and financial liabilities. (Paragraph 55 provides guidance for determining classes of financial assets.)***~~

~~***(b) whether fair values of financial assets and financial liabilities are determined directly, in full or in part, by reference to published price quotations in an active market or are estimated using a valuation technique (see HKAS 39, paragraphs AG71-AG79).***~~

~~***(c) whether its financial statements include financial instruments measured at fair values that are determined in full or in part using a valuation technique based on assumptions that are not supported by observable market prices or rates. If changing any such assumption to a reasonably possible alternative would result in a significantly different fair value, the entity shall state this fact and disclose the effect on the fair value of a range of reasonably possible alternative assumptions. For this purpose, significance shall be judged with respect to profit or loss and total assets or total liabilities.***~~

~~***(d) the total amount of the change in fair value estimated using a valuation technique that was recognised in profit or loss during the period.***~~

~~93. Disclosure of fair value information includes disclosure of the method used in determining fair value and the significant assumptions made in its application. For example, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses and interest or discount rates if they are significant.~~

~~Other Disclosures~~

~~Derecognition~~

~~*94.* ***(a) An entity may have either transferred a financial asset (see paragraph 18 of HKAS 39) or entered into the type of arrangement described in paragraph 19 of HKAS 39 in such a way that the arrangement does not qualify as a transfer of a financial asset. If the entity either continues to recognise all of the asset or continues to recognise the asset to the extent of the entity's continuing involvement (see HKAS 39, paragraphs 29 and 30) it shall disclose for each class of financial asset:***~~

~~***(i) the nature of the assets;***~~

~~***(ii) the nature of the risks and rewards of ownership to which the entity remains exposed;***~~

~~***(iii) when the entity continues to recognise all of the asset, the carrying amounts of the asset and of the associated liability; and***~~

~~***(iv) when the entity continues to recognise the asset to the extent of its continuing involvement, the total amount of the asset, the amount of the asset that the entity continues to recognise and the carrying amount of the associated liability.***~~

~~Collateral~~

~~***(b) An entity shall disclose the carrying amount of financial assets pledged as collateral for liabilities, the carrying amount of financial assets pledged as collateral for contingent liabilities, and (consistently with paragraphs 60(a) and 63(g)) any material terms and conditions relating to assets pledged as collateral.***~~

~~***(c) When an entity has accepted collateral that it is permitted to sell or repledge in the absence of default by the owner of the collateral, it shall disclose:***~~

~~***(i) the fair value of the collateral accepted (financial and non-financial assets);***~~

~~***(ii) the fair value of any such collateral sold or repledged and whether the entity has an obligation to return it; and***~~

~~***(iii) any material terms and conditions associated with its use of this collateral (consistently with paragraphs 60(a) and 63(g)).***~~

~~**Compound financial instruments with multiple embedded derivatives**~~

~~*(d) If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 28) and the instrument has multiple embedded derivative features whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features and the effective interest rate on the liability component (excluding any embedded derivatives that are accounted for separately).*~~

~~**Financial assets and financial liabilities at fair value through profit or loss (see also paragraph AG40)**~~

~~*(e) An entity shall disclose the carrying amounts of financial assets and financial liabilities that:*~~

~~*(i) are classified as held for trading; and*~~

~~*(ii) were, upon initial recognition, designated by the entity as financial assets and financial liabilities at fair value through profit or loss (i.e. those that are not financial instruments classified as held for trading).*~~

~~*(f) If the entity has designated a financial liability as at fair value through profit or loss, it shall disclose:*~~

~~*(i) the amount of change in its fair value that is not attributable to changes in a benchmark interest rate (e.g. LIBOR); and*~~

~~*(ii) the difference between its carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.*~~

~~**Reclassification**~~

~~*(g) If the entity has reclassified a financial asset as one measured at cost or amortised cost rather than at fair value (see HKAS 39, paragraph 54), it shall disclose the reason for that reclassification.*~~

~~**Income statement and equity**~~

~~*(h) An entity shall disclose material items of income, expense and gains and losses resulting from financial assets and financial liabilities, whether included in profit or loss or as a separate component of equity. For this purpose, the disclosure shall include at least the following items:*~~

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

~~*(ii) for available-for-sale financial assets, the amount of any gain or loss recognised directly in equity during the period and the amount that was removed from equity and recognised in profit or loss for the period; and*~~

~~***(iii)** the amount of interest income accrued on impaired financial assets, in accordance with HKAS 39, paragraph AG93.*~~

~~**Impairment**~~

~~***(i)** An entity shall disclose the nature and amount of any impairment loss recognised in profit or loss for a financial asset, separately for each significant class of financial asset (paragraph 55 provides guidance for determining classes of financial assets).*~~

~~**Defaults and breaches**~~

~~***(j)** With respect to any defaults of principal, interest, sinking fund or redemption provisions during the period on loans payable recognised as at the balance sheet date, and any other breaches during the period of loan agreements when those breaches can permit the lender to demand repayment (except for breaches that are remedied, or in response to which the terms of the loan are renegotiated, on or before the balance sheet date), an entity shall disclose:*~~

~~***(i)** details of those breaches;*~~

~~***(ii)** the amount recognised as at the balance sheet date in respect of the loans payable on which the breaches occurred; and*~~

~~***(iii)** with respect to amounts disclosed under (ii), whether the default has been remedied or the terms of the loans payable renegotiated before the date the financial statements were authorised for issue.*~~

~~95. For the purpose of disclosing information on breaches of loan agreements in accordance with paragraph 94(j), loans payable include issued debt instruments and financial liabilities other than short-term trade payables on normal credit terms. When such a breach occurred during the period, and the breach has not been remedied or the terms of the loan payable have not been renegotiated by the balance sheet date, the effect of the breach on the classification of the liability as current or non-current is determined under HKAS 1.~~[†]

Effective Date

***96.** An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is ~~not~~ permitted. <u>An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 39. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.</u>*

***97.** This Standard shall be applied ~~on a prospective basis only.~~ <u>retrospectively, and accounting policies adopted in respect of each period presented shall be disclosed. When comparative information for prior periods is not available when this Standard is first applied, such information need not be presented, but an entity shall disclose that fact.</u>*

Withdrawal of Other Pronouncements

98. This Standard, together with HKAS 39 Financial Instruments: Recognition and Measurement, supersede SSAP 24 Accounting for Investments in Securities issued in 1999.[*]

[†] Paragraphs 51-95 are deleted for annual periods beginning on or after 1 January 2007.
[*] In October 2005 the Institute relocated all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*.

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 18, 'on the entity's balance sheet' is amended to 'in the entity's statement of financial position'.

In paragraph 29, last sentence, 'on its balance sheet' is amended to 'in its statement of financial position'.

In paragraph 40, 'income statement' is amended to 'statement of comprehensive income or separate income statement (if presented)' (twice).

Paragraph 97A is added as follows:

97A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 40. 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.

The Application Guidance is amended as described below.

In paragraph AG31, 'on the balance sheet' is amended to 'in the statement of financial position'.

In paragraph AG39, 'on an entity's balance sheet' is amended to 'in an entity's statement of financial position'.

Appendix

Application Guidance

HKAS 32 *Financial Instruments: ~~Disclosure and~~ Presentation*

This appendix is an integral part of the Standard.

AG1. This Application Guidance explains the application of particular aspects of the Standard.

AG2. The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in HKAS 39 *Financial Instruments: Recognition and Measurement.*

Definitions (paragraphs 11-14)

Financial Assets and Financial Liabilities

AG3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.

AG4. Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

(a) trade accounts receivable and payable;
(b) notes receivable and payable;
(c) loans receivable and payable; and
(d) bonds receivable and payable.

In each case, one party’s contractual right to receive (or obligation to pay) cash is matched by the other party’s corresponding obligation to pay (or right to receive).

AG5. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

AG6. ‘Perpetual’ debt instruments (such as ‘perpetual’ bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.* Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

AG7. A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.

AG8. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of HKFRS4.

AG9. Under HKAS 17 *Leases* a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).

AG10. Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

AG11. Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

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

asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (e.g. an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardised in form and traded on organised markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 8).

AG21. A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.

AG22. Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.

AG23. The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

AG24. ~~Although the Standard was not developed to apply to commodity or other contracts that do not satisfy the definition of a financial instrument or fall within paragraph 8, entities may regard it as appropriate to apply the relevant disclosure requirements of this Standard to such contracts.~~ [Deleted].

Offsetting a Financial Asset and a Financial Liability (paragraphs 42-50)

AG38. To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.

AG39. The Standard does not provide special treatment for so-called ‘synthetic instruments’, which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt. Each of the individual financial instruments that together constitute a ‘synthetic instrument’ represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a ‘synthetic instrument’ is an asset and another is a liability, they are not offset and presented on an entity’s balance sheet on a net basis unless they meet the criteria for offsetting in paragraph 42. ~~Disclosures are provided about the significant terms and conditions of each financial instrument, although an entity may indicate in addition the nature of the relationship between the individual instruments (see paragraph 65).~~

~~Disclosure~~

~~Financial Assets and Financial Liabilities at Fair Value Through Profit or Loss (paragraph 94(f))~~

~~AG40.~~ [Deleted].~~If an entity designates a financial liability as at fair value through profit or loss, it is required to disclose the amount of change in the fair value of the liability that is not attributable to changes in a benchmark interest rate (e.g. LIBOR). For a liability whose fair value is determined on the basis of an observed market price, 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 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 liability using the liability’s contractual cash flows at the start of the period and a discount rate equal to the sum of the benchmark interest rate at the end of the period and the instrument-specific component of the internal rate of return at the start of the period as determined in (a).~~

~~(c) The amount determined in (b) is then decreased for any cash paid on the liability during the period and increased to reflect the increase in fair value that arises because the contractual cash flows are one period closer to their due date.~~

~~(d) The difference between the observed market price of the liability at the end of the period and the amount determined in (c) is the change in fair value that is not attributable to changes in the benchmark interest rate. This is the amount to be disclosed.~~

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, HKAS 32.

HKAS 32 is based on IAS 32 *Financial Instruments: Disclosure and Presentation*. In approving HKAS 32, the Council of the Hong Kong Society of Accountants considered and agreed with the IASB's basis for conclusions on IAS 32 (as revised 2003). Accordingly, there are no significant differences between HKAS 32 and IAS 32. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IAS 32 referred to below generally correspond with those in HKAS 32.

BC1. This Basis for Conclusions summarises the International Accounting Standard Board's considerations in reaching its conclusions on revising IAS 32 *Financial Instruments: Disclosure and Presentation*[*] in 2003. Individual Board members gave greater weight to some factors than to others.

BC2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. The Board received over 170 comment letters on the Exposure Draft.

BC3. Because the Board did not reconsider the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39, this Basis for Conclusions does not discuss requirements in IAS 32 that the Board has not reconsidered.

Definitions (paragraphs 11-14 and AG3-AG24)

Financial Asset, Financial Liability and Equity Instrument (paragraphs 11 and AG3 – AG14)

BC4. The revised IAS 32 addresses the classification as financial assets, financial liabilities or equity instruments of financial instruments that are indexed to, or settled in, an entity's own equity instruments. As discussed further in paragraphs BC6–BC15, the Board decided to preclude equity classification for such contracts when they (a) involve an obligation to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity, (b) in the case of a non-derivative, are not for the receipt or delivery of a fixed number of shares or (c) in the case of a derivative, are not for the exchange of a fixed number of shares for a fixed amount of cash or another financial asset. The Board also decided to preclude equity classification for contracts that are

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7. The paragraphs relating to disclosures that were originally published in this Basis for Conclusions were relocated, if still relevant, to the Basis for Conclusions on IFRS 7.

derivatives on derivatives on an entity's own equity. Consistently with this decision, the Board also decided to amend the definitions of financial asset, financial liability and equity instrument in IAS 32 to make them consistent with the guidance about contracts on an entity's own equity instruments. The Board did not reconsider other aspects of the definitions as part of this project to revise IAS 32, for example the other changes to the definitions proposed by the Joint Working Group in its Draft Standard *Financial Instruments and Similar Items* published by the Board's predecessor body, IASC, in 2000.

Presentation (paragraphs 15-50 and AG25-AG39)

Liabilities and Equity (paragraphs 15-27 and AG25-AG29)

BC5. The revised IAS 32 addresses whether derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments are financial assets, financial liabilities or equity instruments. The original IAS 32 dealt with aspects of this issue piecemeal and it was not clear how various transactions (e.g. net share settled contracts and contracts with settlement options) should be treated under the Standard. The Board concluded that it needed to clarify the accounting treatment for such transactions.

BC6. The approach agreed by the Board can be summarised as follows:

A contract on an entity's own equity is an equity instrument if, and only if:

(a) it contains no contractual obligation to transfer cash or another financial asset, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and

(b) if the instrument will or may be settled in the entity's own equity instruments, it is either (i) a non-derivative that includes no contractual obligation for the entity to deliver a variable number of its own equity instruments, or (ii) a derivative that will be settled by the entity exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraphs 17-20 and AG25-AG26)

Puttable Instruments (paragraph 18(b))

BC7. The Board decided that ~~an~~ a financial instrument that gives the holder the right to put the instrument back to the entity for cash or another financial asset is a financial liability of the entity. Such financial instruments are commonly issued by mutual funds, unit trusts, co-operative and similar entities, often with the redemption amount being equal to a proportionate share in the net assets of the entity. Although the legal form of such financial instruments often includes a right to the residual interest in the assets of an entity available to holders of such instruments, the inclusion of an option for the holder to put the instrument back to the entity for cash or another financial asset means that the instrument meets the definition of a financial liability. The classification as a financial liability is independent of considerations such as when the right is exercisable, how the amount payable or receivable upon exercise of the right is determined, and whether the puttable instrument has a fixed maturity.

BC30. This approach removes the need to estimate inputs to, and apply, complex option pricing models to measure the equity component of some compound financial instruments. The Board also noted that the absence of a prescribed approach led to a lack of comparability among entities applying IAS 32 and that it therefore was desirable to specify a single approach.

BC31. The Board noted that a requirement to use the with-and-without method, under which the liability component is determined first, is consistent with the proposals of the Joint Working Group of Standard Setters in its Draft Standard and Basis for Conclusions in *Financial Instruments and Similar Items*, published by HKASC in December 2000 (see Draft Standard, paragraphs 74 and 75 and Application Supplement, paragraph 318).

Treasury Shares (paragraphs 33, 34 and AG36)

BC32. The revised Standard incorporates the guidance in SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*. The acquisition and subsequent resale by an entity of its own equity instruments represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument, rather than a gain or loss to the entity.

Interest, Dividends, Losses and Gains (paragraphs 35-41 and AG37)

Costs of an equity transaction (paragraphs 35 and 37-39)

BC33. The revised Standard incorporates the guidance in SIC-17 *Equity— Costs of an Equity Transaction*. Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of the transaction to which they relate. Linking the equity transaction and costs of the transaction reflects in equity the total cost of the transaction.

BC34. [Deleted].
-BC48.

~~Disclosure (paragraphs 51-95)~~

~~Interest Rate Risk and Credit Risk (paragraphs 67-85)~~

~~BC34. The Board did not consider amendments to the disclosures on interest rate risk and credit risk. It will do so as part of its project to review IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. This project will also consider requirements for the presentation of financial instruments on the face of the balance sheet and income statement.~~

~~Fair Value (paragraphs 86-93)~~

~~BC35. The exemption from the requirement to provide disclosures about fair value in IAS 32, paragraph 90, is consistent with the exemption from the requirement to measure particular financial assets and financial liabilities at fair value under IAS 39, paragraphs 46 and 47. Accordingly, 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. 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 exception from the~~

~~requirement to disclose fair value information for such financial assets and financial liabilities.~~

~~BC36. 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, such as 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, in particular when there are many valuation 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 valuation 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 all interdependencies between assumptions when making the disclosure. Additionally, the Board considered the view that this disclosure might imply that a fair value established by a valuation technique is less valid than one established by other means. However, the Board noted that fair values that are estimated by valuation techniques are more subjective than those established from an observable market price, and concluded that users should be given information to help them in assessing this subjectivity.~~

~~Financial Assets Carried at an Amount in Excess of Fair Value~~

~~BC37. The Board eliminated the disclosure requirements in IAS 32 regarding financial assets carried at an amount in excess of fair value, including the reasons for not reducing the carrying amount. IAS 39 requires financial assets classified as either held-to-maturity investments or as loans and receivables to be carried at amortised cost, which may exceed fair value. Because IAS 39 contains requirements governing the measurement of financial assets and IAS 32 requires fair value information to be provided in a way that permits comparisons with the financial assets' carrying amounts, the requirement to disclose separate information about financial assets carried at an amount in excess of fair value is redundant.~~

~~Other Disclosures (paragraphs 94, 95 and AG40)~~

~~Derecognition (paragraph 94(a))~~

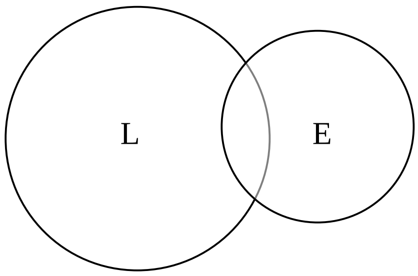
~~BC38. An entity may have either transferred a financial asset (see IAS 39, paragraph 18) or have entered into the type of arrangement described in paragraph 19 of IAS 39, in such a way that the arrangement does not qualify as a transfer of a financial asset. If the entity either continues to recognise all of the asset or continues to recognise the asset to the extent of its continuing involvement, the revised Standard requires disclosure of the nature and extent of the financial asset and any associated liabilities (see paragraph 94(a)). Such disclosure helps users of the financial statements to evaluate the significance of such transactions and may be relevant, for example, if an entity sells a portfolio of receivables and provides a limited guarantee of only one risk. In that example, the amount of the transferred receivables the transferor continues to recognise may be much riskier than the amount it derecognises.~~

~~Multiple Embedded Derivative Features (paragraph 94(d))~~

~~BC39. The Board noted that the separation of the liability and equity components of a compound financial instrument 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.~~

~~BC40. 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 in cases where 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, i.e. 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, i.e. the equity conversion option on the straight debt. The total area covered by 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.~~



~~BC41. Under the approach in paragraph BC25, 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.~~

~~BC42. 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 disclosure of the existence of issued compound financial instruments with multiple embedded derivative features that have interdependent values and the effective yield on the liability component is important. Such disclosure highlights the impact of multiple embedded derivative features on the amounts reported as liabilities and equity and interest expense for the issuer of a compound financial instrument.~~

~~Financial Assets and Financial Liabilities at Fair Value Through Profit or Loss (paragraphs 94(e), 94(f) and AG40)~~

~~BC43. The revised Standard requires disclosure of the carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated by the entity upon initial recognition as financial assets and financial liabilities at fair value through profit or loss. The Board concluded that an indication of the extent to which an entity designates financial assets and financial liabilities at fair value through profit or loss is useful to users because there are no restrictions on the items that can be so designated and because these items do not meet the definition of held for trading.~~

~~BC44. The revisions to IAS 39 include the ability for entities to designate a non-derivative financial liability as held at fair value through profit or loss. Paragraph 94(f)(i) requires disclosure of the change in fair value of such a financial liability that is not attributable to changes in a benchmark interest rate. The Board considered this disclosure in its deliberations on the fair value measurement of financial liabilities and whether changes in the credit risk of a liability should be included in its fair value measurement when the fair value option is used in IAS 39. The Board agreed that such changes should be included (i.e. the fair value of financial liabilities is not adjusted to exclude the effect of changes in the credit quality of the liability). Its reasons for this decision are set out in the Basis for Conclusions on IAS 39, paragraphs BC87-BC92.~~

~~BC45. The Board considered comments received on the Exposure Draft of proposed amendments to IAS 39 that argued that the fair value of financial liabilities should exclude the effects of an entity's credit risk. Such comments noted that (a) recognising a gain or loss when there is a change in an entity's own creditworthiness results in potentially misleading information; and (b) users may misinterpret the profit or loss effects of changes in credit risk, especially in the absence of disclosures.~~

~~BC46. The Board noted that the issue arises because of the change in the credit risk of the liability, rather than that of the entity. It agreed that requiring disclosure of the change in fair value of the financial liability that is caused by changes in the liability's credit risk would help alleviate the concerns expressed. However, the Board noted that providing this disclosure would often not be practicable because it may not be possible to separate and measure reliably that part of the change in fair value. Therefore, 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 believes this is 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 will provide users with information with which to understand the profit or loss effect of such a change in credit risk.~~

~~BC47. The Board concluded that when an entity has designated a financial liability as at fair value through profit or loss, disclosure should be given of 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 94(f)(ii)). 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.~~

~~Defaults and Breaches (paragraph 94(j))~~

~~BC48. The revised Standard requires disclosures of defaults in the payment of principal and interest, breaches of sinking fund or redemption provisions on loans payable, and any other breaches when those breaches can permit the lender to demand repayment of loans payable. Such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.~~

when determining if the group as a whole has an obligation that would give rise to a financial liability. To the extent there is such an obligation, the instrument (or component of the instrument that is subject to the obligation) is a financial liability in consolidated financial statements.

~~(i)~~ [Deleted].~~The Standard has clarified that the disclosure proposals in the Exposure Draft relating to when fair value is estimated using a valuation technique did not require disclosure of sensitivity to *all* valuation assumptions not supported by observable market prices. Rather, the sensitivity disclosure is required only if:~~

~~(i) the fair value is sensitive to a particular assumption;~~

~~(ii) reasonably possible alternatives for that assumption would result in a significantly different result; and~~

~~(iii) that assumption is not supported by observable market prices or rates.~~

~~(j)~~ [Deleted].~~For financial liabilities designated as at fair value through profit or loss, the Standard requires disclosure of the amount of the change in fair value that is not attributable to changes in a benchmark interest rate. This disclosure gives an indication of how much of the change in fair value is caused by changes in the credit risk of the liability.~~

(k) In August 2005, the IASB issued IFRS 7 Financial Instruments: Disclosures. As a result, disclosures relating to financial instruments, if still relevant, were relocated to IFRS 7.

Dissenting Opinion

Dissent of James J Leisenring

DO1. Mr Leisenring dissents from IAS 32 because, in his view, the conclusions about the accounting for forward purchase contracts and written put options on an issuer's equity instruments that require physical settlement in exchange for cash are inappropriate. IAS 32 requires a forward purchase contract to be recognised as though the future transaction had already occurred. Similarly it requires a written put option to be accounted for as though the option had already been exercised. Both of these contracts result in combining the separate forward contract and the written put option with outstanding shares to create a synthetic liability.

DO2. Recording a liability for the present value of the fixed forward price as a result of a forward contract is inconsistent with the accounting for other forward contracts. Recording a liability for the present value of the strike price of an option results in recording a liability that is inconsistent with the *Framework* as there is no present obligation for the strike price. In both instances the shares considered to be subject to the contracts are outstanding, have the same rights as any other shares and should be accounted for as outstanding. The forward and option contracts meet the definition of a derivative and should be accounted for as derivatives rather than create an exception to the accounting required by IAS 39. Similarly, if the redemption feature is embedded in the equity instrument (for example, a redeemable preference share) rather than being a free-standing derivative contract, the redemption feature should be accounted for as a derivative.

DO3. Mr Leisenring also objects to the conclusion that a purchased put or call option on a fixed number of an issuer's equity instruments is not an asset. The rights created by these contracts meet the definition of an asset and should be accounted for as assets and not as a reduction in equity. These contracts also meet the definition of derivatives that should be accounted for as such consistently with IAS 39.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraphs BC8 and BC22 are footnoted as follows:

BC8 The Board … also agreed that it should provide examples of how such entities might present their income statement* and balance sheet† (see Illustrative Examples 7 and 8).

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

† IAS 1 (revised 2007) replaced the term 'balance sheet' with 'statement of financial position'.

BC22 The Standard requires the separate presentation ~~on~~ in an entity's balance sheet* of liability and equity components of a single financial instrument. …

* IAS 1 (as revised in 2007) replaced the term 'balance sheet' with 'statement of financial position'.

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

In paragraphs IE32 and IE33, 'an income statement and balance sheet format' is amended to 'a format of a statement of comprehensive income and statement of financial position'.

In the statement of financial position following paragraph IE33, '**RESERVES**' is amended to '**OTHER COMPONENTS OF EQUITY**'.

In paragraph IE45, 'income statement' is amended to 'profit or loss'.

APPENDIX:

Comparison with International Accounting Standards

Appendix A. Application Guidance

Appendix B. Amendments to Other Pronouncements

Appendix C. Amendments resulting from other HKFRSs

BASIS FOR CONCLUSIONS

ILLUSTRATIVE EXAMPLES

TABLE OF CONCORDANCE

Hong Kong Accounting Standard 33 *Earnings per Share* (HKAS 33) is set out in paragraphs 1-76 and the Appendices A and B. All the paragraphs have equal authority. HKAS 33 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

(g) ordinary shares issued for the rendering of services to the entity are included as the services are rendered.

The timing of the inclusion of ordinary shares is determined by the terms and conditions attaching to their issue. Due consideration is given to the substance of any contract associated with the issue.

22. Ordinary shares issued as part of the ~~purchase consideration~~cost of a business combination ~~that is an acquisition~~ are included in the weighted average number of shares from the ~~date of the~~ acquisition date. This is because the acquirer incorporates ~~the results of the operations of the acquiree~~ into its income statement the acquiree's profits and losses from that date. ~~Ordinary shares issued as part of a business combination that is a uniting of interests[1] are included in the calculation of the weighted average number of shares for all periods presented. This is because the financial statements of the combined entity are prepared as if the combined entity had always existed. Therefore, the number of ordinary shares used for the calculation of basic earnings per share in a business combination that is a uniting of interests[*] is the aggregate of the weighted average number of shares of the combined entities, adjusted to equivalent shares of the entity whose shares are outstanding after the combination.~~

23. Ordinary shares that will be issued upon the conversion of a mandatorily convertible instrument are included in the calculation of basic earnings per share from the date the contract is entered into.

24. Contingently issuable shares are treated as outstanding and are included in the calculation of basic earnings per share only from the date when all necessary conditions are satisfied (ie the events have occurred). Shares that are issuable solely after the passage of time are not contingently issuable shares, because the passage of time is a certainty. Outstanding ordinary shares that are contingently returnable (ie subject to recall) are not treated as outstanding and are excluded from the calculation of basic earnings per share until the date the shares are no longer subject to recall.

25. [Deleted]

26. The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources.

27. Ordinary shares may be issued, or the number of ordinary shares outstanding may be reduced, without a corresponding change in resources. Examples include:

(a) a capitalisation or bonus issue (sometimes referred to as a stock dividend);

(b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;

(c) a share split; and

(d) a reverse share split (consolidation of shares).

---

[*] ~~A business combination that is a uniting of interests is analogous to a group reconstruction that satisfies the criteria for the use of merger accounting.~~

46. Options and warrants are dilutive when they would result in the issue of ordinary shares for less than the average market price of ordinary shares during the period. The amount of the dilution is the average market price of ordinary shares during the period minus the issue price. Therefore, to calculate diluted earnings per share, potential ordinary shares are treated as consisting of both the following:

(a) a contract to issue a certain number of the ordinary shares at their average market price during the period. Such ordinary shares are assumed to be fairly priced and to be neither dilutive nor antidilutive. They are ignored in the calculation of diluted earnings per share.

(b) a contract to issue the remaining ordinary shares for no consideration. Such ordinary shares generate no proceeds and have no effect on profit or loss attributable to ordinary shares outstanding. Therefore, such shares are dilutive and are added to the number of ordinary shares outstanding in the calculation of diluted earnings per share.

47. Options and warrants have a dilutive effect only when the average market price of ordinary shares during the period exceeds the exercise price of the options or warrants (ie they are 'in the money'). Previously reported earnings per share are not retroactively adjusted to reflect changes in prices of ordinary shares.

47A. For share options and other share-based payment arrangements to which HKFRS 2 *Share-based Payment* applies, the issue price referred to in paragraph 46 and the exercise price referred to in paragraph 47 shall include the fair value of any goods or services to be supplied to the entity in the future under the share option or other share-based payment arrangement.

48. Employee share options with fixed or determinable terms and non-vested ordinary shares are treated as options in the calculation of diluted earnings per share, even though they may be contingent on vesting. They are treated as outstanding on the grant date. Performance-based employee share options are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.

Convertible instruments

49. The dilutive effect of convertible instruments shall be reflected in diluted earnings per share in accordance with paragraphs 33 and 36.

50. Convertible preference shares are antidilutive whenever the amount of the dividend on such shares declared in or accumulated for the current period per ordinary share obtainable on conversion exceeds basic earnings per share. Similarly, convertible debt is antidilutive whenever its interest (net of tax and other changes in income or expense) per ordinary share obtainable on conversion exceeds basic earnings per share.

51. The redemption or induced conversion of convertible preference shares may affect only a portion of the previously outstanding convertible preference shares. In such cases, any excess consideration referred to in paragraph 17 is attributed to those shares that are redeemed or converted for the purpose of determining whether the remaining outstanding preference shares are dilutive. The shares redeemed or converted are considered separately from those shares that are not redeemed or converted.

Contingently issuable shares

52. As in the calculation of basic earnings per share, contingently issuable ordinary shares are treated as outstanding and included in the calculation of diluted earnings per share if the conditions are satisfied (ie the events have occurred). Contingently issuable shares are included from the beginning of the period (or from the date of the contingent share agreement, if later). If the conditions are not satisfied, the number of contingently issuable shares included in the diluted earnings per share calculation is based on the number of shares that would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires.

53. If attainment or maintenance of a specified amount of earnings for a period is the condition for contingent issue and if that amount has been attained at the end of the reporting period but must be maintained beyond the end of the reporting period for an additional period, then the additional ordinary shares are treated as outstanding, if the effect is dilutive, when calculating diluted earnings per share. In that case, the calculation of diluted earnings per share is based on the number of ordinary shares that would be issued if the amount of earnings at the end of the reporting period were the amount of earnings at the end of the contingency period. Because earnings may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares until the end of the contingency period because not all necessary conditions have been satisfied.

54. The number of ordinary shares contingently issuable may depend on the future market price of the ordinary shares. In that case, if the effect is dilutive, the calculation of diluted earnings per share is based on the number of ordinary shares that would be issued if the market price at the end of the reporting period were the market price at the end of the contingency period. If the condition is based on an average of market prices over a period of time that extends beyond the end of the reporting period, the average for the period of time that has lapsed is used. Because the market price may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares until the end of the contingency period because not all necessary conditions have been satisfied.

55. The number of ordinary shares contingently issuable may depend on future earnings and future prices of the ordinary shares. In such cases, the number of ordinary shares included in the diluted earnings per share calculation is based on both conditions (ie earnings to date and the current market price at the end of the reporting period). Contingently issuable ordinary shares are not included in the diluted earnings per share calculation unless both conditions are met.

56. In other cases, the number of ordinary shares contingently issuable depends on a condition other than earnings or market price (for example, the opening of a specific number of retail stores). In such cases, assuming that the present status of the condition remains unchanged until the end of the contingency period, the contingently issuable ordinary shares are included in the calculation of diluted earnings per share according to the status at the end of the reporting period.

57. Contingently issuable potential ordinary shares (other than those covered by a contingent share agreement, such as contingently issuable convertible instruments) are included in the diluted earnings per share calculation as follows:

(a) an entity determines whether the potential ordinary shares may be assumed to be issuable on the basis of the conditions specified for their issue in accordance with the contingent ordinary share provisions in paragraphs 52-56; and

(b) if those potential ordinary shares should be reflected in diluted earnings per share, an entity determines their impact on the calculation of diluted earnings per share by following the provisions for options and warrants in paragraphs 45-48, the provisions for convertible instruments in paragraphs 49-51, the provisions for contracts that may be settled in ordinary shares or cash in paragraphs 58-61, or other provisions, as appropriate.

However, exercise or conversion is not assumed for the purpose of calculating diluted earnings per share unless exercise or conversion of similar outstanding potential ordinary shares that are not contingently issuable is assumed.

Contracts that may be settled in ordinary shares or cash

58. When an entity has issued a contract that may be settled in ordinary shares or in cash at the entity's option, the entity shall presume that the contract will be settled in ordinary shares, and the resulting potential ordinary shares shall be included in diluted earnings per share if the effect is dilutive.

59. When such a contract is presented for accounting purposes as an asset or a liability, or has an equity component and a liability component, the entity shall adjust the numerator for any changes in profit or loss that would have resulted during the period if the contract had been classified wholly as an equity instrument. That adjustment is similar to the adjustments required in paragraph 33.

60. For contracts that may be settled in ordinary shares or cash at the holder's option, the more dilutive of cash settlement and share settlement shall be used in calculating diluted earnings per share.

61. An example of a contract that may be settled in ordinary shares or cash is a debt instrument that, on maturity, gives the entity the unrestricted right to settle the principal amount in cash or in its own ordinary shares. Another example is a written put option that gives the holder a choice of settling in ordinary shares or cash.

Purchased options

62. Contracts such as purchased put options and purchased call options (ie options held by the entity on its own ordinary shares) are not included in the calculation of diluted earnings per share because including them would be antidilutive. The put option would be exercised only if the exercise price were higher than the market price and the call option would be exercised only if the exercise price were lower than the market price.

Written put options

63. Contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive. If these contracts are 'in the money' during the period (ie the exercise or settlement price is above the average market price for that period), the potential dilutive effect on earnings per share shall be calculated as follows:

(a) ***it shall be assumed that at the beginning of the period sufficient ordinary shares will be issued (at the average market price during the period) to raise proceeds to satisfy the contract;***

(b) ***it shall be assumed that the proceeds from the issue are used to satisfy the contract (ie to buy back ordinary shares); and***

(c) ***the incremental ordinary shares (the difference between the number of ordinary shares assumed issued and the number of ordinary shares received from satisfying the contract) shall be included in the calculation of diluted earnings per share.***

Retrospective Adjustments

64. If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the balance sheet date but before the financial statements are authorised for issue, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares. The fact that per share calculations reflect such changes in the number of shares shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for~~:~~ the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.

65. An entity does not restate diluted earnings per share of any prior period presented for changes in the assumptions used in earnings per share calculations or for the conversion of potential ordinary shares into ordinary shares.

Presentation

66. An entity shall present on the face of the income statement basic and diluted earnings per share for profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity and for profit or loss attributable to the ordinary equity holders of the parent entity for the period for each class of ordinary shares that has a different right to share in profit for the period. An entity shall present basic and diluted earnings per share with equal prominence for all periods presented.

67. Earnings per share is presented for every period for which an income statement is presented. If diluted earnings per share is reported for at least one period, it shall be reported for all periods presented, even if it equals basic earnings per share. If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line on the income statement.

68. An entity that reports a discontinuing operation shall disclose the basic and diluted amounts per share for the discontinuing operation either on the face of the income statement or in the notes ~~to the financial statements~~.

69. An entity shall present basic and diluted earnings per share, even if the amounts are negative (ie a loss per share).

ordinary equity holders. The disclosure of the terms and conditions of such financial instruments and other contracts is encouraged, if not otherwise required (see ~~HKAS 32~~HKFRS 7 *Financial Instruments: Disclosures* [*]).

73. ***If an entity discloses, in addition to basic and diluted earnings per share, amounts per share using a reported component of the income statement other than one required by this Standard, such amounts shall be calculated using the weighted average number of ordinary shares determined in accordance with this Standard. Basic and diluted amounts per share relating to such a component shall be disclosed with equal prominence and presented in the notes ~~to the financial statements~~. An entity shall indicate the basis on which the numerator(s) is (are) determined, including whether amounts per share are before tax or after tax. If a component of the income statement is used that is not reported as a line item in the income statement, a reconciliation shall be provided between the component used and a line item that is reported in the income statement.***

Effective Date

74. ***An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.***

74A. If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.

Withdrawal of Other Pronouncements

75. This Standard supersedes SSAP 5 *Earnings Per Share* revised in 1998.

76. This Standard supersedes Interpretation 10 *Earnings Per Share—Financial Instruments and Other Contracts that May Be Settled in Shares.*

[*] Effective for annual periods beginning on or after 1 January 2007.

Appendix B

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~B1. In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at December 2003, references to the current version of SSAP 5 *Earnings Per Share* are amended to HKAS 33 *Earnings per Share.*~~

Appendix C

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 2 is replaced as follows:

2 This Standard shall apply to:

(a) the separate or individual financial statements of an entity:

(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market; and

(b) the consolidated financial statements of a group with a parent:

(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 4, '**on the face of its separate income statement**' is amended to '**in its statement of comprehensive income**'.

Paragraph 4A is added as follows:

4A **If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007), it presents earnings per share only in that separate statement.**

In paragraph 13, '*Presentation of Financial Statements'* is deleted.

Paragraph 67 is amended as follows: '… dual presentation can be accomplished in one line <u>in</u> ~~on~~ the ~~income~~ statement <u>of comprehensive income</u>.'

Paragraphs 67A, 68A, 73A and 74A are added as follows:

67A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents basic and diluted earnings per share, as required in paragraphs 66 and 67, in that separate statement.

68A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents basic and diluted earnings per share for the discontinued operation, as required in paragraph 68, in that separate statement or in the notes.

73A **Paragraph 73 applies also to an entity that discloses, in addition to basic and diluted earnings per share, amounts per share using a reported component of the separate income statement (as described in paragraph 81 of HKAS 1 (as revised in 2007)), other than one required by this Standard.**

74A **HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it added paragraphs 4A, 67A, 68A and 73A. 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.**

Illustrative Examples accompanying HKAS 33, Example 12 is amended as follows:

The heading '**Example 12 Calculation of basic and diluted earnings per share and income statement presentation (comprehensive example)**' is amended to '**Example 12 Calculation and presentation of basic and diluted earnings per share (comprehensive example)**'.

In the paragraph following the first table under **Full Year 20X1**, 'on its income statement' is amended to 'in its statement of comprehensive income'.

Illustrative Examples

These examples accompany, but are not part of, HKAS 33.

Contents

Calculation of basic earnings per share

		20X0	20X1	20X2
20X0 basic EPS as originally reported:	CU1,100÷500 shares	CU2.20		
20X0 basic EPS restated for rights issue:	$\dfrac{\text{CU1,100}}{(\text{500 shares } x \text{ 1.1})}$	CU2.00		
20X1 basic EPS including effects of rights issue:	$\dfrac{\text{CU1,500}}{(500\ x\ 1.1\ x\ 2 \div 12) + (600\ x\ 10 \div 12)}$		CU2.54	
20X2 basic EPS:	CU1,800÷600 shares			CU3.00

Example 5 - Effects of Share Options on Diluted Earnings per Share

Reference: HKAS 33, paragraphs 45-47

Profit attributable to ordinary equity holders of the parent entity for year 20X1	CU1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	CU20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	CU15.00

Calculation of earnings per share

	Earnings	*Shares*	*Per share*
Profit attributable to ordinary equity holders of the parent entity for year 20X1	CU1,200,000		
Weighted average shares outstanding during year 20X1		500,000	
Basic earnings per share			CU2.40
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: (100,000 *x* CU15.00) ÷ CU20.00	*	(75,000)	
Diluted earnings per share	CU1,200,000	525,000	CU2.29

* Earnings have not increased because the total number of shares has increased only by the number of shares (25,000) deemed to have been issued for no consideration (see paragraph 46(b) of the Standard).

Example 5A – Determining the Exercise Price of Employee Share Options

Weighted average number of unvested share options per employee	1,000
Weighted average amount per employee to be recognised over the remainder of the vesting period for employee services to be rendered as consideration for the share options, determined in accordance with HKFRS 2 *Share-based Payment*	CU1,200
Cash exercise price of unvested share options	CU15

Calculation of adjusted exercise price

Fair value of services yet to be rendered per employee:	CU1,200
Fair value of services yet to be rendered per option: (CU1,200 / 1,000)	CU1.20
Total exercise price of share options: (CU15.00 + CU1.20)	CU16.20

Example 8 – Convertible Bonds Settled in Shares or Cash at the Issuer's Option

Reference: HKAS 33, paragraphs 31-33, 36, 58 and 59

An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ~~common~~ ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ~~common~~ordinary share is CU3. Income tax is ignored.

Profit attributable to ordinary equity holders of the parent entity Year 1	CU1,000,000
Ordinary shares outstanding	1,200,000
Convertible bonds outstanding	2,000
Allocation of proceeds of bond issue:	
Liability component	CU1,848,122[5]
Equity component	CU151,878
	CU2,000,000

The liability and equity components would be determined in accordance with HKAS 32 *Financial Instruments: Disclosure and Presentation*. These amounts are recognised as the initial carrying amounts of the liability and equity components. The amount assigned to the issuer conversion option equity element is an addition to equity and is not adjusted.

Basic earnings per share Year 1:

$$\frac{\text{CU}1{,}000{,}000}{1{,}200{,}000} = \text{CU}0.83 \text{ per ordinary share}$$

[5] This represents the present value of the principal and interest discounted at 9% - CU2,000,000 payable at the end of three years; CU120,000 payable annually in arrears for three years.

Contents

Hong Kong Accounting Standard 34

Interim Financial Reporting

Hong Kong Accounting Standard 34 *Interim Financial Reporting* (HKAS 34) is set out in paragraphs 1-46. All the paragraphs have equal authority. HKAS 34 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix E

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 16 is amended as follows:

16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period:

...

(g) the following segment ~~revenue and segment result for business segments or geographical segments, whichever is the entity's primary basis of segment reporting~~ information (disclosure of segment ~~data~~ information is required in an entity's interim financial report only if ~~HKAS 14 Segment Reporting~~ HKFRS 8 Operating Segments requires that entity to disclose segment ~~data~~ information in its annual financial statements)~~;~~:

(i) revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(ii) intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(iii) a measure of segment profit or loss;

(iv) total assets for which there has been a material change from the amount disclosed in the last annual financial statements;

(v) a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss;

(vi) a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation;

...

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as described below.

> Hong Kong Accounting Standard 34 *Interim Financial Reporting* (HKAS 34) is set out in paragraphs ~~1–46~~ 1–47. All the paragraphs …

Paragraphs 4, 5 and 8 are amended as follows:

4 ...

Interim financial report **means a financial report containing either a complete set of financial statements (as described in HKAS 1 *Presentation of Financial Statements* (as revised in 2007)) or a set of condensed financial statements (as described in this Standard) for an interim period.**

5 HKAS 1 (as revised in 2007) defines a complete set of financial statements as including the following components:

(a) ~~a balance sheet~~ a statement of financial position as at the end of the period;

(b) ~~an income statement~~ a statement of comprehensive income for the period;

(c) a statement of changes in equity for the period; ~~showing either:~~

~~(i) all changes in equity; or~~

~~(ii) changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;~~

(d) a ~~cash flow~~ statement of cash flows for the period; ~~and~~

(e) notes, comprising a summary of significant accounting policies and other explanatory ~~notes.~~ information; and

(f) 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.

8 An interim financial report shall include …

(a) a condensed ~~balance sheet~~ statement of financial position;

(b) a condensed ~~income~~ statement of comprehensive income, presented as either:

(i) a condensed single statement; or

(ii) a condensed separate income statement and a condensed statement of comprehensive income;

(c) a condensed statement of changes in equity ~~showing either (i) all changes in equity or (ii) changes in equity other than those arising from capital transactions with owners and distributions to owners;~~

(d) a condensed ~~cash flow~~ statement of cash flows; and

(e) selected explanatory notes.

Paragraph 8A is added as follows:

8A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents interim condensed information from that separate statement.

Paragraph 11 is amended as follows:

11 In the statement that presents the components of profit or loss for an interim period, an entity shall present ~~B~~basic and diluted earnings per share ~~shall be presented on the face of an income statement, complete or condensed,~~ for ~~an interim~~ that period.

Paragraph 11A is added as follows:

11A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), it presents basic and diluted earnings per share in that separate statement.

Paragraph 12 is amended as follows:

12 HKAS 1 (as revised in 2007) provides guidance on the structure of financial statements. …

Paragraph 13 is deleted.

In paragraph 16(i), '**last annual balance sheet date**' is amended to '**end of the last annual reporting period**'.

Paragraph 20 is amended as follows:

20 Interim reports shall ...

(a) … financial year~~;~~.

(b) ~~income~~ statements of comprehensive income for the current interim period and cumulatively for the current financial year to date, with comparative ~~income~~ statements of comprehensive income for the comparable interim periods (current and year-to-date) of the immediately preceding financial year~~;~~. As permitted by HKAS 1 (as revised in 2007), an interim report may present for each period either a single statement of comprehensive income, or a statement displaying components of profit or loss (separate income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).

(c) statement ~~showing~~ of changes in equity … preceding financial year~~; and~~.

(d) …

In paragraph 21, 'ending on the interim reporting date' is amended to 'up to the end of the interim period'.

In paragraph 30(b), 'on the balance sheet' is amended to 'in the statement of financial position'.

In paragraph 31, 'both at annual and interim financial reporting dates' is amended to 'at the end of both annual and interim financial reporting periods'.

In paragraph 32, 'at an interim reporting date' is amended to 'at the end of an interim reporting period' and 'at an annual reporting date' is amended to 'at the end of an annual reporting period'.

Paragraph 47 is added as follows:

47 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 4, 5, 8, 11, 12 and 20, deleted paragraph 13 and added paragraphs 8A and 11A. 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.

Appendix F

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Appendix B accompanying HKAS 34 is amended as described below.

In paragraph B3, ‘the income statement’ is amended to ‘profit or loss’.

In paragraph B10, ‘at interim financial reporting dates’ is amended to ‘at the end of interim financial reporting periods’, ‘at an interim reporting date’ is amended to ‘at the end of an interim reporting period’ and ‘at an annual reporting date’ is amended to ‘at the end of an annual reporting period’.

In paragraph B11, ‘at an interim financial reporting date’ is amended to ‘at the end of an interim financial reporting period’.

In paragraph B25, ‘any financial reporting date’ is amended to ‘the end of any financial reporting period’.

In paragraph B30, ‘in profit or loss or in equity’ is amended to ‘in profit or loss or in other comprehensive income’.

Hong Kong Accounting Standard 36 *Impairment of Assets* (HKAS 36) is set out in paragraphs 1-141 and Appendices A and B. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. HKAS 36 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix B

Amendment to HKAS 16

The amendment in this appendix shall be applied when an entity applies HKAS 16 Property, Plant and Equipment . *This appendix is superseded when HKAS 36* Impairment of Assets *becomes effective. This appendix replaces the consequential amendments made by HKAS 16 to SSAP 31(which is referred to in HKAS 16 Appendix paragraph A4 as "HKAS 36"). HKAS 36 incorporates the requirements of the paragraphs in this appendix. Consequently, the amendments from HKAS 16 are not necessary once an entity is subject to HKAS 36 . Accordingly, this appendix is applicable only to entities that elect to apply HKAS 16 before its effective date.*

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~B1. HKAS 16 *Property, Plant and Equipment* is amended as described below. In the Appendix, paragraph A4 is amended to read as follows:~~

~~A4. SSAP 31 *Impairment of Assets* is amended as described below.~~

~~In the Standard, paragraphs 4, 9, 34, 37, 38, 41, 42, 59, 96 and 104 are amended to read as follows:~~

~~4. This Standard applies to assets that are carried at revalued amount (fair value) under other Standards, such as the revaluation model in HKAS 16 *Property, Plant and Equipment*. However, identifying whether a revalued asset may be impaired depends on the basis used to determine fair value:~~

~~…~~

~~***9. In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:***~~

~~**...**~~

~~***Internal sources of information***~~

~~**...**~~

~~***(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, and plans to dispose of an asset before the previously expected date; and***~~

~~**…**~~

~~34. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.~~

~~***37. Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:***~~

~~...~~

~~***(b) improving or enhancing the asset's performance.***~~

~~38. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:~~

~~…~~

~~(b) future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.~~

~~41. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits associated with the cash outflow (see Appendix A, Example 6).~~

~~42. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.~~

~~***59. An impairment loss shall be recognised as an expense in the income statement immediately, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in HKAS 16*** **Property, Plant and Equipment*****). Any impairment loss of a revalued asset shall be treated as a revaluation decrease under that other Standard.***~~

~~***96. In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:***~~

~~...~~

~~***Internal sources of information***~~

~~***(d) significant changes with a favourable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used***~~

~~***or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs; and***~~

~~**...**~~

~~***104. A reversal of an impairment loss for an asset shall be recognised as income immediately in the income statement, unless the asset is carried at revalued amount under another Standard (for example, in accordance with the revaluation model in HKAS 16*** **Property, Plant and Equipment*****). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase under that other Standard.***~~

~~In Appendix A, Example 6 is amended to read as follows:~~

~~**Example 6 - Treatment of Future Costs**~~

~~*In this example, tax effects are ignored.*~~

~~**Background**~~

~~A54. At the end of 20X0, entity F tests a machine for impairment. The machine is a cash-generating unit. It is carried at depreciated historical cost and its carrying amount is CU150,000. It has an estimated remaining useful life of 10 years.~~

~~A55. The machine's recoverable amount (ie higher of value in use and net selling price) is determined on the basis of a value in use calculation. Value in use is calculated using a pre-tax discount rate of 14 per cent.~~

~~A56. Management approved budgets reflect:~~

~~(a) estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition; and~~

~~(b) that in 20X4, costs of CU25,000 will be incurred to enhance the machine's performance by increasing its productive capacity.~~

~~A57. At the end of 20X4, costs to enhance the machine's performance are incurred. The machine's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph A60 and a current discount rate is the same as at the end of 20X0.~~

~~**At the End of 20X0**~~

~~Schedule 1. Calculation of the machine's value in use at the end of 20X0~~

~~*Year*~~	~~*Future cash flows*~~	~~*Discounted at 14%*~~
	~~CU~~	~~CU~~
~~20X1~~	~~22,165 (1)~~	~~19,443~~
~~20X2~~	~~21,450 (1)~~	~~16,505~~
~~20X3~~	~~20,550 (1)~~	~~13,871~~
~~20X4~~	~~24,725 (1)(2)~~	~~14,639~~
~~20X5~~	~~25,325 (1)(3)~~	~~13,153~~
~~20X6~~	~~24,825 (1)(3)~~	~~11,310~~
~~20X7~~	~~24,123 (1)(3)~~	~~9,640~~
~~20X8~~	~~25,533 (1)(3)~~	~~8,951~~
~~20X9~~	~~24,234 (1)(3)~~	~~7,452~~
~~20X10~~	~~22,850 (1)(3)~~	~~6,164~~
~~Value in use~~		~~121,128~~

~~(1) Includes estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition.~~

~~(2) Excludes estimated costs to enhance the machine's performance reflected in management budgets.~~

~~(3) Excludes estimated benefits expected from enhancing the machine's performance reflected in management budgets.~~

~~A58. The machine's recoverable amount (value in use) is less than its carrying amount. Therefore, F recognises an impairment loss for the machine.~~

~~Schedule 2. Calculation of the impairment loss at the end of 20X0~~

	~~*Machine*~~
	~~CU~~
~~Carrying amount before impairment loss~~	~~150,000~~
~~Recoverable amount (Schedule 1)~~	~~121,128~~
~~Impairment loss~~	~~(28,872)~~
~~Carrying amount after impairment loss~~	~~121,128~~

~~**Years 20X1 - 20X3**~~

~~A59. No event occurs that requires the machine's recoverable amount to be re-estimated. Therefore, no calculation of recoverable amount is required to be performed.~~

~~**At the End of 20X4**~~

~~A60. The costs to enhance the machine's performance are incurred. Therefore, in determining the machine's value in use, the future benefits expected from enhancing the machine's performance are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. As a consequence, in accordance with~~

~~paragraphs 95 and 96 of HKAS 36, the recoverable amount of the machine is recalculated at the end of 20X4. *Machine* CU Carrying amount before impairment loss 150,000 Recoverable amount (Schedule 1) 121,128 Impairment loss (28,872) Carrying amount after impairment loss 121,128~~

~~Schedule 3. Calculation of the machine's value in use at the end of 20X4~~

~~*Year*~~	~~*Future cash flows*(1)~~	~~*Discounted at 14%*~~
	~~CU~~	~~CU~~
~~20X5~~	~~30,321~~	~~26,597~~
~~20X6~~	~~32,750~~	~~25,200~~
~~20X7~~	~~31,721~~	~~21,411~~
~~20X8~~	~~31,950~~	~~18,917~~
~~20X9~~	~~33,100~~	~~17,191~~
~~20X10~~	~~27,999~~	~~12,756~~
~~Value in use~~		~~122,072~~

~~(1) Includes estimated benefits expected from enhancing the machine's performance reflected in management budgets~~

~~A61. The machine's recoverable amount (ie value in use) is higher than the machine's carrying amount and depreciated historical cost (see Schedule 4). Therefore, K reverses the impairment loss recognised for the machine at the end of 20X0 so that the machine is carried at depreciated historical cost.~~

~~Schedule 4. Calculation of the reversal of the impairment loss at the end of 20X4~~

	~~*Machine*~~
	~~*CU*~~
~~Carrying amount at the end of 20X0 (Schedule 2)~~	~~121,128~~
~~*End of 20X4*~~	
~~Depreciation charge (20X1 to 20X4 – Schedule 5)~~	~~(48,452)~~
~~Costs to enhance the asset's performance~~	~~25,000~~
~~Carrying amount before reversal~~	~~97,676~~
~~Recoverable amount (Schedule 3)~~	~~122,072~~
~~Reversal of the impairment loss~~	~~17,324~~
~~Carrying amount after reversal~~	~~115,000~~
~~Carrying amount: depreciated historical cost (Schedule 5)~~	~~115,000~~(1)

~~(1) The value in use of the machine exceeds what its carrying amount would have been at depreciated historical cost. Therefore, the reversal is limited to an amount that does not result in the carrying amount of the machine exceeding depreciated historical cost.~~

~~Schedule 5. Summary of the carrying amount of the machine~~

~~*Year*~~	~~*Depreciated historical cost*~~ ~~CU~~	~~*Recoverable amount*~~ ~~CU~~	~~*Adjusted depreciation charge*~~ ~~CU~~	~~*Impairment loss*~~ ~~CU~~	~~*Carrying amount after impairment*~~ ~~CU~~
~~20X0~~	~~150,000~~	~~121,128~~	~~0~~	~~(28,872)~~	~~121,128~~
~~20X1~~	~~135,000~~	~~nc~~	~~(12,113)~~	~~0~~	~~109,015~~
~~20X2~~	~~120,000~~	~~nc~~	~~(12,113)~~	~~0~~	~~96,902~~
~~20X3~~	~~105,000~~	~~nc~~	~~(12,113)~~	~~0~~	~~84,789~~
~~20X4~~	~~90,000~~		~~(12,113)~~		
~~enhancement~~	~~25,000~~		~~–~~		
	~~115,000~~	~~122,072~~	~~(12,113)~~	~~17,324~~	~~115,000~~
~~20X5~~	~~95,833~~	~~nc~~	~~(19,167)~~	~~0~~	~~95,833~~

~~nc = not calculated as there is no indication that the impairment loss may have increased/decreased.~~

Appendix D

Amendments Resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued pronouncements 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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraphs 61 and 120 are amended as follows:

61 An impairment loss on a non-revalued asset is recognised in profit or loss. However, an impairment loss on a revalued asset is recognised ~~directly against any revaluation surplus for the asset~~ <u>in other comprehensive income</u> to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that same asset. <u>Such an impairment loss on a revalued asset reduces the revaluation surplus for that asset</u>

120 A reversal of an impairment loss on a revalued asset is ~~credited directly to equity under the heading~~ <u>recognised in other comprehensive income and increases the</u> revaluation surplus <u>for that asset</u>. However, …

In paragraphs 126 and 129, '**directly in equity**' is amended to '**in other comprehensive income**'.

Paragraph 140A is added as follows:

140A IAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraphs 61, 120, 126 and 129. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

HKFRS 8 *Operating Segment* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph IN11 is amended as follows:

IN11 SSAP 31 required goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it related. It employed a "bottom-up/top-down" approach under which the goodwill was, in effect, tested for impairment by allocating its carrying amount to each cash-generating unit or smallest group of cash-generating units to which a portion of that carrying amount could be allocated on a reasonable and consistent basis. The Standard similarly requires goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it relates. However, the Standard clarifies that:

...

(b) each unit or group of units to which the goodwill is allocated should:

(i) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(ii) not be larger than an operating segment ~~based on either the entity's primary or the entity's secondary reporting format~~ determined in accordance with ~~HKAS 14 *Segment Reporting*~~ HKFRS 8 *Operating Segments*.

Paragraph 80 is amended as follows:

80 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:

...

(b) not be larger than an operating segment ~~based on either the entity's primary or the entity's secondary reporting format~~ determined in accordance with ~~HKAS 14 *Segment Reporting*~~ HKFRS 8 *Operating Segments*.

Paragraph 129 is amended as follows:

129 An entity that reports segment information in accordance with ~~HKAS 14 *Segment Reporting*~~ HKFRS 8 *Operating Segments* shall disclose the following for each reportable segment ~~based on an entity's primary reporting format~~:

In paragraph 130, subparagraphs (c)(ii), (d)(i) and (d)(ii) are amended as follows:

130 (c) (ii) if the entity reports segment information in accordance with ~~HKAS 14~~ HKFRS 8, the reportable segment to which the asset belongs~~, based on the entity's primary reporting format~~.

130 (d) (i) a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reportable segment as defined in HKFRS 8):

(ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with ~~HKAS 14~~ HKFRS 8, by reportable segment ~~based on the entity's primary reporting format~~; and

requirements currently associated with the impairment test might be reduced if the subsequent cash flow test were in place.

APPENDIX
Amendments to Basis for Conclusions resulting from other HKFRSs

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC144 is footnoted as follows:

> In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*. IFRS 8 does not require disclosure of primary and secondary segment information. See paragraph BC150A.

In the footnote to paragraph BC147, the following is added at the end:

> IAS 14 was replaced by IFRS 8 in 2006. See paragraph BC150A.

Paragraph BC150A is added after paragraph BC150, as follows:

BC150A In 2006 IFRS 8 replaced IAS 14 and changed the basis for identifying segments. Under IAS 14, two sets of segments were identified–one based on related products and services, and the other on geographical areas. Under IFRS 8, operating segments are identified on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. The objective of the change was to improve the disclosure of segment information, not to change the requirements of IAS 36 relating to the allocation of goodwill for impairment testing. The previous wording of the requirement in IAS 36 that each unit or group of units to which goodwill is allocated shall "not be larger than a segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with IAS 14" has been amended by IFRS 8 to "not be larger than an operating segment determined in accordance with IFRS 8". The arguments set out above in support of the original requirement based on segments determined in accordance with IAS 14 support the revised requirements based on segments determined in accordance with the requirements in IFRS 8.

The second sentence of paragraph BC166(b) is footnoted as follows:

> In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*, which does not require disclosure of primary and secondary segment information. See paragraph BC150A.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

At the end of the rubric preceding the Introduction a paragraph is added as follows:

> *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)*.

Paragraph BCZ108 is footnoted as follows:

BCZ108 IAS 36 requires that an impairment loss on a revalued asset should be recognised as an expense in the income statement* immediately, except that it should be recognised directly in equity† to the extent that it reverses a previous revaluation on the same asset.

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

† As a consequence of the revision of IAS 1 (revised 2007) an impairment loss is recognised in other comprehensive income.

HKAS 36 Impairment of Assets
Illustrative Examples

Contents

Appendix
Amendments to Implementation Guidance resulting from other HKFRSs

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph IE80 is amended as follows:

IE80 Entity M is a multinational manufacturing firm that uses geographical segments ~~as its primary format~~ for reporting segment information. M's three reportable segments ~~based on that format~~ are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to three individual cash–generating units–two in Europe (units A and B) and one in North America (unit C)–and to one group of cash-generating units (comprising operation XYZ) in Asia. Units A, B and C and operation XYZ each represent the lowest level within M at which the goodwill is monitored for internal management purposes.

APPENDICES

A. **Tables – Provisions, Contingent Liabilities, Contingent Assets and Reimbursements**

B. **Decision Tree**

C. **Examples: Recognition**

D. **Examples: Disclosure**

E. **Comparison with International Accounting Standards**

~~**F.** **Amendments resulting from other HKFRSs**~~

Hong Kong Accounting Standard 37 *Provisions, Contingent Liabilities and Contingent Assets* (HKAS 37) is set out in paragraphs 1-96. All the paragraphs have equal authority. HKAS 37 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Present obligation as a result of a past obligating event - The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - When the lease becomes onerous, an outflow of resources embodying economic benefits is probable (Until the lease becomes onerous, the entity accounts for the lease under HKAS 17 *Leases*).

Conclusion - A provision is recognised for the best estimate of the unavoidable lease payments (see paragraphs 5(c), 14 and 66).

Example 8A - An Onerous Contract

Same facts as example 8 except that the old factory can be used as a temporary godown generating a low level of income.

Conclusion - A provision is recognised for the best estimate of the net amount of the unavoidable lease costs i.e. the gross unavoidable lease costs less the probable net revenue expected from the godown operations (see paragraph 5(c), 14 and 66).

Example 9: A Single Guarantee

On 31 December 1999, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2000, the financial condition of Entity B deteriorates and at 30 June 2000 Entity B files for protection from its creditors.

This contract meets the definition of an insurance contract in HKFRS 4 *Insurance Contracts*, but is within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*, because it also meets the definition of a financial guarantee contract in HKAS 39. If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either HKAS 39 or HKFRS 4 to such financial guarantee contracts. HKFRS 4 permits the issuer to continue its existing accounting policies for insurance contracts if specified minimum requirements are satisfied. HKFRS 4 also permits changes in accounting policies that meet specified criteria. The following is an example of an accounting policy that HKFRS 4 permits and that also complies with the requirements in HKAS 39 for financial guarantee contracts within the scope of HKAS 39.

(a) At 31 December 1999

Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement – No outflow of benefits is probable at 31 December 1999.

Conclusion – The guarantee is recognised at fair value.

(b) At 31 December 2000

Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement – At 31 December 2000, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion – The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation (see paragraphs 14 and 23), and (b) the amount initially recognised less, when appropriate, cumulative amortisation in accordance with HKAS 18 *Revenue*.

~~Note: Where an entity gives guarantees in exchange for a fee, revenue is recognised under HKAS 18~~ ~~*Revenue*.~~

Example 10: A Court Case

After a wedding in 2000, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of authorisation of the financial statements for the year to 31 December 2000 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 2001, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

Appendix F

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 25, 'balance sheet items' is amended to 'items in the statement of financial position'.

In paragraph 75, 'of users taken' is amended to 'that users make'.

In Appendix C, Example 6:

> 'At the balance sheet date of 31 December 1999' is replaced by
> 'At 31 December 1999, the end of the reporting period'
>
> 'At the balance sheet date of 31 December 2000' is replaced by
> 'At 31 December 2000, the end of the reporting period'.

Hong Kong Accounting Standard 38
Intangible Assets

Objective

1. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

Scope

2. This Standard shall be applied in accounting for intangible assets, except:

- ***(a) intangible assets that are within the scope of another Standard;***
- ***(b) financial assets, as defined in HKAS 32 Financial Instruments: Presentation; and***
- ***(c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6*** **Exploration for and Evaluation of Mineral Resources*****); and***
- ***(d~~e~~) ~~mineral rights and~~ expenditure on the ~~exploration for, or~~ development and extraction of minerals, oil, natural gas and similar non-regenerative resources.***

3. If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

- (a) intangible assets held by an entity for sale in the ordinary course of business (see HKAS 2 *Inventories* and HKAS 11 *Construction Contracts*).
- (b) deferred tax assets (see HKAS 12 *Income Taxes*).
- (c) leases that are within the scope of HKAS 17 *Leases*.
- (d) assets arising from employee benefits (see HKAS 19 *Employee Benefits*).
- (e) financial assets as defined in HKAS32. The recognition and measurement of some financial assets are covered by HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures*.
- (f) goodwill acquired in a business combination (see HKFRS 3 *Business Combinations*).
- (g) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of HKFRS 4 *Insurance Contracts*. HKFRS 4 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.

SSAP 29 *Intangible Assets* issued in 2001 was effective.

Transitional Provisions and Effective Date

129. ***If an entity elects in accordance with paragraph 85 of HKFRS 3* Business Combinations *to apply HKFRS 3 from any date before the effective dates set out in paragraphs 78-84 of HKFRS 3, it also shall apply this Standard prospectively from that same date. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of its recognised intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8* Accounting Policies, Changes in Accounting Estimates and Errors.**

130. ***Otherwise, an entity shall apply this Standard:***

(a) ***to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 1 January 2005; and***

(b) ***to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 1 January 2005. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with HKAS 8.***

130A. An entity shall apply the amendments in paragraph 2 for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 for an earlier period, those amendments shall be applied for that earlier period.

Exchanges of Similar Assets

131. The requirement in paragraphs 129 and 130(b) to apply this Standard prospectively means that if an exchange of assets was measured before the effective date of this Standard on the basis of the carrying amount of the asset given up, the entity does not restate the carrying amount of the asset acquired to reflect its fair value at the acquisition date.

Early Application

132. ***Entities to which paragraph 130 applies are encouraged to apply the requirements of this Standard before the effective dates specified in paragraph 130. However, if an entity applies this Standard before those effective dates, it also shall apply HKFRS 3 and HKAS 36* Impairment of Assets *at the same time.***

Withdrawal of SSAP 29

133. This Standard supersedes SSAP 29 *Intangible Assets* (issued in 2001).

Appendix

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.

HKAS 23 *Borrowing Costs* (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 32 is amended as follows:

32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with ~~the capitalisation treatment permitted in~~ HKAS 23 *Borrowing Costs*.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 85 and 86 are amended as follows:

85 If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be ~~credited directly to~~ <u>recognised in other comprehensive income and accumulated in</u> equity under the heading of revaluation surplus. However, ...

86 If an intangible … However, the decrease shall be ~~debited directly to equity under the heading of revaluation surplus~~ <u>recognised in other comprehensive income</u> to the extent of any credit balance in the revaluation surplus in respect of that asset. <u>The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.</u>

In paragraph 87, 'through the income statement' is amended to 'through profit or loss'.

In paragraph 118(e)(iii), '**directly in equity**' is amended to '**in other comprehensive income**'.

Paragraph 130B is added as follows:

130B HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 85, 86 and 118(e)(iii). 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.

Contents

Hong Kong Accounting Standard 39

Financial Instruments: Recognition and Measurement

Basis for Conclusions

Implementation Guidance *see separate booklet*

Illustrative Example

Hong Kong Accounting Standard 39 *Financial Instruments: Recognition and Measurement* HKAS 39) is set out in paragraphs 1-109 and Appendices A, ~~and~~ B and C. All the paragraphs have equal authority. HKAS 39 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Hong Kong Accounting Standard 39

Financial Instruments: Recognition and Measurement

Objective

1[*]. The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting ~~and disclosing~~ information about financial instruments are ~~set out~~ in HKAS 32 *Financial Instruments: ~~Disclosure and~~ Presentation*. Requirements for disclosing information about financial instruments are in HKFRS 7 *Financial Instruments: Disclosures*.

Scope

2. This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for under HKAS 27 **Consolidated and Separate Financial Statements,** ***HKAS 28*** **Investments in Associates** ***or HKAS 31*** **Interests in Joint Ventures.** ***However, entities shall apply this Standard to an interest in a subsidiary, associate or joint venture that according to HKAS 27, HKAS 28 or HKAS 31 is accounted for under this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in HKAS 32.***

(b) rights and obligations under leases to which HKAS 17 **Leases** ***applies. However:***

(i) lease receivables recognised by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 15-37, 58, 59, 63-65 and Appendix A paragraphs AG36-AG52 and AG84-AG93);

(ii) finance lease payables recognised by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 39-42 and Appendix A paragraphs AG57-AG63); and

(iii) derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 10-13 and Appendix A paragraphs AG27-AG33).

(c) employers' rights and obligations under employee benefit plans, to which HKAS 19 **Employee Benefits** ***applies.***

(~~e~~d) financial instruments issued by the entity that meet the definition of an equity instrument in HKAS 32 (including options and warrants). However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.

[*] Effective for annual periods beginning on or after 1 January 2007.

(~~d~~e) *rights and obligations arising under (i) an insurance contract as defined in HKFRS 4 Insurance Contracts~~,~~ other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 9, or (ii) ~~under~~ a contract that is within the scope of HKFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in a contract within the scope of HKFRS 4 if the derivative is not itself a contract within the scope of HKFRS 4 (see paragraphs 10-13 and Appendix A paragraphs AG2~~3~~7-AG33). ~~Furthermore, if an insurance contract is a financial guarantee contract entered into, or retained, on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer shall apply this Standard to the contract (see paragraph 3 and Appendix A paragraph AG4A).~~ Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or HKFRS 4 to such financial guarantee contracts (see paragraphs AG4 and AG4A). The issuer may make that election contract by contract, but the election for each contract is irrevocable.*

~~(f) *financial guarantee contracts (including letters of credit and other credit default contracts) that provide for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument (see paragraph 3). An issuer of such a financial guarantee contract shall initially recognise it at fair value, and subsequently measure it at the higher of (i) the amount recognised under HKAS 37* Provisions, Contingent Liabilities and Contingent Assets*, and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with HKAS 18* Revenue. *Financial guarantees are subject to the derecognition provisions of this Standard (see paragraphs 39-42 and Appendix A paragraphs AG57-AG63).*~~

(~~g~~f) *contracts for contingent consideration in a business combination (see ~~paragraphs 65-67 of HKAS 22~~* HKFRS 3 *Business Combinations). This exemption applies only to the acquirer.*

(g) contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.

~~(h) *contracts that require a payment based on climatic, geological or other physical variables (see Appendix A paragraph AG1). However, other types of derivatives that are embedded in such contracts are subject to the embedded derivatives provisions of this Standard (for example, if an interest rate swap is contingent on a climatic variable such as heating degree days, the interest rate swap element is an embedded derivative that is within the scope of this Standard – see paragraphs 10-13 and Appendix A paragraphs AG27-AG33).*~~

(~~i~~h) *~~except as described~~ loan commitments other than those loan commitment described in paragraph 4. ~~loan commitments that cannot be settled net in cash or another financial instrument. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction). An issuer of a commitment to provide a loan at a below-market interest rate shall initially recognise it at fair value, and subsequently measure it at the higher of (i) the amount recognised under HKAS 37 and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with HKAS 18.~~ An issuer of loan commitments shall apply HKAS 37 to ~~other~~ loan commitments that are not within the scope of this Standard. However, all ~~L~~loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 15-42 and Appendix A paragraphs AG36-AG63).*

(i) financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 Share-based Payment applies, except for contracts within the scope of paragraphs 5–7 of this Standard, to which this Standard applies.

(j) rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognises as a provision in accordance with HKAS 37, or for which, in an earlier period, it recognised a provision in accordance with HKAS 37.

3. *~~Financial guarantee contracts are subject to this Standard if they provide for payments to be made in response to changes in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (sometimes called the 'underlying'). For example, a financial guarantee contract that provides for payments to be made if the credit rating of a debtor falls below a particular level is within the scope of this Standard.~~[Deleted]*

4. *~~Loan commitments that the entity designates as financial liabilities at fair value through profit or loss are within the scope of this Standard. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.~~ The following loan commitments are within the scope of this Standard:*

(a) ~~Loan~~ loan commitments that the entity designates as financial liabilities at fair value through profit or loss ~~are within the scope of this Standard~~. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.

(b) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).

(c) commitments to provide a loan at a below-market interest rate. Paragraph 47(d) specifies the subsequent measurement of liabilities arising from these loan commitments.

5. ***This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.***

6. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

   (a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

   (b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

   (c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

   (d) when the non-financial item that is the subject of the contract is readily convertible to cash.

   A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 5 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

7. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 6(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions

8. The terms defined in HKAS 32 are used in this Standard with the meanings specified in paragraph 11 of HKAS 32. HKAS 32 defines the following terms:

- financial instrument
- financial asset
- financial liability
- equity instrument

and provides guidance on applying those definitions.

9. The following terms are used in this Standard with the meanings specified:

Definition of a Derivative

A derivative is a financial instrument or other contract within the scope of this Standard (see paragraphs 2-7) with all three of the following characteristics:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(c) it is settled at a future date.

Definitions of Four Categories of Financial Instruments

A financial asset or financial liability at fair value through profit or loss is a financial asset or financial liability that meets either of the following conditions.

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:

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

(ii) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

(iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

(b) ***~~Upon initial recognition it is designated by the entity as at fair value through profit or loss. Any financial asset or financial liability within the scope of this Standard may be designated when initially recognised as a financial asset or financial liability at fair value through profit or loss except for investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81).~~ Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either***

(i) ***it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or***

(ii) ***a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in HKAS 24 Related Party Disclosures (issued in 2004)), for example the entity's board of directors and chief executive officer.***

In HKFRS 7, paragraphs 9-11 and B4 * ***require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions. For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.***

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.

It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69-AG82, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG16-AG25) other than:

(a) ***those that the entity upon initial recognition designates as at fair value through profit or loss;***

* Effective for annual periods beginning on or after 1 January 2007.

(b) ***those that the entity designates as available for sale; and***

(c) ***those that meet the definition of loans and receivables.***

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

(i) ***are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;***

(ii) ***occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or***

(iii) ***are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) ***those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;***

(b) ***those that the entity upon initial recognition designates as available for sale; or***

(c) ***those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.***

An interest acquired in a pool of assets that are not loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Definition of a Financial Guarantee Contract

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Definitions Relating to Recognition and Measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see HKAS 18), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Derecognition is the removal of a previously recognised financial asset or financial liability from an entity's balance sheet.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. *

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see Appendix A paragraph AG13). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Definitions Relating to Hedge Accounting

A firm commitment is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

A forecast transaction is an uncommitted but anticipated future transaction.

A hedging instrument is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (paragraphs 72-77 and Appendix A paragraphs AG94-AG97 elaborate on the definition of a hedging instrument).

A hedged item is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged (paragraphs 78-84 and Appendix A paragraphs AG98-AG101 elaborate on the definition of hedged items).

* Paragraphs 48, 49 and AG69-AG82 of Appendix A contain requirements for determining the fair value of a financial asset or financial liability.

***Hedge effectiveness* is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see Appendix A paragraphs AG105-AG113).**

Embedded Derivatives

10. An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable~~.~~, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

11. An embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract (see Appendix A paragraphs AG30 and AG33);

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).

If an embedded derivative is separated, the host contract shall be accounted for under this Standard if it is a financial instrument, and in accordance with other appropriate Standards if it is not a financial instrument. This Standard does not address whether an embedded derivative shall be presented separately on the face of the financial statements.

11A. Notwithstanding paragraph 11, if a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:

(a) the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or

(b) it is clear with little or no analysis when a similar hybrid (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

12. If an entity is required by this Standard to separate an embedded derivative from its host contract, but is unable to measure the embedded derivative separately either at acquisition or at a subsequent financial reporting date, it shall ~~treat~~ designate the entire hybrid (combined) contract as ~~a financial asset or financial liability that is held for trading~~ at fair value through profit or loss.

13. If an entity is unable to determine reliably the fair value of an embedded derivative on the basis of its terms and conditions (for example, because the embedded derivative is based on an unquoted equity instrument), the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) instrument and the fair value of the host contract, if those can be determined under this Standard. If the entity is unable to determine the fair value of the embedded derivative using this method, paragraph 12 applies and the hybrid (combined) instrument is ~~treated as held for trading~~ designated as at fair value through profit or loss.

Subsequent Measurement of Financial Assets

45. For the purpose of measuring a financial asset after initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 9:

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

(b) held-to-maturity investments;

(c) loans and receivables; and

(d) available-for-sale financial assets.

These categories apply to measurement and profit or loss recognition under this Standard. The entity may use other descriptors for these categories or other categorisations when presenting information on the face of the financial statements. The entity shall disclose in the notes the information required by ~~HKAS 32~~HKFRS 7*.

46. After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:

(a) loans and receivables as defined in paragraph 9, which shall be measured at amortised cost using the effective interest method;

(b) held-to-maturity investments as defined in paragraph 9, which shall be measured at amortised cost using the effective interest method; and

(c) investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost (see Appendix A paragraphs AG80 and AG81).

Financial assets that are designated as hedged items are subject to measurement under the hedge accounting requirements in paragraphs 89-102. All financial assets except those measured at fair value through profit or loss are subject to review for impairment in accordance with paragraphs 58-70 and Appendix A paragraphs AG84-AG93.

Subsequent Measurement of Financial Liabilities

47. After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost.

* Effective for annual periods beginning on or after 1 January 2007.

(b) ***financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or ~~is accounted for using~~ when the continuing involvement approach applies. Paragraphs 29 and 31 apply to the measurement of such financial liabilities***

(c) ***financial guarantee contracts as defined in paragraph 9. After initial recognition, an issuer of such a contract shall (unless paragraph 47(a) or (b) applies) measure it at the higher of:***

(i) ***the amount determined in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets; and***

(ii) ***the amount initially recognised (see paragraph 43) less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 Revenue.***

(d) ***commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall (unless paragraph 47(a) applies) measure it at the higher of:***

(i) ***the amount determined in accordance with HKAS 37; and***

(ii) ***the amount initially recognised (see paragraph 43) less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18.***

Financial liabilities that are designated as hedged items are subject to ~~measurement under~~ the hedge accounting requirements in paragraphs 89-102.

Fair Value Measurement Considerations

48*. ***In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, ~~or~~ HKAS 32 or HKFRS 7, an entity shall apply paragraphs AG69-AG82 of Appendix A.***

48A. The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (ie without modification or repackaging) or based on any available observable market data.

* Effective for annual periods beginning on or after 1 January 2007.

49. The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Reclassifications

50. An entity shall not reclassify a financial instrument into or out of the fair value through profit or loss category while it is held or issued.

51. If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held to maturity, it shall be reclassified as available for sale and remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 55(b).

52. Whenever sales or reclassifications of more than an insignificant amount of held-to-maturity investments do not meet any of the conditions in paragraph 9, any remaining held-to-maturity investments shall be reclassified as available for sale. On such reclassification, the difference between their carrying amount and fair value shall be accounted for in accordance with paragraph 55(b).

53. If a reliable measure becomes available for a financial asset or financial liability for which such a measure was previously not available, and the asset or liability is required to be measured at fair value if a reliable measure is available (see paragraphs 46(c) and 47), the asset or liability shall be remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 55.

54. If, as a result of a change in intention or ability or in the rare circumstance that a reliable measure of fair value is no longer available (see paragraphs 46(c) and 47) or because the 'two preceding financial years' referred to in paragraph 9 have passed, it becomes appropriate to carry a financial asset or financial liability at cost or amortised cost rather than at fair value, the fair value carrying amount of the financial asset or the financial liability on that date becomes its new cost or amortised cost, as applicable. Any previous gain or loss on that asset that has been recognised directly in equity in accordance with paragraph 55(b) shall be accounted for as follows:

- ***(a) In the case of a financial asset with a fixed maturity, the gain or loss shall be amortised to profit or loss over the remaining life of the held-to-maturity investment using the effective interest method. Any difference between the new amortised cost and maturity amount shall also be amortised over the remaining life of the financial asset using the effective interest method, similar to the amortisation of a premium and a discount. If the financial asset is subsequently impaired, any gain or loss that has been recognised directly in equity is recognised in profit or loss in accordance with paragraph 67.***

- ***(b) In the case of a financial asset that does not have a fixed maturity, the gain or loss shall remain in equity until the financial asset is sold or otherwise disposed of, when it shall be recognised in profit or loss. If the financial asset is subsequently impaired any previous gain or loss that has been recognised directly in equity is recognised in profit or loss in accordance with paragraph 67.***

Gains and Losses

55. ***A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship (see paragraphs 89-102), shall be recognised, as follows.***

(a) ***A gain or loss on a financial asset or financial liability classified as at fair value through profit or loss shall be recognised in profit or loss.***

(b) ***A gain or loss on an available-for-sale financial asset shall be recognised directly in equity, through the statement of changes in equity (see HKAS 1*** **Presentation of Financial Statements*****), except for impairment losses (see paragraphs 67-70) and foreign exchange gains and losses (see Appendix A paragraph AG83), until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in equity shall be recognised in profit or loss. However, interest calculated using the effective interest method (see paragraph 9) is recognised in profit or loss (see HKAS 18*** **Revenue*****). Dividends on an available-for-sale equity instrument are recognised in profit or loss when the entity's right to receive payment is established (see HKAS 18).***

56. ***For financial assets and financial liabilities carried at amortised cost (see paragraphs 46 and 47), a gain or loss is recognised in profit or loss when the financial asset or financial liability is derecognised or impaired, and through the amortisation process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 78-84 and Appendix A paragraphs AG98-AG101) the accounting for the gain or loss shall follow paragraphs 89-102.***

57. ***If an entity recognises financial assets using settlement date accounting (see paragraph 38 and Appendix A paragraphs AG53 and AG56), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets carried at cost or amortised cost (other than impairment losses). For assets carried at fair value, however, the change in fair value shall be recognised in profit or loss or in equity, as appropriate under paragraph 55.***

Impairment and Uncollectibility of Financial Assets

58. ***An entity shall assess at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.***

79. Unlike loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates. However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.

80. For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities or segments in the same group only in the individual or separate financial statements of those entities or segments and not in the consolidated financial statements of the group. As an exception, the foreign currency risk of an intragroup monetary item (eg a payable/receivable between two subsidiaries) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation ~~under~~ in accordance with HKAS 21 *The Effects of Changes in Foreign Exchange Rates*. ~~Under~~ In accordance with HKAS 21, foreign exchange rate gains and losses on intragroup monetary items are not fully eliminated on consolidation when the intragroup monetary item is transacted between two group entities that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

Designation of Financial Items as Hedged Items

81. If the hedged item is a financial asset or financial liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value (such as one or more selected contractual cash flows or portions of them or a percentage of the fair value) provided that effectiveness can be measured. For example, an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free interest rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument).

81A. In a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), the portion hedged may be designated in terms of an amount of a currency (e.g. an amount of dollars, euro, pounds or rand) rather than as individual assets (or liabilities). Although the portfolio may, for risk management purposes, include assets and liabilities, the amount designated is an amount of assets or an amount of liabilities. Designation of a net amount including assets and liabilities is not permitted. The entity may hedge a portion of the interest rate risk associated with this designated amount. For example, in the case of a hedge of a portfolio containing prepayable assets, the entity may hedge the change in fair value that is attributable to a change in the hedged interest rate on the basis of expected, rather than contractual, repricing dates. When the portion hedged is based on expected repricing dates, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if a portfolio that contains prepayable items is hedged with a non-prepayable derivative, ineffectiveness arises if the dates on which items in the hedged portfolio are expected to prepay are revised, or actual prepayment dates differ from those expected.

Effective Date and Transitional Provisions

103. An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 32. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact. Except as provided for in paragraphs 104 and 105 below, retrospective application is not permitted.

103A An entity shall apply the amendment in paragraph 2(j) for annual periods beginning on or after 1 January 2006. If an entity applies HK(IFRIC)-Int 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds for an earlier period, this amendment shall be applied for that earlier period.

103B Financial Guarantee Contracts (Amendments to HKAS 39 and HKFRS 4), issued in September 2005, amended paragraphs 2(e) and (h), 4, 47 and AG4, added paragraph AG4A, added a new definition of financial guarantee contracts in paragraph 9, and deleted paragraph 3. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies these changes for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 32[*] and HKFRS 4 at the same time.

104. The transition to this Standard should be as follows:

(a) [not used]

(b) for those transactions entered into before the beginning of the financial year in which this Standard is initially applied that the entity did previously designate as hedges, the recognition, derecognition, and measurement provisions of this Standard should be applied prospectively. Therefore, if the previously designated hedge does not meet the conditions for an effective hedge set out in paragraph 88 and the hedging instrument is still held, hedge accounting will no longer be appropriate starting with the beginning of the financial year in which this Standard is initially applied. Accounting in prior financial years should not be retrospectively changed to conform to the requirements of this Standard. Paragraphs 91 and 101 explain how to discontinue hedge accounting;

(c) at the beginning of the financial year in which this Standard is initially applied , an entity should recognise all derivatives in its balance sheet as either assets or liabilities and should measure them at fair value (except for a derivative that is linked to and that must be settled by delivery of an unquoted equity instrument whose fair value cannot be measured reliably). Because all derivatives, other than those that are designated hedging instruments, are considered held for trading, the difference between previous carrying amount (which may have been zero) and fair value of derivatives should be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which this Standard is initially applied (other than for a derivative that is a designated hedging instrument);

[*] When an entity applies HKFRS 7, the reference to HKAS 32 is replaced by a reference to HKFRS 7.

(d) ***at the beginning of the financial year in which this Standard is initially applied, an entity should apply the criteria in paragraphs 43-54 to identify those financial assets and liabilities that should be measured at fair value and those that should be measured at amortised cost, and it should remeasure those assets as appropriate. Any adjustment of the previous carrying amount should be recognised as an adjustment of the balance of retained earnings or, if appropriate, another category of equity**** ***at the beginning of the financial year in which this Standard is initially applied;***

(e) ***at the beginning of the financial year in which this Standard is initially applied, any balance sheet positions in fair value hedges of existing assets and liabilities should be accounted for by adjusting their carrying amounts to reflect the fair value of the hedging instrument;***

(f) ***if an entity's hedge accounting policies prior to initial application of this Standard had included deferral, as assets and liabilities, of gains or losses on cash flow hedges, at the beginning of the financial year in which this Standard is initially applied, those deferred gains and losses should be reclassified as a separate component of equity to the extent that the transactions meet the criteria in paragraph 88 and, thereafter, accounted for as set out in paragraphs 97-100;***

(g) ***transactions entered into before the beginning of the financial year in which this Standard is initially applied should not be retrospectively designated as hedges;***

(h) ***if a securitisation, transfer, or other derecognition transaction was entered into prior to the beginning of the financial year in which this Standard is initially applied, the accounting for that transaction shall not be retrospectively changed to conform to the requirements of this Standard; and***

(i) ***sales or transfers of held-to-maturity investments before the beginning of the financial year in which this Standard is initially applied do not trigger the "tainting" rules in paragraph 9. If an entity has sold or transferred held-to-maturity investments previously so designated under SSAP 24 in the two preceding financial years, it is not prevented to continue to classify such financial assets as held-to-maturity investments at the beginning of the financial year in which this Standard is initially applied.***

~~***105. When this Standard is first applied, an entity is permitted to designate a previously recognised financial asset as available for sale despite the requirement in paragraph 9 to make such designation upon initial recognition. For any such financial asset previously designated as available for sale,the entity shall recognise all cumulative changes in fair value in a separate component of equity until subsequent derecognition or impairment, when the entity shall transfer that cumulative gain or loss to profit or loss. For any financial instrument so re-designated as at fair value through profit or loss or available for sale, the entity shall also:***~~

* Preparers are reminded of the requirement to apply the revised transitional provision consistently for all similar transactions and to disclose the accounting policy used in the notes to the financial statements.

105. When this Standard is first applied, an entity is permitted to designate a previously recognised financial asset as available for sale. For any such financial asset the entity shall recognise all cumulative changes in fair value in a separate component of equity until subsequent derecognition or impairment, when the entity shall transfer that cumulative gain or loss to profit or loss. The entity shall also:

(a) restate the financial asset ~~or financial liability~~ using the new designation in the comparative financial statements; and

(b) disclose the fair value of the financial assets ~~or financial liabilities designated into each category~~ at the date of designation and ~~the~~their classification and carrying amount in the previous financial statements.

105A. An entity shall apply paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

105B. An entity that first applies paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 in its annual period beginning before 1 January 2006.

(a) is permitted, when those new and amended paragraphs are first applied, to designate as at fair value through profit or loss any previously recognised financial asset or financial liability that then qualifies for such designation. When the annual period begins before 1 September 2005, such designations need not be completed until 1 September 2005 and may also include financial assets and financial liabilities recognised between the beginning of that annual period and 1 September 2005. Notwithstanding paragraph 91, any financial assets and financial liabilities designated as at fair value through profit or loss in accordance with this subparagraph that were previously designated as the hedged item in fair value hedge accounting relationships shall be de-designated from those relationships at the same time they are designated as at fair value through profit or loss.

(b) shall disclose the fair value of any financial assets or financial liabilities designated in accordance with subparagraph (a) at the date of designation and their classification and carrying amount in the previous financial statements.

(c) shall de-designate any financial asset or financial liability previously designated as at fair value through profit or loss if it does not qualify for such designation in accordance with those new and amended paragraphs. When a financial asset or financial liability will be measured at amortised cost after de-designation, the date of de-designation is deemed to be its date of initial recognition.

(d) *shall disclose the fair value of any financial assets or financial liabilities de-designated in accordance with subparagraph (c) at the date of de-designation and their new classifications.*

105C. An entity that first applies paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 in its annual period beginning on or after 1 January 2006

(a) *shall de-designate any financial asset or financial liability previously designated as at fair value through profit or loss only if it does not qualify for such designation in accordance with those new and amended paragraphs. When a financial asset or financial liability will be measured at amortised cost after de-designation, the date of de-designation is deemed to be its date of initial recognition.*

(b) *shall not designate as at fair value through profit or loss any previously recognised financial assets or financial liabilities.*

(c) *shall disclose the fair value of any financial assets or financial liabilities de-designated in accordance with subparagraph (a) at the date of de-designation and their new classifications.*

105D. An entity shall restate its comparative financial statements using the new designations in paragraph 105B or 105C provided that, in the case of a financial asset, financial liability, or group of financial assets, financial liabilities or both, designated as at fair value through profit or loss, those items or groups would have met the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A at the beginning of the comparative period or, if acquired after the beginning of the comparative period, would have met the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A at the date of initial recognition.

106. [not used]

107. [not used]

107A Notwithstanding paragraph 104, an entity may apply the requirements in the last sentence of paragraph AG76, and paragraph AG76A, in either of the following ways:

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

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

108. [not used]

108A An entity shall apply the last sentence of paragraph 80, and paragraphs AG99A and AG99B, for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity has designated as the hedged item an external forecast transaction that

(a) is denominated in the functional currency of the entity entering into the transaction,

(b) gives rise to an exposure that will have an effect on consolidated profit or loss (ie is denominated in a currency other than the group's presentation currency), and

(c) would have qualified for hedge accounting had it not been denominated in the functional currency of the entity entering into it,

it may apply hedge accounting in the consolidated financial statements in the period(s) before the date of application of the last sentence of paragraph 80, and paragraphs AG99A and AG99B.

108B An entity need not apply paragraph AG99B to comparative information relating to periods before the date of application of the last sentence of paragraph 80 and paragraph AG99A.

Withdrawal of Other Pronouncements

109. This Standard supersedes SSAP 24 *Accounting for Investments in Securities*.

Appendix A

Application Guidance

This appendix is an integral part of the Standard.

Scope (paragraphs 2-7)

AG1. Some ~~C~~contracts ~~that~~ require a payment based on climatic, geological or other physical variables ~~are commonly used as insurance policies~~. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) ~~Under such contracts, the payment made is based on the amount of loss to the insured entity. Rights and obligations under insurance contracts that do not principally involve the transfer of financial risks are excluded from the scope of this Standard by paragraph 2(d). The payout under some contracts that require a payment based on climatic, geological or other physical variables is unrelated to the amount of an insured entity's loss. Such contracts are excluded from the scope of this Standard by paragraph 2(h).~~ If those contracts are not within the scope of HKFRS 4, they are within the scope of this Standard.

AG2. This Standard does not change the requirements relating to employee benefit plans that comply with HKAS 26 *Accounting and Reporting by Retirement Benefit Plans* and royalty agreements based on the volume of sales or service revenues that are accounted for under HKAS 18 *Revenue*.

AG3. Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor entity uses HKAS 28 *Investments in Associates* to determine whether the equity method of accounting is appropriate for such an investment. Similarly, the investor entity uses HKAS 31 *Interests in Joint Ventures* to determine whether proportionate consolidation or the equity method is appropriate for such an investment. If neither the equity method nor proportionate consolidation is appropriate, the entity applies this Standard to that strategic investment.

~~AG4~~. AG3A This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations ~~arising under insurance contracts that are excluded by~~ that paragraph 2(~~d~~e) excludes because they arise under contracts within the scope of HKFRS 4.

AG4 Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):

(a) Although a financial guarantee contract meets the definition of an insurance contract in HKFRS 4 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or

HKFRS 4 to such financial guarantee contracts. If this Standard applies, paragraph 43 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 29–37 and AG47–AG52 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

(i) the amount determined in accordance with HKAS 37; and

(ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 (see paragraph 47(c)).

(b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts, as defined in this Standard, and are not insurance contracts, as defined in HKFRS 4. Such guarantees are derivatives and the issuer applies this Standard to them.

(c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies HKAS 18 in determining when it recognises the revenue from the guarantee and from the sale of goods.

AG4A Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's communications with customers and regulators, contracts, business documentation and financial statements. Furthermore, insurance contracts are often subject to accounting requirements that are distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies. In such cases, an issuer's financial statements typically include a statement that the issuer has used those accounting requirements.

Definitions (paragraphs 8-9)

Designation as at fair value through profit or loss

AG4B Paragraph 9 of this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through profit or loss provided that doing so results in more relevant information.

AG4C The decision of an entity to designate a financial asset or financial liability as at fair value through profit or loss is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. In the case of designation as at fair value through profit or loss, paragraph 9 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 9, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Paragraph 9(b)(i): Designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise

AG4D Under HKAS 39, measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as available for sale (with most changes in fair value recognised directly in equity) and a liability the entity considers related would be measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were classified as at fair value through profit or loss.

AG4E The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9(b)(i).

(a) An entity has liabilities whose cash flows are contractually based on the performance of assets that would otherwise be classified as available for sale. For example, an insurer may have liabilities containing a discretionary participation feature that pay benefits based on realised and/or unrealised investment returns of a specified pool of the insurer's assets. If the measurement of those liabilities reflects current market prices, classifying the assets as at fair value through profit or loss means that changes in the fair value of the financial assets are recognised in profit or loss in the same period as related changes in the value of the liabilities.

(b) An entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by HKFRS 4, paragraph 24), and financial assets it considers related that would otherwise be classified as available for sale or measured at amortised cost.

(c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through profit or loss (ie are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met, for example because the requirements for effectiveness in paragraph 88 are not met.

(d) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example:

(i) the entity has financed a portfolio of fixed rate assets that would otherwise be classified as available for sale with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through profit or loss corrects the inconsistency that would otherwise arise from measuring the assets at fair value with changes reported in equity and the debentures at amortised cost.

(ii) the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through profit or loss eliminates the inconsistency in the timing of recognition of gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

AG4F In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through profit or loss may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through profit or loss at its initial recognition and, at that time, any remaining transactions are expected to occur.

AG4G It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through profit or loss if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100[*] and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through profit or loss. However, because designation as at fair value through profit or loss can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (eg changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (ie percentage) of a liability.

Paragraph 9(b)(ii): A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy

[*] In this Standard, monetary amounts are denominated in ‘currency units’ (CU).

AG4H An entity may manage and evaluate the performance of a group of financial assets, financial liabilities or both in such a way that measuring that group at fair value through profit or loss results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, rather than on the nature of its financial instruments.

AG4I The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9(b)(ii).

(a) The entity is a venture capital organisation, mutual fund, unit trust or similar entity whose business is investing in financial assets with a view to profiting from their total return in the form of interest or dividends and changes in fair value. HKAS 28 and HKAS 31 allow such investments to be excluded from their scope provided they are measured at fair value through profit or loss. An entity may apply the same accounting policy to other investments managed on a total return basis but over which its influence is insufficient for them to be within the scope of HKAS 28 or HKAS 31.

(b) The entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued ‘structured products’ containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments. A similar example could be an entity that originates fixed interest rate loans and manages the resulting benchmark interest rate risk using a mix of derivative and non-derivative financial instruments.

(c) The entity is an insurer that holds a portfolio of financial assets, manages that portfolio so as to maximise its total return (ie interest or dividends and changes in fair value), and evaluates its performance on that basis. The portfolio may be held to back specific liabilities, equity or both. If the portfolio is held to back specific liabilities, the condition in paragraph 9(b)(ii) may be met for the assets regardless of whether the insurer also manages and evaluates the liabilities on a fair value basis. The condition in paragraph 9(b)(ii) may be met when the insurer’s objective is to maximise total return on the assets over the longer term even if amounts paid to holders of participating contracts depend on other factors such as the amount of gains realised in a shorter period (eg a year) or are subject to the insurer’s discretion.

AG4J As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial instruments as at fair value through profit or loss on the basis of this condition shall so designate all eligible financial instruments that are managed and evaluated together.

AG4K Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 9(b)(ii). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity's key management personnel—clearly demonstrates that its performance is evaluated on a total return basis, no further documentation is required to demonstrate compliance with paragraph 9(b)(ii).

Effective Interest Rate

AG5. In some cases, financial assets are acquired at a deep discount that reflects incurred credit losses. Entities include such incurred credit losses in the estimated cash flows when computing the effective interest rate.

AG6. When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date. For example, if a premium or discount on a floating rate instrument reflects interest that has accrued on the instrument since interest was last paid, or changes in market rates since the floating interest rate was reset to market rates, it will be amortised to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e. interest rates) is reset to market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortised over the expected life of the instrument.

AG7. For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect movements in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

AG8. If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as income or expense in profit or loss.

Derivatives

AG9. Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000* if six-month LIBOR increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.

AG10. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g. a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g. a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (see paragraphs 5-7).

AG11. One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.

AG12. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognised as a derivative financial instrument. Rather, this Standard provides for special accounting for such regular way contracts (see paragraphs 38 and AG53-AG56).

AG12A The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

* In this Standard, monetary amounts are denominated in 'currency units' (CU).

Transaction Costs

AG13. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Financial Assets and Financial Liabilities Held for Trading

AG14. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

AG15. Financial liabilities held for trading include:

(a) derivative liabilities that are not accounted for as hedging instruments;

(b) obligations to deliver financial assets borrowed by a short seller (i.e. an entity that sells financial assets it has borrowed and does not yet own);

(c) financial liabilities that are incurred with an intention to repurchase them in the near term (e.g. a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

(d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Held-to-Maturity Investments

AG16. An entity does not have a positive intention to hold to maturity an investment in a financial asset with a fixed maturity if:

(a) the entity intends to hold the financial asset for an undefined period;

(b) the entity stands ready to sell the financial asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated by the entity) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources and terms or changes in foreign currency risk; or

(c) the issuer has a right to settle the financial asset at an amount significantly below its amortised cost.

AG17. A debt instrument with a variable interest rate can satisfy the criteria for a held-to-maturity investment. Equity instruments cannot be held-to-maturity investments either because they have an indefinite life (such as ordinary shares) or because the amounts the holder may receive can vary in a manner that is not predetermined (such as for share options, warrants and similar rights). With respect to the definition of held-to-maturity investments, fixed or determinable payments and fixed maturity mean that a contractual arrangement defines the amounts and dates of payments to the holder, such as interest and principal payments. A significant risk of non-payment does not preclude classification of a financial asset as held to maturity as long as its contractual payments are fixed or determinable and the other criteria for that classification are met. If the terms of a perpetual debt instrument provide for interest payments for an indefinite period, the instrument cannot be classified as held to maturity because there is no maturity date.

AG18. The criteria for classification as a held-to-maturity investment are met for a financial asset that is callable by the issuer if the holder intends and is able to hold it until it is called or until maturity and the holder would recover substantially all of its carrying amount. The call option of the issuer, if exercised, simply accelerates the asset's maturity. However, if the financial asset is callable on a basis that would result in the holder not recovering substantially all of its carrying amount, the financial asset cannot be classified as a held-to-maturity investment. The entity considers any premium paid and capitalised transaction costs in determining whether the carrying amount would be substantially recovered.

AG19. A financial asset that is puttable (i.e. the holder has the right to require that the issuer repay or redeem the financial asset before maturity) cannot be classified as a held-to-maturity investment because paying for a put feature in a financial asset is inconsistent with expressing an intention to hold the financial asset until maturity.

AG20. For most financial assets, fair value is a more appropriate measure than amortised cost. The held-to-maturity classification is an exception, but only if the entity has a positive intention and the ability to hold the investment to maturity. When an entity's actions cast doubt on its intention and ability to hold such investments to maturity, paragraph 9 precludes the use of the exception for a reasonable period of time.

AG21. A disaster scenario that is only remotely possible, such as a run on a bank or a similar situation affecting an insurer, is not something that is assessed by an entity in deciding whether it has the positive intention and ability to hold an investment to maturity.

AG22. Sales before maturity could satisfy the condition in paragraph 9—and therefore not raise a question about the entity's intention to hold other investments to maturity—if they are attributable to any of the following:

(a) a significant deterioration in the issuer's creditworthiness. For example, a sale following a downgrade in a credit rating by an external rating agency would not

Loans and Receivables

AG26. Any non-derivative financial asset with fixed or determinable payments (including loan assets, trade receivables, investments in debt instruments and deposits held in banks) could potentially meet the definition of loans and receivables. However, a financial asset that is quoted in an active market (such as a quoted debt instrument, see paragraph AG71) does not qualify for classification as a loan or receivable. Financial assets that do not meet the definition of loans and receivables may be classified as held-to-maturity investments if they meet the conditions for that classification (see paragraphs 9 and AG16-AG25). On initial recognition of a financial asset that would otherwise be classified as a loan or receivable, an entity may designate it as a financial asset at fair value through profit or loss, or available for sale.

Embedded Derivatives (paragraphs 10-13)

AG27. If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.

AG28. An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

AG29. Generally, multiple embedded derivatives in a single instrument are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see HKAS 32~~ *Financial Instruments: Disclosure and Presentation*~~) are accounted for separately from those classified as assets or liabilities. In addition, if an instrument has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.

AG30. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 11(a)) in the following examples. In these examples, assuming the conditions in paragraph 11(b) and (c) are met, an entity accounts for the embedded derivative separately from the host contract.

(a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.

(b) A call option embedded in an equity instrument that enables the issuer to reacquire that equity instrument at a specified price is not closely related to the host equity instrument from the perspective of the holder (from the issuer's perspective, the call option is an equity instrument provided it meets the conditions for that classification under HKAS 32, in which case it is excluded from the scope of this Standard).

(c) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.

(d) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(e) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(f) An equity conversion feature embedded in a convertible debt instrument is not closely related to the host debt instrument from the perspective of the holder of the instrument (from the issuer's perspective, the equity conversion option is an equity instrument and excluded from the scope of this Standard provided it meets the conditions for that classification under HKAS 32).

(g) A call, put, ~~surrender~~ or prepayment option embedded in a host debt ~~instrument~~ contract or host insurance contract is not closely related to the host ~~instrument~~ contract unless the option's exercise price is approximately equal ~~to the debt instrument's amortised cost~~ on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host debt ~~instrument~~contract is made before separating the equity element under HKAS 32.

(h) Credit derivatives that are embedded in a host debt instrument and allow one party (the 'beneficiary') to transfer the credit risk of a particular reference asset, which it may not own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it.

AG31. An example of a hybrid instrument is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through profit or loss, it is required to separate an embedded derivative (i.e. the indexed principal payment) under paragraph 11 because the host contract is a debt instrument under paragraph AG27 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG30(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

AG32. In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the combined instrument at the redemption amount that is payable at the balance sheet date if the holder exercised its right to put the instrument back to the issuer.

AG33. The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt ~~instrument~~contract or insurance contract is closely related to the host ~~instrument~~ contract unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) An embedded floor or cap on the interest rate on a debt ~~instrument~~ contract or insurance contract is closely related to the host ~~debt instrument~~contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the ~~instrument~~ contract is issued, and the cap or floor is not leveraged in relation to the host instrument contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g. a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

(c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (e.g. a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because HKAS 21 *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognised in profit or loss.

(d) An embedded foreign currency derivative in a host contract that is ~~not a financial instrument~~an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature and requires payments denominated in one of the following currencies:

(i) the functional currency of any substantial party to th~~e~~at contract;

(ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

(iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g. a relatively stable and liquid currency that is commonly used in local business transactions or external trade).

~~(Such a contract is not a host contract with an embedded foreign currency derivative.)~~

(e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.

(f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) contingent rentals based on related sales or (iii) contingent rentals based on variable interest rates.

(g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

(h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (ie without considering the host contract).

Instruments containing embedded derivatives

AG33A When an entity becomes a party to a hybrid (combined) instrument that contains one or more embedded derivatives, paragraph 11 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through profit or loss. For that reason this Standard permits the entire instrument to be designated as at fair value through profit or loss.

AG33B Such designation may be used whether paragraph 11 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 11A would not justify designating the hybrid (combined) instrument as at fair value through profit or loss in the cases set out in paragraph 11A(a) and (b) because doing so would not reduce complexity or increase reliability.

Recognition and Derecognition (paragraphs 14-42)

Initial Recognition (paragraph 14)

AG34. As a consequence of the principle in paragraph 14, an entity recognises all of its contractual rights and obligations under derivatives in its balance sheet as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG49). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (see paragraph AG50).

AG35. The following are examples of applying the principle in paragraph 14:

(a) unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.

(b) assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, rather, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard under paragraphs 5-7, its net fair value is recognised as an asset or liability on the commitment date (see (c) below). In addition, if a previously unrecognised firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognised as an asset or liability after the inception of the hedge (see paragraphs 93 and 94).

(c) a forward contract that is within the scope of this Standard (see paragraphs 2-7) is recognised as an asset or a liability on the commitment date, rather than on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.

(d) option contracts that are within the scope of this Standard (see paragraphs 2-7) are recognised as assets or liabilities when the holder or writer becomes a party to the contract.

(e) planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

fair value (e.g. because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

AG73. If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.

No Active Market: Valuation Technique

AG74. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm’s length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

AG75. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm’s length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

AG76. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

AG76A The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. The application of paragraph AG76 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability. In such a case, HKAS 39 requires that a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

AG77. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (i.e. similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued.

AG78. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.

AG79. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made. Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.

No Active Market: Equity Instruments

AG80. The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 46(c) and 47) is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

AG81. There are many situations in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 46(c) and 47) is likely not to be significant. Normally it is possible to estimate the fair value of a financial asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

Inputs to Valuation Techniques

AG82. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others).

(a) *The time value of money (i.e. interest at the basic or risk-free rate).* Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general rate, such as LIBOR or a swap rate, as the benchmark rate. (Because a rate such as LIBOR is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate.) In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.

(b) *Credit risk.* The effect on fair value of credit risk (i.e. the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.

(c) *Foreign currency exchange prices.* Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.

(d) *Commodity prices.* There are observable market prices for many commodities.

(e) *Equity prices.* Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.

(f) *Volatility (i.e. magnitude of future changes in price of the financial instrument or other item).* Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.

(g) *Prepayment risk and surrender risk.* Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount—see paragraph 49.)

(h) *Servicing costs for a financial asset or a financial liability.* Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

Gains and Losses (paragraphs 55-57)

AG83. An entity applies HKAS 21 to financial assets and financial liabilities that are monetary items in accordance with HKAS 21 and denominated in a foreign currency. Under HKAS 21, any foreign exchange gains and losses on monetary assets and monetary liabilities are recognised in profit or loss. An exception is a monetary item that is designated as a hedging instrument in either a cash flow hedge (see paragraphs 95-101) or a hedge of a net investment (see paragraph 102). For the purpose of recognising foreign exchange gains and losses under HKAS 21, a monetary available-for-sale financial asset is treated as if it were carried at amortised cost in the foreign currency. Accordingly, for such a financial asset, exchange differences resulting from changes in amortised cost are recognised in profit or loss and other changes in carrying amount are recognised in accordance with paragraph 55(b). For available-for-sale financial assets that are not monetary items under HKAS 21 (for example, equity instruments), the gain or loss that is recognised directly in equity under paragraph 55(b) includes any related foreign exchange component. If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are recognised in profit or loss.

Impairment and Uncollectibility of Financial Assets (paragraphs 58-70)

Financial Assets Carried at Amortised Cost (paragraphs 63-65)

AG84. Impairment of a financial asset carried at amortised cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair value measurement on financial assets that are otherwise measured at amortised cost. If the terms of a loan, receivable or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. If a loan, receivable or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 63 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset carried at amortised cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

AG85. The process for estimating impairment considers all credit exposures, not only those of low credit quality. For example, if an entity uses an internal credit grading system it considers all credit grades, not only those reflecting a severe credit deterioration.

AG86. The process for estimating the amount of an impairment loss may result either in a single amount or in a range of possible amounts. In the latter case, the entity recognises an impairment loss equal to the best estimate within the range, [*] taking into account all relevant information available before the financial statements are issued about conditions existing at the balance sheet date.

AG87. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. However, loss probabilities and other loss statistics differ at a group level between (a) assets that have been individually evaluated for impairment and found not to be impaired and (b) assets that have not been individually evaluated for impairment, with the result that a different amount of impairment may be required. If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment.

[*] HKAS 37, paragraph 39 contains guidance on how to determine the best estimate in a range of possible outcomes.

AG88. Impairment losses recognised on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

AG89. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience, use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

AG90. As an example of applying paragraph AG89, an entity may determine, on the basis of historical experience, that one of the main causes of default on credit card loans is the death of the borrower. The entity may observe that the death rate is unchanged from one year to the next. Nevertheless, some of the borrowers in the entity's group of credit card loans may have died in that year, indicating that an impairment loss has occurred on those loans, even if, at the year-end, the entity is not yet aware which specific borrowers have died. It would be appropriate for an impairment loss to be recognised for these 'incurred but not reported' losses. However, it would not be appropriate to recognise an impairment loss for deaths that are expected to occur in a future period, because the necessary loss event (the death of the borrower) has not yet occurred.

AG91. When using historical loss rates in estimating future cash flows, it is important that information about historical loss rates is applied to groups that are defined in a manner consistent with the groups for which the historical loss rates were observed. Therefore, the method used should enable each group to be associated with information about past loss experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions.

because consolidation recognises in profit or loss the subsidiary's profit or loss, rather than changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

AG99A Paragraph 80 states that in consolidated financial statements the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in a cash flow hedge, provided the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. For this purpose an entity can be a parent, subsidiary, associate, joint venture or branch. If the foreign currency risk of a forecast intragroup transaction does not affect consolidated profit or loss, the intragroup transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same group unless there is a related external transaction. However, when the foreign currency risk of a forecast intragroup transaction will affect consolidated profit or loss, the intragroup transaction can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same group if there is an onward sale of the inventory to a party external to the group. Similarly, a forecast intragroup sale of plant and equipment from the group entity that manufactured it to a group entity that will use the plant and equipment in its operations may affect consolidated profit or loss. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognised for the plant and equipment may change if the forecast intragroup transaction is denominated in a currency other than the functional currency of the purchasing entity.

AG99B If a hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with paragraph 95(a) shall be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

Designation of Financial Items as Hedged Items (paragraphs 81 and 81A)

AG99AC. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, that designated portion must be less than the total cash flows of the asset or liability. For example, in the case of a liability whose effective interest rate is below LIBOR, an entity cannot designate (a) a portion of the liability equal to the principal amount plus interest at LIBOR and (b) a negative residual portion. However, the entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk (e.g. only for changes that are attributable to changes in LIBOR). For example, in the case of a financial liability whose effective interest rate is 100 basis points below LIBOR, an entity can designate as the hedged item the entire liability (i.e. principal plus interest at LIBOR minus 100 basis points) and hedge the change in the fair value or cash flows of that entire liability that is attributable to changes in LIBOR. The entity may also choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG100.

AG99~~B~~D. In addition, if a fixed rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a portion equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day it first designates the hedged item. For example, assume an entity originates a fixed rate financial asset of CU100 that has an effective interest rate of 6 per cent at a time when LIBOR is 4 per cent. It begins to hedge that asset some time later when LIBOR has increased to 8 per cent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates it as the hedged item for its then fair value of CU90, the effective yield would have been 9.5 per cent. Because LIBOR is less than this effective yield, the entity can designate a LIBOR portion of 8 per cent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e. CU90) and the amount repayable on maturity (i.e. CU100).

Designation of Non-Financial Items as Hedged Items (paragraph 82)

AG100. Changes in the price of an ingredient or component of a non-financial asset or non-financial liability generally do not have a predictable, separately measurable effect on the price of the item that is comparable to the effect of, say, a change in market interest rates on the price of a bond. Thus, a non-financial asset or non-financial liability is a hedged item only in its entirety or for foreign exchange risk. If there is a difference between the terms of the hedging instrument and the hedged item (such as for a hedge of the forecast purchase of Brazilian coffee using a forward contract to purchase Colombian coffee on otherwise similar terms), the hedging relationship nonetheless can qualify as a hedge relationship provided all the conditions in paragraph 88 are met, including that the hedge is expected to be highly effective. For this purpose, the amount of the hedging instrument may be greater or less than that of the hedged item if this improves the effectiveness of the hedging relationship. For example, a regression analysis could be performed to establish a statistical relationship between the hedged item (e.g. a transaction in Brazilian coffee) and the hedging instrument (e.g. a transaction in Columbian coffee). If there is a valid statistical relationship between the two variables (i.e. between the unit prices of Brazilian coffee and Columbian coffee), the slope of the regression line can be used to establish the hedge ratio that will maximise expected effectiveness. For example, if the slope of the regression line is 1.02, a hedge ratio based on 0.98 quantities of hedged items to 1.00 quantities of the hedging instrument maximises expected effectiveness. However, the hedging relationship may result in ineffectiveness that is recognised in profit or loss during the term of the hedging relationship.

Designation of Groups of Items as Hedged Items (paragraphs 83 and 84)

AG101. A hedge of an overall net position (e.g. the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than of a specific hedged item, does not qualify for hedge accounting. However, almost the same effect on profit or loss of hedge accounting for this type of hedging relationship can be achieved by designating as the hedged item part of the underlying items. For example, if a bank has CU100 of assets and CU90 of liabilities with risks and terms of a similar nature and hedges the net CU10 exposure, it can designate as the hedged item CU10 of those assets. This designation can be used if such assets and liabilities are fixed rate instruments, in which case it is a fair value hedge, or if they are variable rate instruments, in which case it is a cash flow hedge. Similarly, if an entity has a firm commitment to make a purchase in a foreign currency of CU100 and a firm commitment to make a sale in the foreign currency of CU90, it can hedge the net amount of CU10 by acquiring a derivative and designating it as a hedging instrument associated with CU10 of the firm purchase commitment of CU100.

Hedge Accounting (paragraphs 85-102)

AG102. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed rate debt instrument as a result of changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.

AG103. An example of a cash flow hedge is the use of a swap to change floating rate debt to fixed rate debt (i.e. a hedge of a future transaction where the future cash flows being hedged are the future interest payments).

AG104. A hedge of a firm commitment (e.g. a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, under paragraph 87 a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Assessing Hedge Effectiveness

AG105. A hedge is regarded as highly effective only if both of the following conditions are met:

(a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG100.

(b) The actual results of the hedge are within a range of 80-125 per cent. For example, if actual results are such that the loss on the hedging instrument is CU120 and the gain on the cash instrument is CU100, offset can be measured by 120 / 100, which is 120 per cent, or by 100 / 120, which is 83 per cent. In this example, assuming the hedge meets the condition in (a) the entity would conclude that the hedge has been highly effective.

AG106. Effectiveness is assessed, at a minimum, at the time an entity prepares its annual or interim financial statements.

AG107. This Standard does not specify a single method for assessing hedge effectiveness. The method an entity adopts for assessing hedge effectiveness depends on its risk management strategy. For example, if the entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. In some cases, an entity adopts different methods for different types of hedges. An entity's documentation of its hedging strategy includes its procedures for assessing effectiveness. Those procedures state whether the assessment includes all of the gain or loss on a hedging instrument or whether the instrument's time value is excluded.

AG107A. If an entity hedges less than 100 per cent of the exposure on an item, such as 85 per cent, it shall designate the hedged item as being 85 per cent of the exposure and shall measure ineffectiveness based on the change in that designated 85 per cent exposure. However, when hedging the designated 85 per cent exposure, the entity may use a hedge ratio of other than one to one if that improves the expected effectiveness of the hedge, as explained in paragraph AG100.

AG108. If the principal terms of the hedging instrument and of the hedged asset, liability, firm commitment or highly probable forecast transaction are the same, the changes in fair value and cash flows attributable to the risk being hedged may be likely to offset each other fully, both when the hedge is entered into and afterwards. For example, an interest rate swap is likely to be an effective hedge if the notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item. In addition, a hedge of a highly probable forecast purchase of a commodity with a forward contract is likely to be highly effective if:

(a) the forward contract is for the purchase of the same quantity of the same commodity at the same time and location as the hedged forecast purchase;

(b) the fair value of the forward contract at inception is zero; and

(c) either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and recognised in profit or loss or the change in expected cash flows on the highly probable forecast transaction is based on the forward price for the commodity.

AG109. Sometimes the hedging instrument offsets only part of the hedged risk. For example, a hedge would not be fully effective if the hedging instrument and hedged item are denominated in different currencies that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk.

derecognised item was scheduled, because this determines the repricing time period(s) from which to remove it and hence the amount to remove from the separate line item referred to in paragraph AG114(g). When an item is derecognised, if it can be determined in which time period it was included, it is removed from that time period. If not, it is removed from the earliest time period if the derecognition resulted from higher than expected prepayments, or allocated to all time periods containing the derecognised item on a systematic and rational basis if the item was sold or became impaired.

AG129. In addition, any amount relating to a particular time period that has not been derecognised when the time period expires is recognised in profit or loss at that time (see paragraph 89A). For example, assume an entity schedules items into three repricing time periods. At the previous redesignation, the change in fair value reported in the single line item on the balance sheet was an asset of CU25. That amount represents amounts attributable to periods 1, 2 and 3 of CU7, CU8 and CU10, respectively. At the next redesignation, the assets attributable to period 1 have been either realised or rescheduled into other periods. Therefore, CU7 is derecognised from the balance sheet and recognised in profit or loss. CU8 and CU10 are now attributable to periods 1 and 2, respectively. These remaining periods are then adjusted, as necessary, for changes in fair value as described in paragraph AG114(g).

AG130. As an illustration of the requirements of the previous two paragraphs, assume that an entity scheduled assets by allocating a percentage of the portfolio into each repricing time period. Assume also that it scheduled CU100 into each of the first two time periods. When the first repricing time period expires, CU110 of assets are derecognised because of expected and unexpected repayments. In this case, all of the amount contained in the separate line item referred to in paragraph AG114(g) that relates to the first time period is removed from the balance sheet, plus 10 per cent of the amount that relates to the second time period.

AG131. If the hedged amount for a repricing time period is reduced without the related assets (or liabilities) being derecognised, the amount included in the separate line item referred to in paragraph AG114(g) that relates to the reduction shall be amortised in accordance with paragraph 92.

AG132. An entity may wish to apply the approach set out in paragraphs AG114-AG131 to a portfolio hedge that had previously been accounted for as a cash flow hedge in accordance with HKAS 39. Such an entity would revoke the previous designation of a cash flow hedge in accordance with paragraph 101(d), and apply the requirements set out in that paragraph. It would also redesignate the hedge as a fair value hedge and apply the approach set out in paragraphs AG114-AG131 prospectively to subsequent accounting periods.

Transition (paragraphs 103-108B)

AG133. An entity may have designated a forecast intragroup transaction as a hedged item at the start of an annual period beginning on or after 1 January 2005 (or, for the purpose of restating comparative information, the start of an earlier comparative period) in a hedge that would qualify for hedge accounting in accordance with this Standard (as amended by the last sentence of paragraph 80). Such an entity may use that designation to apply hedge accounting in consolidated financial statements from the start of the annual period beginning on or after 1 January 2005 (or the start of the earlier comparative period). Such an entity shall also apply paragraphs AG99A and AG99B from the start of the annual period beginning on or after 1 January 2005. However, in accordance with paragraph 108B, it need not apply paragraph AG99B to comparative information for earlier periods.

Appendix B

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard 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.

~~Amendments to HKFRS 1~~

~~B1. HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~Standard~~

~~Paragraphs 25A, 27A, 36A and 47A are added and paragraphs 13, 27 and 30 are amended to read as follows:~~

~~13 An entity may elect to use one or more of the following exemptions:~~

~~(a) ….~~

~~(e) compound financial instruments (paragraph 23);~~

~~(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs 24 and 25); and~~

~~(g) designation of previously recognised financial instruments (paragraph 25A).~~

~~Designation of previously recognised financial instruments~~

~~25A HKAS 39 *Financial Instruments: Recognition and Measurement* permits a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss or as available for sale. Despite this requirement, an entity is permitted to make such a designation at the date of transition to HKFRSs.~~

~~27 Except as permitted by paragraph 27A, a first-time adopter shall apply the derecognition requirements in HKAS 39 prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities under its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognise those assets and liabilities under HKFRSs (unless they qualify for recognition as a result of a later transaction or event).~~

~~27A Notwithstanding paragraph 27, 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.~~

~~30 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.~~

~~Exemption from the requirement to restate comparative information for HKAS 39~~

~~36A In its first HKFRS financial statements, an entity that adopts HKFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with HKAS 32 and HKAS 39. An entity that chooses to present comparative information that does not comply with HKAS 32 and HKAS 39 in its first year of transition shall:~~

~~(a) apply its previous GAAP to financial instruments within the scope of HKAS 32 and HKAS 39 in the comparative information;~~

~~(b) disclose this fact together with the basis used to prepare this information; and~~

~~(c) disclose the nature of the main adjustments that would make the information comply with HKAS 32 and HKAS 39. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (i.e. the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first HKFRS reporting period (i.e. the first period that includes information that complies with HKAS 32 and HKAS 39) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)-(f) of HKAS 8. Paragraph 28(f) applies only to amounts presented in the balance sheet at the comparative period's reporting date.~~

~~In the case of an entity that chooses to present comparative information that does not comply with HKAS 32 and HKAS 39, references to the 'date of transition to HKFRSs' shall mean, in the case of HKAS 32 and HKAS 39 only, the beginning of the first HKFRS reporting period.~~

~~Disclosure~~

~~47A 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 as available for sale in accordance with paragraph 25A. The entity shall disclose the fair value of any financial assets or financial liabilities designated into each category and the classification and carrying amount in the previous financial statements.~~

~~**Appendix A**~~

~~The following definition is added:~~

~~**first HKFRS reporting period**~~	~~The reporting period ending on the **reporting date** of an entity's **first HKFRS financial statements**.~~

~~**Guidance on Implementing**~~

~~The guidance on implementing HKFRS 1 is amended to read as follows:~~

~~IG36 For compound instruments outstanding at the date of transition to HKFRSs, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (HKAS 32, paragraph 30). An entity determines those carrying amounts using the version of HKAS 32 effective at the reporting date for its first HKFRS financial statements. If the liability component is no longer outstanding at the date of transition to HKFRSs, a first-time adopter need not separate the initial equity component of the instrument from the cumulative interest accreted on the liability component (paragraph 28 of the HKFRS).~~

~~IG52 An entity recognises and measures all financial assets and financial liabilities in its opening HKFRS balance sheet in accordance with HKAS 39, except as specified in paragraphs 27-30 of the HKFRS, which address derecognition and hedge accounting, and paragraph 36A, which permits an exemption from restating comparative information.~~

~~**Recognition**~~

~~IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under HKAS 39 and have not yet qualified for derecognition under HKAS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised under previous GAAP before 1 January 2004, to which the entity does not choose to apply paragraph 27A (see paragraphs 27 and 27A of the HKFRS). For example, an entity that does not apply paragraph 27A does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred beginning before 1 January 2004 if those transactions qualified for derecognition under previous GAAP. However, any further transfers of financial assets to the same securitisation or other transaction that occurred beginning on or after 1 January 2004 qualify for derecognition only if they meet the derecognition criteria of HKAS 39.~~

~~**Embedded derivatives**~~

~~IG55 When HKAS 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 HKAS 39 reflect circumstances at that date (HKAS 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 (HKAS 39, paragraph~~

~~12). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see HKAS 39, paragraph 46(c)), with changes in fair value recognised in profit or loss.~~

~~Measurement~~

~~IG56 In preparing its opening HKFRS balance sheet, an entity applies the criteria in HKAS 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 HKAS 39, paragraph 51, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying HKAS 39 reflecting the entity's intention and ability at the date of transition to HKFRSs. It follows that sales or transfers of held-to-maturity investments before the date of transition to HKFRSs do not trigger the 'tainting' rules in HKAS 39, paragraph 9.~~

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

~~(c) under HKAS 39, paragraph 9, derivative financial assets and derivative financial liabilities are always deemed held for trading (except for a derivative that is a designated and effective hedging instrument). The result is that an entity measures all derivative financial assets and derivative financial liabilities at fair value.~~

~~(d) to comply with HKAS 39, paragraph 50, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening HKFRS balance sheet as at fair value through profit or loss if, and 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 HKFRSs, 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 HKFRSs.~~

~~(e) to comply with HKAS 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.~~

~~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~~

~~HKFRSs only to the extent that it results from adopting HKAS 39. Because all derivatives, other than those that 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 shall be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which HKAS 39 is initially applied (other than for a derivative that is a designated and effective hedging instrument).~~

~~IG58B HKAS 8 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 under HKAS 8, with appropriate disclosures (HKAS 8, paragraphs 32-30).~~

~~IG59 An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain directly in equity. If an investment is classified as at fair value through profit or loss, the pre-HKAS 39 revaluation gain that had been recognised in equity is reclassified into retained earnings on initial application of HKAS 39. If, on initial application of HKAS 39, an investment is classified as available for sale, then the pre-HKAS 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 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 transfers to profit or loss the cumulative gain or loss remaining in equity (HKAS 39, paragraph 55(b)).~~

~~Hedge accounting~~

~~IG60 Paragraphs 28-30 of the HKFRS deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of transition to HKFRSs 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, under 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 HKFRSs. 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 under 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, under previous GAAP, was either (i) not recognised or (ii) deferred in the balance sheet as an asset or liability.~~

~~IG60B An entity may, under its previous GAAP, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of transition to HKFRSs, 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 HKAS 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 that had been recognised directly in equity is recognised in profit or loss. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge under HKAS 39, hedge accounting is no longer appropriate starting from the date of transition to HKFRSs.~~

~~Basis for Conclusions~~

~~Paragraph BC17(a) is amended to read as follows:~~

~~BC17 (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.~~

~~Paragraph BC20 is amended to read as follows:~~

~~BC20 An entity may have derecognised financial assets or financial liabilities under its previous GAAP that do not qualify for derecognition under 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:~~

~~...~~

~~(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.~~

~~Paragraphs BC22A and BC22B are added and paragraphs BC22 and BC23 are amended to read as follows:~~

~~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 under 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.~~

~~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.~~

~~Paragraph BC30 is amended to read as follows:~~

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

~~(a) ….~~

~~(e) compound financial instruments (paragraphs BC56-BC58);~~

~~(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs BC59-BC63); and~~

~~(g) designation of previously recognised financial instruments (paragraph BC63A).~~

~~Paragraph BC63A is added:~~

~~BC63A IAS 39 (as revised in 2003) permits an entity to designate, on initial recognition only, a financial instrument as (a) a financial asset or financial liability at fair value through profit or loss or (b) available for sale. Despite this requirement, an entity that had already applied IFRSs before the effective date of IAS 39 (as revised in 2003) may, on initial application of IAS 39 (as revised in 2003), so designate a previously recognised financial instrument. The Board decided to treat first-time adopters in the same way as entities that already apply IFRSs. Accordingly, a first-time adopter of IFRSs may similarly designate a previously recognised financial instrument at the date of transition to IFRSs. Such an entity is required to disclose the amount of previously recognised financial instruments that it so designates.~~

~~Paragraph BC77 is amended to read as follows:~~

~~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 transition 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 (i.e. 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.~~

~~Paragraph BC82 is amended to read as follows:~~

~~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.~~

~~Paragraph BC89 is amended to read as follows and paragraph BC89A is added:~~

~~BC89 Some respondents to ED 1 suggested that it would be onerous to prepare comparative information under 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 (e.g. 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. The disclosures in paragraph 36A inform users of the lack of comparability.~~

~~Paragraph BC97 of the Basis for Conclusions is deleted.~~

~~Amendments to HKAS 12~~

~~B2. HKAS 12 *Income Taxes* is amended as described below.~~

~~The first sentence of paragraph 20 is amended to read as follows:~~

~~20. HKFRSs permit or require certain assets to be carried at fair value or to be revalued (see, for example, HKAS 16 *Property, Plant and Equipment*, HKAS 38 *Intangible Assets, HKAS 39 Financial Instruments: Recognition and Measurement* and HKAS 40 *Investment Property*).~~

~~Example 9 of Appendix A is amended to read as follows:~~

~~9. The liability component of a compound financial instrument (for example a convertible bond) is measured at a discount to the amount repayable on maturity (see HKAS 32 *Financial Instruments: Disclosure and Presentation*). The discount is not deductible in determining taxable profit (tax loss).~~

~~Amendments to HKAS 18~~

~~B3. HKAS 18 *Revenue* is amended as described below.~~

~~Paragraph 30 is amended to read as follows:~~

~~***30. Revenue shall be recognised on the following bases:***~~

~~***(a) interest shall be recognised using the effective interest method as set out in HKAS 39, paragraphs 9 and AG5-AG8;***~~

~~***(b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and***~~

~~***(c) dividends shall be recognised when the shareholder's right to receive payment is established.***~~

~~Paragraph 31 is deleted.~~

~~Example 5 of the Appendix is amended to read as follows:~~

~~*5. Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.*~~

~~For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, HKAS 39 *Financial Instruments: Recognition and Measurement* applies.~~

~~Example 8 of the Appendix is amended to read as follows:~~

~~*8. Instalment sales, under which the consideration is receivable in instalments.*~~

~~Revenue attributable to the sale price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.~~

~~Example 14 of the Appendix is amended to read as follows:~~

~~*14. Financial service fees.*~~

~~The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.~~

~~*(a) Fees that are an integral part of the effective interest rate of a financial instrument.*~~

~~Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognised in profit or loss the fees are recognised as revenue when the instrument is initially recognised.~~

~~*(i) Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under HKAS 39 is classified as a financial asset at fair value through profit or loss.*~~

~~Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related direct costs, are deferred and recognised as an adjustment to the effective interest rate.~~

~~*(ii) Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of HKAS 39.*~~

~~If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of HKAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related direct costs, is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of HKAS 39 are accounted for as derivatives and measured at fair value.~~

~~*(b) Fees earned as services are provided.*~~

~~*(i) Fees charged for servicing a loan.*~~

~~Fees charged by an entity for servicing a loan are recognised as revenue as the services are provided.~~

~~*(ii) Commitment fees to originate a loan when the loan commitment is outside the scope of HKAS 39.*~~

~~If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of HKAS 39, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of HKAS 39 are accounted for as derivatives and measured at fair value.~~

~~*(c) Fees that are earned on the execution of a significant act.*~~

~~The fees are recognised as revenue when the significant act has been completed, as in the examples below.~~

~~*(i) Commission on the allotment of shares to a client.*~~

~~The commission is recognised as revenue when the shares have been allotted.~~

~~*(ii) Placement fees for arranging a loan between a borrower and an investor.*~~

~~The fee is recognised as revenue when the loan has been arranged.~~

~~*(iii) Loan syndication fees.*~~

~~A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.~~

~~B4. [Not used]~~

~~B5. [Not used]~~

~~Amendments to HKAS 36~~

~~B6. HKAS 36 *Impairment of Assets* is amended as described below:~~

~~Standard~~

~~Paragraph 1 is amended to read as follows:~~

~~***1. This Standard shall be applied in accounting for the impairment of all assets, other than:***~~

~~…~~

~~***(e) financial assets that are included in the scope of HKAS* 39 Financial Instruments: Recognition and Measurement;**~~

~~…~~

~~Amendments to HKAS 37~~

~~B7. HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is amended as described below.~~

~~Paragraphs 1 and 2 are amended to read as follows:~~

~~***1. This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:***~~

~~***(a) those resulting from executory contracts, except where the contract is onerous;***~~

~~***(b) those arising in insurance entities from contracts with policyholders; and***~~

~~***(c) those covered by another Standard.***~~

~~2. This Standard does not apply to financial instruments (including guarantees) that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*. For financial guarantees excluded from the scope of HKAS 39, this Standard applies as set out in paragraph 2(f) of HKAS 39.~~

~~Example 9 is amended to read as follows:~~

~~**Example 9: A Single Guarantee**~~

~~On 31 December 1999, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2000, the financial condition of Entity B deteriorates and at 30 June 2000 Entity B files for protection from its creditors.~~

~~(a) At 31 December 1999~~

~~**Present obligation as a result of a past obligating event** The obligating event is the giving of the guarantee, which gives rise to a legal obligation.~~

~~**An outflow of resources embodying economic benefits in settlement** No outflow of benefits is probable at 31 December 1999.~~

~~**Conclusion** The guarantee is recognised at fair value (see paragraph 2(f) of HKAS 39).~~

~~(b) At 31 December 2000~~

~~**Present obligation as a result of a past obligating event** The obligating event is the giving of the guarantee, which gives rise to a legal obligation.~~

~~**An outflow of resources embodying economic benefits in settlement** At 31 December 2000, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.~~

~~**Conclusion** The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation (see paragraphs 14 and 23), and (b) the amount initially recognised less, when appropriate, cumulative amortisation in accordance with HKAS 18 *Revenue*.~~

~~Note: Where an entity gives guarantees in exchange for a fee, revenue is recognised under HKAS 18 *Revenue*.~~

~~B8. [Not used]~~

Appendix C

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

References to:

- 'recognised in equity' and 'recognised directly in equity' are amended to 'recognised in other comprehensive income'.
- 'separate balance sheet line item' are amended to 'separate line item in the statement of financial position'.

In the last sentence of paragraph 11, '**on the face of the financial statements**' is amended to '**in the statement of financial position**'.

In paragraph 12, '**at a subsequent financial reporting date**' is amended to '**at the end of a subsequent financial reporting period**'.

In paragraph 14, '**on its balance sheet**' is amended to '**in its statement of financial position**'.

Paragraphs 54 and 55 are amended as follows:

54 If, as a result … Any previous gain or loss on that asset that has been recognised ~~directly~~ in ~~equity~~ <u>other comprehensive income</u> in accordance with paragraph 55(b) shall be accounted for as follows:

(a) In the case … If the financial asset is subsequently impaired, any gain or loss that has been recognised ~~directly in equity~~ <u>in other comprehensive income</u> is ~~recognised in~~ <u>reclassified from equity to</u> profit or loss in accordance with paragraph 67.

(b) In the case of a financial asset that does not have a fixed maturity, the gain or loss shall ~~remain in equity until the financial asset is sold or otherwise disposed of, when it shall~~ be recognised in profit or loss <u>when the financial asset is sold or otherwise disposed of</u>. If the financial asset is subsequently impaired any previous gain or loss that has been recognised ~~directly in equity is recognised~~ in <u>other comprehensive income is reclassified from equity to</u> profit or loss in accordance with paragraph 67.

55 A gain or loss … shall be recognised, as follows.

…

(b) A gain or loss on an available-for-sale financial asset shall be recognised ~~directly in equity, through the statement of changes in equity (see HKAS 1 *Presentation of Financial Statements*),~~ in other comprehensive income, except for impairment losses (see paragraphs 67–70) and foreign exchange gains and losses (see Appendix A paragraph AG83), until the financial asset is derecognised.~~, a~~ At ~~which~~ that time, the cumulative gain or loss previously recognised in ~~equity~~ other comprehensive income shall be ~~recognised in~~ reclassified from equity to profit or loss as a reclassification adjustment (see HKAS 1 *Presentation of Financial Statements* (as revised in 2007)). However, …

In paragraph 68, '**removed from equity and recognised in profit or loss**' is amended to '**reclassified from equity to profit or loss**'.

In paragraph 95(a), '**recognised directly in equity through the statement of changes in equity (see HKAS 1)**' is amended to '**recognised in other comprehensive income**'.

In paragraph 97, '**reclassified into profit or loss**' is amended to **'reclassified from equity to profit or loss as a reclassification adjustment (see HKAS 1 (as revised in 2007))'**.

Paragraphs 98 and 100 are amended as follows:

98 If a hedge …

(a) It reclassifies the associated gains and losses that were recognised ~~directly in equity~~ in other comprehensive income in accordance with paragraph 95 ~~in~~to profit or loss as a reclassification adjustment (see HKAS 1 (revised 2007)) in the same period or periods during which the asset acquired or liability assumed affects profit or loss (such as in the periods that depreciation expense or cost of sales is recognised). However, if an entity expects that all or a portion of a loss recognised ~~directly in equity~~ in other comprehensive income will not be recovered in one or more future periods, it shall reclassify from equity ~~in~~to profit or loss as a reclassification adjustment the amount that is not expected to be recovered.

(b) It removes the associated gains and losses that were recognised ~~directly~~ in ~~equity~~ other comprehensive income in accordance with paragraph 95 …

100 For cash flow hedges other than those covered by paragraphs 97 and 98, amounts that had been recognised in other comprehensive income ~~directly in equity~~ shall be ~~recognised in~~ reclassified from equity to profit or loss as a reclassification adjustment (see HKAS 1 (revised 2007)) in the same period or periods during which the hedged forecast transaction affects profit or loss (for example, when a forecast sale occurs).

In paragraph 101, '**remains recognised directly in equity**' is amended to '**has been recognised in other comprehensive income**', '**shall remain separately recognised in equity**' is amended to '**shall remain separately in equity**' and '**shall be recognised in profit or loss**' is amended to '**shall be reclassified from equity to profit or loss as a reclassification adjustment**'.

Paragraph 102 is amended as follows:

102 Hedges of a net investment …

(a) the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 88) shall be recognised <u>in other comprehensive income</u> ~~directly in equity through the statement of changes in equity (see HKAS 1)~~; and

(b) the ineffective portion shall be recognised in profit or loss.

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognised <u>in other comprehensive income</u> ~~directly in equity~~ shall be ~~recognised in~~ <u>reclassified from equity to</u> profit or loss <u>as a reclassification adjustment (see HKAS 1 (revised 2007))</u> on disposal of the foreign operation.

Paragraph 103C is added as follows:

103C HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 26, 27, 34, 54, 55, 57, 67, 68, 95(a), 97, 98, 100, 102, 105, 108, AG4D, AG4E(d)(i), AG56, AG67, AG83 and AG99B. 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.

Paragraphs 105 and 108 are amended as follows:

105 When … For any such financial asset, the entity shall recognise all cumulative changes in fair value in a separate component of equity until subsequent derecognition or impairment, when the entity shall ~~transfer~~ <u>reclassify</u> that cumulative gain or loss <u>from equity</u> to profit or loss <u>as a reclassification adjustment (see HKAS 1 (revised 2007))</u>. The entity ...

108 An entity shall not adjust the carrying amount of non-financial assets and non-financial liabilities to exclude gains and losses related to cash flow hedges that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied. At the beginning of the financial period in which this Standard is first applied, any amount recognised <u>outside profit or loss (in other comprehensive income or</u> directly in equity<u>)</u> for a hedge of a firm commitment that under this Standard is accounted for as a fair value hedge shall be reclassified as an asset or liability, except for a hedge of foreign currency risk that continues to be treated as a cash flow hedge.

Appendix A *Application guidance* is amended as described below.

In paragraph AG4E(d)(i), ‘changes reported in equity’ is amended to ‘changes recognised in other comprehensive income’.

In paragraph AG25, ‘each subsequent balance sheet date’ is amended to ‘the end of each subsequent reporting period’.

In paragraph AG51(a), ‘on its balance sheet’ is amended to ‘in its statement of financial position’.

In paragraph AG67, 'The next financial reporting date' is amended to 'The end of the reporting period'.

Paragraph AG99B is amended as follows:

AG99B If a hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised in other comprehensive income ~~directly in equity~~ in accordance with paragraph 95(a) shall be reclassified ~~into~~ from equity to profit or loss as a reclassification adjustment in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

In paragraph AG129, ‘on the balance sheet’ is amended to ‘in the statement of financial position’.

The Illustrative Example accompanying HKAS 39 is amended as described below.

In paragraphs IE14, IE18, IE24, IE26, IE28 and IE30, ‘income statement’ is amended to ‘profit or loss’.

References to ‘balance sheet line item’ are amended to ‘line item in the statement of financial position’.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, HKAS 39.

HKAS 39 is based on IAS 39 *Financial Instruments: Recognition and Measurement*. In approving HKAS 39, the Council of the Hong Kong ~~Society~~ Institute of Certified Public Accountants considered and agreed with the IASB's basis for conclusions on IAS 39 (as amended in March 2004 and subsequently). Accordingly, there are no significant differences between HKAS 39 and IAS 39. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IAS 39 referred to below generally correspond with those in HKAS 39.

BC1. This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions on revising IAS 39 *Financial Instruments: Recognition and Measurement* in 2003. Individual Board members gave greater weight to some factors than to others.

BC2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of Proposed Amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. In August 2003 the Board published a further Exposure Draft of Proposed Amendments to IAS 39 on *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk*, with a comment deadline of 14 November 2003.

BC3. Because the Board's intention was not to reconsider the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39, this Basis for Conclusions does not discuss requirements in IAS 39 that the Board has not reconsidered.

Background

BC4. The original version of IAS 39 became effective for financial statements covering financial years beginning on or after 1 January 2001. It reflected a mixed measurement model in which some financial assets and financial liabilities are measured at fair value and others at cost or amortised cost, depending in part on an entity's intention in holding an instrument.

BC5. The Board recognises that accounting for financial instruments is a difficult and controversial subject. The Board's predecessor body, the International Accounting Standards Committee (IASC) began its work on the issue some 15 years ago, in 1988. During the next eight years it published two Exposure Drafts, culminating in the issue of IAS 32 on disclosure and presentation in 1995. IASC decided that its initial proposals on recognition and measurement should not be progressed to a Standard, in view of:

- the critical response they had attracted;
- evolving practices in financial instruments; and

(d) meetings between members of the Board and its staff and various groups of constituents to explore further issues raised in comment letters and at the roundtable discussions.

BC11A. Some of the comment letters on the June 2002 Exposure Draft and participants in the roundtables raised a significant issue for which the June 2003 Exposure Draft had not proposed any changes. This was hedge accounting for a portfolio hedge of interest rate risk (sometimes referred to as 'macro hedging') and the related question of the treatment in hedge accounting of deposits with a demand feature (sometimes referred to as 'demand deposits' or 'demandable liabilities'). In particular, some were concerned that it was very difficult to achieve fair value hedge accounting for a macro hedge in accordance with previous versions of IAS 39.

BC11B. In the light of these concerns, the Board decided to explore whether and how IAS 39 might be amended to enable fair value hedge accounting to be used more readily for a portfolio hedge of interest rate risk. This resulted in a further Exposure Draft of Proposed Amendments to IAS 39 that was published in August 2003 and on which more than 120 comment letters were received. The amendments proposed in the Exposure Draft were finalised in March 2004.

BC11C After those amendments were issued in March 2004 the Board received further comments from constituents calling for further amendments to the Standard. In particular, as a result of continuing discussions with constituents, the Board became aware that some, including prudential supervisors of banks, securities companies and insurers, were concerned that the fair value option might be used inappropriately. These constituents were concerned that:

(a) entities might apply the fair value option to financial assets or financial liabilities whose fair value is not verifiable. If so, because the valuation of these financial assets and financial liabilities is subjective, entities might determine their fair value in a way that inappropriately affects profit or loss.

(b) the use of the option might increase, rather than decrease, volatility in profit or loss, for example if an entity applied the option to only one part of a matched position.

(c) if an entity applied the fair value option to financial liabilities, it might result in an entity recognising gains or losses in profit or loss associated with changes in its own creditworthiness.

In response to those concerns, the Board published in April 2004 an Exposure Draft of proposed restrictions to the fair value option. In March 2005 the Board held a series of round-table meetings to discuss proposals with invited constituents. As a result of this process, the Board issued an amendment to IAS 39 in June 2005 relating to the fair value option.

BC12. The Board did not reconsider the fundamental approach to accounting for financial instruments contained in IAS 39. Some of the complexity in existing requirements is inevitable in a mixed measurement model based in part on management's intentions for holding financial instruments and given the complexity of finance concepts and fair value estimation issues. The amendments reduce some of the complexity by clarifying the Standard, eliminating internal inconsistencies and incorporating additional guidance into the Standard.

BC13. The amendments also eliminate or mitigate some differences between IAS 39 and US GAAP related to the measurement of financial instruments. Already, the measurement requirements in IAS 39 are, to a large extent, similar to equivalent requirements in US GAAP, in particular, those in FASB SFAS 114 *Accounting by Creditors for Impairment of a Loan*, SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities* and SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*.

BC14. The Board will continue its consideration of issues related to the accounting for financial instruments. However, it expects that the basic principles in the improved IAS 39 will be in place for a considerable period.

Scope

Loan Commitments (paragraphs 2(i) and 4)

BC15. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. In the IAS 39 implementation guidance process, the question was raised whether a bank's loan commitments are derivatives accounted for at fair value under IAS 39. This question arises because a commitment to make a loan at a specified rate of interest during a fixed period of time meets the definition of a derivative. In effect, it is a written option for the potential borrower to obtain a loan at a specified rate.

BC16. To simplify the accounting for holders and issuers of loan commitments, the Board decided to exclude particular loan commitments from the scope of IAS 39. The effect of the exclusion is that an entity will not recognise and measure changes in fair value of these loan commitments that result from changes in market interest rates or credit spreads. This is consistent with the measurement of the loan that results if the holder of the loan commitment exercises its right to obtain financing, because changes in market interest rates do not affect the measurement of an asset measured at amortised cost (assuming it is not designated in a category other than loans and receivables).

BC17. However, the Board decided that an entity should be permitted to measure a loan commitment at fair value with changes in fair value recognised in profit or loss on the basis of designation at inception of the loan commitment as a financial liability through profit or loss. This may be appropriate, for example, if the entity manages risk exposures related to loan commitments on a fair value basis.

BC18. The Board further decided that a loan commitment should be excluded from the scope of IAS 39 only if it cannot be settled net. If the value of a loan commitment can be settled net in cash or another financial instrument, including when the entity has a past practice of selling the resulting loan assets shortly after origination, it is difficult to justify its exclusion from the requirement in IAS 39 to measure at fair value similar instruments that meet the definition of a derivative.

BC19. Some comments received on the Exposure Draft disagreed with the Board’s proposal that an entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination should apply IAS 39 to all of its loan commitments. The Board considered this concern and agreed that the words in the Exposure Draft did not reflect the Board’s intention. Thus, the Board clarified that if an entity has a past practice of selling the assets resulting from its loan commitments shortly after origination, it applies IAS 39 only to its loan commitments in the same class.

BC20. Finally, the Board decided that commitments to provide a loan at a below-market interest rate should be initially measured at fair value, and subsequently measured at the higher of (a) the amount that would be recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* ~~in the same way as financial guarantees (see paragraph BC23)~~. It noted that without such a requirement, liabilities that result from such commitments might not be recognised in the balance sheet, because in many cases no cash consideration is received.

BC20A As discussed in paragraphs BC21–BC23E, the Board amended IAS 39 in 2005 to address financial guarantee contracts. In making those amendments, the Board moved the material on loan commitments from the scope section of the Standard to the section on subsequent measurement (paragraph 47(d)). The purpose of this change was to rationalise the presentation of this material without making substantive changes.

Financial Guarantee Contracts (paragraphs 2(~~f~~e), 9, 47(c), AG4 and ~~3~~AG4A)

BC21. ~~The Exposure Draft proposed that financial guarantee contracts that provide for specified payments to be made to reimburse the holder for a loss it has incurred because a specified debtor fails to make payment when due should be initially recognised and measured by the issuer in accordance with IAS 39. Subsequently, they should be measured in accordance with IAS 37~~ ~~*Provisions, Contingent Liabilities and Contingent Assets*~~ ~~at the amount an entity would rationally be expected to pay to settle the obligation or to transfer it to a third party. This amendment would have clarified that an issued financial guarantee contract meets the definition of a liability and should be recognised as such.~~ In finalising IFRS 4 *Insurance Contracts* in early 2004, the Board reached the following conclusions:

(a) Financial guarantee contracts can have various legal forms, such as that of a guarantee, some types of letter of credit, a credit default contract or an insurance contract. However, although this difference in legal form may in some cases reflect differences in substance, the accounting for these instruments should not depend on their legal form.

(b) If a financial guarantee contract is not an insurance contract, as defined in IFRS 4, it should be within the scope of IAS 39. This was the case before the Board finalised IFRS 4.

(c) As required before the Board finalised IFRS 4, if a financial guarantee contract was entered into or retained on transferring to another party financial assets or financial liabilities within the scope of IAS 39, the issuer should apply IAS 39 to that contract even if it is an insurance contract, as defined in IFRS 4.

(d) Unless (c) applies, the following treatment is appropriate for a financial guarantee contract that meets the definition of an insurance contract:

(i) At inception, the issuer of a financial guarantee contract has a recognisable liability and should measure it at fair value. If a financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary.

(ii) Subsequently, the issuer should measure the contract at the higher of the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

BC22. ~~Some of the comments received on the Exposure Draft expressed concern that applying IAS 37 after initial recognition would result in individual financial guarantees being measured at nil immediately after initial recognition if the probability threshold in IAS 37 was not met, and thus the entity would recognise an immediate gain.~~ Mindful of the need to develop a 'stable platform' of Standards for 2005, the Board finalised IFRS 4 in early 2004 without specifying the accounting for these contracts and then published an Exposure Draft *Financial Guarantee Contracts and Credit Insurance* in July 2004 to expose for public comment the conclusion set out in paragraph BC21(d). The Board set a comment deadline of 8 October 2004 and received more than 60 comment letters. Before reviewing the comment letters, the Board held a public education session at which it received briefings from representatives of the International Credit Insurance & Surety Association and of the Association of Financial Guaranty Insurers.

BC23. ~~To address this concern, the Board decided to clarify that financial guarantees are initially measured at fair value, and subsequently measured at the higher of (a) the amount that would be recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.~~ Some respondents to the Exposure Draft of July 2004 argued that there were important economic differences between credit insurance contracts and other forms of contract that met the proposed definition of a financial guarantee contract. However, both in developing the Exposure Draft and in subsequently discussing the comments received, the Board was unable to identify differences that would justify differences in accounting treatment.

BC23A Some respondents to the Exposure Draft of July 2004 noted that some credit insurance contracts contain features, such as cancellation and renewal rights and profit-sharing features, that the Board will not address until phase II of its project on insurance contracts. They argued that the Exposure Draft did not give enough guidance to enable them to account for these features. The Board concluded it could not address such features in the short term. The Board noted that when credit insurers issue credit insurance contracts, they typically recognise a liability measured as either the premium received or an estimate of the expected losses. However, the Board was concerned that some other issuers of financial guarantee contracts might argue that no recognisable liability existed at inception. To provide a temporary solution that balances these competing concerns, the Board decided the following:

(a) If the issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 or IFRS 4 to such financial guarantee contracts.

(b) In all other cases, the issuer of a financial guarantee contract should apply IAS 39.

BC23B The Board does not regard criteria such as those described in paragraph BC23A(a) as suitable for the long term, because they can lead to different accounting for contracts that have similar economic effects. However, the Board could not find a more compelling approach to resolve its concerns for the short term. Moreover, although the criteria described in paragraph BC23A(a) may appear imprecise, the Board believes that the criteria would provide a clear answer in the vast majority of cases. Paragraph AG4A gives guidance on the application of those criteria.

BC23C The Board considered convergence with US GAAP. In US GAAP, the requirements for financial guarantee contracts (other than those covered by US standards specific to the insurance sector) are in FASB Interpretation 45 *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). The recognition and measurement requirements of FIN 45 do not apply to guarantees issued between parents and their subsidiaries, between entities under common control, or by a parent or subsidiary on behalf of a subsidiary or the parent. Some respondents to the Exposure Draft of July 2004 asked the Board to provide a similar exemption. They argued that the requirement to recognise these financial guarantee contracts in separate or individual financial statements would cause costs disproportionate to the likely benefits, given that intragroup transactions are eliminated on consolidation. However, to avoid the omission of material liabilities from separate or individual financial statements, the Board did not create such an exemption.

BC23D The Board issued the amendments for financial guarantee contracts in August 2005. After those amendments, the recognition and measurement requirements for financial guarantee contracts within the scope of IAS 39 are consistent with FIN 45 in some areas, but differ in others:

(a) Like FIN 45, IAS 39 requires initial recognition at fair value.

(b) IAS 39 requires systematic amortisation, in accordance with IAS 18, of the liability recognised initially. This is compatible with FIN 45, though FIN 45 contains less prescriptive requirements on subsequent measurement. Both IAS 39 and FIN 45 include a liability adequacy (or loss recognition) test, although the tests differ because of underlying differences in the Standards to which those tests refer (IAS 37 and SFAS 5).

(c) Like FIN 45, IAS 39 permits a different treatment for financial guarantee contracts issued by insurers.

(d) Unlike FIN 45, IAS 39 does not contain exemptions for parents, subsidiaries or other entities under common control. However, any differences are reflected only in the separate or individual financial statements of the parent, subsidiaries or common control entities.

BC23E Some respondents to the Exposure Draft of July 2004 asked for guidance on the treatment of financial guarantee contracts by the holder. However, this was beyond the limited scope of the project.

Contracts to Buy or Sell a Non-Financial Item (paragraphs 5-7 and AG10)

BC24. Before the amendments, IAS 39 and IAS 32 were not consistent with respect to the circumstances in which a commodity-based contract meets the definition of a financial instrument and is accounted for as a derivative. The Board concluded that the amendments should make them consistent on the basis of the notion that a contract to buy or sell a non-financial item should be accounted for as a derivative when it (i) can be settled net or by exchanging financial instruments and (ii) is not held for the purpose of receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements (a 'normal' purchase or sale). In addition, the Board concluded that the notion of when a contract can be settled net should include contracts:

(a) where the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments;

(b) for which the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(c) in which the non-financial item that is the subject of the contract is readily convertible to cash.

Because practices of settling net or taking delivery of the underlying and selling it within a short period after delivery also indicate that the contracts are not 'normal' purchases or sales, such contracts are within the scope of IAS 39 and are accounted for as derivatives. The Board also decided to clarify that a written option that can be settled net in cash or another financial instrument, or by exchanging financial instruments, is within the scope of the Standard and cannot qualify as a 'normal' purchase or sale.

Definitions

Loans and Receivables (paragraphs 9, 46(a) and AG26)

BC25. The principal difference between loans and receivables and other financial assets is that loans and receivables are not subject to the tainting provisions that apply to held-to-maturity investments. Loans and receivables that are not held for trading may be measured at amortised cost even if an entity does not have the positive intention and ability to hold the loan asset until maturity.

BC26. The Board decided that the ability to measure a financial asset at amortised cost without consideration of the entity's intention and ability to hold the asset until maturity is most appropriate when there is no liquid market for the asset. It is less appropriate to extend the category to debt instruments traded in liquid markets. The distinction for measurement purposes between liquid debt instruments that are acquired upon issue and liquid debt instruments that are acquired shortly afterwards is difficult to justify on conceptual grounds. Why should a liquid debt instrument that is purchased on the day of

Continuing Involvement in a Transferred Asset (paragraphs 30-35)

BC67. The Board decided that if the entity determines that it has neither retained nor transferred substantially all of the risks and rewards of an asset and that it has retained control, the entity should continue to recognise the asset to the extent of its continuing involvement. This is to reflect the transferor's continuing exposure to the risks and rewards of the asset and that this exposure is not related to the entire asset, but is limited in amount. The Board noted that precluding derecognition to the extent of the continuing involvement is useful to users of financial statements in such cases, because it reflects the entity's retained exposure to the risks and rewards of the financial asset better than full derecognition.

BC68. When the entity transfers some significant risks and rewards and retains others and derecognition is precluded because the entity retains control of the transferred asset, the entity no longer retains all the upside and downside exposure to gains and losses resulting from the transferred asset. Therefore, the revised IAS 39 requires the asset and the associated liability to be measured in a way that ensures that any changes in value of the transferred asset that are not attributed to the entity are not recognised by the entity.

BC69. For example, special measurement and income recognition issues arise if derecognition is precluded because the transferor has retained a call option or written a put option and the asset is measured at fair value. In those situations, in the absence of additional guidance, application of the general measurement and income recognition requirements for financial assets and financial liabilities in IAS 39 may result in accounting that does not represent the transferor's rights and obligations related to the transfer.

BC70. As another example, if the transferor retains a call option on a transferred available-for-sale financial asset and the fair value of the asset decreases below the exercise price, the transferor does not suffer a loss because it has no obligation to exercise the call option. In that case, the Board decided that it is appropriate to adjust the measurement of the liability to reflect that the transferor has no exposure to decreases in the fair value of the asset below the option exercise price. Similarly, if a transferor writes a put option and the fair value of the asset exceeds the exercise price, the transferee need not exercise the put. Because the transferor has no right to increases in the fair value of the asset above the option exercise price, it is appropriate to measure the asset at the lower of (a) the option exercise price and (b) the fair value of the asset.

Measurement

Fair Value ~~Measurement~~ Option (paragraph 9)

BC71. The Board concluded that it could simplify the application of IAS 39 (as revised in 2000) for some entities by permitting the use of fair value measurement for any financial instrument. With one exception (see paragraph ~~BC82~~9), this greater use of fair value is optional. The fair value measurement option does not require entities to measure more financial instruments at fair value.

BC72. ~~The previous version of~~ IAS 39 (as revised in 2000) did not permit an entity to measure particular categories of financial instruments at fair value with changes in fair value recognised in profit or loss. Examples included:

(a) originated loans and receivables, including a debt instrument acquired directly from the issuer, unless they met the conditions for classification as held for trading in paragraph 9.

(b) financial assets classified as available for sale, unless as an accounting policy choice gains and losses on all available-for-sale financial assets were recognised in profit or loss or they met the conditions for classification as held for trading in paragraph 9.

(c) non-derivative financial liabilities, even if the entity had a policy and practice of actively repurchasing such liabilities or they formed part of an arbitrage/customer facilitation strategy or fund trading activities.

BC73. The Board decided in IAS 39 (as revised in 2003) to permit entities to designate irrevocably on initial recognition any financial instrument as one to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). To impose discipline on this approach, the Board decided that financial instruments should not be reclassified into or out of the category of fair value through profit or loss. In particular, some comments received on the Exposure Draft of proposed amendments to IAS 39 published in June 2002 suggested that entities could use the fair value option to recognise selectively changes in fair value in profit or loss. The Board noted that the requirement to designate irrevocably on initial recognition the financial instruments for which the fair value option is to be applied results in an entity being unable to 'cherry pick' in this way. This is because it will not be known at initial recognition whether the fair value of the instrument will increase or decrease.

BC73A. Following the issue of IAS 39 (as revised in 2003), as a result of continuing discussions with constituents on the fair value option, the Board became aware that some, including prudential supervisors of banks, securities companies and insurers, were concerned that the fair value option might be used inappropriately (as discussed in paragraph BC11C). In response to those concerns, the Board published in April 2004 an Exposure Draft of proposed restrictions to the fair value option contained in IAS 39 (as revised in 2003). After discussing comments received from constituents and a series of public round-table meetings, the Board issued an amendment to IAS 39 in June 2005 permitting entities to designate irrevocably on initial recognition financial instruments that meet one of three conditions (see paragraphs 9(b)(i), 9(b)(ii) and 11A) as ones to be measured at fair value through profit or loss.

~~BC74. The change simplifies the application of IAS 39 by mitigating some anomalies that result from the different measurement attributes in the Standard. In particular, for financial instruments designated in this way:~~

~~(a) it eliminates the need for hedge accounting for hedges of fair value exposures when there are natural offsets, and thereby eliminates the related burden of designating, tracking and analysing hedge effectiveness.~~

~~(b) it eliminates the burden of separating embedded derivatives.~~

~~(c) it eliminates problems arising from a mixed measurement model where financial assets are measured at fair value and related financial liabilities are measured at amortised cost. In particular, it eliminates volatility in profit or loss and equity that results when matched positions of financial assets and financial liabilities are not measured consistently.~~

~~(d) the option to recognise unrealised gains and losses on available-for-sale financial assets in profit or loss is no longer necessary.~~

~~(e) it de-emphasises interpretive issues around what constitutes trading.~~

BC74. In the amendment to the fair value option, the Board identified three situations in which permitting designation at fair value through profit or loss either results in more relevant information (cases (a) and (b) below) or is justified on the grounds of reducing complexity or increasing measurement reliability (case (c) below). These are:

(a) when such designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise (paragraphs BC75-BC75B);

(b) when a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy (paragraphs BC76-BC76B); and

(c) when an instrument contains an embedded derivative that meets particular conditions (paragraphs BC77-BC78).

BC74A. The ability for entities to use the fair value option simplifies the application of IAS 39 by mitigating some anomalies that result from the different measurement attributes in the Standard. In particular, for financial instruments designated in this way:

(a) it eliminates the need for hedge accounting for hedges of fair value exposures when there are natural offsets, and thereby eliminates the related burden of designating, tracking and analysing hedge effectiveness.

(b) it eliminates the burden of separating embedded derivatives.

(c) it eliminates problems arising from a mixed measurement model when financial assets are measured at fair value and related financial liabilities are measured at amortised cost. In particular, it eliminates volatility in profit or loss and equity that results when matched positions of financial assets and financial liabilities are not measured consistently.

(d) the option to recognise unrealised gains and losses on available-for-sale financial assets in profit or loss is no longer necessary.

(e) it de-emphasises interpretative issues around what constitutes trading.

Designation as at fair value through profit or loss eliminates or significantly reduces a measurement or recognition inconsistency (paragraph 9(b)(i))

~~BC75. Permitting entities to designate at inception any financial instrument at fair value through profit or loss reduces the need for hedge accounting for hedges of fair value exposures and the resulting complexity in accounting for such hedges. Rather than being designated as a hedged item, the item could be designated at fair value through profit or loss to achieve recognition of offsetting fair value gains and losses in the same periods.~~

BC75. IAS 39, like comparable standards in some national jurisdictions, imposes a mixed-attribute measurement model. It requires some financial assets and liabilities to be measured at fair value, and others to be measured at amortised cost. It requires some gains and losses to be recognised in profit or loss, and others to be recognised initially as a component of equity. This combination of measurement and recognition requirements can result in inconsistencies, which some refer to as 'accounting mismatches', between the accounting for an asset (or group of assets) and a liability (or group of liabilities). The notion of an accounting mismatch necessarily involves two propositions. First, an entity has particular assets and liabilities that are measured, or on which gains and losses are recognised, inconsistently; second, there is a perceived economic relationship between those assets and liabilities. For example, a liability may be considered to be related to an asset when they share a risk that gives rise to opposite changes in fair value that tend to offset, or when the entity considers that the liability funds the asset.

BC75A. Some entities can overcome measurement or recognition inconsistencies by using hedge accounting or, in the case of insurers, shadow accounting. However, the Board recognises that those techniques are complex and do not address all situations. In developing the amendment to the fair value option, the Board considered whether it should impose conditions to limit the situations in which an entity could use the option to eliminate an accounting mismatch. For example, it considered whether entities should be required to demonstrate that particular assets and liabilities are managed together, or that a management strategy is effective in reducing risk (as is required for hedge accounting to be used), or that hedge accounting or other ways of overcoming the inconsistency are not available.

BC75B. The Board concluded that accounting mismatches arise in a wide variety of circumstances. In the Board's view, financial reporting is best served by providing entities with the opportunity to eliminate perceived accounting mismatches whenever that results in more relevant information. Furthermore, the Board concluded that the fair value option may validly be used in place of hedge accounting for hedges of fair value exposures, thereby eliminating the related burden of designating, tracking and analysing hedge effectiveness. Hence, the Board decided not to develop detailed prescriptive guidance about when the fair value option could be applied (such as requiring effectiveness tests similar to those required for hedge accounting) in the amendment on the fair value option. Rather, the Board decided to require disclosures in IAS 32* about:

- the criteria an entity uses for designating financial assets and financial liabilities as at fair value through profit or loss
- how the entity satisfies the conditions in this Standard for such designation
- the nature of the assets and liabilities so designated
- the effect on the financial statement of using this designation, namely the carrying amounts and net gains and losses on assets and liabilities so designated, information about the effect of changes in a financial liability's credit quality on changes in its fair value, and information about the credit risk of loans or receivables and any related credit derivatives or similar instruments.

* In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy (paragraph 9(b)(ii))

BC76. ~~Permitting classification by designation also reduces the burden of separating embedded derivatives from hybrid instruments into host instruments and embedded derivative contracts. For example, under the previous version of IAS 39, an entity did not separate embedded derivatives in financial instruments that were held for trading. The Board noted that many preparers, auditors and others find the requirements to separate embedded derivatives difficult to apply in practice. For example, when applying these requirements an entity will need to carry out a detailed analysis of its financial instruments to identify embedded derivatives. Often it may be easier for the entity to determine the fair value of the combined instrument as a whole rather than to identify the terms of the embedded derivative and separately measure the embedded derivative at fair value, if, for example, the combined instrument is traded in an active market.~~ The Standard requires financial instruments to be measured at fair value through profit or loss in only two situations, namely when an instrument is held for trading or when it contains an embedded derivative that the entity is unable to measure separately. However, the Board recognised that some entities manage and evaluate the performance of financial instruments on a fair value basis in other situations. Furthermore, for instruments managed and evaluated in this way, users of financial statements may regard fair value measurement as providing more relevant information. Finally, it is established practice in some industries in some jurisdictions to recognise all financial assets at fair value through profit or loss. (This practice was permitted for many assets in IAS 39 (as revised in 2000) as an accounting policy choice in accordance with which gains and losses on all available-for-sale financial assets were reported in profit or loss.)

BC76A. In the amendment to IAS 39 relating to the fair value option issued in June 2005, the Board decided to permit financial instruments managed and evaluated on a fair value basis to be measured at fair value through profit or loss. The Board also decided to introduce two requirements to make this category operational. These requirements are that the financial instruments are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and that information about the financial instruments is provided internally on that basis to the entity's key management personnel.

BC76B. In looking to an entity's documented risk management or investment strategy, the Board makes no judgement on what an entity's strategy should be. However, the Board noted that users, in making economic decisions, would find useful both a description of the chosen strategy and how designation at fair value through profit or loss is consistent with it. Accordingly, IAS 32[*] requires such disclosures. The Board also noted that the required documentation of the entity's strategy need not be on an item-by-item basis, nor need it be in the level of detail required for hedge accounting. However, it should be sufficient to demonstrate that using the fair value option is consistent with the entity's risk management or investment strategy. In many cases, the entity's existing documentation, as approved by its key management personnel, should be sufficient for this purpose.

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

The instrument contains an embedded derivative that meets particular conditions (paragraph 11A)

BC77. ~~An additional benefit of permitting classification by designation is that the choice in the original IAS 39 of recognising fair value gains and losses on available-for-sale financial assets either in equity or in profit or loss is no longer necessary. An entity can achieve recognition of gains and losses on such assets in profit or loss by designating the asset at fair value through profit or loss. It also increases comparability across entities in how gains and losses on available-for-sale financial assets are recognised. Accordingly, the Board decided that the choice that was in the original IAS 39 should be removed and that gains and losses on available-for-sale financial assets should be recognised in equity.~~ The Standard requires virtually all derivative financial instruments to be measured at fair value. This requirement extends to derivatives that are embedded in an instrument that also includes a non-derivative host contract if the embedded derivative meets the conditions in paragraph 11. Conversely, if the embedded derivative does not meet those conditions, separate accounting with measurement of the embedded derivative at fair value is prohibited. Therefore, to satisfy these requirements, the entity must:

(a) identify whether the instrument contains one or more embedded derivatives,

(b) determine whether each embedded derivative is one that must be separated from the host instrument or one for which separation is prohibited, and

(c) if the embedded derivative is one that must be separated, determine its fair value at initial recognition and subsequently.

BC77A. For some embedded derivatives, like the prepayment option in an ordinary residential mortgage, this process is fairly simple. However, entities with more complex instruments have reported that the search for and analysis of embedded derivatives (steps (a) and (b) in paragraph BC77) significantly increase the cost of complying with the Standard. They report that this cost could be eliminated if they had the option to fair value the combined contract.

BC77B. Other entities report that one of the most common uses of the fair value option is likely to be for structured products that contain several embedded derivatives. Those structured products will typically be hedged with derivatives that offset all (or nearly all) of the risks they contain, whether or not the embedded derivatives that give rise to those risks are separated for accounting purposes. Hence, the simplest way to account for such products is to apply the fair value option so that the combined contract (as well as the derivatives that hedge it) is measured at fair value through profit or loss. Furthermore, for these more complex instruments, the fair value of the combined contract may be significantly easier to measure and hence be more reliable than the fair value of only those embedded derivatives that IAS 39 requires to be separated.

BC78. ~~Permitting designation at fair value through profit or loss mitigates problems arising from a mixed measurement model when assets are measured at fair value and related liabilities are measured at amortised cost. For example, the inability to classify non-derivative liabilities as held for trading under IAS 39 creates problems for entities with matched asset and liability positions. Under IAS 39, an entity is not permitted to designate~~

~~non-derivative financial assets or non-derivative financial liabilities as hedging instruments, except for foreign currency exposures, and thus cannot use hedge accounting to eliminate such a mismatch. Because financial liabilities may now be designated at fair value through profit or loss, an entity can consistently recognise fair value changes on matched financial asset and financial liability positions.~~ The Board sought to strike a balance between reducing the costs of complying with the embedded derivatives provisions of this Standard and the need to respond to the concerns expressed regarding possible inappropriate use of the fair value option. The Board determined that allowing the fair value option to be used for any instrument with an embedded derivative would make other restrictions on the use of the option ineffective, because many financial instruments include an embedded derivative. In contrast, limiting the use of the fair value option to situations in which the embedded derivative must otherwise be separated would not significantly reduce the costs of compliance and could result in less reliable measures being included in the financial statements. Therefore, the Board decided to specify situations in which an entity cannot justify using the fair value option in place of assessing embedded derivatives—when the embedded derivative does not significantly modify the cash flows that would otherwise be required by the contract or is one for which it is clear with little or no analysis when a similar hybrid instrument is first considered that separation is prohibited.

The role of prudential supervisors

BC78A. The Board considered the circumstances of regulated financial institutions such as banks and insurers in determining the extent to which conditions should be placed on the use of the fair value option. The Board recognised that regulated financial institutions are extensive holders and issuers of financial instruments and so are likely to be among the largest potential users of the fair value option. However, the Board noted that some of the prudential supervisors that oversee these entities expressed concern that the fair value option might be used inappropriately.

BC79. ~~The fair value measurement option enables (but does not require) entities to measure financial instruments at fair value with changes in fair value recognised in profit or loss. Accordingly, it does not restrict an entity's ability to use other accounting methods (such as amortised cost). Some respondents to the Exposure Draft would have preferred more pervasive changes to expand the use of fair values and limit the choices available to entities, such as the elimination of the held-to-maturity category or the cash flow hedge accounting approach. Although such changes have the potential to make the principles in IAS 39 more coherent and less complex, the Board did not consider such changes as part of this project to improve IAS 39.~~ The Board noted that the primary objective of prudential supervisors is to maintain the financial soundness of individual financial institutions and the stability of the financial system as a whole. Prudential supervisors achieve this objective partly by assessing the risk profile of each regulated institution and imposing a risk-based capital requirement.

BC79A. The Board noted that these objectives of prudential supervision differ from the objectives of general purpose financial reporting. The latter is intended 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 Board acknowledged that for the purposes of determining what level of capital an institution should maintain, prudential supervisors may wish to understand the circumstances in which a regulated financial institution has chosen to apply the fair value option and evaluate the rigour of the institution's fair value measurement practices and the robustness of its underlying risk management strategies, policies and practices. Furthermore, the Board agreed that certain disclosures would assist both prudential supervisors in their evaluation of capital requirements and investors in making economic decisions. In particular, the Board decided to require an entity to disclose how it has satisfied the conditions in paragraphs 9(b), 11A and 12 for using the fair value option, including, for instruments within paragraph 9(b)(ii), 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.

Other matters

BC80. ~~Some comments received on the Exposure Draft suggested limiting the scope of the fair value option (e.g. to instruments that are traded in an active market or to exclude financial liabilities—see paragraphs BC87-BC92). The Board concluded it should not restrict the fair value option because to do so would limit its main benefits, discussed above.~~ IAS 39 (as revised in 2000) contained an accounting policy choice for the recognition of gains and losses on available-for-sale financial assets—such gains and losses could be recognised either in equity or in profit or loss. The Board concluded that the fair value option removed the need for such an accounting policy choice. An entity can achieve recognition of gains and losses on such assets in profit or loss in appropriate cases by using the fair value option. Accordingly, the Board decided that the choice that was in IAS 39 (as revised in 2000) should be removed and that gains and losses on available-for-sale financial assets should be recognised in equity when IAS 39 was revised in 2003.

BC80A. The fair value option permits (but does not require) entities to measure financial instruments at fair value with changes in fair value recognised in profit or loss. Accordingly, it does not restrict an entity's ability to use other accounting methods (such as amortised cost). Some respondents to the Exposure Draft of proposed amendments to IAS 39 published in June 2002 would have preferred more pervasive changes to expand the use of fair values and limit the choices available to entities, such as the elimination of the held-to-maturity category or the cash flow hedge accounting approach. Although such changes have the potential to make the principles in IAS 39 more coherent and less complex, the Board did not consider such changes as part of the project to improve IAS 39.

BC81. Comments received on the Exposure Draft of proposed amendments to IAS 39 published in June 2002 also questioned the proposal that all items measured at fair value through profit or loss should have the descriptor 'held for trading'. Some comments noted that 'held for trading' is commonly used with a narrower meaning, and it may be confusing for users if instruments designated at fair value through profit or loss are also called 'held for trading'. Therefore, the Board considered using a fifth category of financial instruments—'fair value through profit or loss'—to distinguish those instruments to which the fair value option was applied from those classified as held for trading. The Board rejected this possibility because it believed adding a fifth category of financial instruments would unnecessarily complicate the Standard. Rather, the Board concluded that 'fair value though profit or loss' should be used to describe a category that encompasses financial instruments classified as held for trading and those to which the fair value option is applied.

BC82. In addition, the Board decided to include a requirement for an entity to classify a financial liability as held for trading if it is incurred principally for the purpose of repurchasing it in the near term or it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. In these circumstances, the absence of a requirement to measure such financial liabilities at fair value permits cherry-picking of unrealised gains or losses. For example, if an entity wishes to recognise a gain, it can repurchase a fixed rate debt instrument that was issued in an environment where interest rates were lower than in the reporting period and if it wishes to recognise a loss, it can repurchase an issued debt instrument that was issued in an environment in which interest rates were higher than in the reporting period. However, a financial liability is not classified as held for trading merely because it funds assets that are held for trading.

BC83. The Board decided to include in revised IAS 32[*] a requirement to disclose the settlement amount repayable at maturity of a liability that is designated as at fair value through profit or loss. This gives users of financial statements information about the amount owed by the entity to its creditors in the event of its liquidation.

BC84. The Board also decided to include in IAS 39 (as revised in 2003) the ability for entities to designate a loan or receivable as available for sale (see paragraph 9). The Board decided that, in the context of the existing mixed measurement model, there are no reasons to limit to any particular type of asset the ability to designate an asset as available for sale.

Application of the Fair Value Measurement Option to a Component or a Proportion ~~Portion~~ (Rather than the Entirety) of a Financial Asset or a Financial Liability

BC85. Some comments received on the Exposure Draft of proposed amendments to IAS 39 published in June 2002 argued that the fair value ~~measurement~~ option should be extended so that it could also be applied to a ~~portion~~ component of a financial asset or a financial liability (e.g. changes in fair value attributable to one risk such as changes in a benchmark interest rate). The arguments included (a) concerns regarding inclusion of own credit risk in the measurement of financial liabilities and (b) the prohibition on using non-derivatives as hedging instruments (cash instrument hedging).

BC86. The Board concluded that IAS 39 should not extend the fair value measurement option to ~~portions~~ components of financial assets or financial liabilities. It was concerned (a) about difficulties in measuring the change in value of the ~~portion~~ component because of ordering issues and joint effects (i.e. if the ~~portion~~ component is affected by more than one risk, it may be difficult to isolate accurately and measure the ~~portion~~component); (b) that the amounts recognised in the balance sheet would be neither fair value nor cost; and (c) that a fair value adjustment for a ~~portion~~ component may move the carrying amount of an instrument away from its fair value. ~~The Board agreed to address separately the issue of cash instrument hedging.~~ In finalising the 2003 amendments to IAS 39, the Board separately considered the issue of cash instrument hedging (see paragraphs BC144 and BC 145).

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

BC86A. Other comments received on the April 2004 Exposure Draft of proposed restrictions to the fair value option contained in IAS 39 (as revised in 2003) suggested that the fair value option should be extended so that it could be applied to a proportion (ie a percentage) of a financial asset or financial liability. The Board was concerned that such an extension would require prescriptive guidance on how to determine a proportion. For example if an entity were to issue a bond totalling CU100 million in the form of 100 certificates each of CU1 million, would a proportion of 10 per cent be identified as 10 per cent of each certificate, 10 million specified certificates, the first (or last) 10 million certificates to be redeemed, or on some other basis? The Board was also concerned that the remaining proportion, not being subject to the fair value option, could give rise to incentives for an entity to 'cherry pick' (ie to realise financial assets or financial liabilities selectively so as to achieve a desired accounting result). For these reasons, the Board decided not to allow the fair value option to be applied to a proportion of a single financial asset or financial liability. However, if an entity simultaneously issues two or more identical financial instruments, it is not precluded from designating only some of those instruments as being subject to the fair value option (for example, if doing so achieves a significant reduction in a recognition or measurement inconsistency, as explained in paragraph AG4G). Thus, in the above example, the entity could designate 10 million specified certificates if to do so would meet one of the three criteria in paragraph BC74.

~~Own~~ Credit Risk of Liabilities

BC87. The Board discussed the issue of including changes in ~~own~~ the credit risk of a financial liability in ~~the~~ its fair value measurement ~~of financial liabilities~~. It considered responses to the Exposure Draft of proposed amendments to IAS 39 published in June 2002 that expressed concern about the effect of including this component in the fair value measurement and that suggested the fair value option should be restricted to exclude all or some financial liabilities. However, the Board concluded that the fair value option could be applied to any financial liability, and decided not to restrict the option in the Standard (as revised in 2003) because to do~~ing~~ so would negate some of the benefits of the fair value option set out in paragraph BC74A.

BC88. The Board considered comments on the Exposure Draft that disagreed with the view that, in applying the fair value option to financial liabilities, an entity should recognise income as a result of deteriorating credit quality (and a loan expense as a result of improving credit quality). Commentators noted that it is not useful to report lower liabilities when an entity is in financial difficulty precisely because its debt levels are too high, and that it would be difficult to explain to users of financial statements the reasons why income would be recognised when ~~an entity's~~ a liability's creditworthiness deteriorates. These comments suggested that fair value should exclude the effects of changes in ~~own~~ the instrument's credit risk.

BC89. However, the Board noted that because financial statements are prepared on a going concern basis, credit risk affects the value at which liabilities could be repurchased or settled. Accordingly, the fair value of a financial liability reflects the credit risk relating to that liability. Therefore, it decided to include credit risk relating to a financial liability in the fair value measurement of that liability for the following reasons:

(a) entities realise changes in fair value, including fair value attributable to ~~own~~ the liability's credit risk, for example, by renegotiating or repurchasing liabilities or by using derivatives;

(b) changes in credit risk affect the observed market price of a financial liability and hence its fair value;

(c) it is difficult from a practical standpoint to exclude changes in credit risk from an observed market price; and

(d) the fair value of a financial liability (i.e. the price of that liability in an exchange between a knowledgeable, willing buyer and a knowledgeable, willing seller) on initial recognition reflects ~~the~~ its credit risk ~~relating to that liability~~. The Board believes that it is inappropriate to include credit risk in the initial fair value measurement of financial liabilities, but not subsequently.

BC90 The Board also considered whether the ~~portion~~ component of the fair value of a financial liability attributable to changes in credit quality should be specifically disclosed, separately presented in the income statement, or separately presented in equity. The Board decided that whilst separately presenting or disclosing such changes might~~would often~~ be difficult in practice, ~~not be practicable because it might not be possible to separate and measure reliably that part of the change in fair value. However, it noted that~~ disclosure of such information would be useful to users of financial statements and would help alleviate the concerns expressed. Therefore, it decided to include in IAS 32* ~~to require~~ a disclosure to help identify ~~of~~ the changes in the fair value of a financial liability ~~that is not attributable to changes in a benchmark rate~~that arise from changes in the liability's credit risk. The Board believes this is 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 will provide users with information with which to understand the profit or loss effect of such a change in credit risk.

BC91. The Board decided to clarify that this issue relates to the credit risk of the financial liability, rather than the creditworthiness of the entity. The Board noted that this more appropriately describes the objective of what is included in the fair value measurement of financial liabilities.

BC92. The Board also noted that the fair value of liabilities secured by valuable collateral, guaranteed by third parties or ranking ahead of virtually all other liabilities is generally unaffected by changes in the entity's creditworthiness.

Measurement of Financial Liabilities with a Demand Feature

BC93. Some comments received on the Exposure Draft requested clarification of how to determine fair value for financial liabilities with a demand feature (e.g. demand deposits), when the fair value measurement option is applied or the liability is otherwise measured at fair value. In other words, could the fair value be less than the amount payable on demand, discounted from the first date that an amount could be required to be paid (the 'demand amount'), such as the amount of the deposit discounted for the period that the entity expects the deposit to be outstanding? Some commentators believe that the fair value of financial liabilities with a demand feature is less than the demand amount, for reasons that include the consistency of such measurement with how those financial liabilities are treated for risk management purposes.

* In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

BC94. The Board agreed that this issue should be clarified in IAS 39. It confirmed that the fair value of a financial liability with a demand feature is not less than the amount payable on demand discounted from the first date that the amount could be required to be paid. This conclusion is the same as in the original IAS 32. The Board noted that in many cases, the market price observed for such financial liabilities is the price at which they are originated between the customer and the deposit-taker—i.e. the demand amount. It also noted that recognising a financial liability with a demand feature at less than the demand amount would give rise to an immediate gain on the origination of such a deposit, which the Board believes is inappropriate.

Fair Value Measurement Guidance (paragraphs AG69-AG82)

BC95. The Board decided to include in the revised IAS 39 expanded guidance about how to determine fair values, in particular for financial instruments for which no quoted market price is available (Appendix A paragraphs AG74-AG82). The Board decided that it is desirable to provide clear and reasonably detailed guidance about the objective and use of valuation techniques to achieve reliable and comparable fair value estimates when financial instruments are measured at fair value.

Use of Quoted Prices in Active Markets (paragraphs AG71-AG73)

BC96. The Board considered comments received that disagreed with the proposal in the Exposure Draft that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market. Some respondents argued that (a) valuation techniques are more appropriate for measuring fair value than a quoted price in an active market (e.g. for derivatives) and (b) valuation models are consistent with industry best practice, and are justified because of their acceptance for regulatory capital purposes.

BC97. However, the Board confirmed that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market, notably because (a) in an active market, the quoted price is the best evidence of fair value, given that fair value is defined in terms of a price agreed by a knowledgeable, willing buyer and a knowledgeable, willing seller; (b) it results in consistent measurement across entities; and (c) fair value as defined in the Standard does not depend on entity-specific factors. The Board further clarified that a quoted price includes market-quoted rates as well as prices.

Hedge accounting

(q) The Standard requires that when a hedged forecast transaction actually occurs and results in the recognition of a financial asset or a financial liability, the gain or loss deferred in equity does not adjust the initial carrying amount of the asset or liability (i.e. 'basis adjustment' is prohibited), but remains in equity and is recognised in profit or loss consistently with the recognition of gains and losses on the asset or liability. For hedges of forecast transactions that will result in the recognition of a non-financial asset or a non-financial liability, the entity has a choice of whether to apply basis adjustment or retain the hedging gain or loss in equity and recognise it in profit or loss when the asset or liability affects profit or loss.

(r) The Exposure Draft proposed to treat hedges of firm commitments as fair value hedges (rather than as cash flow hedges). The Standard adopts this requirement but clarifies that a hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge.

(s) The Exposure Draft maintained the prior guidance that a forecast intragroup transaction may be designated as the hedged item in a foreign currency cash flow hedge provided the transaction is highly probable, meets all other hedge accounting criteria, and will result in the recognition of an intragroup monetary item. The Standard (as revised in 2003) did not include this guidance in the light of comments received from some constituents questioning its conceptual basis. After the revised Standard was issued, constituents raised concerns that it was common practice for entities to designate a forecast intragroup transaction as the hedged item and that the revised IAS 39 created a difference from US GAAP. In response to these concerns, the Board published an Exposure Draft in July 2004. That Exposure Draft proposed to allow an entity to apply hedge accounting in the consolidated financial statements to a highly probable forecast external transaction denominated in the functional currency of the entity entering into the transaction, provided the transaction gave rise to an exposure that would have an effect on the consolidated profit or loss (ie was denominated in a currency other than the group's presentation currency). After discussing the comment letters received on that Exposure Draft, the Board decided to permit the foreign currency risk of a forecast intragroup transaction to be the hedged item in a cash flow hedge in consolidated financial statements provided the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. In issuing this amendment the Board concluded that:

(i) allowing a forecast intragroup transaction to be designated as the hedged item in consolidated financial statements is consistent with the functional currency framework in IAS 21 *The Effects of Changes in Foreign Exchange Rates*, which recognises a functional currency exposure whenever a transaction (including a forecast transaction) is denominated in a currency different from the functional currency of the entity entering into the transaction.

(ii) allowing a forecast transaction (intragroup or external) to be designated as the hedged item in consolidated financial statements would not be consistent with the functional currency framework in IAS 21 if the transaction is denominated in the functional currency of the entity entering into it. Accordingly, such transactions should not be permitted to be designated as hedged items in a foreign currency cash flow hedge.

(iii) it is consistent with paragraphs 97 and 98 that any gain or loss that is recognised directly in equity in a cash flow hedge of a forecast intragroup transaction should be reclassified into consolidated profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

Transition

(~~s~~t) The revised Standard adopts the proposal in the Exposure Draft that, on transition, an entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or a financial liability at fair value through profit or loss or available for sale. However, a disclosure requirement has been added to IAS 32[*] to provide information about the fair value of the financial assets or financial liabilities designated into each category and the classification and carrying amount in the previous financial statements.

(~~t~~u) The Exposure Draft proposed retrospective application of the derecognition provisions of the revised IAS 39 to financial assets derecognised under the original IAS 39. The Standard requires prospective application, namely that entities do not recognise those assets that were derecognised under the original Standard, but permits retrospective application from a date of the entity's choosing, provided that the information needed to apply IAS 39 to assets and liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

(v) The Exposure Draft proposed, and the revised Standard originally required, retrospective application of the 'day 1' gain or loss recognition requirements in paragraph AG76. After the revised Standard 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:

(i) to permit entities to apply the requirements in the last sentence of paragraph AG76 in any one of the following ways:

- retrospectively, as previously required by IAS 39
- prospectively to transactions entered into after 25 October 2002, the effective date of equivalent US GAAP requirements
- prospectively to transactions entered into after 1 January 2004, the date of transition to IFRSs for many entities.

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclsoures.*

(ii) to clarify that a gain or loss should be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. Some constituents asked the Board to clarify that straight-line amortisation is an appropriate method of recognising the difference between a transaction price (used as fair value in accordance with paragraph AG76) and a valuation made at the time of the transaction that was not based solely on data from observable markets. The Board decided not to do this. It concluded that although straight-line amortisation may be an appropriate method in some cases, it will not be appropriate in others.

Dissenting Opinions

Dissent of Anthony T Cope, James J Leisenring and Warren J McGregor

DO1. Messrs Cope, Leisenring and McGregor dissent from the issue of this Standard.

DO2. Mr Leisenring dissents because he disagrees with the conclusions concerning derecognition, impairment of certain assets and the adoption of basis adjustment hedge accounting in certain circumstances.

DO3. The Standard requires in paragraphs 30 and 31 that to the extent of an entity's continuing involvement in an asset, a liability should be recognised for the consideration received. Mr Leisenring believes that the result of that accounting is to recognise assets that fail to meet the definition of assets and to record liabilities that fail to meet the definition of liabilities. Furthermore, the Standard fails to recognise forward contracts, puts or call options and guarantees that are created, but instead records a fictitious 'borrowing' as a result of rights and obligations created by those contracts. There are other consequences of the continuing involvement approach that has been adopted. For transferors, it results in very different accounting by two entities when they have identical contractual rights and obligations only because one entity once owned the transferred financial asset. Furthermore, the 'borrowing' that is recognised is not accounted for like other loans, so no interest expense may be recorded. Indeed, implementing the proposed approach requires the specific override of measurement and presentation standards applicable to other similar financial instruments that do not arise from derecognition transactions. For example, derivatives created by derecognition transactions are not accounted for at fair value. For transferees, the approach also requires the override of the recognition and measurement requirements applicable to other similar financial instruments. If an instrument is acquired in a transfer transaction that fails the derecognition criteria, the transferee recognises and measures it differently from an instrument that is acquired from the same counterparty separately.

DO4. Mr Leisenring also disagrees with the requirement in paragraph 64 to include an asset that has been individually judged not to be impaired in a portfolio of similar assets for an additional portfolio assessment of impairment. Once an asset is judged not to be impaired, it is irrelevant whether the entity owns one or more similar assets as those assets have no implications for whether the asset that was individually considered for impairment is or is not impaired. The result of this accounting is that two entities could each own 50 per cent of a single loan. Both entities could conclude the loan is not impaired. However, if one of the two entities happens to have other loans that are similar, it would be allowed to recognise an impairment with respect to the loan where the other entity is not. Accounting for identical exposures differently is unacceptable. Mr Leisenring believes that the arguments in paragraph BC115 are compelling.

DO5. Mr Leisenring also dissents from paragraph 98 which allows but does not require basis adjustment for hedges of forecast transactions that result in the recognition of non-financial assets or liabilities. This accounting results in always adjusting the recorded asset or liability at the date of initial recognition away from its fair value. It also records an asset, if the basis adjustment alternative is selected, at an amount other than its cost as defined in IAS 16 *Property, Plant and Equipment* and further described in paragraph 16 of that Standard. If a derivative were to be considered a part of the cost of acquiring an asset, hedge accounting in these circumstances should not be elective to be consistent with IAS 16. Mr Leisenring also objects to creating this alternative as a result of an improvement project that ostensibly had as an objective the reduction of alternatives. The non-comparability that results from this alternative is both undesirable and unnecessary.

DO6. Mr Leisenring also dissents from the application guidance in paragraph AG71 and in particular the conclusion contained in paragraph BC98. He does not believe that an entity that originates a contract in one market should measure the fair value of the contract by reference to a different market in which the transaction did not take place. If prices change in the transacting market, that price change should be recognised when subsequently measuring the fair value of the contract. However, there are many implications of switching between markets when measuring fair value that the Board has not yet addressed. Mr Leisenring believes a gain or loss should not be recognised based on the fact a transaction could occur in a different market.

DO7. Mr Cope dissents from paragraph 64 and agrees with Mr Leisenring’s analysis and conclusions on loan impairment as set out above in paragraph DO4. He finds it counter-intuitive that a loan that has been determined not to be impaired following careful analysis should be subsequently accounted for as if it were impaired when included in a portfolio.

Dissent of Mary E Barth, Robert P Garnett and Geoffrey Whittington

DO1. Professor Barth, Mr Garnett and Professor Whittington dissent from the amendment to IAS 39 Financial Instruments: Recognition and Measurement—The Fair Value Option. Their dissenting opinions are set out below.

DO2. These Board members note that the Board considered the concerns expressed by the prudential supervisors on the fair value option as set out in the December 2003 version of IAS 39 when it finalised IAS 39. At that time the Board concluded that these concerns were outweighed by the benefits, in terms of simplifying the practical application of IAS 39 and providing relevant information to users of financial statements, that result from allowing the fair value option to be used for any financial asset or financial liability. In the view of these Board members, no substantive new arguments have been raised that would cause them to revisit this conclusion. Furthermore, the majority of constituents have clearly expressed a preference for the fair value option as set out in the December 2003 version of IAS 39 over the fair value option as contained in the amendment.

DO3. Those Board members note that the amendment introduces a series of complex rules, including those governing transition which would be entirely unnecessary in the absence of the amendment. There will be consequential costs to preparers of financial statements, in order to obtain, in many circumstances, substantially the same result as the much simpler and more easily understood fair value option that was included in the December 2003 version of IAS 39. They believe that the complex rules will also inevitably lead to differing interpretations of the eligibility criteria for the fair value option contained in the amendment.

DO4. These Board members also note that, for paragraph 9(b)(i), application of the amendment may not mitigate, on an ongoing basis, the anomaly of volatility in profit or loss that results from the different measurement attributes in IAS 39 any more than would the option in the December 2003 version of IAS 39. This is because the fair value designation is required to be continued even if one of the offsetting instruments is derecognised. Furthermore, for paragraphs 9(b)(i), 9(b)(ii) and 11A, the fair value designation continues to apply in subsequent periods, irrespective of whether the initial conditions that permitted the use of the option still hold. Therefore, these Board members question the purpose of and need for requiring the criteria to be met at initial designation.

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

> *This Basis for Conclusions accompanies, but is not part of, IAS 39.*
>
> *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).*

Paragraphs BC75, BC125, BC155, BC167, BC221(c) and BC222(p) and (s)(iii) are footnoted as follows:

BC75 IAS 39 … It requires some gains and losses to be recognised in profit or loss, and others to be recognised initially as a component of equity.* This combination of measurement and recognition requirements can result in inconsistencies, which some refer to as 'accounting mismatches', between the accounting for an asset (or group of assets) and a liability (or group of liabilities). The notion …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 these other gains and losses are recognized in other comprehensive income.

BC125 In the Exposure Draft … The Board noted that this was consistent with the recognition of changes in the fair value of available-for-sale financial assets directly in equity* (see paragraph 55(b)).

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such changes are recognised in other comprehensive income.

BC155 The question … The entity enters into a derivative to hedge against possible future changes in the US dollar/euro exchange rate. Such a hedge is classified as a cash flow hedge under IAS 39, with the effect that gains and losses on the hedging instrument (to the extent that the hedge is effective) are initially recognised in equity.* The question …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such gains and losses are recognised in other comprehensive income.

BC167 If the internal swap … This is because the gains and losses on the internal swap in the banking book would be recognised in equity* to the extent the hedge is effective and the gains and losses on the internal swap in the trading book would be recognised in profit or loss.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such gains and losses are recognised in other comprehensive income.

BC221(c) The Board decided to eliminate the option to recognise in profit or loss gains and losses on available-for-sale financial assets (IAS 39, paragraph 55(b)), and thus require such gains and losses to be recognised in equity.* The change …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such gains and losses are recognised in other comprehensive income.

BC222 The main changes from the Exposure Draft's proposals are as follows:

...

(p) The Exposure Draft … Impairment losses recognised on available-for-sale equity instruments cannot be reversed through profit or loss, ie any subsequent increase in fair value is recognised in equity.*

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such an increase is recognised in other comprehensive income.

(s) The Exposure Draft ...

(iii) it is consistent with paragraphs 97 and 98 that any gain or loss that is recognised directly in equity* in a cash flow hedge of a forecast intragroup transaction should be reclassified into consolidated profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such a gain or loss is recognised in other comprehensive income.

SECTION F: HEDGING

Commodity Futures	Commodity prices
Interest Rate Forward Linked to Government Debt (Treasury Forward)	Interest rates
Currency Forward	Currency rates
Commodity Forward	Commodity prices
Equity Forward	Equity prices (equity of another entity)

The above list provides examples of contracts that normally qualify as derivatives under HKAS 39. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions of HKAS 39 may apply, for example, if it is a weather derivative (see ~~HKAS 39.2(h) and~~ HKAS 39.AG1), a contract to buy or sell a non-financial item such as commodity (see HKAS 39.5 and HKAS 39.AG10) or a contract settled in an entity's own shares (see HKAS 32.21-HKAS 32.24). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

E.4.8 Impairment: recognition of collateral

If an impaired financial asset is secured by collateral ~~and foreclosure is probable~~ that does not meet the recognition criteria for assets in other Standards, is the collateral recognised as an asset separate from the impaired financial asset?

No. The measurement of the impaired financial asset reflects the fair value of the collateral. The collateral ~~would generally not meet the recognition criteria until it is transferred to the lender. Accordingly, the collateral~~ is not recognised as an asset separate from the impaired financial asset ~~before foreclosure~~ unless it meets the recognition criteria for an asset in another Standard.

F.1.12 Hedges of more than one type of risk

Issue (a) - Normally a hedging relationship is designated between an entire hedging instrument and a hedged item so that there is a single measure of fair value for the hedging instrument. Does this preclude designating a single financial instrument simultaneously as a hedging instrument in both a cash flow hedge and a fair value hedge?

No. For example, entities commonly use a combined interest rate and currency swap to convert a variable rate position in a foreign currency to a fixed rate position in the functional currency. HKAS 39.76 allows the swap to be designated separately as a fair value hedge of the currency risk and a cash flow hedge of the interest rate risk provided the conditions in HKAS 39.76 are met.

Issue (b) - If a single financial instrument is a hedging instrument in two different hedges, is special disclosure required?

~~HKAS 32.58~~ HKFRS 7.22 requires disclosures separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation. The instrument in question would be reported in the HKAS 32.58 disclosures separately for each type of hedge.

Section G: Other

G.1 Disclosure of changes in fair value

HKAS 39 requires financial assets classified as available for sale (AFS) and financial assets and financial liabilities at fair value through profit or loss to be remeasured to fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss, and fair value changes for AFS assets are recognised in equity. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

~~HKAS 32.94(h)~~ HKFRS 7.20 requires ~~material~~ items of income, expense and gains and losses to be disclosed ~~whether included in profit or loss or in equity.~~ This disclosure requirement encompasses ~~material~~ items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of ~~material~~ fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in equity. Further breakdown is provided of changes that relate to:

(a) AFS assets, showing separately the amount of gain or loss recognised directly in equity during the period and the amount that was removed from equity and recognised in profit or loss for the period;

(b) financial assets ~~and~~ or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) classified as held for trading in accordance with HKAS 39; and

(c) hedging instruments.

~~HKAS 32~~ HKFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with HKAS 39 ~~classifies~~ it categorises as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, ~~HKAS 32.94(e)~~ HKFRS 7.8 requires disclosure of the carrying amounts of financial assets ~~and~~ or financial liabilities at fair value through profit or loss, showing separately ~~that~~: (i) those designated as such upon initial recognition ~~are classified as held for trading~~ and (ii) ~~were, upon initial recognition, designated by the entity as financial assets and financial liabilities at fair value through profit or loss (ie those not financial instruments~~ those ~~classified as~~ held for trading~~)~~ in accordance with HKAS 39.

G.2 HKAS 39 and HKAS 7 – Hedge accounting: cash flow statements

How should cash flows arising from hedging instruments be classified in cash flow statements?

Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in HKAS 7 has not been updated to reflect HKAS 39, the classification of cash flows arising from hedging instruments in the cash flow statement should be consistent with the classification of these instruments as hedging instruments under HKAS 39.

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

References to ‘deferred in equity’, ‘reported in equity’, ‘recognised in equity’ and ‘recognised directly in equity’ are amended to ‘recognised in other comprehensive income’.

In the tables in Questions D.2.1 and D.2.2, ‘changes in equity’ is amended to ‘changes in other comprehensive income’.

In Question E.2.1, ‘on its balance sheet’ is amended to ‘in its statement of financial position’.

Question E.3.1 is amended as follows:

> **Entity A holds … On 20 December ~~2000~~ 20X0, the fair value of the shares is CU120 and the cumulative gain recognised in other comprehensive income ~~equity~~ is CU20. … Under HKAS 39.55(b), should Entity A ~~recognise~~ reclassify the cumulative gain of CU20 recognised ~~in equity~~ in other comprehensive income from equity to ~~in~~ profit or loss as a reclassification adjustment?**
>
> Yes. The transaction qualifies for derecognition under HKAS 39. HKAS 39.55(b) requires ~~that~~ the cumulative gain or loss ~~that has been recognised in equity~~ on an available-for-sale financial asset that has been recognised in other comprehensive income to be ~~recognised in~~ reclassified from equity to profit or loss when the asset is derecognised. In the …

Question E.3.2 is amended as follows:

> **For an available-for-sale monetary financial asset, the entity ~~reports~~ recognises changes in the carrying amount relating to changes in foreign exchange rates in profit or loss in accordance with HKAS 21.23(a) and HKAS 21.28 and other changes in the carrying amount in other comprehensive income ~~in equity~~ in accordance with HKAS 39. How is the cumulative gain or loss that is recognised ~~in equity~~ in other comprehensive income determined?**
>
> ...
>
> To illustrate: on 31 December 20X1 ~~2001~~ Entity A acquires a bond … Entity A classifies the bond as available for sale, and thus recognises gains and losses ~~in equity~~ in other comprehensive income. The entity’s …

On 31 December 20X2 ~~2002~~, the foreign currency has appreciated … In this case, the cumulative gain or loss to be recognised in other comprehensive income and accumulated in equity ~~directly in equity~~ is the difference between the fair value and the amortised cost on 31 December 20X2 ~~2002~~, ie LC38 (= LC2,120 – LC2,082).

Interest received on the bond on 31 December 20X2 ~~2002~~ is FC59 (= LC118). Interest …

Cr	Fair value change in ~~equity~~ other comprehensive income	LC38

On 31 December 20X3 ~~2003~~, the foreign currency has appreciated further … The cumulative gain or loss to be ~~recognised directly~~ accumulated in equity is the difference between the fair value and the amortised cost on 31 December 20X3 ~~2003~~, ie negative LC40 (= LC2,675 – LC2,715). Thus, ~~there is a debit to~~ the amount recognised in other comprehensive income ~~equity~~ equals ~~to~~ the change in the difference during 20X3 ~~2003~~ of LC78 (= LC40 + LC38).

Interest received on the bond on 31 December 20X3 ~~2003~~ is FC59 (= LC148). Interest …

Dr	Fair value change in other comprehensive income ~~equity~~	LC78

Question E.3.3 is amended as follows:

- the heading ‘**E.3.3 HKAS 39 and HKAS 21 Exchange differences arising on translation of foreign entities: equity or income?**’ is amended to ‘**E.3.3 HKAS 39 and HKAS 21 Exchange differences arising on translation of foreign entities: other comprehensive income or profit or loss?**’.

- (in the fourth paragraph of the answer) ‘its income statement’ is amended to ‘its profit or loss’.

- (in the last paragraph of the answer) ‘classified as equity’ is amended to ‘accumulated in equity’.

In Question E.3.4 the answer is amended as follows:

- ‘*Income statement*’ is amended to ‘*Profit or loss*’.

- ‘in profit or loss or in equity’ is amended to ‘in profit or loss or in other comprehensive income’.

- ‘recognises gains and losses on available-for-sale monetary financial assets in equity’ is amended to ‘recognises gains and losses on available-for-sale monetary financial assets in other comprehensive income’.

- ‘resulting in a loss in equity’ is amended to ‘resulting in a loss recognised in other comprehensive income’.

Question E.4.9 is amended as follows:

- '**be recognised in profit or loss'** is amended to '**be reclassified from equity to profit or loss as a reclassification adjustment'**.

- ‘removed from equity and recognised in profit or loss’ is amended to ‘reclassified from equity to profit or loss’.

- ‘also recognised in profit or loss’ is amended to ‘also reclassified from equity to profit or loss’.

In Question F.1.2, in the answer to the second question, ‘future sale is recognised in profit or loss’ is amended to ‘future sale is reclassified from equity to profit or loss as a reclassification adjustment’.

In Question F.1.5 the answer is amended as follows:

> No. An internal contract designated at the subsidiary level or by a division as a hedge results in the recognition of changes in the fair value of the item being hedged in profit or loss (a fair value hedge) or in the recognition of the changes in the fair value of the internal derivative ~~in equity~~ in other comprehensive income (a cash flow hedge). There is no basis for changing the measurement attribute of the item being hedged in a fair value hedge unless the exposure is offset with an external derivative. There is also no basis for ~~including~~ recognising the gain or loss on the internal derivative in ~~equity~~ in other comprehensive income for one entity and recognising it in profit or loss by the other entity unless it is offset with an external derivative. In cases … It should be noted, however, that there will be no effect on profit or loss and ~~equity~~ other comprehensive income of reversing … Just as the internal derivatives offset at the treasury level, their use as fair value hedges by two separate entities or divisions within the consolidated group will also result in the offset of the fair value amounts recognised in profit or loss, and their use as cash flow hedges by two separate entities or divisions within the consolidated group will also result in the fair value amounts being offset against each other in other comprehensive income ~~equity~~. However, there may be an effect on individual line items in both the consolidated ~~income~~ statement of comprehensive income and the consolidated ~~balance sheet~~ statement of financial position, for example when internal derivatives that hedge assets (or liabilities) in a fair value hedge are offset by internal derivatives that are used as a fair value hedge of other assets (or liabilities) that are recognised in a different line item in the statement of financial position ~~balance sheet~~ or statement of comprehensive income ~~statement line item~~. In addition, to the extent that one of the internal contracts is used as a cash flow hedge and the other is used in a fair value hedge, ~~the effect on profit or loss and equity~~ gains and losses recognised would not offset since the gain (or loss) on the internal derivative used as a fair value hedge would be recognised in profit or loss and the corresponding loss (or gain) on the internal derivative used as a cash flow hedge would be recognised in ~~equity~~ other comprehensive income.

In Question F.1.6 the second paragraph of the answer is amended as follows:

- 'profit or loss or [in] equity' is amended to 'profit or loss or [in] other comprehensive income'.

- ‘gains and losses that are initially recognised in equity are recognised in profit or loss’ is amended to ‘gains and losses that are initially recognised in other comprehensive income are reclassified from equity to profit or loss’.

- ‘profit or loss and equity’ is amended to ‘profit or loss and other comprehensive income’.

Question F.1.7 is amended as described below.

The following references are amended as described below.

- ‘*Dr Equity*’ is amended to ‘*Dr Other comprehensive income*’.

- ‘*Cr Equity*’ is amended to ‘*Cr Other comprehensive income*’.

- ‘Income’ is amended to ‘Profit or loss’.

- ‘Equity’ is amended to ‘Other comprehensive income’.

In *Case 1*, 'the income statements' is amended to 'profit or loss'.

Case 2 is amended as follows:

...

A and B complete the necessary documentation, the hedges are effective, and both A and B qualify for hedge accounting in their individual financial statements. A ~~defers~~ recognises the gain of LC20 on its internal derivative transaction in ~~a hedging reserve in equity~~ other comprehensive income and B ~~defers~~ recognises the loss of LC50 in ~~its hedging reserve in equity~~ other comprehensive income. TC does …

Case 3 is amended as follows:

…

As in cases 1 and 2, A and B apply hedge accounting for their cash flow hedges and TC measures its derivatives at fair value. A ~~defers~~ recognises a gain of LC20 on its internal derivative transaction ~~in equity~~ in other comprehensive income and B ~~defers~~ recognises a loss of LC50 on its internal derivative transaction in other comprehensive income ~~in equity~~. …

In Questions F.1.7 *Case 3* and *Case 4*, F.5.2, F.5.3 and F.5.6, ‘Cr Equity’ and ‘Dr Equity’ are amended to ‘Cr Other comprehensive income’ and ‘Dr Other comprehensive income’ respectively.

In the answer to Question F.1.10, ‘reports changes in the fair value of the share in equity’ is amended to ‘recognises changes in the fair value of the share in other comprehensive income’.

In the answers to Questions F.2.4 and F.6.5, ‘recognised directly in equity through the statement of changes in equity’ is amended to ‘recognised in other comprehensive income’.

In Question F.3.3, ‘**the income statement**’ is amended to ‘**profit or loss**’.

In Question F.3.4, ‘amount recognised directly in equity is transferred to profit or loss’ is amended to ‘amount recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment’.

In Question F.5.2, ‘it credits the effective portion of the change in fair value of the swap, ie the net change in fair value of CU49, to equity’ is amended to ‘it recognises the effective portion of the change in fair value of the swap, ie the net change in fair value of CU49, in other comprehensive income’.

In Question F.5.3, ‘2001’ is amended to ‘20X1, ‘2002’ is amended to ‘20X2’ and ‘it debits the entire change in fair value of the forward contract (CU80) to equity’ is amended to ‘it recognises the entire change in fair value of the forward contract (CU80) in other comprehensive income’.

In Question F.5.6, references to the years ‘2001’ and ‘2002’ are amended to ‘20X1’ and ‘20X2’ respectively and ‘directly in equity’ is amended to ‘in other comprehensive income’ (six times).

Question F.6.2 is amended as described below.

The section ‘*Systems considerations*’ of Issue (b) is amended as follows:

- ‘the adjustments to equity from changes in the fair value of a hedging instrument should be recognised in profit or loss’ is amended to ‘the cumulative gains and losses recognised in other comprehensive income from changes in the fair value of a hedging instrument should be reclassified to profit or loss’.

- ‘should be recognised in profit or loss’ is amended to ‘should be reclassified from equity to profit or loss’.

In Issue (f), ‘recognised initially in equity are reclassified out of equity and recognised in profit or loss’ is amended to ‘recognised initially in other comprehensive income are reclassified from equity to profit or loss’.

Issue (g) is amended as follows:

- ‘should be recognised in profit or loss’ is amended to ‘should be reclassified from equity to profit or loss’.

- ‘are recognised in profit or loss’ is amended to ‘are reclassified from equity to profit or loss’.

In Issue (h), ‘net cumulative gain or loss is recognised in profit or loss’ is amended to ‘net cumulative gain or loss is reclassified from equity to profit or loss’.

Issue (j) is amended as follows:

- ‘are reclassified into profit or loss’ is amended to ‘are reclassified from equity to profit or loss’.
- ‘shall reclassify immediately into profit or loss’ is amended to ‘shall reclassify immediately from equity to profit or loss’.

In Question F.6.3, the section ‘*Systems considerations*’ in ‘**Designation objectives**’ is amended as follows:

- (in the second paragraph) ‘track of deferred derivative gains and losses in equity’ is amended to ‘track of gains and losses recognised in other comprehensive income’.
- (in the second paragraph, twice) ‘be recognised in profit or loss’ is amended to ‘be reclassified from equity to profit or loss’.
- (in the second and third paragraphs) ‘be reclassified out of equity’ is amended to ‘be reclassified from equity to profit or loss’.

In Question F.6.4, ‘amounts recognised in equity are released to profit or loss’ is amended to ‘amounts recognised in other comprehensive income are reclassified from equity to profit or loss’.

Contents

Hong Kong Accounting Standard 40

Investment Property

Hong Kong Accounting Standard 40 *Investment Property* (HKAS 40) is set out in paragraphs 1-86. All the paragraphs have equal authority. HKAS 40 shall be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Standards*. 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.

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 62 is amended as follows:

62 Up to the date … In other words:

(a) any resulting decrease in the carrying amount of the property is recognised in profit or loss. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is ~~charged against that~~ recognised in other comprehensive income and reduces the revaluation surplus within equity.

(b) any resulting increase in the carrying amount is treated as follows:

(i) …

(ii) any remaining part of the increase is ~~credited directly in equity in~~ recognised in other comprehensive income and increases the revaluation surplus within equity. On subsequent …

Paragraph 85A is added as follows:

85A HKAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 62. 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.

IASC Basis for Conclusions on IAS 40 (2000)

Contents

IASC Basis for Conclusions on IAS 40 (2000) Investment Property

This Basis for Conclusions was issued by the Board of the former International Accounting Standards Committee (IASC) in 2000. Apart from the deletion of paragraphs B10-B15, B25 and B26, this Basis has not been revised by the IASB. Those paragraphs are no longer relevant and have been deleted to avoid the risk that they might be read out of context. However, cross-references to paragraphs in IAS 40 as issued in 2000 have been marked to show the corresponding paragraphs in IAS 40 as revised by the IASB in 2003 (superseded references are struck through and new references are underlined). Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ. In addition, the text has been annotated where references to material in other standards are no longer valid, following the revision of those standards. Reference should be made to the IASB's Basis for Conclusions on the amendments made in 2003.

Background

B1. The IASC Board (the "Board") approved IAS 25, Accounting for Investments, in 1986. In 1994, the Board approved a reformatted version of IAS 25 presented in the revised format adopted for International Accounting Standards from 1991. Certain terminology was also changed at that time to bring it into line with then current IASC practice. No substantive changes were made to the original approved text.

B2. IAS 25 was one of the standards that the Board identified for possible revision in E32, Comparability of Financial Statements. Following comments on the proposals in E32, the Board decided to defer consideration of IAS 25, pending further work on Financial Instruments. In 1998, the Board approved IAS 38, Intangible Assets, and IAS 39, Financial Instruments: Recognition and Measurement, leaving IAS 25 to cover investments in real estate, commodities and tangible assets such as vintage cars and other collectors' items.

B3. In July 1999, the Board approved E64, Investment Property, with a comment deadline of 31 October 1999. The Board received 121 comment letters on E64. Comment letters came from various international organisations, as well as from 28 individual countries. The Board approved IAS 40, Investment Property, in March 2000. Paragraph B67 below summarises the changes that the Board made to E64 in finalising IAS 40.

B4. IAS 40 permits entities to choose between a fair value model and a cost model. As explained in paragraphs B47-48 below, the Board believes that it is impracticable, at this stage, to require a fair value model for all investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve greater maturity.

Need for a Separate Standard

B5. Some commentators argued that investment property should fall within the scope of IAS 16, Property, Plant and Equipment, and that there is no reason to have a separate standard on investment property. They believe that:

(a) it is not possible to distinguish investment property rigorously from owner-occupied property covered by IAS 16 and without reference to management intent. Thus, a distinction between investment property and owner-occupied property will lead to a free choice of different accounting treatments in some cases; and

(b) the fair value accounting model proposed in E64 is not appropriate, on the grounds that fair value is not relevant and, in some cases, not reliable in the case of investment property. The accounting treatments in IAS 16 are appropriate not only for owner-occupied property, but also for investment property.

B6. Having reviewed the comment letters, the Board still believes that the characteristics of investment property differ sufficiently from the characteristics of owner-occupied property that there is a need for a separate Standard on investment property. In particular, the Board believes that information about the fair value of investment property, and about changes in its fair value, is highly relevant to users of financial statements. The Board believes that it is important to permit a fair value model for investment property, so that entities can report fair value information prominently. The Board tried to maintain consistency with IAS 16, except for differences dictated by the choice of a different accounting model.

Scope

Investment Property Entities

B7. Some commentators argued that the Standard should cover only investment property held by entities that specialise in owning such property (and, perhaps, also other investments) and not cover investment property held by other entities. The Board rejected this view because the Board could find no conceptual and practical way to distinguish rigorously any class of entities for which the fair value model would be less or more appropriate.

Investment Property Reportable Segments

B8. Some commentators suggested that the Board should limit the scope of the Standard to entities that have a reportable segment whose main activity is investment property. These commentators argued that an approach linked to reportable segments would require an entity to adopt the fair value model when the entity considers investment property activities to be an important element of its financial performance and would allow an entity to adopt IAS 16 in other cases.

B9. An approach linked to reportable segments would lead to lack of comparability between investment property held in investment property segments and investment property held in other segments. For this reason, the Board rejected such an approach.

~~Long Operating Leases~~

~~B10. As proposed in E64, the Standard does not permit a lessee to treat its interest in property held under an operating lease as investment property, even if the lessee acquired its interest in exchange for a large up-front payment or the lease has a very long term. Instead, IAS 17, Leases, requires the lessee to recognise the lease payments as an expense on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.~~

~~B11. In some countries, such as Hong Kong and the United Kingdom, enterprises commonly make a large up-front payment to acquire a long-term interest in property (sometimes known as a leasehold interest). Some lessees consider that a leasehold interest is, in economic substance, virtually indistinguishable from rights acquired on buying a property. Indeed, some commentators noted that outright ownership of land or buildings is impossible in some markets, such as Hong Kong, and that property "ownership" in these markets is invariably transferred by selling rights under operating leases. Some commentators, particularly from these countries, felt that lessees should be permitted to use the fair value model to account for such interests.~~

~~B12. Some commentators suggested amending paragraph 11 of IAS 17, Leases, so that such leases could be classified as finance leases. This paragraph states that a lessee of land does not receive substantially all of the risks and rewards incident to ownership if title is not expected to pass to the lessee by the end of the lease term.~~

~~B13. The Board found no conceptual basis for distinguishing one class of operating leases for which a fair value model might be appropriate from another class of operating leases where it might be more appropriate to continue the existing cost-based accounting model under IAS 17. In particular, the Board concluded that an up-front payment does not change the economic substance of a lease sufficiently to justify an accounting treatment that differs from the treatment used for otherwise similar leases with no up-front payment. A distinction based on the presence or absence of an up-front payment is difficult to reconcile with the accrual basis of accounting.~~

~~B14. The Board concluded that the Standard on investment property should not deal with property held under an operating lease and that IAS 17, Leases, should continue to deal with all operating leases. The Board also concluded that no other solution is practicable without a fundamental review of lease accounting.~~

~~B15. Some commentators urged IASC to begin a fundamental review of lease accounting as soon as possible. The G4+1 group of standard setters is currently undertaking such a review and published a paper on this subject in December 1999. The Board is monitoring progress on this project with interest. However, the Board does not currently have such a review on its own work plan.~~

Investment Property under Construction

B16. E64 proposed that investment property under construction should be measured at fair value. E64 argued that fair value is the most relevant measure and that fair value of investment property under construction is not necessarily more difficult to measure than completed investment property. For example, where an investment property under construction is largely pre-leased, there may be less uncertainty about future cash inflows than for a completed investment property that is largely vacant.

B17. Some commentators argued that it is difficult to estimate fair value reliably for investment property under construction, because a market may not exist for property under construction. They argued that there may be considerable uncertainty about the cost to complete investment property under construction and about the income that such property will generate. Therefore, they suggested that an entity should not measure investment property at more than cost if the investment property is still under construction.

B18. The Board was persuaded by this argument and concluded that investment property under construction should be excluded from the scope of this Standard and should be covered by IAS 16.

B19. Paragraph ~~52~~58 of the Standard addresses cases where an entity begins to redevelop an existing investment property for continued future use as investment property. One approach would be to require a temporary transfer out of investment property into property under development (subject to IAS 16) for the duration of the redevelopment. However, the Board felt that such temporary transfers would be confusing and would be of little or no benefit to users of financial statements. This approach would also need arbitrary rules to distinguish major redevelopments that would result in such a temporary transfer from less significant works that would not lead to such a transfer. Accordingly, paragraph ~~52~~58 states that the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

B20. When an entity completes the construction or development of a self-constructed investment property that will be carried at fair value, there is likely to be a difference between the fair value of the property at that date and its previous carrying amount. The Board considered two approaches to accounting for such differences under the fair value model.

(a) Under the first approach, the difference would be transferred to revaluation surplus. This approach would be consistent with the Standard's approach to transfers from owner-occupied property to investment property.

(b) Under the second approach, the difference would be recognised in net profit or loss for the period. The Board concluded that this second approach gives a more meaningful picture of performance (see paragraph ~~59~~65).

Property Occupied by Another Entity in the Same Group

B21. In some cases, an entity owns property that is leased to, and occupied by, another entity in the same group. The property does not qualify as investment property in consolidated financial statements that include both entities, because the property is owner-occupied from the perspective of the group as a whole. However, from the perspective of the individual entity that owns it, the property is investment property if it meets the definition set out in the Standard.

B22. Some commentators believe that the definition of investment property should exclude properties that are occupied by another entity in the same group. Alternatively, they suggest that the Standard should not require investment property accounting in individual financial statements for properties that do not qualify as investment property in consolidated financial statements. They believe that:

(a) it could be argued (at least in some such cases) that the property does not meet the definition of investment property from the perspective of a subsidiary whose property is occupied by another entity in the same group—the subsidiary's motive for holding the property is to comply with a directive from its parent and not necessarily to earn rentals or to benefit from capital appreciation. Indeed, the intra-group lease may not be priced on an arm's length basis;

(b) this requirement would lead to additional valuation costs that would not be justified by the limited benefits to users. For groups with subsidiaries that are required to prepare individual financial statements, the cost could be extensive as entities may create a separate subsidiary to hold each property;

(c) some users may be confused if the same property is classified as investment property in the individual financial statements of a subsidiary and as owner-occupied property in the consolidated financial statements of the parent; and

(d) there is a precedent for a similar exemption (relating to disclosure, rather than measurement) in paragraph 4(c) of IAS 24, Related Party Disclosures, which does not require disclosures in a wholly-owned subsidiary's financial statements if its parent is incorporated in the same country and provides consolidated financial statements in that country.*

B23. Some commentators believe that the definition of investment property should exclude property occupied by any related party. They argue that related parties often do not pay rent on an arm's length basis, that it is often difficult to establish whether the rent is consistent with pricing on an arm's length basis and that rental rates may be subject to arbitrary change. They suggest that fair values are less relevant where property is subject to leases that are not priced on an arm's length basis.

B24. The Board could find no justification for treating property leased to another entity in the same group (or to another related party) differently from property leased to other parties. Therefore, the Board decided that an entity should use the same accounting treatment, regardless of the identity of the lessee.

~~Liabilities Related to Investment Property~~

~~B25. Some commentators suggested that the Standard should address the measurement of liabilities incurred to acquire investment property. Under IAS 39, Financial Instruments: Recognition and Measurement, such liabilities are, in many cases, measured on an amortised cost basis. These commentators believe that there will be a mismatch if the property is measured at fair value.~~

~~B26. The Board concluded that it should not, at this stage, permit or require a fair value model for liabilities incurred to acquire investment properties. The Board also decided not to modify the fair value model for investment property to adjust for mismatches caused by using an amortised-cost basis for related financial liabilities. Under IAS 39, the possibility already exists of a similar mismatch between those financial assets measured at fair value and financial liabilities. The Board is participating in an international Joint Working Group on financial instruments, which is pursuing the possibility of measuring all financial assets and financial liabilities at fair value.~~

Government Grants

B27. IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, permits two methods of presenting grants relating to assets – either setting up a grant as deferred income and amortising the income over the useful life of the asset or deducting the grant in arriving at the carrying amount of the asset. Some believe that both of those methods reflect a historical cost model and are inconsistent with the fair value model set out in this Standard. Indeed, Exposure Draft E65, Agriculture, which proposes a fair value model for biological assets, addresses certain aspects of government grants, as these are a significant factor in accounting for agriculture in some countries.

B28. Some commentators urged IASC to change the accounting treatment of government grants related to investment property. However, most commentators agreed that IASC should not deal with this aspect of government grants now. The Board decided not to revise this aspect of IAS 20 in the project on Investment Property.

B29. Some commentators suggested that IASC should begin a wider review of IAS 20 as a matter of urgency. In early 2000, the G4+1 group of standard setters published a Discussion Paper, "Accounting by Recipients for Non-Reciprocal Transfers, Excluding Contributions by Owners: Their Definition, Recognition and Measurement". The Board's work plan does not currently include a project on the accounting for government grants or other forms of non-reciprocal transfer.

* IAS 24 *Related Party Disclosures* as revised by the IASB in 2003 no longer provides the exemption mentioned in paragraph B22(d).

Definition of Investment Property

B30. The definition of investment property excludes:

(a) owner-occupied property – covered by IAS 16, Property, Plant and Equipment. Under IAS 16, such property is carried at either depreciated cost or revalued amount less subsequent depreciation. In addition, such property is subject to an impairment test; and

(b) property held for sale in the ordinary course of business— covered by IAS 2, Inventories. IAS 2 requires an entity to carry such property at the lower of cost and net realisable value.

B31. These exclusions are consistent with the existing definitions of property, plant and equipment in IAS 16 and inventories in IAS 2. This ensures that all property is covered by one, and only one, of the three Standards.

B32. Some commentators suggested that property held for sale in the ordinary course of business should be treated as investment property rather than as inventories (covered by IAS 2). They argued that:

(a) it is difficult to distinguish property held for sale in the ordinary course of business from property held for capital appreciation; and

(b) it is illogical to require a fair value model for land and buildings held for long-term capital appreciation (investment property) when a cost model is still used for land and buildings held for short-term sale in the ordinary course of business (inventories).

B33. The Board rejected this suggestion because:

(a) if fair value accounting is used for property held for sale in the ordinary course of business, this would raise wider questions about inventory accounting that go beyond the scope of this project; and

(b) it is arguably more important to use fair value accounting for property that may have been acquired over a long period and held for several years (investment property) than for property that was acquired over a shorter period and held for a relatively short time (inventories). With the passage of time, cost-based measurements become increasingly irrelevant. Also, an aggregation of costs incurred over a long period is of questionable relevance.

B34. Some commentators suggested requiring (or at least permitting) entities, particularly financial institutions such as insurance companies, to use the fair value model for their owner-occupied property. They argued that some financial institutions regard their owner-occupied property as an integral part of their investment portfolio and treat it for management purposes in the same way as property leased to others. In the case of insurance companies, the property may be held to back policyholder liabilities. The Board believes that property used for similar purposes should be subject to the same accounting treatment. Accordingly, the Board concluded that no class of entities should use the fair value model for their owner-occupied property.

B35. Some commentators suggested that the definition of investment property should exclude property held for rentals, but not for capital appreciation. In their view, a fair value model may be appropriate for dealing activities, but is inappropriate where an entity has historically held rental property for many years and has no intention of selling it in the foreseeable future. They consider that holding property for long-term rental is a service activity and the assets used in that activity should be treated in the same way as assets used to support other service activities. In their view, holding an investment in property in such cases is similar to holding "held-to-maturity investments", which are measured at amortised cost under IAS 39.

B36. In the Board's view, the fair value model provides useful information about property held for rental, even if there is no immediate intention to sell the property. The economic performance of a property can be regarded as being made up of both rental income earned during the period (net of expenses) and changes in the value of future net rental income. The fair value of an investment property can be regarded as a market-based representation of the value of the future net rental income, regardless of whether the entity is likely to sell the property in the near future. Also, the Standard notes that fair value is determined without deducting costs of disposal—in other words, the use of the fair value model is not intended as a representation that a sale could, or should, be made in the near future.

B37. The classification of hotels and similar property was controversial throughout the project and commentators on E64 had mixed views on this subject. Some see hotels essentially as investments, while others see them essentially as operating properties. Some requested a detailed rule to specify whether hotels (and, perhaps, other categories of property, such as restaurants, bars and nursing homes) should be classified as investment property or as owner-occupied property.

B38. The Board concluded that it is preferable to distinguish investment property from owner-occupied property on the basis of general principles, rather than have arbitrary rules for specific classes of property. Also, it would inevitably be difficult to establish rigorous definitions of specific classes of property to be covered by such rules. Paragraphs ~~9-11~~11-13 of the Standard discuss cases such as hotels in the context of the general principles that apply when an entity provides ancillary services.

B39. Some commentators requested quantitative guidance (such as a percentage) to clarify whether an "insignificant portion" is owner-occupied (paragraph ~~8~~10) and whether ancillary services are "significant" (paragraphs ~~9-11~~11-13 of the Standard). As for similar cases in other Standards, the Board concluded that quantitative guidance would create arbitrary distinctions.

Subsequent Expenditure

B40. Some believe that there is no need to capitalise subsequent expenditure in a fair value model and that all subsequent expenditure should be recognised as an expense. However, others believe – and the Board agreed – that the failure to capitalise subsequent expenditure would lead to a distortion of the reported components of financial performance. Therefore, the Standard requires that an entity should determine whether subsequent expenditure should be capitalised using a test similar to the test used for owner-occupied property in IAS 16.

B41. Some commentators suggested that the test for capitalising subsequent expenditure should not refer to the originally assessed standard of performance. They felt that it is impractical and irrelevant to judge against the originally assessed standard of performance, which may relate to many years in the past. Instead, they suggested that subsequent expenditure should be capitalised if it enhances the previously assessed standard of performance – for example, if it increases the current market value of the property or is intended to maintain its competitiveness in the market. The Board saw some merit in this suggestion.

B42. Nevertheless, the Board believes that a reference to the previously assessed standard of performance would require substantial additional guidance, might not change the way the Standard is applied in practice and might cause confusion. The Board also concluded that it was important to retain the existing reference to the originally assessed standard of performance[*] to be consistent with IAS 16 and IAS 38.

Subsequent Measurement

Accounting Model

B43. Under IAS 25, an entity was permitted to choose from among a variety of accounting treatments for investment property (depreciated cost under the benchmark treatment in IAS 16, Property, Plant and Equipment, revaluation with depreciation under the allowed alternative treatment in IAS 16, cost less impairment under IAS 25 or revaluation under IAS 25).[†]

B44. E64 proposed that all investment property should be measured at fair value. Supporters of the fair value model believe that fair values give users of financial statements more useful information than other measures, such as depreciated cost. In their view, rental income and changes in fair value are inextricably linked as integral components of the financial performance of an investment property and measurement at fair value is necessary if that financial

[*] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 requires all subsequent costs to be covered by its general recognition principle and eliminated the requirement to reference the originally assessed standard of performance. IAS 40 was amended as a consequence of the change to IAS 16

[†] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments. They are replaced with cost model and revaluation model.

performance is to be reported in a meaningful way.

B45. Supporters of the fair value model also note that an investment property generates cash flows largely independently of the other assets held by an entity. In their view, the generation of independent cash flows through rental or capital appreciation distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not merely to property, but also to other assets used in the production or supply process. Proponents of the fair value model for investment property argue that this distinction makes a fair value model more appropriate for investment property than for owner-occupied property.

B46. Those who oppose measurement of investment property at fair value argue that:

(a) there is often no active market for investment property (unlike for many financial instruments). Real estate transactions are not frequent and not homogeneous. Each investment property is unique and each sale is subject to significant negotiations. As a result, fair value measurement will not enhance comparability because fair values are not determinable on a reliable basis, especially in countries where the valuation profession is less well established. A depreciated cost measurement provides a more consistent, less volatile, and less subjective measurement;

(b) IAS 39 does not require fair value measurement for all financial assets, even some that are realised more easily than investment property. It would be premature to consider extending the fair value model until the Joint Working Group on financial instruments has completed its work;

(c) a cost basis is used for "shorter term" assets (such as inventories) for which fair value is, arguably, more relevant than for "held for investment" assets; and

(d) measurement at fair value is too costly in relation to the benefits to users.

B47. This is the first time that the Board has proposed requiring a fair value accounting model for non-financial assets. The comment letters on E64 showed that although many support this step, many others still have significant conceptual and practical reservations about extending a fair value model to non-financial assets, particularly (but not exclusively) for entities whose main activity is not to hold property for capital appreciation. Also, some entities feel that certain property markets are not yet sufficiently mature for a fair value model to work satisfactorily. Furthermore, some believe that it is impossible to create a rigorous definition of investment property and that this makes it impracticable to require a fair value model at present.

B48. For those reasons, the Board believes that it is impracticable, at this stage, to require a fair value model for investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve greater maturity.

B49. IAS 40 permits entities to choose between a fair value model and a cost model. An entity should apply the model chosen to all its investment property. [This choice is not available to a lessee accounting for an investment property under an operating lease as if it were a finance lease—refer to the IASB's Basis for Conclusions on the amendments made in 2003.] The fair value model is the model proposed in E64: investment property should be measured at fair value and changes in fair value should be recognised in the income statement. The cost model is the benchmark treatment[*] in IAS 16, Property, Plant and Equipment: investment property should be measured at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model should disclose the fair value of its investment property.

B50. Under IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies,[†] a change in accounting policies from one model to the other model should be made only if the change will result in a more appropriate presentation of events or transactions. The Board concluded that this is highly unlikely to be the case for a change from the fair value model to the cost model and paragraph ~~25~~31 of the Standard reflects this conclusion.

[*] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.
[†] revised by the IASB in 2003 as IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

B51. The Board believes that it is undesirable to permit three different accounting treatments for investment property. Accordingly, if an entity does not adopt the fair value model, the Standard requires the entity to use the benchmark treatment in IAS 16 and does not permit the use of the allowed alternative treatment. However, an entity may still use the allowed alternative for other properties covered by IAS 16.*

Guidance on Fair Value

B52. The valuation profession will have an important role in implementing the Standard. Accordingly, in developing its guidance on the fair value of investment property, the Board considered not only similar guidance in other IASC literature, but also International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The Board understands that IVSC intends to review, and perhaps revise, its Standards in the near future.

B53. The Board believes that IASC's concept of fair value is similar to the IVSC concept of market value. IVSC defines market value as "the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." The Board believes that the guidance in paragraphs ~~29-30~~36, 37 and ~~32-38~~39-44 of the Standard is, in substance (and largely in wording as well), identical with guidance in IVS 1.

B54. Paragraphs ~~31~~38 and ~~39-46~~45-52 of IAS 40 have no direct counterpart in the IVSC literature. The Board developed much of this material in response to commentators on E64, who asked for more detailed guidance on determining the fair value of investment property. In developing this material, the Board considered guidance on fair value in other IASC Standards and Exposure Drafts, particularly those on financial instruments (IAS 32 and IAS 39), intangible assets (IAS 38) and agriculture (E65).

Independent Valuation

B55. Some commentators believe that fair values should be determined on the basis of an independent valuation, to enhance the reliability of the fair values reported. Others believe, on cost-benefit grounds, that IASC should not require (and perhaps not even encourage) an independent valuation. They believe that it is for preparers to decide, in consultation with auditors, whether an entity has sufficient internal resources to determine reliable fair values. Some also believe that independent valuers with appropriate expertise are not available in some markets.

B56. The Board concluded that an independent valuation is not always necessary. Therefore, as proposed in E64, the Standard encourages, but does not require, an entity to determine the fair value of all investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued. This approach is consistent with the approach to actuarial valuations in IAS 19, Employee Benefits (see IAS 19, paragraph 57)

Inability to Measure Fair Value Reliably

B57. E64 included a rebuttable presumption that an entity will be able to determine reliably the fair value of property held to earn rentals or for capital appreciation. E64 also proposed a reliability exception: IAS 16 should be applied if evidence indicates clearly, when an entity acquires or constructs a property, that fair value will not be determinable reliably on a continuing basis.

B58. Some commentators opposed various aspects of this proposal, on one or more of the following grounds:

(a) the rebuttable presumption underestimates the difficulties of determining fair value reliably. This will often be impossible, particularly where markets are thin or where there is not a well-established valuation profession;

(b) the accounting model under IAS 16 includes an impairment test under IAS 36. However, it is illogical to rely on an impairment test when fair value cannot be determined using cash flow projections, because an impairment test under IAS 36 is also difficult in such cases;

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

(c) where fair value cannot be determined reliably, this fact does not justify charging depreciation. Instead, the property in question should be measured at cost less impairment losses; and

(d) to avoid the danger of manipulation, all efforts should be made to determine fair values, even in a relatively inactive market. Even without an active market, a range of projected cash flows is available. If there are problems in determining fair value, an entity should measure the property at the best estimate of fair value and disclose limitations on the reliability of the estimate. If it is completely impossible to determine fair value, fair value should be deemed to be zero.

B59. The Board concluded that the rebuttable presumption and the reliability exception should be retained, but decided to implement them in a different way. In E64, they were implemented by excluding a property from the definition of investment property if the rebuttable presumption was overcome. Some commentators felt that it was confusing to include such a reliability exception in a definition. Accordingly, the Board moved the reliability exception from the definition to the section on subsequent measurement (paragraphs ~~47-49~~53-55).

B60. Under E64, an entity should not stop using the fair value model if comparable market transactions become less frequent or market prices become less readily available. Some commentators disagreed with this proposal. They argued that there may be cases when reliable estimates are no longer available and that it would be misleading to continue fair value accounting in such cases. The Board decided that it is important to keep the E64 approach, because otherwise entities might use a reliability exception as an excuse to discontinue fair value accounting in a falling market.

B61. In cases where the reliability exception applies, E64 proposed that an entity should continue to apply IAS 16 until disposal of the property. Some commentators proposed that an entity should start applying the fair value model once the fair value becomes measurable reliably. The Board rejected this proposal because it would inevitably be a subjective decision to determine when fair value has become measurable reliably and this subjectivity could lead to inconsistent application.

B62. E64 proposed no specific disclosure where the reliability exception applies. Some commentators felt that disclosure would be important in such cases. The Board agreed and decided to include disclosures consistent with paragraph 170(b) of IAS 39[*] (see paragraphs ~~68 and 69(e)~~78 and 79(e) of IAS 40). Paragraph 170(b) of IAS 39 requires disclosures for financial assets whose fair value cannot be reliably measured.

Gains and Losses on Remeasurement to Fair Value

B63. Some commentators argued that there should be either a requirement or an option to recognise changes in the fair value of investment property in equity,[1] on the grounds that:

(a) the market for property is not liquid enough and market values are uncertain and variable. Investment property is not as liquid as financial instruments and IAS 39 allows an option for available-for-sale investments;

(b) until performance reporting issues are resolved more generally, it is premature to require recognition of fair value changes in the income statement;

(c) recognition of unrealised gains and losses in the income statement increases volatility and does not enhance transparency, because revaluation changes will blur the assessment of an entity's operating performance. It may also cause a presumption that the unrealised gains are available for distribution as dividends;

(d) recognition in equity is more consistent with the historical cost and modified historical cost conventions that are a basis for much of today's accounting. For example, it is consistent with IASC's treatment of revaluations of property, plant and equipment under IAS 16 and with the option available for certain financial instruments under IAS 39;

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

[1] Under IAS 1 *Presentation of Financial Statements*, all such changes reported in equity are presented in a statement showing changes in equity.

(e) for properties financed by debt, changes in the fair value of the properties resulting from interest rate changes should not be recognised in the income statement, since the corresponding changes in the fair value of the debt are not recognised under IAS 39;

(f) under paragraphs 92 and 93 of the Framework, income should be recognised only when it can be measured with sufficient certainty. For example, IAS 11, Construction Contracts, requires certain conditions before an entity can use the percentage-of-completion method. These conditions are not normally met for investment property; and

(g) results from operations should be distinguished from changes in values. For example, under IAS 21, unrealised exchange differences on a foreign entity[*] are recognised in equity.

B64. Some commentators suggested that increases should be recognised in equity and decreases should be recognised in net profit or loss. This is similar to the revaluation model that forms the allowed alternative treatment[†] in IAS 16 (except for the lack of depreciation).

B65. As proposed in E64, the Board concluded that, in a fair value model, changes in the fair value of investment property should be recognised in the income statement as part of net profit or loss for the period. The arguments for this approach include the following:

(a) the conceptual case for the fair value model is built largely on the view that this provides the most relevant and transparent view of the financial performance of investment property. Given this, it would be inconsistent to permit or require recognition in equity;

(b) recognition of fair value changes in equity would create a mismatch because net rental income would be recognised in the income statement, whereas the related consumption of the service potential (recognised as depreciation under IAS 16) would be recognised in equity. Similarly, maintenance expenditure would be recognised as an expense while related increases in fair value would be recognised in equity;

(c) using this approach, there is no need to resolve some difficult and controversial issues that would arise if changes in the fair value of investment property were recognised in equity. These issues include the following:

(i) should fair value changes previously recognised in equity be transferred ("recycled") to net profit or loss on disposal of investment property; and

(ii) should fair value changes previously recognised in equity be transferred ("recycled") to net profit or loss when investment property is impaired? If so, how should such impairment be identified and measured; and

(d) given the difficulty in defining investment property rigorously, entities will sometimes have the option of applying the investment property standard or either of the two treatments in IAS 16. It would be undesirable to include two choices in the investment property standard, as this would give entities a choice (at least occasionally) between four different treatments.

Transfers

B66. When an owner-occupied property carried under the benchmark treatment under IAS 16 becomes an investment property, the measurement basis for the property changes from depreciated cost to fair value. The Board concluded that the effect of this change in measurement basis should be treated as a revaluation under IAS 16 at the date of change in use. The result is that:

(a) the income statement excludes cumulative net increases in fair value that arose before the property became investment property. The portion of this change that arose before the beginning of the current period does not represent financial performance of the

[*] In IAS 21 *The Effects of Changes in Foreign Exchange Rates*, as revised by the IASB in 2003, the term "foreign entity" was replaced by "foreign operation"

[†] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

current period; and

(b) this treatment creates comparability between entities that had previously revalued the property under the allowed alternative treatment in IAS 16 and those entities that had previously used the IAS 16 benchmark treatment.*

Summary of Changes to E64

B67. The most important change between E64 and the final Standard was the introduction of the cost model as an alternative to the fair value model. The other main changes are listed below.

(a) The guidance on determining fair value was expanded, to clarify the following:

(i) the fair value of investment property is not reduced by transaction costs that may be incurred on sale or other disposal (paragraph ~~30~~37 of the Standard). This is consistent with the measurement of financial assets under paragraph 69 of IAS 39.ᶲ E64 was silent on the treatment of such costs;

(ii) measurement is based on valuation at the balance sheet date (paragraph ~~31~~38);

(iii) the best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts (paragraph ~~39~~45). In the absence of such evidence, fair value reflects information from a variety of sources and an entity needs to investigate reasons for any differences between the information from different sources (paragraphs ~~40-41~~46 and 47);

(iv) market value differs from value in use as defined in IAS 36, Impairment of Assets (paragraph ~~43~~49);

(v) there is a need to avoid double counting of investment property and separately recognised assets and liabilities. Integral equipment (such as elevators or air-conditioning) is generally included in the investment property, rather than recognised separately (paragraph ~~44~~50);

(vi) the fair value of investment property does not reflect future capital expenditure that will improve or enhance the asset and does not reflect the related future benefits from this future expenditure (paragraph ~~45~~51);

(vii) an entity uses IAS 37 to account for any provisions associated with investment property (paragraph ~~46~~52); and

(viii) in the exceptional cases when fair value cannot be determined reliably, measurement is under the IAS 16 benchmark treatment* only (in such cases, revaluation under IAS 16 would also not be reliable) and residual value is assumed to be zero (given that fair value cannot be determined reliably) (paragraphs ~~47-48~~53 and 54).

(b) In relation to the scope of the Standard and the definition of investment property:

(i) paragraph ~~3~~4 now clarifies that the Standard does not apply to forests and similar regenerative natural resources and to mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources. This wording is consistent with a similar scope exclusion in IAS 16, Property, Plant and Equipment. The Board did not wish to prejudge its decision on the treatment of such items in the current projects on Agriculture and the Extractive Industries;

(ii) land held for a currently undetermined future use is a further example of investment property (paragraph ~~6(b)~~8(b)), on the grounds that a subsequent decision to use such land as inventory or for development as owner-occupied property would be an investment decision;

(iii) new examples of items that are not investment property are: property held for future use as owner-occupied property, property held for future development

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

ᶲ Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003.

and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal (paragraph ~~7(c)~~9(c));

(iv) property that is being constructed or developed for future use as investment property is now covered by IAS 16 and measured at cost, less impairment losses, if any (paragraph ~~7(d)~~9(d)). E64 proposed that investment property under construction should be measured at fair value; and

(v) the reference to reliable measurement of fair value (and the related requirements in paragraphs 14-15 of E64) was moved from the definition of investment property into the section on subsequent measurement (paragraphs ~~47-49~~53-55).

(c) New paragraph ~~20~~23 deals with start up costs, initial operating losses and abnormal wastage (based on paragraphs 17 and 18 of IAS 16[*]). The Board considered adding guidance on the treatment of incidental revenue earned during the construction of investment property. However, the Board concluded that this raised an issue in the context of IAS 16 and decided that it was beyond the scope of this project to deal with this.

(d) There is an explicit requirement on determining gains or losses on disposal (paragraph ~~62~~69). This is consistent with IAS 16, paragraph 56.[ϕ] There are also new cross-references to:

(i) IAS 17, Leases, and IAS 18, Revenue, as guidance for determining the date of disposal (paragraph ~~61~~67); and

(ii) IAS 37, Provisions, Contingent Liabilities and Contingent Assets, for liabilities retained after disposal (paragraph ~~64~~71).

(e) The Standard states explicitly that an entity should transfer an investment property to inventories when the entity begins to develop the property for subsequent sale in the ordinary course of business (paragraphs ~~51(b) and 52~~57(b) and 58). E64 proposed that all transfers from investment properties to inventories should be prohibited. The Standard also deals more explicitly than E64 with certain other aspects of transfers.

(f) New disclosure requirements include:

(i) extension of the required disclosure on methods and significant assumptions, which are now to include disclosure of whether fair value was supported by market evidence, or whether the estimate is based on other data (which the entity should disclose) because of the nature of the property and the lack of comparable market data (paragraph ~~66(b)~~75(d));

(ii) disclosures of rental income and direct operating expenses (paragraph ~~66(d)~~75(f)); and

(iii) disclosures in the exceptional cases when fair value is not reliably determinable (paragraphs ~~68 and 69(e)~~78 and 79(e)).

(g) E64 proposed a requirement to disclose the carrying amount of unlet or vacant investment property. Some commentators argued that this disclosure was impracticable, particularly for property that is partly vacant. Some also felt that this is a matter for disclosure in a financial review by management, rather than in the financial statements. The Board deleted this disclosure requirement. It should be noted that some indication of vacancy levels may be available from the required disclosure of rental income and from the IAS 17 requirement to disclose cash flows from non-cancellable operating leases (split into less than one year, one to five years and more than five years).

[*] In IAS 16 Property, Plant and Equipment as revised by the IASB in 2003, paragraph 17 and 18 were replaced by paragraphs 19-22.

[ϕ] In IAS 16 Property, Plant and Equipment as revised by the IASB in 2003, paragraph 56 was replaced by paragraphs 68 and 71.

(h) E64 included no specific transitional provisions, which means that IAS 8 would apply. There is a risk that restatement of prior periods might allow entities to manipulate their reported net profit or loss for the period by selective use of hindsight in determining fair values in prior periods. Accordingly, the Board decided to prohibit restatement in the fair value model, except where an entity has already publicly disclosed fair values for prior periods (paragraph ~~70~~80).

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The following footnote to paragraph B63 is deleted:

> 'Under IAS 1 *Presentation of Financial Statements*, all such changes reported in equity are presented in a statement showing changes in equity.'

Contents

Hong Kong Accounting Standard 41 *Agriculture* (IAS 41) is set out in paragraphs 1-59A. *All the* paragraphs have equal authority. HKAS 41 shall be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Appendix

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In paragraph 24(a) of HKAS 41, 'a balance sheet date' is amended to 'the end of a reporting period'.

In the appendix accompanying HKAS 41, the rubric above paragraph A1 is amended as follows:

> *'This appendix, which was prepared by the IASC staff but was not approved by the IASC Board, accompanies, but is not part of, HKAS 41.* <u>*It has been updated to take account of the changes made by* HKAS 1 Presentation of Financial Statements *(as revised in 2007).*</u>'

Example 1 in the appendix is amended as described below.

> In the '**Statement of financial position**' and in the '**Statement of changes in equity**', the reference to 'Accumulated profits' is amended to 'Retained earnings'.

The following footnote to the '**Statement of changes in equity**' is deleted:

> 'This is one of several formats for the statement of changes in equity permitted by HKAS 1.'

In the second footnote, 'HKAS 7 *Cash Flow Statements*' is amended to 'HKAS 7 *Statement of Cash Flows*'.

Basis for Conclusions

Agriculture

This Basis for Conclusions accompanies, but is not part of, HKAS 19.

Background

B1. In 1994, the IASC Board (the "Board" decided to develop an International Accounting Standard on agriculture and appointed a Steering Committee to help define the issues and develop possible solutions. In 1996, the Steering Committee published a Draft Statement of Principles ("DSOP" setting out the issues, alternatives, and the Steering Committee's proposals for resolving the issues and inviting public comment. In response, 42 comment letters were received. The Steering Committee reviewed the comments, revised certain of its recommendations, and submitted them to the Board.

B2. In July 1999, the Board approved Exposure Draft E65, Agriculture, with a comment deadline of 31 January 2000. The Board received 62 comment letters on E65. They came from various international organisations, as well as from 28 individual countries. In April 2000, the IASC Staff sent a questionnaire to enterprises that undertake agricultural activity in an attempt to determine the reliability of the fair value measurement proposed in E65 and received 20 responses from 11 countries. In December 2000, after considering the comments on E65 and responses to the questionnaire, the Board approved IAS 41 *Agriculture* (the Standard). Paragraph B82 below summarises the changes that the Board made to E65 in finalising the Standard.

The Need for an International Accounting Standard on Agriculture

B3. A main objective of the IASC is to develop International Accounting Standards that are relevant in the general purpose financial statements of all businesses. While most International Accounting Standards apply to enterprises in all activities, some International Accounting Standards; for example, IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*[*] and IAS 40 *Investment Property*, deal with issues that arise in particular activities. IASC has also undertaken industry-specific projects on insurance and extractive industries.

B4. Diversity in accounting for agricultural activity has occurred because:

(a) prior to the development of the Standard, assets related to agricultural activity and changes in those assets were excluded from the scope of International Accounting Standards:

(i) IAS 2 *Inventories* excluded "producers" inventories of livestock, agricultural and forest products... to the extent that they are measured at net realisable value in accordance with well established practices in certain industries?

(ii) IAS 16 *Property, Plant and Equipment* did not apply to "forests and similar regenerative natural resources";

(iii) IAS 18 *Revenue* did not deal with revenue arising from "natural increases in herds, and agricultural and forest products" and

(iv) IAS 40 *Investment Property* did not apply to "forests and similar regenerative natural resources";

(b) accounting guidelines for agricultural activity developed by national standard setters have, in general, been piecemeal, developed to resolve a specific issue related to a form of agricultural activity of significance to that country; and

(c) the nature of agricultural activity creates uncertainty or conflicts when applying

[*] In August 2005, IFRS 7 *Financial Instruments: Disclosure* supersedes IAS 30.

B81. The Board did not include the above disclosures in the Standard. The Board noted that requiring item (a) above would not be appropriate since external independent valuations are not commonly used for assets related to agricultural activity, unlike for certain other assets such as investment property. The Board also noted that item (b) is not required in other International Accounting Standards and a unique disclosure requirement is not warranted for agricultural activity. Items (c) and (d) would be outside the scope of the Standard and covered by other International Accounting Standards (IAS 16 or IAS 2 *Inventories*).

Summary of Changes to E65

B82. The Standard made the following principal changes to the proposals in E65:

(a) The Standard includes a reliability exception for biological assets on initial recognition. If the exception is applied, the biological asset should be measured at its cost less any accumulated depreciation and any accumulated impairment losses (paragraph 30 of the Standard). As a consequence, the Standard includes disclosure requirements consistent with paragraph 170(b) of IAS 39 *Financial Instruments: Recognition and Measurement*[*], and paragraph 68 of IAS 40 *Investment Property*[†] (paragraphs 54(a)-(c) and 55 of the Standard), and consistent with paragraphs 60(b)-(d) and 60(e)(v)-(vii) of IAS 16 *Property, Plant and Equipment*[✦] (paragraphs 54(d)-(f) and 55).

(b) If the reliability exception is applied but fair value subsequently becomes reliably measurable and, therefore, an enterprise has started measuring the biological assets at their fair value less estimated point-of-sale costs, the Standard requires the enterprise to disclose a description of the biological assets, an explanation of why fair value has become reliably measurable, and the effect of the change (paragraph 56).

(c) E65 did not specify how to account for point-of-sale costs (such as commissions to brokers). The Standard requires that biological assets and agricultural produce should be measured at their fair value less estimated point-of-sale costs (paragraphs 12-13).

(d) E65 included net realisable value as one of the measurement bases in cases where no active market exists. Net realisable value was deleted from the bases since it is not a market-determined value.

(e) The Standard indicates that market-determined prices or values are used when available. The Standard also indicates that, in some circumstances, market-determined prices or values may not be available for an asset in its present condition. In these circumstances, an enterprise uses the present value of expected net cash flows (paragraphs 18-20).

(f) Guidance on the performance of present value calculations was added (paragraphs 21-23).

(g) E65 did not specify how to account for contracts for the sale of a biological asset or agricultural produce. The Standard indicates that the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a sales contract (paragraph 16).

(h) E65 did not explicitly indicate that a gain or loss may arise on initial recognition of agricultural produce. The Standard clarifies that a gain or loss may arise on initial recognition of agricultural produce; for example, as a result of harvesting and that such a gain or loss should be included in net profit or loss[✻] for the period in which it arises (paragraphs 28-29).

---

[*] Paragraph 170(b) of IAS 39 was replaced by paragraph 90 of IAS 32 *Financial Instruments: Disclosure and Presentation* when the IASB revised those standards in 2003. In 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

[†] Paragraph 68 of IAS 40 was replaced by paragraph 78 when the IASB revised IAS 40 in 2003.

[✦] Paragraph 60 of IAS 16 was replaced by paragraph 73 when IAS 16 was revised in 2003.

[✻] IAS 1 *Presentation of Financial Statements* (revised in 2003) replaced the term 'net profit or loss' with 'profit or loss'.

(i) E65 proposed that costs of producing and harvesting biological assets should be charged to expense when incurred, and that costs that increase the number of units of biological assets owned or controlled by the enterprise should be added to the carrying amount of the asset. The Standard does not explicitly prescribe how to account for subsequent expenditure related to biological assets.

(j) E65 proposed that an enterprise should recognise a conditional government grant as income when there is reasonable assurance that the conditions are met. The Standard requires that a conditional government grant related to a biological asset measured at its fair value less estimated point-of-sale costs, including where a government grant requires an enterprise not to engage in specified agricultural activity, should be recognised as income when, and only when, the conditions attaching to the government grant are met. The Standard also indicates that IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, is applied to a government grant related to a biological asset measured at its cost less any accumulated depreciation and any accumulated impairment losses (paragraphs 34-35 and 37).

(k) E65 provided the following encouragements specific to agricultural activity with regard to alternative treatments allowed in other International Accounting Standards, to achieve consistency with the accounting treatment of activities covered by E65:

  (i) analysing expenses by nature, as set out in IAS 1 Presentation of Financial Statements; and

  (ii) revaluing certain intangible assets used in agricultural activity if an active market exists, as set out in IAS 38 Intangible Assets.

  The Board did not include these encouragements in the Standard. The Board noted that IAS 1 and IAS 38 apply to enterprises that undertake agricultural activity, as well as to those in other activities.

(l) New disclosure requirements include disclosing the:

  (i) basis for making distinctions between consumable and bearer biological assets or between mature and immature biological assets, when an enterprise provides a quantified description of each group of biological assets (paragraph 43);

  (ii) methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest (paragraph 47);

  (iii) fair value less estimated point-of-sale costs of agricultural produce harvested during the period, determined at the point of harvest (paragraph 48);

  (iv) increases resulting from business combinations in the reconciliation of the carrying amount of biological assets (paragraph 50(e)); and

  (v) significant decreases expected in the level of government grants related to agricultural activity covered by the Standard (paragraph 57(c)).

(m) E65 proposed disclosing the:

  (i) extent to which the carrying amount of biological assets reflects a valuation by an external independent valuer or, if there has been no valuation by an external independent valuer, that fact;

  (ii) activities that are unsustainable with an estimated date of cessation of the activities;

  (iii) aggregate carrying amount of an enterprise's agricultural land and the basis (cost or revalued amount) on which the carrying amount was determined under IAS 16; and

  (iv) carrying amount of agricultural produce either on the face of the balance sheet or in the notes.

  The Standard does not include the above disclosures.

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1-47F and Appendices A-B. 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 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 *Framework for 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.

without preparing a complete set of financial statements as defined in HKAS 1 *Presentation of Financial Statements*; 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 under 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 under 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 balance sheet

6 An entity shall prepare an *opening HKFRS balance sheet* at the *date of transition to HKFRSs*. This is the starting point for its accounting under HKFRSs. An entity need not present its opening HKFRS balance sheet in its first HKFRS financial statements.

Accounting policies

7 An entity shall use the same accounting policies in its opening HKFRS balance sheet and throughout all periods presented in its first HKFRS financial statements. Those accounting policies shall comply with each HKFRS effective at the reporting date for its first HKFRS financial statements, except as specified in paragraphs ~~13-34~~13-34B, 36A-36C and 37.

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 it permits early application.

Example: Consistent application of latest version of HKFRSs

BACKGROUND

The reporting date for entity A's first HKFRS financial statements is 31 December 2005. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36). Therefore, its date of transition to HKFRSs is the beginning of business on 1 January 2004 (or, equivalently, close of business on 31 December 2003). Entity A presented financial statements under its *previous GAAP* annually to 31 December each year up to, and including, 31 December 2004.

APPLICATION OF REQUIREMENTS

Entity A is required to apply the HKFRSs effective for periods ending on 31 December 2005 in:

(a) preparing its opening HKFRS balance sheet at 1 January 2004; and

(b) preparing and presenting its balance sheet for 31 December 2005 (including comparative amounts for 2004), income statement, statement of changes in equity and cash flow statement for the year to 31 December 2005 (including comparative amounts for 2004) and disclosures (including comparative information for 2004).

(c) 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 paragraphs 25D, 34A and 34B.

10 Except as described in paragraphs ~~13-34~~13-34B and 36A-36C, an entity shall, in its opening HKFRS balance sheet:

(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.

11 The accounting policies that an entity uses in its opening HKFRS balance sheet 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 balance sheet shall comply with each HKFRS:

(a) paragraphs 13-25G and 36A-36C grant exemptions from some requirements of other HKFRSs.

(b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.

Exemptions from other HKFRSs

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

(a) business combinations (paragraph 15);

(b) *fair value* or revaluation as *deemed cost* (paragraphs 16-19);

(c) employee benefits (paragraph ~~20~~ 20 and 20 A);

(d) cumulative translation differences (paragraphs 21 and 22);

(e) compound financial instruments (paragraph 23);

(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs 24 and 25);

(g) designation of previously recognised financial instruments (paragraph 25A);

(h) share-based payment transactions (paragraphs 25B and 25C);

(i) insurance contracts (paragraph 25D);

(j) decommissioning liabilities included in the cost of property, plant and equipment (paragraph 25E);

(k) leases (paragraph 25F); and

(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G).

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

14 Some exemptions below refer to fair value. HKFRS 3 *Business Combinations* explains how to determine the fair values of identifiable assets and liabilities acquired in a business combination. An entity shall apply those explanations in determining fair values under this HKFRS, unless another HKFRS contains more specific guidance 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.

Business combinations

15 An entity shall apply the requirements in Appendix B to business combinations that the entity recognised before the date of transition to HKFRSs.

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 under HKFRSs.

Leases

25F 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.

Fair value measurement of financial assets or financial liabilities

25G Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in the last sentence of HKAS 39 paragraph AG76, and paragraph AG76A, in either of the following ways:

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

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

Exceptions to retrospective application of other HKFRSs

26 This HKFRS prohibits retrospective application of some aspects of other HKFRSs relating to:

(a) derecognition of financial assets and financial liabilities (paragraphs 27 and 27A);

(b) hedge accounting (paragraphs 28-30);

(c) estimates (paragraphs 31-34);and

(d) assets classified as held for sale and discontinued operations (paragraphs 34A and 34B).

Derecognition of financial assets and financial liabilities

27 Except as permitted by paragraph 27A, a first-time adopter shall apply the derecognition requirements in HKAS 39 prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities under its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognise those assets and liabilities under HKFRSs (unless they qualify for recognition as a result of a later transaction or event).

27A Notwithstanding paragraph 27, 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

28 As required by ~~I~~HKAS 39 *Financial Instruments: Recognition and Measurement*, 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 under previous GAAP as if they were assets or liabilities.

29 An entity shall not reflect in its opening HKFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under ~~I~~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 under previous GAAP, it may designate an individual item within that net position as a hedged item under HKFRSs, provided that it does so no later than the date of transition to HKFRSs.

30 ~~An entity shall apply the transitional provisions of IAS 39 to all other hedging relationships that existed at the date of transition to HKFRSs.~~ 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.

Estimates

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

32 An entity may receive information after the date of transition to HKFRSs about estimates that it had made under previous GAAP. Under paragraph 31, an entity shall treat the receipt of that information in the same way as non-adjusting events after the balance sheet date under HKAS 10 *Events after the Balance Sheet Date*. For example, assume that an entity's date of transition to HKFRSs is 1 January 2004 and new information on 15 July 2004 requires the revision of an estimate made under previous GAAP at 31 December 2003. The entity shall not reflect that new information in its opening HKFRS balance sheet (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 its income statement (or, if appropriate, other changes in equity) for the year ended 31 December 2004.

33 An entity may need to make estimates under 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 under 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.

34 Paragraphs 31-33 apply to the opening HKFRS balance sheet. 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.

Assets classified as held for sale and discontinued operations

34A HKFRS 5 requires that it shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the HKFRS. HKFRS 5 permits an entity to apply the requirements of the HKFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the HKFRS, provided the valuations and other information needed to apply the HKFRS were obtained at the time those criteria were originally met.

34B An entity with a date of transition to HKFRSs before 1 January 2005 shall apply the transitional provisions of HKFRS 5. An entity with a date of transition to HKFRSs on or after 1 January 2005 shall apply HKFRS 5 retrospectively.

PRESENTATION AND DISCLOSURE

35 Except as described in paragraphs 36A-37, ~~T~~this HKFRS does not provide exemptions from the presentation and disclosure requirements in other HKFRSs.

Comparative information

36 To comply with HKAS 1 *Presentation of Financial Statements*, an entity's first HKFRS financial statements shall include at least one year of comparative information under HKFRSs.

Exemption from the requirement to restate comparative information for HKAS 39 and HKFRS 4

36A In its first HKFRS financial statements, an entity that adopts HKFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with HKAS 32, HKAS 39 or HKFRS 4. An entity that chooses to present comparative information that does not comply with

HKAS 32, HKAS 39 or HKFRS 4 in its first year of transition shall:

(a) apply the recognition and measurement requirements of its previous GAAP in the comparative information for financial instruments within the scope of HKAS 32 and HKAS 39 and for insurance contracts within the scope of HKFRS 4;

(b) disclose this fact together with the basis used to prepare this information; and

(c) disclose the nature of the main adjustments that would make the information comply with HKAS 32, HKAS 39 and HKFRS 4. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (ie the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first HKFRS reporting period (ie the first period that includes information that complies with HKAS 32, HKAS 39 and HKFRS 4) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)-(e) and (f)(i) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Paragraph 28(f)(i) applies only to amounts presented in the balance sheet at the comparative period's reporting date.

In the case of an entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and HKFRS 4, references to the 'date of transition to HKFRSs' shall mean, in the case of those Standards only, the beginning of the first HKFRS reporting period. Such entities are required to comply with paragraph 15(c) of HKAS 1 to provide additional disclosures when compliance with the specific requirements in HKFRSs 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.

Exemption from the requirement to present comparative information for HKFRS 6

36B An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 6 *Exploration for and Evaluation of Mineral Resources* before 1 January 2006 need not apply the requirements of HKFRS 6 to comparative information presented in its first HKFRS financial statements.

Exemption from the requirement to provide comparative disclosures for HKFRS 7

36C An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 7 *Financial Instruments: Disclosures* in its first HKFRS financial statements need not present the comparative disclosures required by HKFRS 7 in those financial statements.

Non-HKFRS comparative information and h~~H~~istorical summaries

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

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

APPENDIX C

Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared as at May 2006 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 is IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

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

Differences	**Reasons for the differences**
1. **<u>IFRS 1 Paras 3(a) and 4</u>** **<u>HKFRS 1 Paras 3(a) and 4</u>** 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 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.

HK(IFRIC)- Int 12 *Service Concession Arrangements* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2008

Paragraph 9 is amended as follows:

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 paragraphs 25D, 25H, 34A and 34B.

In paragraph 12(a), the reference to paragraphs 13-25G is changed to 13-25H.

In paragraph 13, subparagraphs (k) and (l) are amended, and subparagraph (m) is inserted, as follows:

(k) leases (paragraph 25F); ~~and~~

(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G~~)~~.; and

(m) a financial asset or an intangible asset accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph 25H).

After paragraph 25G, a new heading and paragraph 25H are inserted as follows:

Service concession arrangements

25H A first-time adopter may apply the transitional provisions in HK(IFRIC)-Int 12 *Service Concession Arrangements*.

HKAS 23 *Borrowing Costs* (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs ~~1–47F~~ 1-47G…

Paragraphs 9, 12 and 13 are amended, after paragraph 25H a heading and paragraph 25I are inserted, and paragraph 47G is added as follows:

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 paragraphs 25D, 25H, 25I, 34A and 34B.

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

(a) paragraphs 13-25~~H~~<u>I</u> and 36A-36C grant exemptions from some requirements of other HKFRSs.

(b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.

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

(a) …

(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G); ~~and~~

(m) a financial asset or an intangible asset accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph 25H)<u>; and</u>

<u>(n) borrowing costs (paragraph 25I).</u>

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

<u>Borrowing costs</u>

25I A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of HKAS 23 *Borrowing Costs*, 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.

47G An entity shall apply the amendments in paragraphs 13(n) and 25I for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 23 for an earlier period, these amendments shall be applied for that earlier period.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs ~~1–47G~~ <u>1–47H</u> and Appendices A–C. All the paragraphs …

In paragraph IN3, 'at the reporting date for its first HKFRS financial statements' is amended to 'at the end of its first HKFRS reporting period'.

Paragraphs 6 and 7 are amended as follows:

6 An entity shall prepare <u>and present</u> an *opening HKFRS* ~~*balance sheet*~~ <u>*statement of financial position*</u> at the *date of transition to HKFRSs*. This is the starting point for its accounting under HKFRSs. ~~An entity need not present its opening HKFRS balance sheet in its first HKFRS financial statements.~~

7 An entity … Those accounting policies shall comply with each HKFRS effective at the ~~reporting date for~~ <u>end of</u> its first HKFRS ~~financial statements~~ <u>reporting period,</u> except as specified in paragraphs 13–34B~~, 36A–36C~~ and 37.

The Example after paragraph 8 is amended as described below.

References to the years ‘2003’ to ‘2005’ are amended to ‘20X3’ to ‘20X5’ respectively.

The paragraphs **Background** and **Application of requirements** are amended as follows:

Background

The ~~reporting date for~~ end of entity A’s first HKFRS ~~financial statements~~ reporting period is 31 December 20X5 ~~2005~~. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36) …

Application of requirements

Entity A … in:

(a) preparing and presenting its opening HKFRS ~~balance sheet~~ statement of financial position at 1 January 20X4 ~~2004~~; and …

Paragraphs 10, 12(a) and 21 are amended as follows:

10 Except as described in paragraphs 13–34B ~~and 36A–36C~~, an entity shall, in its opening HKFRS ~~balance sheet~~ statement of financial position: …

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

(a) paragraphs 13–25I ~~and 36A–36C~~ grant exemptions from some requirements of other HKFRSs.

21 HKAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity:

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

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

In paragraph 32, references to the years ‘2003’ and ‘2004’ are amended to ‘20X4’ and ‘20X5’ respectively.

Paragraphs 32, 35 and 36 are amended as follows:

32 An entity … Instead, the entity shall reflect that new information in ~~its income statement~~ profit or loss (or, if appropriate, other comprehensive income ~~other changes in equity~~) for the year ended 31 December 20X4 ~~2004~~.

35 Except as described in paragraphs ~~36A–~~37, this HKFRS does not provide exemptions from the presentation and disclosure requirements in other HKFRSs.

36 To comply with HKAS 1, an entity's first HKFRS financial statements shall include at least ~~one year of comparative information under HKFRSs~~. 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.

Paragraphs 36A–36C and the headings above them are deleted.

Paragraphs 39 and 45(a) are amended as follows:

39 To comply with paragraph 38, an entity's first HKFRS financial statements shall include: …

(a) (ii) the end … under previous GAAP~~;~~.

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

(c) …

45 To comply with …

(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 ~~reconciliations of~~:

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

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

Paragraph 47C is deleted.

Paragraph 47H is added as follows:

47H HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 6, 7, 8 (Example), 10, 12(a), 21, 32, 35, 36, 39(b) and 45(a), Appendix A and paragraph B2(i) in Appendix B, and deleted paragraphs 36A–36C and 47C. 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.

In Appendix A, the defined terms are amended as follows:

first HKFRS reporting period	The latest reporting period ~~ending on the **reporting date** of~~ covered by an entity's **first HKFRS financial statements**.
opening HKFRS ~~balance sheet~~ statement of financial position	An entity's ~~balance sheet~~ statement of financial position ~~(published or unpublished)~~ at the **date of transition to HKFRSs**.
~~**reporting date**~~	~~The end of the latest period covered by financial statements or by an interim financial report.~~

In Appendix B, paragraph B2(i) is amended as follows:

B2 If a first-time adopter ...

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

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

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 transition 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 (i.e. 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 under previous GAAP involved hedging relationships of a type that does not qualify for hedge accounting under 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 under 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 under IAS 39 (see paragraph 29 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' 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

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

Appendix

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC4 is footnoted as follows:

In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments* (as revised in 2007).

HKAS 23 *Borrowing Costs* (issued in June 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC63D a heading and paragraph BC63E are added as follows:

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

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).*

Paragraphs BC84 and BC89A are footnoted as follows:

BC84 An entity ... Some of those events might qualify as adjusting events under IAS 10 *Events after the Balance Sheet Date*.* However, if the entity made those estimates on a basis consistent with IFRSs

...

* In September 2007 the IASB amended the title of IAS 10 from *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.

BC89A Nevertheless …. The disclosures in paragraph 36A* inform users of the lack of comparability.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007, paragraph 36A has been deleted.

Paragraph BC92 is amended and paragraphs BC92A–BC92C are added as follows:

BC92 Paragraph 39(a) and (b) of the IFRS requires reconciliations of equity and ~~profit or loss~~ 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 40 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.

HKAS 19 *Employee Benefits*

IG18 At the date of transition to HKFRSs, an entity applies HKAS 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 HKFRSs even if its accounting policy under HKAS 19 will involve leaving some later actuarial gains and losses unrecognised (paragraph 20 of the HKFRS). The transitional provisions in HKAS 19 do not apply to an entity's opening HKFRS balance sheet (paragraph 9 of the HKFRS).

IG19 An entity's actuarial assumptions at the date of transition to HKFRSs are consistent with actuarial assumptions made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the HKFRS). 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 HKFRSs that were not necessary under its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to HKFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to HKFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to HKFRSs 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 HKFRSs (paragraph ~~32~~33 of the HKFRS).

IG21 In many cases, an entity's first HKFRS financial statements will reflect measurements of employee benefit obligations at three dates: the reporting date, the date of the comparative balance sheet and the date of transition to HKFRSs. HKAS 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 (HKAS 19, paragraph 57).

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

IG21A An entity may, under 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 HKAS 21 to all acquisitions occurring after the date of transition to HKFRSs.

HKFRS 3 *Business Combinations*

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

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 ~~at fair value~~.

(d) to comply with HKAS 39, paragraph 50, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening HKFRS balance sheet as at fair value through profit or loss if, and 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 HKFRSs, 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 HKFRSs, for an entity that presents its first HKFRS 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 HKFRS reporting period, for an entity that presents its first HKFRS 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 HKAS 39. If the entity restates comparative information for HKAS 39 it shall restate the comparative information only if the financial assets or financial liabilities designated at the start of its first HKFRS reporting period would have met the criteria for such designation in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at the date of transition to HKFRSs or, if acquired after the date of transition to HKFRSs, 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 HKAS 39 at the start of the first HKFRS 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 HKFRSs even if individual financial assets or liabilities within a group were derecognised during the comparative period.

(e) to comply with HKAS 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 HKFRS balance sheet, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in HKAS 39. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount under previous GAAP immediately following the business combination is their deemed cost under HKFRSs at that date (paragraph B2(e) of the HKFRS).

IG58 An entity's estimates of loan impairments at the date of transition to HKFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the HKFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in HKAS 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 HKFRSs only to the extent that it results from adopting HKAS 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 shall be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which HKAS 39 is initially applied (other than for a derivative that is a financial guarantee contracts or a designated and effective hedging instrument).

IG58B HKAS 8 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 under HKAS 8, with appropriate disclosures (HKAS 8, paragraphs 32-40).

IG59 An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain directly in equity. If an investment is classified as at fair value through profit or loss, the pre-HKAS 39 revaluation gain that had been recognised in equity is reclassified into retained earnings on initial application of HKAS 39. If, on initial application of HKAS 39, an investment is classified as available for sale, then the pre-HKAS 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 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 transfers to profit or loss the cumulative gain or loss remaining in equity (HKAS 39, paragraph 55(b)).

Hedge accounting

IG60 Paragraphs 28-30 of the HKFRS deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of transition to HKFRSs 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, under 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 HKFRSs. 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 under previous GAAP; and

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 23 *Borrowing Costs* (issued in June 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraphs IG23 and IG24 are amended as follows. Paragraph IG25 is deleted.

IG23 On first adopting HKFRSs, an entity ~~adopts a policy of~~ begins capitalising borrowing costs (HKAS 23 as revised in 2007) ~~allowed alternative treatment) or not capitalising them (HKAS 23 benchmark treatment). The entity applies that policy consistently in its opening HKFRS balance sheet and in all periods presented in its first HKFRS financial statements~~. In accordance with paragraph 25I of the HKFRS, 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 HKFRSs (whichever is later);

(b) may elect to designate any date before 1 January 2009 or the date of transition to HKFRSs (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 ~~Under the allowed alternative treatment,~~ HKAS 23 requires disclosure of interest capitalised during the period. Neither HKAS 23 nor the HKFRS requires disclosure of the cumulative amount capitalised.

IG25 [Deleted] ~~HKAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of HKAS 23 that meet the criteria for capitalisation. However, if a first-time adopter adopts the HKAS 23 allowed alternative treatment, the HKFRS requires retrospective application of that treatment, even for periods before the effective date of HKAS 23 (paragraph 9 of the HKFRS)~~.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The Guidance on Implementing HKFRS 1 is amended as described below.

In IG Examples 1–4, 201 and 202, ‘Entity [X]’s [An entity’s] first HKFRS financial statements have a reporting date of’ is amended to ‘Entity [X]’s [An entity’s] first HKFRS financial statements are for a period that ends on’.

In IG Examples 1–4, 6–11 and 201, references to the years ‘2001’ to ‘2007’ are amended to ‘20X1’ to ‘20X7’ respectively.

In the heading above paragraph IG2 and in IG Example 1 (Assumption 2), 'HKAS 10 *Events after the Balance Sheet Date*' is amended to 'HKAS 10 *Events after the Reporting Period*'.

In paragraph IG2(b), 'balance sheet' is deleted.

In paragraph IG21, 'the reporting date' is amended to 'the end of the first HKFRS reporting period'.

In paragraph IG31, 'post-balance sheet events review' is amended to 'review of events after the reporting period'.

In paragraph IG36, 'reporting date for its first HKFRS financial statements' is amended to 'end of its first HKFRS reporting period'.

IG Example 10 is amended as follows:

IG Example 10 Interim financial reporting

Background

Entity R's first HKFRS financial statements ~~have~~ are for a ~~reporting date of~~ period that ends on 31 December 20X5 ~~2005~~, and its first interim financial report under HKAS 34 is for the quarter ended 31 March 20X5 ~~2005~~. Entity R prepared previous GAAP annual financial statements for the year ended 31 December 20X4 ~~2004~~, and prepared quarterly reports throughout 20X4 ~~2004~~.

Application of requirements

In each quarterly interim financial report for 20X5 ~~2005~~, entity R includes reconciliations of:

(a) its equity under previous GAAP at the end of the comparable quarter of 20X4 ~~2004~~ to its equity under HKFRSs at that date; and

(b) its total comprehensive income (or, if it did not report such a total, profit or loss) under previous GAAP for the comparable quarter of 20X4 ~~2004~~ (current and year-to-date) to its total comprehensive income ~~profit or loss~~ under HKFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by HKAS 34, entity R's interim financial report for the first quarter of 20X5 ~~2005~~ includes reconciliations of (or a cross reference to another published document that includes these reconciliations):

(a) its equity under previous GAAP at 1 January 20X4 ~~2004~~ and 31 December 20X4 ~~2004~~ to its equity under HKFRSs at those dates; and

(b) its total comprehensive income (or, if it did not report such a total, profit or loss) for 20X4 ~~2004~~ under previous GAAP to its ~~profit or loss~~ total comprehensive income for 20X4 ~~2004~~ under HKFRSs. …

In paragraph IG43, 'the income statement' is amended to 'profit or loss'.

Paragraphs IG52, IG59 and IG60B are amended as follows:

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening HKFRS ~~balance sheet~~ statement of financial position in accordance with HKAS 39, except as specified in paragraphs 27 – 30 of the HKFRS, which address derecognition and hedge accounting~~, and paragraph 36A, which permits an exemption from restating comparative information.~~

IG59 An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain ~~directly in equity~~ outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-HKAS 39 revaluation gain that had been recognised ~~in equity~~ outside profit or loss is reclassified into retained earnings on initial application of HKAS 39. If, on initial application of HKAS 39, an investment is classified as available for sale, then the pre-HKAS 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 ~~transfers~~ reclassifies to profit or loss the cumulative gain or loss remaining in equity (HKAS 39, paragraph 55(b)).

IG60B An entity … Any net cumulative gain or loss that has been reclassified to equity on initial application of HKAS 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 ~~that had been recognised directly in equity is recognised in~~ is reclassified from equity to profit or loss. If …

Paragraph IG63 and IG Example 11 are amended as follows:

IG63 Paragraphs 39(a) and (b), 40 and 41 of the HKFRS require a first-time adopter to disclose reconciliations that give sufficient detail to enable users to understand the material adjustments to the ~~balance sheet, income~~ statement of financial position, statement of comprehensive income and, if applicable, ~~cash flow~~ statement of cash flows. Paragraph 39(a) and (b) requires specific reconciliations of equity and ~~profit or loss~~ total comprehensive income. IG Example 11 shows one way of satisfying these requirements.

IG Example 11 Reconciliation of equity and ~~profit or loss~~ total comprehensive income

...

Reconciliation of ~~profit or loss~~ total comprehensive income for ~~2004~~20X4

Note		*Previous GAAP*	*Effect of transition to HKFRSs*	*HKFRSs*
	Revenue	20,910	0	20,910
1,2,3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530
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 ~~profit or loss~~ total comprehensive income for ~~2004~~ 20X4:

...

6 Available-for-sale financial assets carried at fair value under HKFRSs increased in value by 180 during 20X4. They were carried at cost under previous GAAP. The entity sold available-for-sale financial assets during the year, recognising a gain of 40 in profit or loss. Of that realised gain 30 had been included in the revaluation reserve as at 1 January 20X4 and is reclassified from revaluation reserve 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 40 during 20X4.

8 Adjustments 6 and 7 above lead to an increase of 29 in deferred tax expense.

In IG Example 202, references to '1995' are amended to '20X5' and references to the years '2000' to '2007' are amended to '20Y0' to '20Y7' respectively.

Appendix C

Amendments to other HKFRSs

The amendments in this appendix shall be applied for accounting periods beginning on or after 1 January 2005. If an entity applies this 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.

~~C1 HKAS 12 *Income Taxes* is amended as follows:~~

~~In paragraph 57, the reference to paragraphs 58 to 68 is changed to 58 to 68C.~~

~~Paragraphs 68A-68C and a subheading are inserted as follows:~~

~~**"Current and Deferred Tax Arising from Share-based Payment Transactions**~~

~~68A. In some tax jurisdictions, an entity receives a tax deduction (i.e. an amount that is deductible in determining taxable profit) that relates to remuneration paid in shares, share options or other equity instruments of the entity. The amount of that tax deduction may differ from the related cumulative remuneration expense, and may arise in a later accounting period. For example, in some jurisdictions, an entity may recognise an expense for the consumption of employee services received as consideration for share options granted, in accordance with HKFRS 2 *Share-based Payment*, and not receive a tax deduction until the share options are exercised, with the measurement of the tax deduction based on the entity's share price at the date of exercise.~~

~~68B. As with the research costs discussed in paragraphs 9 and 26(b) of this Standard, the difference between the tax base of the employee services received to date (being the amount the taxation authorities will permit as a deduction in future periods), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset. If the amount the taxation authorities will permit as a deduction in future periods is not known at the end of the period, it should be estimated, based on information available at the end of the period. For example, if the amount that the taxation authorities will permit as a deduction in future periods is dependent upon the entity's share price at a future date, the measurement of the deductible temporary difference should be based on the entity's share price at the end of the period.~~

~~68C. As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event which is recognised, in the same or a different period, directly in equity, or (b) a business combination that is an acquisition. If the amount of the tax~~

~~deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity."~~

~~A new example is inserted into Appendix B:~~

~~**Example 5 – Share-based Payment Transactions**~~

~~In accordance with HKFRS 2 *Share-based Payment*, an entity has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised, and the deduction is based on the options' intrinsic value at exercise date.~~

~~As explained in paragraph 68B of the Standard, the difference between the tax base of the employee services received to date (being the amount the taxation authorities will permit as a deduction in future periods in respect of those services), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset. Paragraph 68B requires that, if the amount the taxation authorities will permit as a deduction in future periods is not known at the end of the period, it should be estimated, based on information available at the end of the period. If the amount that the taxation authorities will permit as a deduction in future periods is dependent upon the entity's share price at a future date, the measurement of the deductible temporary difference should be based on the entity's share price at the end of the period. Therefore, in this example, the estimated future tax deduction (and hence the measurement of the deferred tax asset) should be based on the options' intrinsic value at the end of the period.~~

~~As explained in paragraph 68C of the Standard, if the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, paragraph 68C requires that the excess of the associated current or deferred tax should be recognised directly in equity.~~

~~The entity's tax rate is 40 per cent. The options were granted at the start of year 1, vested at the end of year 3 and were exercised at the end of year 5. Details of the expense recognised for employee services received and consumed in each accounting period, the number of options outstanding at each year-end, and the intrinsic value of the options at each year-end, are as follows:~~

	~~Employee services expense~~	~~Number of options at year-end~~	~~Intrinsic value per option~~
~~Year 1~~	~~188,000~~	~~50,000~~	~~5~~
~~Year 2~~	~~185,000~~	~~45,000~~	~~8~~
~~Year 3~~	~~190,000~~	~~40,000~~	~~13~~
~~Year 4~~	~~0~~	~~40,000~~	~~17~~
~~Year 5~~	~~0~~	~~40,000~~	~~20~~

~~The entity recognises a deferred tax asset and deferred tax income in years 1-4 and current tax income in year 5 as follows. In years 4 and 5, some of the deferred and current tax income is recognised directly in equity, because the estimated (and actual) tax deduction exceeds the cumulative remuneration expense.~~

~~*Year 1*~~

~~Deferred tax asset and deferred tax income:~~

~~(50,000 × 5 × 1/3* × 0.40) =~~	~~33,333~~

~~*The tax base of the employee services received is based on the intrinsic value of the options, and those options were granted for three years' services. Because only one year's services have been received to date, it is necessary to multiply the option's intrinsic value by one-third to arrive at the tax base of the employee services received in year 1.~~

~~The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 83,333 (50,000 × 5 × 1/3) is less than the cumulative remuneration expense of 188,000.~~

~~*Year 2*~~

~~Deferred tax asset at year-end:~~		
~~(45,000 × 8 × 2/3 × 0.40) =~~	~~96,000~~	
~~Less deferred tax asset at start of year~~	~~(33,333)~~	
~~Deferred tax income for year~~		~~62,667*~~

~~*This amount consists of the following:~~

~~Deferred tax income for the temporary difference between the tax base of the employee services received during the year and their carrying amount of nil:~~		
~~(45,000 × 8 × 1/3 × 0.40)~~	~~48,000~~	
~~Tax income resulting from an adjustment to the tax base of employee services received in previous years:~~		
~~(a) increase in intrinsic value: (45,000 × 3 × 1/3 × 0.40)~~	~~18,000~~	
~~(b) decrease in number of options: (5,000 × 5 × 1/3 × 0.40)~~	~~(3,333)~~	
~~Deferred tax income for year~~		~~62,667~~

~~The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 240,000 (45,000 × 8 × 2/3) is less than the cumulative remuneration expense of 373,000 (188,000 + 185,000).~~

~~*Year 3*~~

~~Deferred tax asset at year-end:~~
~~(40,000 × 13 × 0.40) = 208,000~~

~~Less deferred tax asset at start of year (96,000)~~

~~Deferred tax income for year 112,000~~

~~The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 520,000 (40,000 × 13) is less than the cumulative remuneration expense of 563,000 (188,000 + 185,000 + 190,000).~~

~~*Year 4*~~

~~Deferred tax asset at year-end:~~
~~(40,000 × 17 × 0.40) = 272,000~~

~~Less deferred tax asset at start of year (208,000)~~

~~Deferred tax income for year 64,000~~

~~The deferred tax income is recognised partly in profit or loss and partly directly in equity as follows:~~

~~Estimated future tax deduction~~
~~(40,000 × 17) = 680,000~~

~~Cumulative remuneration expense 563,000~~

~~Excess tax deduction 117,000~~

~~Deferred tax income for year 64,000~~

~~Excess recognised directly in equity~~
~~(117,000 × 0.40) = 46,800~~

~~Recognised in profit or loss 17,200~~

~~*Year 5*~~

~~Deferred tax expense~~
~~(reversal of deferred tax asset) 272,000~~

~~Amount recognised directly in equity~~
~~(reversal of cumulative deferred tax income~~
~~recognised directly in equity) 46,800~~

~~Amount recognised in profit or loss 225,200~~

~~Current tax income based on intrinsic value of~~
~~options at exercise date (40,000 × 20 × 0.40) = 320,000~~

~~Amount recognised in profit or loss~~
~~(563,000 × 0.40) = 225,200~~

~~Amount recognised directly in equity 94,800~~

~~*Summary*~~

	Income statement				Balance sheet	
	Employee services expense	Current tax expense (income)	Deferred tax expense (income)	Total tax expense (income)	Equity	Deferred tax asset
Year 1	188,000	0	(333,333)	(333,333)	0	33,333
Year 2	185,000	0	(62,667)	(62,667)	0	96,000
Year 3	190,000	0	(112,000)	(112,000)	0	208,000
Year 4	0	0	(17,200)	(17,200)	(46,800)	272,000
Year 5	0	(225,220)	225,200	0	46,800 (94,800)	0
Totals	563,000	(225,220)	0	(225,2000)	(94,800)	0

~~C2 In paragraph 6 of HKAS 16 *Property, Plant and Equipment*, paragraph 7 of HKAS 38 *Intangible Assets*, and paragraph 5 of HKAS 40 *Investment Property*, as revised in 2003, the definition of *cost* is amended to read as follows:~~

~~"***Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other HKFRSs, e.g. HKFRS 2*** **Share-based Payment.**"~~

~~C3 HKAS 19 *Employee Benefits* is amended as described below.~~

~~**Introduction**~~

~~Paragraph 2 is amended to read as follows:~~

~~"2. The Standard identifies four categories of employee benefits:~~

~~…~~

~~(c) … ; and~~

~~(d) termination benefits~~

~~Paragraph 11 is deleted.~~

~~**Standard**~~

~~Paragraph 1 is amended to read as follows:~~

~~***"1. This Standard should be applied by an employer in accounting for all employee benefits, except those to which HKFRS 2*** **Share-based Payment** ***applies."***~~

~~Paragraph 3 is amended to read as follows:~~

~~"3. The employee benefits to which this Standard applies include those provided: …"~~

~~Paragraph 4 is amended to read as follows:~~

~~"4. Employee benefits include:~~

~~…~~

~~(c) … ; and~~

~~(d) termination benefits.~~

~~Because each category identified in (a)–(d) above has different characteristics, …"~~

~~In paragraph 7:~~

- ~~the definitions of *equity compensation benefits* and *equity compensation plans* are deleted.~~

- ~~in the definitions of *short-term employee benefits*, *post-employment benefits*, and *other long-term employee benefits*, the references to equity compensation benefits are deleted.~~

~~In paragraph 22 the final sentence is deleted.~~

~~Paragraphs 144–152 are deleted.~~

~~In Appendix B the illustrative disclosures under the heading *Equity Compensation Benefits* are deleted.~~

~~**Basis for Conclusions**~~

~~Paragraph 94 is struck through and footnoted as follows:~~

~~"* Paragraphs 144-152 of HKAS 19 were deleted by HKFRS 2 *Share-based Payment*."~~

~~C4 In HKAS 32 *Financial Instruments: Disclosure and Presentation*, a new paragraph 4(f) is inserted, as follows:~~

~~***(f) financial instruments, contracts and obligations under share based payment transactions to which HKFRS 2* Share-based Payment *applies, except for***~~

~~***(i) contracts within the scope of paragraphs 8-10 of this Standard, to which this Standard applies,***~~

~~***(ii) paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements."***~~

~~C5 HKAS 33 *Earnings per Share* is amended as described below.~~

~~Paragraph 47A is inserted as follows:~~

~~"47A. For share options and other share-based payment arrangements to which HKFRS 2 *Share-based Payment* applies, the issue price referred to in paragraph 46 and the exercise price referred to in paragraph 47 shall include the fair value of any goods or services to be supplied to the entity in the future under the share option or other share-based payment arrangement."~~

~~Example 5A is added to the Illustrative Examples, as follows:~~

~~"**Example 5A – Determining the Exercise Price of Employee Share Options**~~

~~Weighted average number of unvested share options per employee~~	~~1,000~~	
~~Weighted average amount per employee to be recognised over the remainder of the vesting period for employee services to be rendered as consideration for the share options, determined in accordance with HKFRS 2 *Share-based Payment*~~	~~CU1,200~~	
~~Cash exercise price of unvested share options~~	~~CU15~~	
~~**Calculation of adjusted exercise price**~~		
~~Fair value of services yet to be rendered per employee:~~		~~CU1,200~~
~~Fair value of services yet to be rendered per option: (CU1,200 / 1,000)~~		~~CU1.20~~
~~Total exercise price of share options: (CU15.00 + CU1.20)~~		~~CU16.20"~~

~~C6 In HKAS 38 *Intangible Assets*, paragraph 26 is deleted.~~

~~C7 In HKAS 39 *Financial Instruments: Recognition and Measurement*, a new paragraph 2(j) is inserted, as follows:~~

> ~~"***(j)*** ***financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2*** **Share-based Payment** ***applies, except for contracts within the scope of paragraphs 5-7 of this Standard, to which this Standard applies.***"~~

~~C8 HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~In paragraph 12, the reference to paragraphs 13-25A is changed to 13-25C.~~

~~Paragraph 13(f) and (g) is amended and a new subparagraph (h) is inserted, as follows:~~

> ~~"(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs 24 and 25);~~
>
> ~~(g) designation of previously recognised financial instruments (paragraph 25A); and~~
>
> ~~(h) share-based payment transactions (paragraphs 25B and 25C)."~~

~~New paragraphs 25B and 25C are inserted, as follows:~~

> ~~"25B 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 that 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 (e.g. 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 later of (a) the date of transition to HKFRSs and (b) 1 January 2005.~~
>
> ~~25C 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."~~

~~New paragraphs IG64 and IG65 are inserted into the Implementation Guidance, as follows:~~

~~"IG64 A first-time adopter is encouraged, but not required, to apply HKFRS 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 HKFRSs and (b) 1 January 2005.~~

~~IG65 For example, if an entity's date of transition to HKFRSs is 1 January 2004, the entity applies HKFRS 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 HKFRSs is 1 January 2010, the entity applies HKFRS 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."~~

~~Paragraph BC30(f) and (g) in the Basis for Conclusions is amended, and a new subparagraph (h) is inserted, as follows:~~

~~"(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs BC59-BC63);~~

~~(g) designation of previously recognised financial instruments (paragraph BC63A); and~~

~~(h) share-based payment transactions (paragraph 63B)."~~

~~A new paragraph 63B is inserted into the Basis for Conclusions, as follows:~~

~~"63B HKFRS 2 *Share-based Payment* contains various transitional provisions. For example, for equity-settled share-based payment arrangements, HKFRS 2 requires an entity to apply HKFRS 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 HKFRS 2. HKFRS 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 HKFRS 2 has not been applied, if the modification occurs after the effective date of HKFRS 2. The Board decided that, in general, first-time adopters should be treated in the same way as entities that already apply HKFRSs. For example, a first-time adopter should not be required to apply HKFRS 2 to equity instruments that were granted on or before 7 November 2002. Similarly, a first-time adopter should not be required to apply HKFRS 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 HKFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before the date of transition to HKFRSs. Similarly, the Board decided that a first-time adopter should not be required to apply HKFRS 2 to liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before 1 January 2005, or before the date of transition to HKFRSs."~~

Contents - Guidance on implementing HKFRS 2, Share-based Payment

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

In the last paragraph of IG Example 11, 'of users taken' is amended to 'that users make'.

new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

6 A business combination may result in a parent-subsidiary relationship in which the acquirer is the *parent* and the acquiree a *subsidiary* of the acquirer. In such circumstances, the acquirer applies this HKFRS in its consolidated financial statements. It includes its interest in the acquiree in any separate financial statements it issues as an investment in a subsidiary (see HKAS 27 *Consolidated and Separate Financial Statements*).

~~6A This Standard defines a subsidiary as "an entity that is controlled by another entity". For this purpose, control is defined as the power to govern the financial and operating policies of another entity so as to obtain benefits from its activities. This definition of subsidiary could result in an investee entity being classified as a subsidiary when it does not meet the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance.~~

~~6B In issuing this Standard, the Hong Kong Society of Accountants has obtained legal opinion on the legality of introducing a requirement in this Standard to consolidate certain entities which are not subsidiaries as defined by section 2(4) of the Companies Ordinance in the group accounts of a company incorporated under the Companies Ordinance ("a Hong Kong incorporated company"). The legal opinion states that the definitions of "subsidiary" and "holding company" in sections 2(4) and 2(7) of the Companies Ordinance are exhaustive for the purposes of group accounts as defined by section 124(1) of the Companies Ordinance ("group accounts"). Accordingly, a Hong Kong incorporated company may not consolidate a company that does not meet the definition of a subsidiary in the Companies Ordinance.~~

7 A business combination may involve the purchase of the net assets, including any goodwill, of another entity rather than the purchase of the equity of the other entity. Such a combination does not result in a parent-subsidiary relationship.

8 Included within the definition of a business combination, and therefore the scope of this HKFRS, are business combinations in which one entity obtains control of another entity but for which the date of obtaining control (ie the acquisition date) does not coincide with the date or dates of acquiring an ownership interest (ie the *date or dates of exchange*). This situation may arise, for example, when an investee enters into share buy-back arrangements with some of its investors and, as a result, control of the investee changes.

9 This HKFRS does not specify the accounting by venturers for interests in joint ventures (see HKAS 31 *Interests in Joint Ventures*).

Business combinations involving entities under common control

10 A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

11 A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and

22 When a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.

23 Similarly, when a business combination involves more than two combining entities, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available. Determining the acquirer in such cases shall include a consideration of, amongst other things, which of the combining entities initiated the combination and whether the assets or revenues of one of the combining entities significantly exceed those of the others.

~~23A In preparing consolidated financial statements of a Hong Kong incorporated company, only companies that fall within the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance may be consolidated. Therefore, for the purposes of applying this Standard, Hong Kong incorporated companies should use the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance where it conflicts with the definition in this Standard.~~

Cost of a business combination

24 The acquirer shall measure the cost of a business combination as the aggregate of:

(a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus

(b) any costs directly attributable to the business combination.

25 The acquisition date is the date on which the acquirer effectively obtains control of the acquiree. When this is achieved through a single exchange transaction, the date of exchange coincides with the acquisition date. However, a business combination may involve more than one exchange transaction, for example when it is achieved in stages by successive share purchases. When this occurs:

(a) the cost of the combination is the aggregate cost of the individual transactions; and

(b) the date of exchange is the date of each exchange transaction (ie the date that each individual investment is recognised in the financial statements of the acquirer), whereas the acquisition date is the date on which the acquirer obtains control of the acquiree.

26 Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required by paragraph 24 to be measured at their fair values at the date of exchange. Therefore, when settlement of all or any part of the cost of a business combination is deferred, the fair value of that deferred component shall be determined by discounting the amounts payable to their present value at the date of exchange, taking into account any premium or discount likely to be incurred in settlement.

75 To give effect to the principle in paragraph 74, the entity shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the period, showing separately:

(a) the gross amount and accumulated impairment losses at the beginning of the period;

(b) additional goodwill recognised during the period except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with HKFRS 5;

(c) adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraph 65;

(d) goodwill included in a disposal group classified as held for sale in accordance with HKFRS 5 and goodwill derecognised during the period without having previously been included in a disposal group classified as held for sale;

(e) impairment losses recognised during the period in accordance with HKAS 36;

(f) net exchange differences arising during the period in accordance with HKAS 21 *The Effects of Changes in Foreign Exchange Rates*;

(g) any other changes in the carrying amount during the period; and

(h) the gross amount and accumulated impairment losses at the end of the period.

76 The entity discloses information about the recoverable amount and impairment of goodwill in accordance with HKAS 36 in addition to the information required to be disclosed by paragraph 75(e).

77 If in any situation the information required to be disclosed by this HKFRS does not satisfy the objectives set out in paragraphs 66, 72 and 74, the entity shall disclose such additional information as is necessary to meet those objectives.

~~***77A When a Hong Kong incorporated company acquires an enterprise which would be a subsidiary as defined in this Standard but is not accounted for as a subsidiary as a result of paragraph 23A, it should disclose in the notes details of the effect on the group accounts had paragraph 23A not applied.***~~

TRANSITIONAL PROVISIONS AND EFFECTIVE DATE

78 Except as provided in paragraph~~s~~ 85~~ and 85A~~, this HKFRS shall apply to the accounting for business combinations for which the *agreement date* is on or after 1 January 2005. ~~An entity shall apply the amendments in paragraphs 6A, 6B, 23A, 77A and 85A for annual beginning on or after 1 January 2006.~~ This HKFRS shall also apply to the accounting for:

(a) goodwill arising from a business combination for which the agreement date is on or after 1 January 2005; or

(b) any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination for which the agreement date is on or after 1 January 2005.

Equity accounted investments

83 For investments accounted for by applying the equity method and acquired on or after 1 January 2005, an entity shall apply this HKFRS in the accounting for:

(a) any acquired goodwill included in the carrying amount of that investment. Therefore, amortisation of that notional goodwill shall not be included in the determination of the entity's share of the investee's profits or losses.

(b) any excess included in the carrying amount of the investment of the entity's interest in the net fair value of the investee's identifiable assets, liabilities and contingent liabilities over the cost of the investment. Therefore, an entity shall include that excess as income in the determination of the entity's share of the investee's profits or losses in the period in which the investment is acquired.

84 For investments accounted for by applying the equity method and acquired before 1 January 2005:

(a) an entity shall apply this HKFRS on a prospective basis, from the beginning of the first annual period beginning on or after 1 January 2005, to any acquired goodwill included in the carrying amount of that investment. Therefore, an entity shall, from that date, discontinue including the amortisation of that goodwill in the determination of the entity's share of the investee's profits or losses.

(b) an entity shall derecognise any negative goodwill included in the carrying amount of that investment at the beginning of the first annual period beginning on or after 1 January 2005, with a corresponding adjustment to the opening balance of retained earnings.

Limited retrospective application

85 An entity is permitted to apply the requirements of this HKFRS to goodwill existing at or acquired after, and to business combinations occurring from, any date before the effective dates outlined in paragraphs 78-84, provided:

(a) the valuations and other information needed to apply the HKFRS to past business combinations were obtained at the time those combinations were initially accounted for; and

(b) the entity also applies HKAS 36 and HKAS 38 prospectively from that same date, and the valuations and other information needed to apply those Standards from that date were previously obtained by the entity so that there is no need to determine estimates that would need to have been made at a prior date.

Limited period of application

~~85A An entity shall apply paragraphs 6A, 6B, 23A and 77A of this Standard from the time when this Standard becomes effective (or earlier) and cease to apply those paragraphs for annual periods beginning on or after 1 January 2006 as a consequence of the Companies (Amendment) Ordinance 2005. This is because the Companies (Amendment) Ordinance 2005 will remove the legal constraint that prevents a Hong~~

~~Kong incorporated company from consolidating in its group accounts a subsidiary that does not meet the legal definition of subsidiary with effect for annual periods beginning on or after 1 January 2006. If an entity has applied these paragraphs for an annual period beginning before 1 January 2006, it should restate the comparative amounts for the prior periods presented in the financial statements prepared for annual periods beginning on or after 1 January 2006 as if those paragraphs had not been applied.~~

WITHDRAWAL OF OTHER PRONOUNCEMENTS

86 This HKFRS supersedes SSAP 30 *Business Combinations* (as issued in 2001).

87 This HKFRS supersedes the following Interpretations:

(a) [Not used]

(b) Interpretation 12 *Business Combinations—Subsequent Adjustment of Fair Values and Goodwill Initially Reported*;

(c) Interpretation 15 *Business Combinations—"Date of Exchange" and Fair Value of Equity Instruments*; and

(d) Interpretation 13 *Goodwill – Continuing Requirements for Goodwill and Negative Goodwill Previously Eliminated Against/Credited to Reserves.*

Appendix C

Amendments to other HKFRSs

The amendments in this appendix shall be applied to the accounting for business combinations for which the agreement date is on or after 1 January 2005, and to the accounting for any goodwill and intangible assets acquired in those business combinations. In all other respects, these amendments shall be applied for annual periods beginning on or after 1 January 2005.

However, if an entity elects in accordance with paragraph 85 to apply HKFRS 3 from any date before the effective dates outlined in paragraphs 78-84, it shall also apply these amendments prospectively from that same date.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~*With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAP) and Interpretations for which there are equivalent International Accounting Standards(IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKAS) and HKAS Interpretations (HKAS-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. Accordingly, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~C1 In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at 1 January 2005, references to SSAP 30 *Business Combinations* are amended to HKFRS 3 *Business Combinations*.~~

~~C2 In HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*, paragraph B1 is amended to read as follows.~~

> ~~B1 A first-time adopter may elect not to apply HKFRS 3 *Business Combinations* 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, it shall restate all later business combinations and shall also apply HKAS 36 *Impairment of Assets* and HKAS 38 *Intangible Assets* from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to HKFRSs, and it shall also apply HKAS 36 and HKAS 38 from 30 June 2002.~~

~~C3 The Guidance on Implementing HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~The heading immediately before paragraph IG22 is amended to read as follows:~~

~~**HKFRS 3 Business Combinations**~~

~~IG Example 2 is amended to read as follows:~~

~~**IG Example 2: Business combination**~~

~~…~~

~~APPLICATION OF REQUIREMENTS~~

~~In its opening (consolidated) HKFRS balance sheet, entity B:~~

~~(a) classifies the business combination as an acquisition by entity B even if the business combination would have qualified under HKFRS 3 as a reverse acquisition by subsidiary C (paragraph B2(a) of the HKFRS).~~

~~…~~

~~In IG Example 3, the reference to SSAP 30 is amended to HKFRS 3.~~

~~IG Example 4 is amended to read as follows:~~

~~**IG Example 4: Business combination — intangible assets**~~

~~BACKGROUND~~

~~Entity F's first HKFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2001, entity F acquired 75 per cent of subsidiary G. Under its previous GAAP, entity F assigned an initial carrying amount of 200 to intangible assets that would not have qualified for recognition under HKAS 38 *Intangible Assets*. The tax base of the intangible assets was nil, giving rise to a deferred tax liability (at 30 per cent) of 60.~~

~~On 31 December 2003 (the date of transition to HKFRSs), …~~

~~C4 HKAS 12 *Income Taxes* is amended as described below.~~

~~**Standard**~~

~~In the Objective, the third paragraph is amended to read as follows:~~

~~This Standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill arising in that business combination or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination.~~

~~Paragraphs 15, 18, 19 and 21 are amended to read as follows:~~

~~***15. A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:***~~

~~***(a) the initial recognition of goodwill; or***~~

~~**…**~~

~~18. Temporary differences also arise when:~~

~~(a) the cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at their fair values, but no equivalent adjustment is made for tax purposes (see paragraph 19);~~

~~(b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);~~

~~(c) goodwill arises in a business combination (see paragraphs 21 and 32);~~

~~…~~

~~19. The cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).~~

~~21. Goodwill arising in a business combination is measured as the excess of the cost of the combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Many taxation authorities do not allow reductions in the carrying amount of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.~~

~~Paragraphs 21A and 21B are added:~~

~~21A. Subsequent reductions in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill are also regarded as arising from the initial recognition of goodwill and are therefore not recognised under paragraph 15(a). For example, if goodwill acquired in a business combination has a cost of 100 but a tax base of nil, paragraph 15(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity~~

~~subsequently recognises an impairment loss of 20 for that goodwill, the amount of the taxable temporary difference relating to the goodwill is reduced from 100 to 80, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the goodwill and is therefore prohibited from being recognised under paragraph 15(a).~~

~~21B. Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, recognised to the extent they do not arise from the initial recognition of goodwill. For example, if goodwill acquired in a business combination has a cost of 100 that is deductible for tax purposes at a rate of 20 per cent per year starting in the year of acquisition, the tax base of the goodwill is 100 on initial recognition and 80 at the end of the year of acquisition. If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at 100, a taxable temporary difference of 20 arises at the end of that year. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.~~

~~Paragraphs 22(a), 24 and 26(c) are amended to read as follows:~~

~~22. …~~

~~(a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill or the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities (see paragraph 19);~~

~~…~~

~~24. A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:~~

~~(a) is not a business combination; and~~

~~(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).~~

~~…~~

~~26. …~~

~~(c) the cost of a business combination is allocated by recognising the identifiable assets acquired and liabilities assumed at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects~~

~~goodwill (see paragraph 66); and~~

~~…~~

~~Paragraph 32 and the preceding heading are deleted.~~

~~Paragraphs 58(b) and 66-68 and the example following paragraph 68 are amended to read as follows and paragraph 68C is added:~~

~~***58. …***~~

~~***(b) a business combination (see paragraphs 66 to 68).***~~

~~66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination. In accordance with HKFRS 3 *Business Combinations*, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and liabilities affect goodwill or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.~~

~~67. As a result of a business combination, an acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. In such cases, the acquirer recognises a deferred tax asset, but does not include it as part of the accounting for the business combination, and therefore does not take it into account in determining the goodwill or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination.~~

~~68. If the potential benefit of the acquiree's income tax loss carry-forwards or other deferred tax assets did not satisfy the criteria in HKFRS 3 for separate recognition when a business combination is initially accounted for but is subsequently realised, the acquirer shall recognise the resulting deferred tax income in profit or loss. In addition, the acquirer shall:~~

~~(a) reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date; and~~

~~(b) recognise the reduction in the carrying amount of goodwill as an expense.~~

~~However, this procedure shall not result in the creation of an excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination, nor shall it increase the amount previously recognised for any such excess.~~

~~**Example**~~

~~An entity acquired a subsidiary that had deductible temporary differences of 300. The tax rate at the time of the acquisition was 30 per cent. The resulting deferred tax asset of 90 was not recognised as an identifiable asset in determining the goodwill of 500 that resulted from the business combination. Two years after the combination, the entity assessed that future taxable profit should be sufficient to recover the benefit of all the deductible temporary differences.~~

~~*The entity recognises a deferred tax asset of 90 and, in profit or loss, deferred tax income of 90. The entity also reduces the carrying amount of goodwill by 90 and recognises an expense for this amount in profit or loss. Consequently, the cost of the goodwill is reduced to 410, being the amount that would have been recognised had the deferred tax asset of 90 been recognised as an identifiable asset at the acquisition date.*~~

~~*If the tax rate had increased to 40 per cent, the entity would have recognised a deferred tax asset of 120 (300 at 40 per cent) and, in profit or loss, deferred tax income of 120. If the tax rate had decreased to 20 per cent, the entity would have recognised a deferred tax asset of 60 (300 at 20 per cent) and deferred tax income of 60. In both cases, the entity would also reduce the carrying amount of goodwill by 90 and recognise an expense for that amount in profit or loss.*~~

~~68C. As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event which is recognised, in the same or a different period, directly in equity, or (b) a business combination. If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity."~~

~~**Appendix A**~~

~~In section A of Appendix A, paragraphs 12 and 13 are amended to read as follows:~~

~~12. The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes. (*Note that on initial recognition, the resulting deferred tax liability increases goodwill or decreases the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination. See paragraph 66 of the Standard*).~~

~~13. Reductions in the carrying amount of goodwill are not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business. (*Note that paragraph 15(a) of the Standard prohibits recognition of the resulting deferred tax liability*).~~

~~In section B of Appendix A, paragraph 9 is amended to read as follows:~~

~~9. A liability is recognised at its fair value in a business combination, but none of the related expense is deducted in determining taxable profit until a later period. (*Note that the resulting deferred tax asset decreases goodwill or increases the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination. See paragraph 66 of the Standard*).~~

~~In section B of Appendix A, paragraph 10 is deleted.~~

~~**Appendix B**~~

~~Example 3 is amended to read as follows:~~

~~On 1 January X5 entity A acquired 100 per cent of the shares of entity B at a cost of 600. At the acquisition date, the tax base in A's tax jurisdiction of A's investment in B is 600. Reductions in the carrying amount of goodwill are not deductible for tax purposes, and the cost of the goodwill would also not be deductible if B were to dispose of its underlying business. The tax rate in A's tax jurisdiction is 30 per cent and the tax rate in B's tax jurisdiction is 40 per cent.~~

~~The fair value of the identifiable assets acquired and liabilities assumed (excluding deferred tax assets and liabilities) by A is set out in the following table, together with their tax bases in B's tax jurisdiction and the resulting temporary differences.~~

	~~*Cost of Acquisition*~~	~~*Tax Base*~~	~~*Temporary Difference*~~
~~Property, plant and equipment~~	~~270~~	~~155~~	~~115~~
~~Accounts receivable~~	~~210~~	~~210~~	~~-~~
~~Inventory~~	~~174~~	~~124~~	~~50~~
~~Retirement benefit obligations~~	~~(30)~~	~~-~~	~~(30)~~
~~Accounts payable~~	~~(120)~~	~~(120)~~	~~-~~
~~Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax~~	~~504~~	~~369~~	~~135~~

~~The deferred tax asset arising from retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 74 of the Standard).~~

~~No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill in B's tax jurisdiction is nil. However, in accordance with paragraph 15(a) of the Standard, A recognises no deferred tax liability for the taxable temporary difference associated with the goodwill in B's tax jurisdiction.~~

~~The carrying amount, in A's consolidated financial statements, of its investment in B is made up as follows:~~

~~Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax~~	~~504~~
~~Deferred tax liability (135 at 40%)~~	~~(54)~~

~~Fair value of identifiable assets acquired and liabilities assumed~~	~~450~~
~~Goodwill~~	~~150~~
~~Carrying amount~~	~~600~~

~~Because, at the acquisition date, the tax base in A's tax jurisdiction of A's investment in B is 600, no temporary difference is associated in A's tax jurisdiction with the investment.~~

~~During X5, B's equity (incorporating the fair value adjustments made as a result of the business combination) changed as follows:~~

~~At 1 January X5~~	~~450~~
~~Retained profit for X5 (net profit of 150, less dividend payable of 80)~~	~~70~~
~~At 31 December X5~~	~~520~~

~~A recognises a liability for any withholding tax or other taxes that it will incur on the accrued dividend receivable of 80.~~

~~At 31 December X5, the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:~~

~~Net assets of B~~	~~520~~
~~Goodwill~~	~~150~~
~~Carrying amount~~	~~670~~

~~The temporary difference associated with A's underlying investment is 70. This amount is equal to the cumulative retained profit since the acquisition date.~~

~~If A has determined that it will not sell the investment in the foreseeable future and that B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to A's investment in B (see paragraphs 39 and 40 of the Standard). Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future (see paragraph 42 of the Standard). A discloses the amount of the temporary difference for which no deferred tax is recognised: ie 70 (see paragraph 81(f) of the Standard).~~

~~…~~

~~C5 HKAS 14 *Segment Reporting* is amended as described below.~~

~~On the title page, the second paragraph after the title of HKAS 14 is amended to read as follows:~~

~~Paragraphs 129 and 130 of HKAS 36 *Impairment of Assets* set out disclosure requirements for reporting impairment losses by segment.~~

~~**Standard**~~

~~Paragraphs 19 and 21 are amended to read as follows:~~

~~19. Examples of segment assets include current assets that are used in the operating activities of the segment, property, plant, and equipment, assets that~~

~~are the subject of finance leases (HKAS 17 *Leases*), and intangible assets. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general entity or head office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or can be allocated to a segment on a reasonable basis, and segment expense includes any impairment losses recognised for goodwill.~~

~~21. Measurements of segment assets and liabilities include adjustments to the prior carrying amounts of the identifiable segment assets and segment liabilities of an entity acquired in a business combination, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recognised in either the parent's separate or the subsidiary's individual financial statements. Similarly, if property, plant or equipment has been revalued after acquisition in accordance with the revaluation model in HKAS 16, then measurements of segment assets reflect those revaluations.~~

~~C6 In HKAS 16 *Property, Plant and Equipment*, paragraph 64 is deleted.~~

~~C7 HKAS 19 *Employee Benefits* is amended as described below.~~

~~**Standard**~~

~~Paragraph 108 is amended to read as follows:~~

~~108. In a business combination, an entity recognises assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see HKFRS 3 *Business Combinations*). The present value of the obligation includes all of the following, even if the acquiree had not recognised them at the acquisition date:~~

~~(a) actuarial gains and losses that arose before the acquisition date (whether or not they fell inside the 10% 'corridor');~~

~~(b) past service cost that arose from benefit changes, or the introduction of a plan, before the acquisition date; and~~

~~…~~

~~C8 In HKAS 27 *Consolidated and Separate Financial Statements*, paragraph 30 is amended to read as follows:~~

~~30. The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date, as defined in HKFRS 3. The income and expenses …~~

~~C9 HKAS 28 *Investments in Associates* is amended as described below:~~

~~The definition of joint control in paragraph 2 is amended to read as follows:~~

~~***Joint control* is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and**~~

~~***operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).***~~

~~In paragraph 15, the reference to HKAS 22 *Business Combinations* is deleted. Following this change and changes made by HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 15 reads as follows:~~

~~15. When an investment in an associate previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.~~

~~Paragraphs 23 and 33 are amended to read as follows:~~

~~23. An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with HKFRS 3 *Business Combinations*. Therefore:~~

~~(a) goodwill relating to an associate is included in the carrying amount of the investment. However, amortisation of that goodwill is not permitted and is therefore not included in the determination of the investor's share of the associate's profits or losses.~~

~~(b) any excess of the investor's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.~~

~~Appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are also made to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the investor's share of the associate's profits or losses after acquisition are made for impairment losses recognised by the associate, such as for goodwill or property, plant and equipment.~~

~~33. Because goodwill included in the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in HKAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested under HKAS 36 for impairment, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in HKAS 39 indicates that the investment may be impaired. In determining the value in use of the investment, an entity estimates:~~

~~(a) its share of the present value of the estimated future cash flows expected to be generated by the associate, including the cash flows from the operations of the associate and the proceeds on the ultimate~~

~~disposal of the investment; or~~

~~(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.~~

~~Under appropriate assumptions, both methods give the same result.~~

~~C10 HKAS 31 *Interests in Joint Ventures* is amended as described below:~~

~~The definition of joint control in paragraph 3 is amended to read as follows:~~

~~***Joint control** is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).*~~

~~Paragraph 11 is amended to read as follows:~~

~~11. The contractual arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to control the activity unilaterally.~~

~~In paragraph 43, the reference to HKAS 22 *Business Combinations* is deleted. Following this change and changes made by HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 43 reads as follows:~~

~~43. When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.~~

~~C11 In HKAS 32 *Financial Instruments: Disclosure and Presentation*, paragraph 4(c) is renumbered as 4(d). Paragraph 4(d) is renumbered as 4(c) and amended to read as follows:~~

~~***(c) contracts for contingent consideration in a business combination (see HKFRS 3** Business Combinations**). This exemption applies only to the acquirer.***~~

~~Following this change and changes made by HKFRS 4 *Insurance Contracts*, paragraph 4(c)-(e) reads as follows:~~

~~***(c) contracts for contingent consideration in a business combination (see HKFRS 3** Business Combinations**). This exemption applies only to the acquirer.***~~

~~***(d) insurance contracts as defined in HKFRS 4** Insurance Contracts**. However, this Standard applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately.***~~

~~***(e) financial instruments that are within the scope of HKFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32***~~

~~***and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see HKAS 39).***~~

~~Paragraph 4(f), inserted by HKFRS 2 *Share-based Payment*, remains unchanged.~~

~~C12 In HKAS 33 *Earnings per Share*, paragraphs 22 and 64 are amended to read as follows:~~

~~22. Ordinary shares issued as part of the cost of a business combination are included in the weighted average number of shares from the acquisition date. This is because the acquirer incorporates into its income statement the acquiree's profits and losses from that date.~~

~~***64. If … shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.***~~

~~C13 In HKAS 34 *Interim Financial Statements*, paragraphs 16(i) and 18 are amended to read as follows:~~

~~***16. …***~~

~~***(i)the effect of changes in the composition of the entity during the interim period, including business combinations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations. In the case of business combinations, the entity shall disclose the information required to be disclosed under paragraphs 66-73 of HKFRS 3*** **Business Combinations;** ***and***~~

~~***…***~~

~~18. Other Standards specify disclosures that should be made in financial statements. In that context, financial statements means complete sets of financial statements of the type normally included in an annual financial report and sometimes included in other reports. Except as required by paragraph 16(i), the disclosures required by those other Standards are not required if an entity's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.~~

~~C14 In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 5 is amended to read as follows:~~

~~5. Where another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, HKFRS 3 *Business Combinations* addresses the treatment by an acquirer of contingent liabilities assumed in a business combination. Similarly, certain types of provisions are also addressed in Standards on:~~

~~…~~

~~C15 In HKAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003), paragraph 2(f) and (h) is deleted by HKFRS 4 *Insurance Contracts*. Paragraph 2(g) is renumbered as paragraph 2(f) and amended as set out below. Paragraph 2(g) is added as set out below. Following these changes and changes made by HKFRS 4, paragraph 2(d)-(g) reads as follows:~~

~~***(d) financial instruments issued by the entity that meet the definition of an equity instrument in HKAS 32 (including options and warrants). However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.***~~

~~***(e) rights and obligations under an insurance contract as defined in HKFRS 4*** **Insurance Contracts** ***or under a contract that is within the scope of HKFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in such a contract if the derivative is not itself a contract within the scope of HKFRS 4 (see paragraphs 10-13 and Appendix A paragraphs AG23-AG33). Furthermore, if an insurance contract is a financial guarantee contract entered into, or retained, on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer shall apply this Standard to the contract (see paragraph 3 and Appendix A paragraph AG4A).***~~

~~***(f)contracts for contingent consideration in a business combination (see HKFRS 3*** **Business Combinations*****). This exemption applies only to the acquirer.***~~

~~***(g) contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.***~~

~~Paragraph 2(i) and (j) is renumbered as 2(h) and (i). Paragraph 2(i) was inserted by HKFRS 2 *Share-based Payment*.~~

~~C16 In the Guidance on Implementing HKAS 39 *Financial Instruments: Recognition and Measurement*, Question F.2.3 and the accompanying answer are amended to read as follows:~~

~~**F.2.3 Hedge accounting: core deposit intangibles**~~

~~**Is hedge accounting treatment permitted for a hedge of the fair value exposure of core deposit intangibles?**~~

~~It depends on whether the core deposit intangible is generated internally or acquired (eg as part of a business combination).~~

~~Internally generated core deposit intangibles are not recognised as intangible assets under HKAS 38. Because they are not recognised, they cannot be designated as a hedged item.~~

~~If a core deposit intangible is acquired together with a related portfolio of deposits, the core deposit intangible is required to be recognised separately as an intangible asset (or as part of the related acquired portfolio of deposits) if it meets the recognition criteria in paragraph 21 of HKAS 38 *Intangible Assets*. A recognised core deposit intangible asset could be designated as a hedged item, but only if it meets the conditions in paragraph 88, including the requirement in paragraph 88(b) that the~~

~~effectiveness of the hedge can be measure reliably. Because it is often difficult to measure reliably the fair value of a core deposit intangible asset other than on initial recognition, it is unlikely that the requirement in paragraph 88(b) will be met.~~

~~C17 HKAS-INT-25 *Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders* is amended as described below.~~

~~The HKAS-INT's Basis for Conclusions should be read as follows:~~

~~BASIS FOR CONCLUSIONS~~

~~[The original text has been marked up to reflect the issue of HKAS 38 in 2004; deleted text is struck through.]~~

~~5. HKAS 12.58 requires current and deferred tax to be included in the net profit or loss for the period, except to the extent the tax arises from a transaction or event that is recognised directly in equity, in the same or a different period, (or arises from a business combination that is an acquisition). HKAS 12.61 requires that current and deferred tax be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.~~

~~C18 HKAS-INT-32 *Intangible Assets – Web Site Costs* is amended as described below.~~

~~Paragraphs 8-10 are amended to read as follows:~~

~~8. A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in HKAS 38.21 for recognition and initial measurement, an entity can satisfy the requirements in HKAS 38.57. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with HKAS 38.57(d) when, for example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.~~

~~9. Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with HKAS 38. The nature of each activity for which expenditure is incurred (eg training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment (additional guidance is provided in the Appendix to this Interpretation). For example:~~

~~(a)the Planning stage is similar in nature to the research phase in HKAS 38.54-.56. Expenditure incurred in this stage shall be recognised as an expense when it is incurred.~~

~~(b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own products and services, are similar in nature to the~~

~~development phase in HKAS 38.57-.64. Expenditure incurred in these stages shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Interpretation when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, shall be included in the cost of development when this condition is met. However, in accordance with HKAS 38.71, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).~~

~~(c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with HKAS 38.69(c). For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.~~

~~(d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense when it is incurred unless it meets the recognition criteria in HKAS 38.18.~~

~~10. A web site that is recognised as an intangible asset under paragraph 8 of this Interpretation shall be measured after initial recognition by applying the requirements of HKAS 38.72-.87. The best estimate of a web site's useful life shall be short.~~

~~The HKAS-INT's Basis for Conclusions should be read as follows:~~

~~BASIS FOR CONCLUSIONS~~

~~[The original text has been marked up to reflect the issue of HKAS 38 in 2004; new text is underlined and deleted text is struck through.]~~

~~11. An intangible asset is defined in HKAS 38.87 as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. HKAS 38.98 provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset.~~

~~12. HKAS 38.6856 requires expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in HKAS 38.18-.6755. HKAS 38.6957 requires expenditure on start-up activities to be recognised as an expense when incurred. An entity enterprise developing its own web site for internal or external access is not undertaking a start-up activity to the extent that an internally generated intangible asset is created. The requirements and guidance in HKAS 38.52-.6740-.55, in addition to the general requirements described in HKAS 38.2119 for recognition and initial measurement of an intangible asset, apply to expenditure incurred on the development of an entity's enterprise's own web site. As described in HKAS 38.65-.6753-.55, the cost of a web site recognised as an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, and is necessary to creating, producing, and preparing the asset for it to be capable of operating in the manner intended by management its intended use.~~

~~13. HKAS 38.5442 requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in HKAS 38.5644 are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditure incurred in the Planning stage of a web site's development is recognised as an expense when incurred.~~

~~14. HKAS 38.5745 requires an intangible asset arising from the development phase of an internal project to be recognised only if an entity enterprise can demonstrate fulfilment of the six criteria specified. One of the criteria is to demonstrate how a web site will generate probable future economic benefits (HKAS 38.5745(d)). HKAS 38.6048 indicates that this criterion is met by assessing the economic benefits to be received from the web site and using the principles in HKAS 36, Impairment of Assets, which considers the present value of estimated future cash flows from continuing use of the web site. Future economic benefits flowing from an intangible asset, as stated in HKAS 38.17, may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity enterprise. Therefore, future economic benefits from a web site may be assessed when the web site is capable of generating revenues. A web site developed solely or primarily for advertising and promoting an entity's enterprise's own products and services is not recognised as an intangible asset, because the entity enterprise cannot demonstrate the future economic benefits that will flow. Consequently, all expenditure on developing a web site solely or primarily for promoting and advertising an entity's enterprise's own products and services is recognised as an expense when incurred.~~

~~15. Under HKAS 38.2119, an intangible asset is recognised if, and only if, it meets specified criteria. HKAS 38.6553 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the specified recognition criteria. When an entity enterprise acquires or creates content for purposes other than to advertise and promote an entity's enterprise's own products and services, it may be possible to identify an intangible asset (eg a licence or a copyright) separate from a web site. However, a separate asset is not recognised when expenditure is directly attributed, or allocated on a reasonable and consistent basis, to creating, producing, and preparing the web site for it to be capable of~~

~~operating in the manner intended by management its intended use – the expenditure is included in the cost of developing the web site.~~

~~16. HKAS 38.6957(c) requires expenditure on advertising and promotional activities to be recognised as an expense when incurred. Expenditure incurred on developing content that advertises and promotes an entity's enterprise's own products and services (eg digital photographs of products) is an advertising and promotional activity, and consequently recognised as an expense when incurred in accordance with HKAS 38.57(c).~~

~~17. Once development of a web site is complete, an entity begins the activities described in the Operating stage. Subsequent expenditure to enhance or maintain an entity's own web site is recognised as an expense when incurred unless it meets the recognition criteria in HKAS 38.18. HKAS 38.20 explains that most subsequent expenditures are likely to maintain the future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria set out in HKAS 38. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure – expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset – be recognised in the carrying amount of an asset*.~~

~~* The new text was added by HKFRS 3 *Business Combinations* in 2004.~~

~~18. An intangible asset is measured after initial recognition by applying the requirements of HKAS 38.72-.8763-.78. The revaluation model Allowed Alternative Treatment in HKAS 38.7564 is applied only when the fair value of an intangible asset can be determined by reference to an active market. However, as an active market is unlikely to exist for web sites, the cost model Benchmark Treatment applies. Additionally, since HKAS 38.84 states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life under HKAS 38.79. As as indicated in HKAS 38.9281, many intangible assets are susceptible to technological obsolescence, and given the history of rapid changes in technology, the useful life of web sites will be short.~~

~~The **Effective Date** paragraph is amended to read as follows:~~

~~**Effective Date:** This Interpretation becomes effective on 15 October 2002. The effects of adopting this Interpretation shall be accounted for using the transitional requirements in SSAP 29 that was issued in 2001. Therefore, when a web site does not meet the criteria for recognition as an intangible asset, but was previously recognised as an asset, the item shall be derecognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, but was not previously recognised as an asset, the intangible asset shall not be recognised at the date when this Interpretation becomes effective. When a web site exists and the expenditure to develop it meets the criteria for recognition as an intangible asset, was previously recognised as an asset and initially measured at cost, the amount initially recognised is deemed to have been properly determined.~~

~~In the Appendix, the Example is amended to read as follows:~~

~~**Stage / Nature of Expenditure**~~	~~**Accounting treatment**~~
~~**Planning**~~	
~~– undertaking feasibility studies~~ ~~– defining hardware and software specifications~~ ~~– evaluating alternative products and suppliers~~ ~~– selecting preferences~~	~~Recognise as an expense when incurred in accordance with HKAS 38.54~~
~~**Application and Infrastructure Development**~~	
~~– purchasing or developing hardware~~	~~Apply the requirements of HKAS 16~~
~~– obtaining a domain name~~ ~~– developing operating software (eg operating system and server software)~~ ~~– developing code for the application~~ ~~– installing developed applications on the web server~~ ~~– stress testing~~	~~Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in HKAS 38.21 and HKAS 38.57*~~
~~**Graphical Design Development**~~	
~~– designing the appearance (eg layout and colour) of web pages~~	~~Recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in HKAS 38.21 and HKAS 38.57*~~
~~**Content Development**~~	
~~– creating, purchasing, preparing (eg creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. Examples of content include information about an entity, products or services offered for sale, and topics that subscribers access~~	~~Recognise as an expense when incurred in accordance with HKAS 38.69(c) to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products). Otherwise, recognise as an expense when incurred, unless the expenditure can be directly attributed to preparing the web site to operate in the manner intended by management, and the web site meets the recognition criteria in HKAS 38.21 and HKAS 38.57*~~

~~Operating~~	
~~– updating graphics and revising content~~ ~~– adding new functions, features and content~~ ~~– registering the web site with search engines~~ ~~– backing up data~~ ~~– reviewing security access~~ ~~– analysing usage of the web site~~	~~Assess whether it meets the definition of an intangible asset and the recognition criteria set out in HKAS 38.18, in which case the expenditure is recognised in the carrying amount of the web site asset~~
~~Other~~	
~~– selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management~~ ~~– clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (eg false-start testing)~~ ~~– training employees to operate the web site~~	~~Recognise as an expense when incurred in accordance with HKAS 38.65-.70~~

~~* All expenditure on developing a web site solely or primarily for promoting and advertising an entity's own products and services is recognised as an expense when incurred in accordance with HKAS 38.68.~~

Appendix D

Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared as at ~~July 2004~~ ~~24 November 2005~~ December 2007 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 3.

The International Financial Reporting Standard comparable with HKFRS 3 is IFRS 3 *Business Combinations*.

There are no major textual differences between HKFRS 3 and IFRS 3.

~~The following sets out the major textual differences between HKFRS 3 and IFRS 3 and the reason for the differences.~~

~~**Differences**~~	~~**Reason for the Differences**~~
~~**Provisions for Hong Kong incorporated companies**~~ ~~Additional paragraphs are inserted:~~ ~~(a) to give the background on why Hong Kong incorporated companies should use the definition of a subsidiary as set out in section 2(4) of the Companies Ordinance (see paragraphs 6A & 6B);~~ ~~(b) to include a specific provision for Hong Kong incorporated companies in applying this Standard (see paragraph 23A); and~~ ~~(c) to require specific disclosures for Hong Kong incorporated companies (see paragraph 77A).~~ ~~Hong Kong incorporated companies should apply these additional paragraphs from the time when the Standard becomes effective (or earlier) and should cease to apply these additional paragraphs for annual periods beginning on or after 1 January 2006.~~	 ~~The Standard recognises that, in preparing consolidated financial statements~~6~~, a company incorporated under the Hong Kong Companies Ordinance does~~may~~ not consolidate an entity that does not meet the definition of a subsidiary under that Ordinance.~~ ~~The Standard also recognises that the above legal constraint will be removed by the Companies (Amendment) Ordinance 2005 with effect for annual periods beginning on or after 2006.~~

Hong Kong Financial Reporting Standard 4 *Insurance Contracts* (HKFRS 4) is set out in paragraphs 1-45 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 Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 4 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

Hong Kong Financial Reporting Standard 4

Insurance Contracts

OBJECTIVE

1 The objective of this HKFRS is to specify the financial reporting for *insurance contracts* by any entity that issues such contracts (described in this HKFRS as an *insurer*). In particular, this HKFRS requires:

(a) limited improvements to accounting by insurers for insurance contracts.

(b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

SCOPE

2 An entity shall apply this HKFRS to:

(a) insurance contracts (including *reinsurance contracts*) that it issues and reinsurance contracts that it holds.

(b)* financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). ~~HKAS 32 *Financial Instruments: Disclosure and Presentation*~~ HKFRS 7 *Financial Instruments: Disclosures* requires disclosure about financial instruments, including financial instruments that contain such features.

3 This HKFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see HKAS 32 and HKAS 39 *Financial Instruments: Recognition and Measurement*), except in the transitional provisions in paragraph 45.

4. An entity shall not apply this HKFRS to:

(a) product warranties issued directly by a manufacturer, dealer or retailer (see HKAS 18 *Revenue* and HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

(b) employers' assets and liabilities under employee benefit plans (see HKAS 19 *Employee Benefits* and HKFRS 2 *Share-based Payment*) and retirement benefit obligations reported by defined benefit retirement plans (see HKAS 26 *Accounting and Reporting by Retirement Benefit Plans*).

(c) contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see HKAS 17 *Leases*, HKAS 18 *Revenue* and HKAS 38 *Intangible Assets*).

* Effective for annual periods beginning on or after 1 January 2007

(d) financial guarantee~~s~~ contracts ~~that an entity enters into or retains on transferring to another party financial assets or financial liabilities within the scope of HKAS 39, regardless of whether the financial guarantees are described as financial guarantees, letters of credit or insurance contracts (see HKAS 39)~~ unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either HKAS 39 and HKAS 32 and HKFRS 7 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

(e) contingent consideration payable or receivable in a business combination (see HKFRS 3 *Business Combinations*).

(f) *direct insurance contracts* that the entity holds (ie direct insurance contracts in which the entity is the *policyholder)*. However, a *cedant* shall apply this HKFRS to reinsurance contracts that it holds.

5 For ease of reference, this HKFRS describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.

6 A reinsurance contract is a type of insurance contract. Accordingly, all references in this HKFRS to insurance contracts also apply to reinsurance contracts.

Embedded derivatives

7 HKAS 39 requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in profit or loss. HKAS 39 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.

8 As an exception to the requirement in HKAS 39, an insurer need not separate, and measure at fair value, a policyholder’s option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirement in HKAS 39 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder’s ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

9 Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

Unbundling of deposit components

10 Some insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is required or permitted to *unbundle* those components:

(a) unbundling is required if both the following conditions are met:

(i) the insurer can measure the deposit component (including any embedded surrender options) separately (ie without considering the insurance component).

(ii) the insurer’s accounting policies do not otherwise require it to of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see HKAS 1 *Presentation of Financial Statements*).

(d) shall, if the contract contains an embedded derivative within the scope of HKAS 39, apply HKAS 39 to that embedded derivative.

(e) shall, in all respects not described in paragraphs 14-20 and 34(a)-(d), continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21-30.

Discretionary participation features in financial instruments

35 The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:

(a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15-19 to the whole contract (ie both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying HKAS 39 to the guaranteed element.

(b) if the issuer classifies part or all of that feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying HKAS 39 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying HKAS 39 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.

(c) although these contracts are financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability.

(d)* although these contracts are financial instruments, an issuer applying paragraph 20(b) of HKFRS 7 to contracts with a discretionary participation feature shall disclose the total interest expense recognised in profit or loss, but need not calculate such interest expense using the effective interest method.

DISCLOSURE

Explanation of recognised amounts

36 An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.

* Effective for annual periods beginning on or after 1 January 2007

37 To comply with paragraph 36, an insurer shall disclose:

(a) its accounting policies for insurance contracts and related assets, liabilities, income and expense.

(b) the recognised assets, liabilities, income and expense (and, if it presents its cash flow statement using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:

(i) gains and losses recognised in profit or loss on buying reinsurance; and

(ii) if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.

(c) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions.

(e) the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements.

(e) reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

~~Amount, timing and uncertainty of cash flows~~ Nature and extent of risks arising from insurance contracts*

38* **An insurer shall disclose information that ~~helps~~ enables users of its financial statements to ~~understand~~ evaluate the ~~amount, timing and uncertainty of future cash flows~~ nature and extent of risks arising from insurance contracts.**

39*. To comply with paragraph 38, an insurer shall disclose:

(a) its objectives, policies and processes for ~~in~~ managing risks arising from insurance contracts and the methods used to manage ~~and its policies for mitigating~~ those risks.

(b) ~~those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.~~ [deleted]

(c) information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:

(i) ~~the~~ sensitivity to insurance risk (see paragraph 39A) ~~of profit or loss and equity to changes in variables that have a material effect on them.~~

* Effective for annual periods beginning on or after 1 January 2007

(ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area, or currency).

(iii) actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.

(d) ~~the~~ information about ~~interest rate risk and~~ credit risk, liquidity risk and market risk that ~~HKAS 32~~ paragraphs 31-42 of HKFRS 7 would require if the insurance contracts were within the scope of ~~HKAS 32~~ HKFRS 7. However:

(i) an insurer need not provide the maturity analysis required by paragraph 39(a) of HKFRS 7 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the balance sheet.

(ii) if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of HKFRS 7. Such an insurer shall also provide the disclosures required by paragraph 41 of HKFRS 7.

(e) information about exposures to ~~interest rate risk or~~ market risk ~~under~~ arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

39A[*] To comply with paragraph 39(c)(i), an insurer shall disclose either (a) or (b) as follows:

(a) a sensitivity analysis that shows how profit or loss and equity would have been affected had changes in the relevant risk variable that were reasonably possible at the balance sheet date occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of HKFRS 7.

[*] Effective for annual periods beginning on or after 1 January 2007

(b) qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

EFFECTIVE DATE AND TRANSITION

40 The transitional provisions in paragraphs 41-45 apply both to an entity that is already applying HKFRSs when it first applies this HKFRS and to an entity that applies HKFRSs for the first-time (a first-time adopter).

41. An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.

41A *Financial Guarantee Contracts* (Amendments to HKAS 39 and HKFRS 4), issued in September 2005, amended paragraphs 4(d), B18(g) and B19(f). An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies those amendments for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 39 and HKAS 32[θ] at the same time.

Disclosure

42 An entity need not apply the disclosure requirements in this HKFRS to comparative information that relates to annual periods beginning before 1 January 2005, except for the disclosures required by paragraph 37(a) and (b) about accounting policies, and recognised assets, liabilities, income and expense (and cash flows if the direct method is used).

43 If it is impracticable to apply a particular requirement of paragraphs 10-35 to comparative information that relates to annual periods beginning before 1 January 2005, an entity shall disclose that fact. Applying the liability adequacy test (paragraphs 15-19) to such comparative information might sometimes be impracticable, but it is highly unlikely to be impracticable to apply other requirements of paragraphs 10-35 to such comparative information. HKAS 8 explains the term 'impracticable'.

44 In applying paragraph 39(c)(iii), an entity need not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies this HKFRS. Furthermore, if it is impracticable, when an entity first applies this HKFRS, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this HKFRS, the entity shall disclose that fact.

Redesignation of financial assets

45 When an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as 'at fair value through profit or loss'. This reclassification is permitted if an insurer changes accounting policies when it first applies this HKFRS and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and HKAS 8 applies.

[θ] When an entity applies HKFRS 7, the reference to HKAS 32 is replaced by reference to HKFRS 7

Appendix A

Defined terms

This appendix is an integral part of the HKFRS.

cedant	The **policyholder** under a **reinsurance contract**.
deposit component	A contractual component that is not accounted for as a derivative under HKAS 39 and would be within the scope of HKAS 39 if it were a separate instrument.
direct insurance contract	An **insurance contract** that is not a **reinsurance contract**.
discretionary participation feature	A contractual right to receive, as a supplement to **guaranteed benefits**, additional benefits: (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: (i) the performance of a specified pool of contracts or a specified type of contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the company, fund or other entity that issues the contract.
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.
financial guarantee contract	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.
financial risk	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
guaranteed benefits	Payments or other benefits to which a particular **policyholder** or investor has an unconditional right that is not subject to the contractual discretion of the issuer.

B16 Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.

B17 An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

Examples of insurance contracts

B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

(a) insurance against theft or damage to property.

(b) insurance against product liability, professional liability, civil liability or legal expenses.

(c) life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).

(d) life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).

(e) disability and medical cover.

(f) surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).

(g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a ~~financial~~ guarantee, some types of letter of credit, a credit derivative default product contract or an insurance contract. ~~However, these contracts are outside the scope of this HKFRS if the entity entered into them, or retained them, on transferring to another party financial assets or financial liabilities within the scope of HKAS 39 (see paragraph 4(d)).~~ However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in HKAS 39 and are within the scope of HKAS 32 and HKAS 39, not this HKFRS (see paragraph 4(d)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either HKAS 39 and HKAS 32[θ] or this Standard to such financial guarantee contracts.

[θ] When an entity applies HKFRS 7, the reference to IAS 32 is replaced by a reference to HKFRS 7

(h) product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this HKFRS. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of HKAS 18 *Revenue* and HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(i) title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.

(j) travel assistance (ie compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.

(k) catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).

(l) insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.

(m) reinsurance contracts.

B19 The following are examples of items that are not insurance contracts:

(a) investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

(b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

(c) self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).

(d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).

(e) derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see HKAS 39).

(f) a ~~financial~~ credit-related guarantee ~~contract~~ (or letter of credit, credit derivative default ~~product~~ contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see HKAS 39).

(g) contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).

(h) catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.

B20 If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of HKAS 39. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

(a) one party recognises the consideration received as a financial liability, rather than as revenue.

(b) the other party recognises the consideration paid as a financial asset, rather than as an expense.

B21 If the contracts described in paragraph B19 do not create financial assets or financial liabilities, HKAS 18 applies. Under HKAS 18, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

Significant insurance risk

B22 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8-B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

B23 Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

B24 The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:

(a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment

Appendix C

Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity adopts this 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.

~~*With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAP) and Interpretations for which there are equivalent International Accounting Standards (IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKAS) and HKAS Interpretations (HKAS-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. Accordingly, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.*~~

~~Amendments to HKAS 32 and HKAS 39~~

~~C1 In HKAS 32 *Financial Instruments: Disclosure and Presentation* paragraph 4(d) is renumbered as 4(c). Paragraph 4(c) is renumbered as 4(d) and amended as set out in paragraph C4.~~

~~Paragraph 6 is deleted.~~

~~The following sentence is added to the end of paragraph AG8:~~

> ~~Some of these contingent rights and obligations may be insurance contracts within the scope of HKFRS 4.~~

~~C2 In HKAS 39 *Financial Instruments: Recognition and Measurement*, paragraph 2(e) is renumbered as paragraph 2(d). Paragraph 2(d) is renumbered as 2(e) and amended as set out in paragraph C5. Paragraph AG4 is amended to read as follows:~~

> ~~AG4. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise under contracts within the scope of HKFRS 4.~~

~~C3 Paragraphs 4(e) of HKAS 32 and 2(h) of HKAS 39 contain scope exclusions for derivatives based on climatic, geological, or other physical variables. Those paragraphs are deleted. As a result, such derivatives are within the scope of HKAS 32 and HKAS 39, unless they meet the definition of an insurance contract and are within the scope of HKFRS 4. Furthermore, paragraph AG1 of HKAS 39 is amended to read as follows:~~

> ~~AG1. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not within the scope of~~

~~HKFRS 4 *Insurance Contracts*, they are within the scope of this Standard.~~

~~In Question B.2 of the Guidance on Implementing HKAS 39, the phrase 'HKAS 39.2(h) and' is deleted from the last paragraph.~~

~~C4 In HKAS 32, a new paragraph 4(e) is inserted. Following this change and changes made by paragraphs C1 and C3, and by HKFRS 3 *Business Combinations*, paragraph 4(c)-(e) reads as follows:~~

~~***(c) contracts for contingent consideration in a business combination (see HKFRS 3*** **Business Combinations*****). This exemption applies only to the acquirer.***~~

~~***(d) insurance contracts as defined in HKFRS 4*** **Insurance Contracts*****. However, this Standard applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately.***~~

~~***(e) financial instruments that are within the scope of HKFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see HKAS 39).***~~

~~Paragraph 4(f), inserted by HKFRS 2 *Share-based Payment*, remains unchanged.~~

~~C5 In HKAS 39, paragraph 2(f) is deleted. Following this change and changes made by paragraphs C2 and C3, and by HKFRS 3 *Business Combinations*, paragraph 2(d)-(g) reads as follows:~~

~~***(d) financial instruments issued by the entity that meet the definition of an equity instrument in HKAS 32 (including options and warrants). However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.***~~

~~***(e) rights and obligations under an insurance contract as defined in HKFRS 4*** **Insurance Contracts** ***or under a contract that is within the scope of HKFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in such a contract if the derivative is not itself a contract within the scope of HKFRS 4 (see paragraphs 10-13 and Appendix A paragraphs AG23-AG33). Furthermore, if an insurance contract is a financial guarantee contract entered into, or retained, on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer shall apply this Standard to the contract (see paragraph 3 and Appendix A paragraph AG4A).***~~

~~***(f) contracts for contingent consideration in a business combination (see HKFRS 3*** **Business Combinations*****). This exemption applies only to the acquirer.***~~

~~***(g) contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.***~~

~~Paragraph 2(i) and (j) is renumbered as 2(h) and (i). Paragraph 2(i) was inserted by HKFRS 2 *Share-based Payment*.~~

~~Paragraph 3 is deleted and replaced by a new paragraph 3 and paragraph AG4A is added, as follows:~~

~~3. Some financial guarantee contracts require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. If that requirement transfers significant risk to the issuer, the contract is an insurance contract as defined in HKFRS 4 (see paragraphs 2(e) and AG4A). Other financial guarantee contracts require payments to be made in response to changes in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Such contracts are within the scope of this Standard.~~

~~AG4A. Financial guarantee contracts may have various legal forms, such as a financial guarantee, letter of credit, credit default contract or insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraphs 2(e) and 3):~~

~~(a) If the contract is not an insurance contract, as defined in HKFRS 4, the issuer applies this Standard. Thus, a financial guarantee contract that requires payments if the credit rating of a debtor falls below a particular level is within the scope of this Standard.~~

~~(b) If the issuer incurred or retained the financial guarantee on transferring to another party financial assets or financial liabilities within the scope of this Standard, the issuer applies this Standard.~~

~~(c) If the contract is an insurance contract, as defined in HKFRS 4, the issuer applies HKFRS 4 unless (b) applies.~~

~~(d) If the issuer gave a financial guarantee in connection with the sale of goods, the issuer applies HKAS 18 in determining when it recognises the resulting revenue.~~

~~In paragraph BC20 of the Basis for Conclusions, the phrase ‘in the same way as financial guarantees (see paragraph BC23)’ is replaced by the phrase ‘at the higher of (a) the amount that would be recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.’~~

~~The heading preceding paragraph BC21 is amended to read as follows:~~

~~**Financial Guarantee Contracts (paragraphs 2(e), 3 and AG4A)**~~

~~Paragraph BC23 is amended to read as follows:~~

~~BC23. In finalising IFRS 4 *Insurance Contracts*, the Board decided that a financial guarantee should, regardless of its legal form (eg financial guarantee, letter of credit, credit default contract, insurance contract) be within the scope of:~~

~~(a) this Standard if it is not an insurance contract, as defined in IFRS 4.~~

~~(b) this Standard, for accounting by the issuer, if the issuer incurred or retained the financial guarantee when it transferred to another party financial assets or financial liabilities within the scope of this Standard.~~

~~(c) IFRS 4 if it is an insurance contract, as defined in IFRS 4, unless (b) applies. However, the Board also decided to develop an Exposure Draft proposing that financial guarantees within the scope of IFRS 4 should be measured initially at fair value and subsequently in the same way as commitments to provide a loan at a below-market interest rate (see paragraph BC20).~~

~~C6 In HKAS 39, paragraph 9, the phrase ‘other variable’ in the definition of a derivative is replaced by the phrase ‘other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract’. The same change is made in paragraph 10 of HKAS 39 and Question B.2 of the *Guidance on Implementing HKAS 39*. The following new paragraph AG12A is added to HKAS 39:~~

~~AG12A. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car’s physical condition, the change in that residual value is specific to the owner of the car.~~

~~C7 In HKAS 32, the following new paragraph 91A is inserted, and in paragraph 86 the cross-reference to paragraph 90 is extended to include paragraph 91A:~~

~~***91A. Some financial assets and financial liabilities contain a discretionary participation feature as described in HKFRS 4*** **Insurance Contracts*****. If an entity cannot measure reliably the fair value of that feature, the entity shall disclose that fact together with a description of the contract, its carrying amount, an explanation of why fair value cannot be measured reliably and, if possible, the range of estimates within which fair value is highly likely to lie.***~~

~~In paragraph 49(e), 'insurance policy' is replaced by 'insurance contract'.~~

~~In the first line of paragraph BC7 of the Basis for Conclusions, 'an instrument' is replaced by 'a financial instrument'.~~

~~C8 In HKAS 39, paragraph AG30 gives examples of embedded derivatives that are regarded as not closely related to a host contract, and paragraph AG33 gives examples of embedded derivatives that are regarded as closely related to a host contract. Paragraphs AG30(g) and AG33 (a), (b) and (d) are amended by the insertion of references to insurance contracts as follows and in paragraph AG33, (g) and (h) are added:~~

~~AG30(g) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element under HKAS 32.~~

~~AG33(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the combined contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.~~

~~(b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.~~

~~(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:~~

~~(i)the functional currency of any substantial party to that contract;~~

~~(ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial~~

~~transactions around the world (such as the US dollar for crude oil transactions); or~~

~~(iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).~~

~~(g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.~~

~~(h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (ie without considering the host contract).~~

~~Amendments to other HKFRSs~~

~~C9 HKAS 18 *Revenue* is amended as described below.~~

~~Paragraph 6(c) is amended to read as follows:~~

~~(c) insurance contracts within the scope of HKFRS 4 *Insurance Contracts*;~~

~~In the Appendix, paragraph 14(a)(iii) and 14(b)(iii) are added as follows:~~

~~*(a)(iii) Origination fees received on issuing financial liabilities measured at amortised cost.*~~

~~These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as 'at fair value through profit or loss', the origination fees received are included, with the related transaction costs incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective yield. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.~~

~~*(b)(iii) Investment management fees*~~

~~Fees charged for managing investments are recognised as revenue as the services are provided.~~

~~Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in HKAS 39, an incremental cost is one that would not have been incurred if the entity had not secured the investment management~~

~~contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.~~

~~Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.~~

~~C10 In HKAS 19 *Employee Benefits*, the following footnote is added to the definition in paragraph 7 of a qualifying insurance policy, after the first occurrence of the word 'policy':~~

~~* A qualifying insurance policy is not necessarily an insurance contract, as defined in HKFRS 4 *Insurance Contracts*.~~

~~C11 In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraphs 1(b) and 4 are deleted and a new paragraph 5(e) is inserted as follows:~~

~~(d)insurance contracts (see HKFRS 4 *Insurance Contracts*). However, this Standard applies to provisions, contingent liabilities and contingent assets of an insurer, other than those arising from its contractual obligations and rights under insurance contracts within the scope of HKFRS 4.~~

~~In paragraph 2 (as amended in 2004 by HKAS 39), the last sentence is deleted.~~

~~In Appendix C, example 9, the following new paragraph is inserted after the first paragraph:~~

~~This contract meets the definition of an insurance contract in HKFRS 4 *Insurance Contracts*. HKFRS 4 permits the issuer to continue its existing accounting policies for insurance contracts if specified minimum requirements are satisfied. HKFRS 4 also permits changes in accounting policies that meet specified criteria. The following is an example of an accounting policy that HKFRS 4 permits.~~

~~In Appendix C, example 9, at the end of case (a), the words "(see paragraph 2(f) of HKAS 39)" are deleted.~~

~~C12 In HKAS 40 *Investment Property*, paragraphs 32A-32C and 75(f)(iv) are added and a cross-reference to paragraph 32A is included in paragraph 30 as follows:~~

~~***30. With the exceptions noted in paragraphs 32A and 34, an entity shall choose as its accounting policy either the fair value model in paragraphs 33-55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property.***~~

~~**Investment property linked to liabilities**~~

~~***32A. An entity may:***~~

~~***(a) choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and***~~

~~***(b) choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).***~~

~~32B. Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 32A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.~~

~~32C. If an entity chooses different models for the two categories described in paragraph 32A, sales of investment property between pools of assets measured using different models shall be recognised at fair value and the cumulative change in fair value shall be recognised in profit or loss. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.~~

~~***75(f)(iv) the cumulative change in fair value recognised in profit or loss on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used (see paragraph 32C).***~~

~~C13 HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~In paragraph 12, the reference to paragraphs 13-25C is amended to refer to paragraphs 13-25D.~~

~~Paragraph 13(g) and (h) is amended and a new subparagraph (i) is inserted, as follows:~~

~~(g) designation of previously recognised financial instruments (paragraph 25A);~~

~~(h) share-based payment transactions (paragraphs 25B and 25C); and~~

~~(i) insurance contracts (paragraph 25D).~~

~~After paragraph 25C, a new heading and paragraph 25D are added, as follows:~~

~~**Insurance contracts**~~

~~25D 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.~~

~~Paragraph 36A and the preceding heading are amended by inserting references to HKFRS 4, to read as follows:~~

~~*Exemption from the requirement to restate comparative information for HKAS 39 and HKFRS 4*~~

~~36A In its first HKFRS financial statements, an entity that adopts HKFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with HKAS 32, HKAS 39 and HKFRS 4. An entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and HKFRS 4 in its first year of transition shall:~~

~~(a) apply its previous GAAP in the comparative information to financial instruments within the scope of HKAS 32 and HKAS 39 and to insurance contracts within the scope of HKFRS 4;~~

~~(b) disclose this fact, together with the basis used to prepare this information; and~~

~~(c) disclose the nature of the main adjustments that would make the information comply with HKAS 32, HKAS 39 and HKFRS 4. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (ie the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first HKFRS reporting period (ie the first period that includes information that complies with HKAS 32, HKAS 39 and HKFRS 4) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)-(e) and (f)(i) of HKAS 8. Paragraph 28(f)(i) applies only to amounts presented in the balance sheet at the comparative period's reporting date.~~

~~In the case of an entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and HKFRS 4, references to the 'date of transition to HKFRSs' shall mean, in the case of those Standards only, the beginning of the first HKFRS reporting period.~~

~~C14. HKAS-Int-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (as amended by HKAS 39) is amended as described below.~~

~~Paragraph 7 is amended to read as follows:~~

~~7. Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, should be accounted for under HKAS 37, HKAS 39 or HKFRS 4, depending on the terms.~~

~~Paragraph 15 is amended as follows:~~

~~15. HKFRS 4 provides guidance for recognising and measuring financial guarantees and similar instruments that provide for payments to be made if the debtor fails to make payments when due, if that contract transfers significant insurance risk to the issuer. Financial guarantee contracts that provide for payments to be made in response to changes in relation to a variable (sometimes referred to as an "underlying") are subject to HKAS 39.~~

Appendix E

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 30 and 39(a) are amended as follows:

30 In some accounting models … The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in ~~equity~~ <u>other comprehensive income</u> if, and only if, the unrealised gains or losses are recognised ~~directly in equity~~ <u>in other comprehensive income</u>. This practice ...

39A To comply with …

(a) a sensitivity analysis that shows how profit or loss and equity would have been affected ~~had~~ <u>if</u> changes in the relevant risk variable that were reasonably possible at the ~~balance sheet date~~ <u>end of the reporting period had</u> occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However …

Paragraph 41B is added as follows:

<u>41B HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 30. 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.</u>

Scope exclusions

BC61 The scope of the IFRS excludes various items that may meet the definition of insurance contracts, but are, or will be, covered by existing or proposed future IFRSs (paragraph 4). The following paragraphs discuss:

(a) financial guarantees and insurance against credit risk (paragraphs BC62-BC68);

(b) product warranties (paragraphs BC69-BC72);

(c) accounting by policyholders (paragraph BC73); and

(d) prepaid service contracts (paragraphs BC74-BC76).

Financial guarantees and insurance against credit risk

BC62 The Basis for Conclusions on IAS 39 explains the reasons for the Board's conclusions on financial guarantee contracts.

BC63-BC68 [Deleted].

~~BC62 Some contracts require specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. If the resulting risk transfer is significant, these contracts meet the definition of an insurance contract. Some of these contracts have the legal form of an insurance contract and others have the legal form of a financial guarantee or letter of credit. In the Board's view, although this difference in legal form may be associated in some cases with differences in substance, the same accounting requirements should, in principle, apply to all contracts with similar substance.~~

~~BC63 Some took the view that the scope of IAS 39 should include all contracts that provide cover against credit risk, on the following grounds:~~

~~(a) Although credit insurers manage credit risk by pooling individual risk within a portfolio, banks also do this in managing the credit risk in a portfolio of financial guarantees. Although banks may rely more on collateral, this is no reason to require a different accounting treatment.~~

~~(b) Banks manage credit risk embedded in their financial assets, and there is no reason to require them to apply a different standard to credit risk embedded in financial guarantees.~~

~~(c) Credit risk is commonly traded in capital markets, even if the specific forms of credit risk embedded in some forms of credit insurance are not traded.~~

~~(d) As noted above, some financial guarantees were already within the scope of IAS 39. To ensure consistent reporting, the scope of IAS 39 should include all contracts that provide protection against similar exposures.~~

~~BC64 Some argued that insurance against credit risk is different from a financial guarantee and should be within the scope of IFRS 4, on the following grounds:~~

(a) ~~Insurance against credit risk is often arranged by the seller of goods and protects the seller against default by the buyer. The fact that default is generally outside the control of the seller, and so is fortuitous, allows the use of~~

~~(a) stochastic methods to estimate future cash flows arising from the contract, because they are random and not subject to moral hazard. By contrast, some financial guarantees, such as some letters of credit, are arranged at the request of the party whose obligation is being guaranteed. Default on such guarantees is partly under the control of that party.~~

~~(b) Insurance against credit risk is part of an insurer's overall insurance activity, and is managed as part of a diversified portfolio in the same way as other insurance activities.~~

~~(c) A credit insurer may refuse to pay a claim if the policyholder did not give full disclosure and may delay payment while a claim is investigated, whereas a guarantor is often required to pay on first notice of a default.~~

~~(d) A credit insurer faces risks similar to those arising in some other insurance contracts. For example, a contract may require payments (either to the debtor or to the creditor) if a debtor's income is reduced by specified adverse events such as unemployment or illness, regardless of whether the debtor continues to make loan payments when due. The issuer of this contract may face risks similar to those faced by a guarantor of the loan.~~

~~(e) Including these contracts within the scope of IAS 39 would compel credit insurers to change their accounting immediately, unlike issuers of other types of insurance contract. Furthermore, some credit insurance contracts contain features, such as cancellation and renewal rights and profit-sharing features, that the Board will not resolve until phase II.~~

~~BC65 When the Board developed ED 5, the following contracts were already within the scope of IAS 39 and the Board concluded that they should remain so:~~

~~(a) a financial guarantee given or retained by a transferor when it derecognises financial assets or financial liabilities. In general, IAS 39 prevents the derecognition of the transferred asset or liability when such a guarantee exists.~~

~~(b) a financial guarantee that does not meet the definition of an insurance contract.~~

~~BC66 Other financial guarantees were within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. In June 2002, an Exposure Draft of amendments to IAS 39 proposed that IAS 39 should deal with all financial guarantees at initial recognition, but that the subsequent measurement of some financial guarantees should remain within the scope of IAS 37. In finalising the revision of IAS 39, issued in December 2003, the Board decided that the issuer of the financial guarantees described in paragraph BC62 (ie those that meet the definition of an insurance contract) should initially recognise them at fair value, and subsequently measure them at the higher of (a) the amount recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.~~

~~BC67 In finalising IFRS 4, the Board reached the following conclusions:~~

~~(a) Financial guarantees can have various legal forms, such as that of a financial guarantee, letter of credit, credit default contract or insurance contract. The accounting should not depend on their legal form.~~

~~(b) A financial guarantee contract should be within the scope of IAS 39 if it is not an insurance contract, as defined in IFRS 4. A financial guarantee qualifies as an insurance contract if it requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument, provided that the resulting risk transfer is significant.~~

~~(c) If an insurance contract is a financial guarantee contract incurred or retained on transferring to another party financial assets or financial liabilities within the scope of IAS 39, the issuer should apply IAS 39 to that contract (even though the contract is an insurance contract, as defined).~~

~~(d) Unless (c) applies, the measurement described in the last sentence of paragraph BC66 is appropriate for a financial guarantee contract that meets the definition of an insurance contract. However, the Board acknowledged the need to expose this conclusion for comment. Mindful of the need to develop a 'stable platform' of Standards for 2005, the Board decided to finalise IFRS 4 without specifying the accounting for these contracts and to develop an Exposure Draft on this topic. In the meantime, the liability adequacy test in paragraphs 15-19 may be particularly relevant if the insurer's accounting policies would not otherwise require it to recognise a liability at the inception of the contract.~~

~~(e) ED 5 proposed that guarantees incurred or retained on derecognition of a non-financial asset or non-financial liability should be treated in the same way as guarantees incurred or retained on derecognition of a financial asset or financial liability. However, no respondents commented on the substance of this proposal and entities responding to ED 5 were not the entities most likely to be affected by this proposal. Therefore, the Board decided to delete the proposal in finalising IFRS 4. It follows that financial guarantees incurred or retained on the transfer of a non-financial asset:~~

~~(i) are within the scope of IFRS 4 if they meet the definition of an insurance contract (pending amendments from the Exposure Draft discussed in (d)). Among other things, this means that the guarantee given is subject to the liability adequacy test described in paragraphs 15-19 of the IFRS.~~

~~(ii) are not recognised separately if they prevent the derecognition of a non-financial asset, for example if they mean that the transfer does not meet the revenue recognition criteria in IAS 18. In such case, the proceeds received are typically recognised as a liability.~~

~~(iii) otherwise, are within the scope of IAS 39.~~

~~BC68 Some respondents asked the Board to give specific guidance on accounting for financial guarantees received. However, the Board decided that this would not be appropriate. For contracts classified as insurance contracts, the beneficiary of the guarantee is a policyholder; policyholder accounting is beyond the scope of IFRS 4. For contracts within the scope of IAS 39, the beneficiary applies IAS 39; the application of IAS 39 to other contracts is beyond the scope of this project.~~

Product warranties

BC69 A product warranty clearly meets the definition of an insurance contract if an entity issues it on behalf of another party (such as a manufacturer, dealer or retailer). The scope of the IFRS includes such warranties.

BC70 A product warranty issued directly by a manufacturer, dealer or retailer also meets the definition of an insurance contract. Although some might think of this as 'self-insurance', the risk retained arises from existing contractual obligations towards the customer. Some may reason that the definition of insurance contracts should exclude such direct warranties because they do not involve a transfer of risk from buyer to seller, but rather a crystallisation of an existing responsibility. However, in the Board's view, excluding these warranties from the definition of insurance contracts would complicate the definition for only marginal benefit.

BC71 Although such direct warranties create economic exposures similar to warranties issued on behalf of the manufacturer, dealer or retailer by another party (ie the insurer), the scope of the IFRS excludes them because they are closely related to the underlying sale of goods and because IAS 37 addresses product warranties. IAS 18 deals with the revenue received for such warranties.

BC72 In a separate project, the Board is exploring an asset and liability approach to revenue recognition. If this approach is implemented, the accounting model for these direct product warranties may change.

Accounting by policyholders

BC73 The IFRS does not address accounting and disclosure by policyholders for direct insurance contracts because the Board does not regard this as a high priority for phase I. The Board intends to address accounting by policyholders in phase II (see IASB *Update* February 2002 for the Board's discussion of accounting by policyholders). IFRSs address some aspects of accounting by policyholders for insurance contracts:

(a) IAS 37 addresses accounting for reimbursements from insurers for expenditure required to settle a provision.

(b) IAS 16 addresses some aspects of compensation from third parties for property, plant and equipment that was impaired, lost or given up.

(c) Because policyholder accounting is outside the scope of the IFRS, the hierarchy of criteria in paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies to policyholder accounting (see paragraphs BC77-BC86).

(d) A policyholder's rights and obligations under insurance contracts are outside the scope of IAS 32 and IAS 39.

develop.

(c) avoids requiring specific disclosures that may not be needed to meet the underlying objectives in the circumstances of every insurer and could lead to information overload that obscures important information in a mass of detail.

(d) gives insurers flexibility to decide on an appropriate level of aggregation that enables users to see the overall picture but without combining information that has different characteristics.

BC202 Some respondents expressed the following general concerns about the proposed disclosure requirements in ED 5:

(a) The proposed volume of disclosure was excessive and some of it would duplicate extensive material included in some countries in prudential returns.

(b) Some of the proposed disclosures would be difficult and costly to prepare and audit, make it difficult to prepare timely financial statements and provide users with little value.

(c) The proposals in ED 5 would require excessive disclosure of sensitive pricing information and other confidential proprietary information.

(d) Some of the disclosures exceeded those required in other industries, which singled out insurers unfairly. Some felt that the level of disclosure would be particularly burdensome for small insurers, whereas others referred to the difficulty of aggregating information in a meaningful way for large international groups.

BC203* The two principles and most of the supporting requirements are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements (particularly ~~IAS 32~~ IFRS 7). ~~The Board's project on financial risk and other amendments to financial instruments disclosures may lead to amendments to IAS 32 that could require consequential amendments to the disclosures for insurance contracts. Furthermore, that project will consider possible disclosures in various areas that IFRS 4 does not address (eg capital and solvency requirements, market risk, liquidity risk and operational risk).~~

BC203A* IFRS 7 was issued in August 2005 and replaced the disclosure requirements in IAS 32, including those on which the disclosures originally in IFRS 4 were based. Accordingly, the Board amended the disclosure requirements in IFRS 4 to be consistent with IFRS 7, when possible. The Board noted that:

(a) insurers will have both insurance contracts and financial instruments. In particular, some of the investment products issued by insurers are financial instruments, not insurance contracts as defined in IFRS 4. It is more useful for users and easier for preparers if the risk disclosures for insurance contracts and financial instruments are the same.

* Effective for annual periods beginning on or after 1 January 2007.

(b) making the disclosure requirements of IFRS 4 consistent with IFRS 7 makes the disclosures easier to prepare. In particular, IFRS 7 removes the “terms and conditions” disclosure previously in paragraph 39(b) of IFRS 4. Some commentators on ED 5 (the Exposure Draft that preceded IFRS 4) objected to this disclosure requirement, believing it to be onerous and not to provide the most useful information.

(c) the disclosures in IFRS 7 are designed to be implemented as a package, and if implemented piecemeal would result in less useful information for users. For example, the risk disclosures replace the “terms and conditions” disclosure previously in paragraph 60(a) of IAS 32 and paragraph 39(b) of IFRS 4. Merely updating the reference in paragraph 39(d) from IAS 32 to IFRS 7 would have resulted in some, but not all, of the risk disclosures being applicable to insurance contracts and the “terms and conditions” disclosure being retained.

(d) as discussed in paragraph BC207, significant changes to the risk disclosures in paragraphs 38-39A are not expected as a result of phase II of the project on insurance contracts (although consequential changes may be needed to the accounting-related disclosures in paragraphs 36 and 37).

BC203B* Some respondents, particularly preparers, did not agree that IFRS 4 should be amended as part of IFRS 7. In particular, some respondents argued that sensitivity analysis of market risk would be problematic for insurance contracts; they disagreed that such an analysis would be relatively easy to understand or calculate while issues relating to the measurement of fair value for insurance contracts remain unresolved. Those respondents suggested that disclosure requirements on sensitivity analysis should be considered during phase II of the project on insurance contracts, rather than in finalising IFRS 7. The Board noted that this requirement should not be unduly onerous for insurers, nor require them to provide quantitative information, because the sensitivity analysis applies only to changes in market risk variables that have an effect on profit or loss and equity in the period being reported. In addition, the Board noted that a sensitivity analysis is intended to replace the terms and conditions disclosures, which entities found onerous. The Board did not want to *require* insurers to comply with the older terms and conditions disclosures while allowing other entities to use the less onerous sensitivity analysis. However, the Board also noted that providing the sensitivity analysis would mean systems changes for some entities. Because the purpose of IFRS 4 was to minimise such changes pending the outcome of phase II, the Board did not want to require extensive systems changes for insurance contracts as a result of IFRS 7.

BC203C* To address the concerns of those who do not want to make systems changes and those who want to substitute the new sensitivity analysis for the terms and conditions disclosures, the Board decided to permit a choice of sensitivity analysis disclosures for insurance risk only. Paragraph 39A of IFRS 4 has been added so that entities will be able to choose between providing:

(a) the terms and conditions disclosures, together with the qualitative sensitivity analysis currently permitted by IFRS 4; or

(b) the quantitative sensitivity analysis required by IFRS 7 (and permitted, but not required, by IFRS 4).

* Effective for annual periods beginning on or after 1 January 2007.

The Board permitted entities to choose to disclose a combination of qualitative and quantitative sensitivity analysis for insurance risk because it believes that entities should not be prevented from providing more useful information for some insurance risks, even if they do not have the ability to provide this information for all insurance risks. The Board noted that this option was a temporary solution to the problems cited in paragraph BC203B and would be eliminated in phase II.

BC204 Many respondents asked the Board to clarify the status of the Implementation Guidance. In particular, some felt that the Implementation Guidance appeared to impose detailed and voluminous requirements that contradicted the Board's stated intention in paragraph BC201. In response to requests from respondents, the Board added paragraph IG12 to clarify the status of the implementation guidance on disclosure.

BC205 Some suggested that some of the disclosures, particularly those that are qualitative rather than quantitative or convey management's assertions about possible future developments, should be located outside the financial statements in a financial review by management. However, in the Board's view, the disclosure requirements are all essential and should be part of the financial statements.

BC206 Some argued that the disclosure requirements could be particularly onerous and less relevant for a subsidiary, especially if the parent guarantees the liabilities or the parent reinsures all the liabilities. However, the Board decided that no exemptions from the disclosure principles were justified. Nevertheless, the high level and flexible approach adopted by the Board enables a subsidiary to disclose the required information in a way that suits its circumstances.

BC207 Some respondents expressed concerns that the disclosure proposals in ED 5 might require extensive systems changes in phase I that might not be needed in phase II. The Board expects that both disclosure principles will remain largely unchanged for phase II, although the guidance to support them may need refinement because different information will be available and because insurers will have experience of developing systems to meet the disclosure principles in phase I.

Materiality

BC208 Some respondents expressed concerns that the IFRS (reinforced by the Implementation Guidance) might require disclosure of excessively detailed information that might not be beneficial to users. In response to these concerns, the Board included in the Implementation Guidance a discussion of materiality taken from IAS 1.

BC209 Some respondents suggested that some of the qualitative disclosures should not be subject to the normal materiality threshold, which might, in their view, lead to excessive disclosure. They proposed using different terminology, such as 'significant', to reinforce that message. However, the Board noted that not requiring disclosure of material information would be inconsistent with the definition of materiality. Thus, the Board concluded that the disclosure should, in general, rely solely on the normal definition of materiality.

BC210 In one place, the IFRS refers to a different notion. Paragraph 37(c) refers to 'the assumptions that have the greatest effect on the measurement of' assets, liabilities, income and expense arising from insurance contracts. Because many assumptions could be relevant, the Board decided to narrow the scope of the disclosure somewhat.

Explanation of recognised amounts Assumptions

BC211 The first disclosure principle in the IFRS requires disclosure of amounts in an insurer's balance sheet and income statement that arise from insurance contracts (paragraph 36 of the IFRS). In support of this principle, paragraph 37(c) and (d) requires disclosure about assumptions and changes in assumptions. The disclosure of assumptions both assists users in testing reported information for sensitivity to changes in those assumptions and enhances their confidence in the transparency and comparability of the information.

BC212 Some expressed concerns that information about assumptions and changes in assumptions might be costly to prepare and of limited usefulness. There are many possible assumptions that could be disclosed: excessive aggregation would result in meaningless information, whereas excessive disaggregation could be costly, lead to information overload, and reveal commercially sensitive information. In response to these concerns, the disclosure about the assumptions focuses on the process used to derive them.

BC213 Some respondents argued that it is difficult to disclose meaningful information about changes in interdependent assumptions. As a result, an analysis by sources of change often depends on the order in which the analysis is performed. To acknowledge this difficulty, the IFRS does not specify a rigid format or contents for this analysis. This allows insurers to analyse the changes in a way that meets the objective of the disclosure and is appropriate for the risks they face and the systems that they have, or can enhance at a reasonable cost.

Changes in insurance liabilities

BC214 Paragraph 37(e) of the IFRS requires a reconciliation of changes in insurance liabilities, reinsurance assets and, if any, deferred acquisition costs. IAS 37 requires broadly comparable disclosure of changes in provisions, but the scope of IAS 37 excludes insurance contracts. Disclosure about changes in deferred acquisition costs is important because some existing methods use adjustments to deferred acquisition costs as a means of recognising some effects of remeasuring the future cash flows from an insurance contract (for example, to reflect the result of a liability adequacy test).

~~Amount, timing and uncertainty of cash flows~~Nature and extent of risk arising from insurance contracts*

BC215* The second disclosure principle in the IFRS requires disclosure of information that ~~helps~~ enables users of its financial statements to ~~understand~~ evaluate the ~~amount, timing and uncertainty of future cash flows~~ nature and extent of risks arising from insurance contracts (paragraph 38 of the IFRS). The Implementation Guidance supporting this principle builds largely on existing requirements in IFRSs, particularly the disclosures for financial instruments in ~~IAS 32~~IFRS 7.

* Effective for annual periods beginning on or after 1 January 2007.

BC216 Some respondents read the draft Implementation Guidance accompanying ED 5 as implying that the IFRS would require disclosures of estimated cash flows. That was not the Board's intention because insurers cannot be expected to have systems to prepare detailed estimates of cash flows in phase I (beyond what is needed for the liability adequacy test). The Board revised the Implementation Guidance to emphasise that the second disclosure principle requires disclosure **about** cash flows (ie disclosure that helps users understand their amount, timing and uncertainty), not disclosure **of** cash flows.

Insurance risk

BC217 For insurance risk (paragraph 39(c)), the disclosures are intended to be consistent with the spirit of the disclosures required by IAS 32. The usefulness of particular disclosures about insurance risk depends on the circumstances of a particular insurer. Therefore, the requirements are written in general terms to allow practice in this area to evolve.

Sensitivity analysis

BC218 Paragraph 39(c)(i) requires disclosure of a sensitivity analysis. The Board decided not to include specific requirements that may not be appropriate in every case and could impede the development of more useful forms of disclosure or become obsolete.

BC219 IAS 32 requires disclosure of a sensitivity analysis only for assumptions that are not supported by observable market prices or rates. However, because the IFRS does not require a specific method of accounting for embedded options and guarantees, including some that are partly dependent on observable market prices or rates, paragraph 39(c)(i) requires a sensitivity analysis for all variables that have a material effect, including variables that are observable market prices or rates.

Appendix
Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The first footnote to paragraph BC138 is amended as follows:

BC138 If embedded values are recognised in the statement of financial position ~~balance sheet~~, they are typically presented as two components: an insurance liability and a separate intangible asset. This is similar to the expanded presentation that the IFRS permits in a business combination or portfolio transfer.

In paragraph BC160, ‘accumulated profits’ is amended to ‘retained earnings’.

Paragraph BC211 is footnoted as follows:

BC211 The first disclosure principle in the IFRS requires disclosure of amounts in an insurer’s balance sheet* and income statement† that arise from insurance contracts (paragraph 36 of the IFRS). ...

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) replaced the term ‘balance sheet’ with ‘statement of financial position’.

† IAS 1 (revised 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

This guidance accompanies, but is not part of, HKFRS 4. This version was published in March 2006 and applies when an entity adopts HKFRS 7 *Financial Instruments: Disclosures*. It supersedes the version published with HKFRS 4 in August 2004. The text of the revised section (paragraphs IG11-IG71), marked up to show the changes from the previous version, is available from the HKICPA Website at www.hkicpa.org.hk for a limited period.

1.8	Investment contract[(a)] that does not contain a discretionary participation feature.	Within the scope of HKAS 39.
1.9	Investment contract containing a discretionary participation feature.	Paragraph 35 of the HKFRS sets out requirements for these contracts, which are excluded from the scope of HKAS 39.
1.10	Investment contract in which payments are contractually linked (with no discretion) to returns on a specified pool of assets held by the issuer.	Within the scope of HKAS 39. Payments denominated in unit values representing the fair value of the specified assets are measured at current unit value (see paragraph AG33(g) of Appendix A of HKAS 39).
1.11	Contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. The contract may have various legal forms (eg insurance contract, financial guarantee or letter of credit).	Insurance contract, but within the scope of HKAS 39, not HKFRS 4. However, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either HKAS 39 and ~~HKAS 32~~ HKFRS 7* or HKFRS 4 to such financial guarantee contracts. Within the scope of the HKFRS, unless the contract was entered into or retained on the transfer of financial assets or financial liabilities within the scope of HKAS 39. If the issuer's accounting policies do not require it to recognise a liability at inception, the liability adequacy test in paragraphs 15-19 of the HKFRS may be particularly relevant. The legal form of the contract does not affect its recognition and measurement. Accounting by the holder of such a contract is excluded from the scope of HKAS 39 and HKFRS 4 (unless the contract is a reinsurance contract). Therefore, paragraphs 10-12 of HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors apply. Those paragraphs specify criteria to use in developing an accounting policy if no HKFRS applies specifically to an item.
1.12	A credit-related ~~financial~~ guarantee that does not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee ~~contract~~ is one that requires payments in response to changes in a specified credit rating or credit index.	Not an insurance contract. A derivative within ~~Within~~ the scope of HKAS 39.

* Effective for annual periods beginning on or after 1 January 2007.

1.13	Guarantee fund established by contract. The contract requires all participants to pay contributions to the fund so that it can meet obligations incurred by participants (and, perhaps, others). Participants would typically be from a single industry, eg insurance, banking or travel.	The contract that establishes the guarantee fund is an insurance contract (see IG Example 1.11).
1.14	Guarantee fund established by law.	The commitment of participants to contribute to the fund is not established by a contract, so there is no insurance contract. Within the scope of HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
1.15	Residual value insurance or residual value guarantee. Guarantee by one party of the fair value at a future date of a non-financial asset held by a beneficiary of the insurance or guarantee.	Insurance contract within the scope of the HKFRS (unless changes in the condition of the asset have an insignificant effect). The risk of changes in the fair value of the non-financial asset is not a financial risk because the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific asset held (a non-financial variable). However, if the contract compensates the beneficiary only for changes in market prices and not for changes in the condition of the beneficiary's asset, the contract is a derivative and within the scope of HKAS 39. Residual value guarantees given by a lessee under a finance lease are within the scope of HKAS 17 *Leases*.
1.16	Product warranties issued directly by a manufacturer, dealer or retailer.	Insurance contracts, but excluded from the scope of the HKFRS (see HKAS 18 *Revenue* and HKAS 37).
1.17	Product warranties issued by a third party.	Insurance contracts, no scope exclusion. Same treatment as other insurance contracts.
1.18	Group insurance contract that gives the insurer an enforceable and non-cancellable contractual right to recover all claims paid out of future premiums, with appropriate compensation for the time value of money.	Insurance risk is insignificant. Therefore, the contract is a financial instrument within the scope of HKAS 39. Servicing fees are within the scope of HKAS 18 (recognise as services are provided, subject to various conditions).
1.19	Catastrophe bond: bond in which principal, interest payments or both are reduced if a specified triggering event occurs and the triggering event does not include a condition that the issuer of the bond suffered a loss.	Financial instrument with embedded derivative. Both the holder and the issuer measure the embedded derivative at fair value.
1.20	Catastrophe bond: bond in which principal, interest payments or both are reduced significantly if a specified triggering event occurs and the triggering event includes a condition that the issuer of the bond suffered a loss.	The contract is an insurance contract, and contains an insurance component (with the issuer as policyholder and the holder as the insurer) and a deposit component. (a) If specified conditions are met, paragraph 10 of the HKFRS requires the holder to unbundle the deposit

		component and apply HKAS 39 to it. (b) The issuer accounts for the insurance component as reinsurance if it uses the bond for that purpose. If the issuer does not use the insurance component as reinsurance, it is not within the scope of the HKFRS, which does not address accounting by policyholders for direct insurance contracts. (c) Under paragraph 13 of the HKFRS, the holder could continue its existing accounting for the insurance component, unless that involves the practices prohibited by paragraph 14.
1.21	An insurance contract issued by an insurer to a defined benefit pension plan covering the employees of the insurer, or of another entity consolidated within the same financial statements as the insurer.	The contract will generally be eliminated from the financial statements, which will include: (a) the full amount of the pension obligation under HKAS 19 *Employee Benefits*, with no deduction for the plan's rights under the contract. (b) no liability to policyholders under the contract. (c) the assets backing the contract.
1.22	An insurance contract issued to employees as a result of a defined contribution pension plan. The contractual benefits for employee service in the current and prior periods are not contingent on future service. The insurer also issues similar contracts on the same terms to third parties.	Insurance contract within the scope of the HKFRS. If the employer pays part or all of the employee's premiums, the payment by the employer is an employee benefit within the scope of HKAS 19. See also HKAS 19, paragraphs 39-42 and 104-104D. Furthermore, a 'qualifying insurance policy' as defined in HKAS 19 need not meet the definition of an insurance contract in this HKFRS.
1.23	Loan contract containing a prepayment fee that is waived if prepayment results from the borrower's death.	Not an insurance contract. Before entering into the contract, the borrower faced no risk corresponding to the prepayment fee. Hence, although the loan contract exposes the lender to mortality risk, it does not transfer a pre-existing risk from the borrower. Thus, the risk associated with the possible waiver on death of the prepayment fee is not insurance risk (paragraphs B12 and B24(b) of Appendix B of the HKFRS).
1.24	Loan contract that waives repayment of the entire loan balance if the borrower dies.	This contract contains a deposit component (the loan) and an insurance component (waiver of the loan balance on death, equivalent to a cash death benefit). If specified conditions are met, paragraph 10 of the HKFRS requires or permits unbundling. If the insurance component is not unbundled, the contract is an insurance contract if the insurance component is significant in relation to the whole contract.

Appendix
Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph IG43 is amended as follows:

IG43 Under ~~HKAS 14 *Segment Reporting*~~ HKFRS 8 *Operating Segments*, the identification of reportable segments reflects ~~differences in the risks and returns of an entity's products and services~~ the way in which management allocates resources and assesses performance. ~~HKAS 14 takes the position that the segments identified in an organisational and management structure and internal financial reporting system normally provide an appropriate segmentation for financial reporting.~~ An insurer might adopt a similar approach to identify broad classes of insurance contracts for disclosure purposes, although it might be appropriate to disaggregate disclosures down to the next level. For example, if an insurer identifies life insurance as a reportable segment for ~~HKAS 14~~ HKFRS 8, it might be appropriate to report separate information about, say, life insurance, annuities in the accumulation phase and annuities in the payout phase.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

IG Example 4 is amended as follows:

IG Example 4: Shadow accounting

Background

[Third paragraph] … Before adopting ~~IFRSs~~HKFRSs for the first time in 20X5 ~~2005~~, insurer A measured financial assets on a cost basis. … Thus, insurer A measures the assets at fair value and recognises changes in their fair value ~~directly in equity, through the statement of changes in equity~~ in other comprehensive income. In 20X5 ~~2005~~, insurer A recognises unrealised gains …

In 20X6 ~~2006~~, insurer A sells the assets for an amount equal to their fair value at the end of 20X5 ~~2005~~ and, to comply with ~~IAS~~HKAS 39, ~~transfers~~ reclassifies the now-realised gain of CU10 from equity to profit or loss as a reclassification adjustment.

Application of paragraph 30 of the ~~IFRS~~HKFRS

[First paragraph] … If insurer A adopts shadow accounting, it amortises DAC in 20X5 ~~2005~~ by an additional CU2 … Because insurer A recognised the change in their fair value ~~in equity~~ in other comprehensive income, it recognises the additional amortisation of CU2 ~~directly in equity, through the statement of changes in equity~~ in other comprehensive income.

When insurer A sells the assets in 20X6 ~~2006~~, it makes no further adjustment to DAC, but ~~transfers~~ reclassifies DAC amortisation of CU2, relating to the now-realised gain, from equity to profit or loss as a reclassification adjustment.

> In summary, shadow accounting treats an unrealised gain in the same way as a realised gain, except that the unrealised gain and resulting DAC amortisation are (a) recognised ~~in equity~~ in other comprehensive income rather than in profit or loss and (b) ~~transferred~~ reclassified from equity to profit or loss when the gain on the asset becomes realised. …

In paragraph IG15, in the quotation from ~~IAS~~HKAS 1, 'of users taken' is amended to 'that users make'.

In paragraph IG24, 'disclose' is amended to 'present'.

Paragraph IG27 is amended as follows:

IG27 Some insurers present a detailed analysis of the sources of their earnings from insurance activities either in the ~~income~~ statement of comprehensive income or in the notes ~~as a complement to an income statement presented in a more traditional format~~. Such …

Paragraph IG32(h) is amended as follows:

IG32 (h) the nature and extent of uncertainties affecting specific assumptions. In addition, to comply with paragraphs ~~116–122~~ 125–131 of ~~IAS~~HKAS 1, ... Paragraph ~~120~~ 129 of ~~IAS~~HKAS 1 gives further guidance on this disclosure.

In paragraph IG46, 'on the balance sheet' is amended to 'in the statement of financial position'.

Contents

Appendix C

Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period.

With effect from 1 January 2005, all the existing Statements of Standard Accounting Practice (SSAP) and Interpretations for which there are equivalent International Accounting Standards(IAS) and SIC Interpretations will be renamed as Hong Kong Accounting Standards (HKAS) and HKAS Interpretations (HKAS-Int) with numbers corresponding to the equivalent IAS and SIC Interpretations, respectively. Accordingly, the accounting standard and paragraph references that appear below may differ from those found in the existing SSAPs as they have taken into account the changes to be made to the name, number, paragraph numbering as well as appendix referencing of the existing SSAPs in order to conform to those of the equivalent IASs.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~C1 HKAS 1 *Presentation of Financial Statements*, is amended as described below.~~

~~Paragraph 68 is amended to read as follows:~~

~~***68. As a minimum, the face of the balance sheet shall include line items that present the following amounts to the extent that they are not presented in accordance with paragraph 68A:***~~

~~***(a) ...***~~

~~Paragraph 68A is added as follows:~~

~~***68A. The face of the balance sheet shall also include line items that present the following amounts:***~~

~~***(a) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with HKFRS 5* **Non-current Assets Held for Sale and Discontinued Operations*****; and***~~

~~***(b) liabilities included in disposal groups classified as held for sale in accordance with HKFRS 5.***~~

~~Paragraph 81 is amended to read as follows:~~

~~***81. As a minimum, the face of the income statement shall include line items that present the following amounts for the period:***~~

~~***...***~~

~~***(d) tax expense;***~~

~~***(e)*** ***a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and***~~

~~***(f)*** ***profit or loss.***~~

~~Paragraph 87(e) is amended to read as follows:~~

~~(e) discontinued operations;~~

~~C2 In HKAS 10 *Events after the Balance Sheet Date*, paragraph 22(b) and (c) is amended to read as follows:~~

~~(b) announcing a plan to discontinue an operation;~~

~~(c) major purchases of assets, classification of assets as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, other disposals of assets, or expropriation of major assets by government;~~

~~C3 HKAS 14 *Segment Reporting* is amended as described below. Paragraph 52 is amended to read as follows:~~

~~***52.*** ***An entity shall disclose segment result for each reportable segment, presenting the result from continuing operations separately from the result from discontinued operations.***~~

~~Paragraph 52A is added as follows:~~

~~***52A.*** ***An entity shall restate segment results in prior periods presented in the financial statements so that the disclosures required by paragraph 52 relating to discontinued operations relate to all operations that had been classified as discontinued at the balance sheet date of the latest period presented.***~~

~~Paragraph 67 is amended to read as follows:~~

~~***67.*** ***An entity shall present a reconciliation between the information disclosed for reportable segments and the aggregated information in the consolidated or individual financial statements. In presenting the reconciliation, the entity shall reconcile segment revenue to entity revenue from external customers (including disclosure of the amount of entity revenue from external customers not included in any segment); segment result from continuing operations shall be reconciled to a comparable measure of entity operating profit or loss from continuing operations as well as to entity profit or loss from continuing operations; segment result from discontinued operations shall be reconciled to entity profit or loss from discontinued operations; segment assets shall be...***~~

~~C4 HKAS 16 *Property, Plant and Equipment*, is amended as described below.~~

~~Paragraph 3 is amended to read as follows:~~

~~3. This Standard does not apply to:~~

~~(a) property, plant and equipment classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations;*~~

~~(b) biological assets...; or~~

~~(c) mineral rights...~~

~~However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (b) and (c).~~

~~Paragraph 55 is amended to read as follows:~~

~~55. ... Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, ...~~

~~Paragraph 73(e)(ii) is amended to read as follows:~~

~~***(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;***~~

~~Paragraph 79(c) is amended to read as follows:~~

~~(c) the carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with HKFRS 5;~~

~~C5 In HKAS 17 *Leases*, paragraph 41A is added as follows:~~

~~41A. An asset under a finance lease that is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 shall be accounted for in accordance with that HKFRS.~~

~~C6 HKAS 27 *Consolidated and Separate Financial Statements* is amended as described below.~~

~~Paragraph 12 is amended to read as follows:~~

~~***12. Consolidated financial statements shall include all subsidiaries of the parent.****~~

~~A footnote is added to paragraph 12, as follows:~~

~~* If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it shall be accounted for in accordance with that Standard.~~

~~Paragraphs 16-18 are deleted.~~

~~Paragraph 37 is amended to read as follows:~~

~~***37. When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 shall be accounted for either:***~~

~~***(a) at cost, or***~~

~~***(b) in accordance with HKAS 39.***~~

~~***The same accounting shall be applied for each category of investments. Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 shall be accounted for in accordance with that HKFRS.***~~

~~Paragraph 39 is amended to read as follows:~~

~~***39. Investments in jointly controlled entities and associates that are accounted for in accordance with HKAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.***~~

~~Paragraph 40(a) and (b) is deleted.~~

~~In the Basis for Conclusions, at the end of paragraph BC14 a footnote is added, as follows:~~

~~* In March 2004, the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removes this scope exclusion and now eliminates the exemption from consolidation when control is intended to be temporary. See IFRS 5 Basis for Conclusions for further discussion.~~

~~C7 HKAS 28 *Investments in Associates* is amended as described below.~~

~~Paragraph 13 is amended to read as follows:~~

~~***13. An investment in an associate shall be accounted for using the equity method except when:***~~

~~***(a)the investment is classified as held for sale in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations*****;***~~

~~***(b) ...***~~

~~Paragraph 14 is amended to read as follows:~~

~~***14. Investments described in paragraph 13(a) shall be accounted for in accordance with HKFRS 5.***~~

~~Paragraph 15 is amended so that, after the deletion of the reference to SSAP 30 *Business Combinations* made by HKFRS 3 *Business Combinations*, it reads as follows:~~

~~15. When an investment in an associate previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.~~

~~Paragraph 16 is deleted.~~

~~Paragraph 38 is amended to read as follows:~~

~~…~~

~~***38. …disclosed. The investor's share of any discontinued operations of such associates shall also be separately disclosed.***~~

~~In the Basis for Conclusions, at the end of paragraph BC14 a footnote is added, as follows:~~

~~* In March 2004, the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removes this scope exclusion and now eliminates the exemption from applying the equity method when significant influence over an associate is intended to be temporary. See IFRS 5 Basis for Conclusions for further discussion.~~

~~C8 HKAS 31 *Interests in Joint Ventures* is amended as described below.~~

~~Paragraph 2(a) is amended to read as follows:~~

~~***(a) the interest is classified as held for sale in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations;**~~

~~Paragraph 42 is amended to read as follows:~~

~~42.***Interests in jointly controlled entities that are classified as held for sale in accordance with HKFRS 5 shall be accounted for in accordance with that HKFRS.***~~

~~Paragraph 43 is amended so that, after the deletion of the reference to SSAP 30 *Business Combinations* made by HKFRS 3, it reads as follows:~~

~~43.When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly.~~

~~Paragraph 44 is deleted.~~

~~In the Basis for Conclusions, at the end of paragraph BC13 a footnote is added, as follows~~:

~~* In March 2004, the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removes this scope exclusion and now eliminates the exemption from applying proportionate consolidation or the equity method when joint control of a joint venture is intended to be temporary. See IFRS 5 Basis for Conclusions for further discussion.~~

~~C9 SSAP 31 *Impairment of Assets* is amended as described below.~~

~~Paragraph 1 is amended to read as follows:~~

~~***1.This Standard shall be applied in accounting for the impairment of all assets, other than:***~~

~~***(a) ...***~~

~~***(f) ... (see HKAS 40* Investment Property*);***~~

~~***(g) ... (see HKAS 41* Agriculture*); and***~~

~~***(h) non-current assets (or disposal groups) classified as held for sale in accordance with HKFRS 5* Non-current Assets Held for Sale and Discontinued Operations.**~~

~~Paragraph 2 is amended to read as follows:~~

~~2.This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing Standards applicable to these assets already contain specific requirements for recognising and measuring these assets.~~

~~In paragraph 5 the definition of a cash-generating unit is amended to read as follows:~~

~~***A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.***~~

~~A footnote is added to the last sentence of paragraph 9(f), as follows:~~

~~* Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of HKAS 36 and is accounted for in accordance with HKFRS 5.~~

~~C10 HKAS 36 *Impairment of Assets* is amended as described below.~~

~~All references to 'net selling price' are replaced by 'fair value less costs to sell'.~~

~~Paragraph 2 is amended to read as follows:~~

~~***2. This Standard shall be applied in accounting for the impairment of all assets, other than:***~~

~~***(a) …***~~

~~***(i)*** ***non-current assets (or disposal groups) classified as held for sale in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations*****.***~~

~~Paragraph 3 is amended to read as follows:~~

~~3.This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, or assets classified as held for sale (or included in a disposal group that is classified as held for sale) because existing Standards applicable to these assets contain requirements for recognising and measuring these assets.~~

~~In paragraph 6 the definition of a cash-generating unit is amended to read as follows:~~

~~***A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.***~~

~~A footnote is added to the last sentence of paragraph 12(f), as follows:~~

~~* Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of the Standard and is accounted for in accordance with HKFRS 5.~~

~~C11 In HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 9 is amended to read as follows:~~

~~9. This Standard applies to provisions for restructurings (including discontinued operations). When a restructuring meets the definition of a discontinued operation, additional disclosures may be required by HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.~~

~~C12 SSAP 29 *Intangible Assets* is amended as described below.~~

~~Paragraph 2 is amended to read as follows:~~

~~2....For example, this Standard does not apply to:~~

~~(a)...~~

~~(d)... ;~~

~~(e)... and Measurement); and~~

~~(g) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.~~

~~Paragraph 79 is amended to read as follows:~~

~~***79. ... Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations** ***and the date that the asset is derecognised.***~~

~~Paragraph 106 is amended to read as follows:~~

~~106. Amortisation does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5.~~

~~Paragraph 107(e)(ii) is amended to read as follows:~~

~~(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;~~

~~C13. HKAS 38 *Intangible Assets* is amended as described below.~~

~~Paragraph 3 is amended to read as follows:~~

~~3. ... For example, this Standard does not apply to:~~

~~(a) …~~

~~(h) non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.~~

~~Paragraph 97 is amended to read as follows:~~

~~***97. ... Amortisation shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations** ***and the date that the asset is derecognised...***~~

~~Paragraph 117 is amended to read as follows:~~

~~117. Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5.~~

~~Paragraph 118(e)(ii) is amended to read as follows:~~

~~(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;~~

~~C14 HKAS 40 *Investment Properties* is amended as described below.~~

~~Paragraph 9(a) is amended to read as follows:~~

~~(a) property intended for sale in the ordinary course of business…~~

~~Paragraph 56 is amended to read as follows:~~

~~***56. After initial recognition, an entity that chooses the cost model shall measure all of its investment properties in accordance with HKAS 16's requirements for that model other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations.** ***Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with HKFRS 5.***~~

~~Paragraph 76(c) is amended to read as follows:~~

~~***(c) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;***~~

~~Paragraph 79(d)(iii) is amended to read as follows:~~

~~***(iii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with HKFRS 5 and other disposals;***~~

~~C15 HKAS 41 *Agriculture* is amended as described below.~~

~~Paragraph 30 is amended to read as follows:~~

~~***30. There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less estimated point-of-sale costs. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with HKFRS 5*** **Non-current Assets Held for Sale and Discontinued Operations,** ***it is presumed that fair value can be measured reliably.***~~

~~Paragraph 50(c) is amended to read as follows:~~

~~***(c) decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5;***~~

~~C16 HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* is amended as described below.~~

~~Paragraph 12(b) is amended to read as follows:~~

~~(b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.~~

~~Paragraph 26 is amended to read as follows:~~

~~26 This HKFRS prohibits retrospective application of some aspects of other HKFRSs relating to:~~

~~(a) …~~

~~(b) hedge accounting (paragraphs 28-30);~~

~~(c) estimates (paragraphs 31-34); and~~

~~(d) assets classified as held for sale and discontinued operations.~~

~~Paragraph 34A is added as follows:~~

~~34A HKFRS 5 requires that it shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the HKFRS. HKFRS 5 permits an entity to apply the requirements of the HKFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the HKFRS, provided the valuations and other information needed to apply the HKFRS were obtained at the time those criteria were originally met.~~

~~Paragraph 34B is added as follows:~~

~~34B An entity with a date of transition to HKFRSs before 1 January 2005 shall apply the transitional provisions of HKFRS 5. An entity with a date of transition to HKFRSs on or after 1 January 2005 shall apply HKFRS 5 retrospectively.~~

~~C17 HKFRS 3 *Business Combinations* is amended as described below.~~

~~Paragraph 36 is amended to read as follows:~~

~~**36 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which shall be recognised at fair value less costs to sell. Any difference...**~~

~~Paragraph 75(b) and (d) is amended to read as follows:~~

~~(b) additional goodwill recognised during the period except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with HKFRS 5;~~

~~(d) goodwill included in a disposal group classified as held for sale in accordance with HKFRS 5 and goodwill derecognised during the period without having previously been included in a disposal group~~

~~classified as held for sale;~~

~~C18 In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, applicable at 31 March 2004, references to 'discontinuing operations' are amended to 'discontinued operations'.~~

Appendix E

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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 41 is amended as follows:

41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

...

(d) if applicable, the <u>reportable</u> segment in which the non-current asset (or disposal group) is presented in accordance with ~~HKAS 14 Segment Reporting~~ <u>HKFRS 8 *Operating Segments*</u>.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

In paragraph 28, ‘in the same income statement caption’ is amended to ‘in the same caption in the statement of comprehensive income’.

Paragraph 33A is added as follows:

33A If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of HKAS 1 (as revised in 2007), a section identified as relating to discontinued operations is presented in that separate statement.

In paragraph 38, ‘recognised directly in equity’ is amended to ‘recognised in other comprehensive income’.

Paragraph 44A is added as follows:

44A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 3 and 38, and added paragraph 33A. 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.

In Appendix A, the definition of **current asset** is amended as follows:

> An entity shall classify an asset as current when: ~~that satisfies any of the following criteria:~~
>
> (a) it ~~is~~ expects~~ed~~ to ~~be~~realise~~d in~~ the asset, or ~~is~~ intends~~ed for~~ to ~~sale~~ sell or consum~~eption~~ it, in~~, the entity's~~ its normal operating cycle;
>
> (b) it ~~is held~~ holds the asset primarily for the purpose of ~~being~~ trading~~ed~~;
>
> (c) it ~~is~~ expects~~ed~~ to ~~be~~ realise~~d~~ the asset within twelve months after the ~~balance sheet date~~ reporting period; or
>
> (d) ~~it~~ the asset is cash or a cash equivalent (as defined in HKAS 7) unless the asset ~~it~~ is restricted from being exchanged or used to settle a liability for at least twelve months after the ~~balance sheet date~~ reporting period.

HKFRS 5 is based on IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. In approving HKFRS 5, the Council of the Hong Kong Society of Accountants considered and agreed with the IASB's basis for conclusions on IFRS 5. Accordingly, there are no significant differences between HKFRS 5 and IFRS 5. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IFRS 5 referred to below generally correspond with those in HKFRS 5.

Contents

Basis for Conclusions IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Appendix
Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC37 is footnoted as follows:

BC37 When an asset or a disposal group held for sale is part of a foreign operation with a functional currency that is different from the presentation currency of the group, an exchange difference will have been recognised in equity* arising from the translation of the asset or disposal group into the presentation currency of the group. IAS 21 …

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* (as revised in 2007) such a difference is recognised in other comprehensive income.

The footnote to paragraph BC54 is amended as follows:

Greater disaggregation of the disposal group ~~on the face of~~ in the statement of financial position ~~balance sheet~~ is permitted but not required.

Paragraph BC76 is footnoted as follows:

BC76 The Board believes … The IFRS therefore permits an analysis of the single net amount to be presented either in the notes or ~~on the face of~~ in the income statement.*

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

In paragraph BC85, a footnote is added as follows:

Measurement on initial classification	Converged, other than cumulative exchange differences recognised directly in equity* that are included in the carrying amount of the assets (or disposal group) under US GAAP but are not under IFRS 5.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* (as revised in 2007) such differences are recognised in other comprehensive income.

Contents

Guidance on Implementing HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

In Example 11, the title is amended as follows:

> **'XYZ GROUP – ~~INCOME~~ STATEMENT <u>OF COMPREHENSIVE INCOME</u> FOR THE YEAR ENDED 31 DECEMBER 20X2 (illustrating the classification of expenses by function)'**
>
> Example 11 is footnoted as follows:
>
> '(b) The entity did not recognise any components of other comprehensive income in the periods presented.'

In Example 12, in footnote (a) and in the statement of financial position, 'directly in equity' is amended to 'in other comprehensive income and accumulated in equity'.

Contents

Hong Kong Financial Reporting Standard 6 *Exploration for and Evaluation of Mineral Resources* (HKFRS 6) is set out in paragraphs 1-27 and Appendices A and B. 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 6 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for 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.

MEASUREMENT OF EXPLORATION AND EVALUATION ASSETS

Measurement at recognition

8 Exploration and evaluation assets shall be measured at cost.

Elements of cost of exploration and evaluation assets

9 An entity shall determine ~~a~~an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies;

(c) exploratory drilling;

(d) trenching;

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

10 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The *Framework* and HKAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development.

11 In accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.

Measurement after recognition

12 After recognition, an entity shall apply either the cost model or the revaluation model to the exploration and evaluation assets. If the revaluation model is applied (either the model in HKAS 16 *Property, Plant and Equipment* or the model in HKAS 38) it shall be consistent with the classification of the assets (see paragraph 15).

Changes in accounting policies

13 An entity may change its accounting policies for exploration and evaluation expenditures if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in HKAS 8.

14 To justify changing its accounting policies for exploration and evaluation expenditures, an entity shall demonstrate that the change brings its financial statements closer to meeting the criteria in HKAS 8, but the change need not achieve full compliance with those criteria.

Appendix B
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2006. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period. In the amendments, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~B1 In HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*, a heading and paragraph 36B are added as follows:~~

~~**Exemption from the requirement to provide comparative disclosures for HKFRS 6**~~

~~36B An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 6 *Exploration for and Evaluation of Mineral Resources* before 1 January 2006 need not present the disclosures required by HKFRS 6 for comparative periods in its first HKFRS financial statements.~~

~~B2 In HKAS 16 *Property, Plant and Equipment* (as amended by HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*), paragraph 3 is amended to read as follows:~~

~~3. This Standard does not apply to:~~

~~(a) property, plant and equipment classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;~~

~~(b) biological assets related to agricultural activity (see HKAS 41 *Agriculture*); or~~

~~(c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6 *Exploration for and Evaluation of Mineral Resources*); or~~

~~(dc) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.~~

~~However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (b) and (cd).~~

~~B3 In HKAS 38 *Intangible Assets* (as revised in 2004), paragraph 2 is amended to read as follows:~~

~~***2. This Standard shall be applied in accounting for intangible assets, except:***~~

~~***(a) intangible assets that are within the scope of another Standard;***~~

~~***(b) financial assets, as defined in HKAS 39*** **Financial Instruments: Recognition and Measurement*****;***~~

~~***(c) the recognition and measurement of exploration and evaluation assets (see HKFRS 6*** **Exploration for and Evaluation of Mineral Resources*****); and***~~

~~***(dc) mineral rights and expenditure on the exploration for, or development and extraction of minerals, oil, natural gas and similar non-regenerative resources.***~~

Appendix 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.

HKFRS 8 *Operating Segments* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraph 21 is amended as follows:

21 An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment. Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than ~~a segment based on either the entity's primary or secondary reporting format~~ an operating segment determined in accordance with ~~HKAS 14 Segment Reporting~~ HKFRS 8 *Operating Segments*.

Basis for Conclusions
IFRS 6 Exploration for and Evaluation of Mineral Resources

HKFRS 6 is based on IFRS 6 Exploration for and Evaluation of Mineral Resources. In approving HKFRS 6, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's basis for conclusions on IFRS 6. Accordingly, there are no significant differences between HKFRS 6 and IFRS 6. The IASB's basis for conclusions is reproduced below. The paragraph numbers of IFRS 6 referred to below generally correspond with those in HKFRS 6.

Contents

BC65A In June 2005, the Board made a minor amendment to IFRS 1 paragraph 36B to clarify its intention that the exemption provided in this paragraph applies to the recognition and measurement requirements of IFRS 6, as well as the disclosure requirements.

SUMMARY OF CHANGES FROM ED 6

BC66 The following is a summary of the main changes from ED 6 to the IFRS. The Board:

(a) deleted the specific prohibition against including administration and other general overhead costs in the initial measurement of an exploration and evaluation asset (paragraph BC28).

(b) introduced a requirement for the entity to classify exploration and evaluation assets as either tangible or intangible according to the nature of the asset acquired and to apply this classification consistently (paragraphs BC32-BC34).

(c) amended the impairment principle so that an impairment is recognised on the basis of an assessment of facts and circumstances and measured, presented and disclosed in accordance with IAS 36, subject to the modification of the level at which the impairment is assessed (paragraphs BC36-BC39).

(d) deleted the indicators of impairment proposed in ED 6 and replaced them with examples of facts and circumstances that would suggest that an exploration and evaluation asset was impaired (paragraphs BC36-BC39).

(e) deleted the special cash-generating unit for exploration and evaluation assets and instead required that the entity determine an accounting policy for allocating exploration and evaluation assets to a cash-generating unit or units for the purpose of the impairment test (paragraphs BC40-BC47).

(f) amended the effective date of the IFRS so that the IFRS is effective for annual periods beginning on or after 1 January 2006 (paragraph BC58).

(g) provided transitional relief for ~~disclosure for~~ entities adopting IFRSs for the first time and adopting the IFRS before 1 January 2006 (paragraphs BC59-BC65).

Appendix
Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC46 is footnoted as follows:

> In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*, which does not require the identification of primary and secondary segments. See paragraph BC150A of the Basis for Conclusions on IAS 36 *Impairment of Assets*.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraphs BC57 and BC65A are amended and a footnote added as follows:

BC57 The Board … It noted that if the project is significant, paragraph ~~103~~ 112(c) of IAS 1 already requires its disclosure, ie as additional information that is necessary for an understanding of the financial statements.

BC65A In June 2005 the Board made a minor amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* paragraph 36B* to clarify its intention that the exemption provided in this paragraph applies to the recognition and measurement requirements of IFRS 6, as well as the disclosure requirements.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007, paragraph 36B of IFRS 1 was deleted.

APPENDICES

Hong Kong Financial Reporting Standard 7 *Financial Instruments: Disclosures* (HKFRS 7) is set out in paragraphs 1-45 and Appendices A-D. 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. 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 *Framework for 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.

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 reporting date, 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 and 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 disclosure requirements in HKAS 27, HKAS 28 or HKAS 31 in addition to those in 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) contracts for contingent consideration in a business combination (see HKFRS 3 *Business Combinations*). This exemption applies only to the acquirer.

(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 Standard 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.

- financial guarantee contract
- financial asset or financial liability held for trading
- forecast transaction
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale

Appendix C
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2007. Amendments to the Basis for Conclusions and Guidance on Implementing other HKFRSs are in the Appendices to the Basis for Conclusions on HKFRS 7 and the Guidance on Implementing HKFRS 7 respectively. If an entity applies the HKFRS for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~C1 In Hong Kong Financial Reporting Standards, including Hong Kong Accounting Standards and Interpretations, references to HKAS 32 *Financial Instruments: Disclosure and Presentation* are replaced by references to HKAS 32 *Financial Instruments: Presentation*, unless otherwise stated below.~~

~~C2 HKAS 32 *Financial Instruments: Disclosure and Presentation* is amended as described below.~~

~~The title is amended to "HKAS 32 *Financial Instruments: Presentation*".~~
~~Paragraph 1 is deleted and paragraphs 2 – 4(a) are amended as follows:~~

~~2 This Standard contains requirements for the presentation of financial instruments and identifies the information that should be disclosed about them. The presentation requirements apply The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. The Standard requires disclosure of information about factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments and the accounting policies applied to those instruments. This Standard also requires disclosure of information about the nature and extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them, and management's policies for controlling those risks.~~

~~3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in HKAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in HKFRS 7 *Financial Instruments: Disclosures*.~~

~~Scope~~

~~**4 This Standard shall be applied by all entities to all types of financial instruments except:**~~

~~**(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with under 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 entities shall apply this Standard to an interest in a subsidiary, associate or joint venture that according to HKAS 27, HKAS 28 or HKAS 31 is accounted for under using HKAS 39 *Financial Instruments: Recognition and***~~

~~***Measurement*.; in those In these cases, entities shall apply the disclosure requirements in HKAS 27, HKAS 28 and or HKAS 31 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives on linked to interests in subsidiaries, associates or joint ventures.**~~

~~Paragraphs 5 and 7 are deleted.~~

~~The second sentence of paragraph 40 is amended as follows:~~

~~40 … In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of HKAS 1 and HKFRS 7. HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.…~~

~~The last sentence of paragraph 47 is amended as follows:~~

~~47 … When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 76 36 of HKFRS 7.~~

~~The last sentence of paragraph 50 is amended as follows:~~

~~50 … When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 76 36 of HKFRS 7.~~

~~Paragraphs 51-95 are deleted.~~

~~Paragraph 98 is footnoted as follows:~~

~~In October 2005 the Institute relocated all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*.~~

~~In the Appendix (Application Guidance), paragraphs AG24 and AG40 and the last sentence of paragraph AG39 are deleted.~~

~~C3 HKAS 1 *Presentation of Financial Statements* is amended as described below.~~

~~Paragraph 4 is deleted.~~

~~In paragraph 56, "HKAS 32" is replaced by "HKFRS 7 *Financial Instruments: Disclosures*", and in paragraphs 105(d)(ii) and 124, "HKAS 32" is replaced by "HKFRS 7".~~

~~The last sentence of paragraph 71(b) is amended as follows:~~

~~71(b) …For example, a bank financial institution may amends the above descriptions to provide information that is relevant to the operations of a financial institution apply the more specific requirements in HKAS 30.~~

~~The fourth sentence of paragraph 84 is amended as follows:~~

~~84 … For example, a bank financial institution may amends the descriptions to provide information that is relevant to the operations of a financial institution. apply the more specific requirements in HKAS 30.~~

~~C4 HKAS 14 *Segment Reporting* is amended as described below.~~

In paragraphs 27(a) and (b), 31, 32, 46 and 74, the phrase "the board of directors and [to] [the] chief executive officer" is replaced by "key management personnel".

In paragraphs 27(b), 30 and 32 the phrase "the directors and management" is replaced by "key management personnel".

The first sentence of paragraph 27 is amended as follows:

27 An entity's internal organisational and management structure and its system of internal financial reporting to key management personnel (for example, the board of directors and the chief executive officer) shall normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the entity and, therefore, for determining which reporting format is primary and which is secondary, except as provided in subparagraphs (a) and (b) below:…

The third sentence of paragraph 28 is amended as follows:

28 … Therefore, except in rare circumstances, an entity will report segment information in its financial statements on the same basis as it reports internally to key management personnel top management. …

The first sentence of paragraph 33 is amended as follows:

33 Under this Standard, most entities will identify their business and geographical segments as the organisational units for which information is reported to key management personnel the board of directors (particularly the supervisory non-management directors, if any) and to the chief executive officer (, or the senior operating decision maker, which in some cases may be a group of several people,) for the purpose of evaluating each unit's past performance and for making decisions about future allocations of resources. …

C5 In paragraph 31 of HKAS 17 *Leases*, "HKAS 32 *Financial Instruments: Disclosure and Presentation*" is replaced by "HKFRS 7 *Financial Instruments: Disclosures*", and in paragraphs 35, 47 and 56, "HKAS 32" is replaced by "HKFRS 7".

C6 In paragraph 72 of HKAS 33 *Earnings per Share*, "HKAS 32" is replaced by "HKFRS 7 *Financial Instruments: Disclosures*".

C7 HKAS 39 *Financial Instruments: Recognition and Measurement* is amended as described below.

Paragraph 1 is amended as follows:

1 The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting and disclosing information about financial instruments are set out in HKAS 32 *Financial Instruments: Disclosure and Presentation*. Requirements for disclosing information about financial instruments are in HKFRS 7 *Financial Instruments: Disclosures*.

In paragraph 45, "HKAS 32" is replaced by "HKFRS 7".

Paragraph 48 is amended as follows:

48 In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, or HKAS 32 or HKFRS 7, an entity shall apply paragraphs AG69-AG82 of Appendix A.

~~C8 HKAS 39 *Financial Instruments: Recognition and Measurement* (as amended in July 2005) is amended as described below.~~

~~In paragraph 9, the definition of a financial asset or financial liability at fair value through profit or loss is amended as follows:~~

~~… **In HKAS 32, paragraphs 66, 94 and AG40 HKFRS 7, paragraphs 9-11 and B4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, …**~~

~~C9 In HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards,* paragraph 36A is amended, and a heading and paragraph 36C are added as follows:~~

~~36A In its first HKFRS financial statements, an entity that adopts HKFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with HKAS 32, HKAS 39 and or HKFRS 4. An entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and or HKFRS 4 in its first year of transition shall:~~

~~(a) apply the recognition and measurement requirements of its previous GAAP in the comparative information to for financial instruments within the scope of HKAS 32 and HKAS 39 and to for insurance contracts within the scope of HKFRS 4;~~

~~…~~

~~In the case of an entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and HKFRS 4, references to the “date of transition to HKFRSs” shall mean, in the case of those Standards only, the beginning of the first HKFRS reporting period. Such entities are required to comply with paragraph 15(c) of HKAS 1 to provide additional disclosures when compliance with the specific requirements in HKFRSs 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.~~

~~**Exemption from the requirement to provide comparative disclosures for HKFRS 7**~~

~~36C An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 7 *Financial Instruments: Disclosures* in its first HKFRS financial statements need not present the comparative disclosures required by HKFRS 7 in those financial statements.~~

~~C10 HKFRS 4 *Insurance Contracts* is amended as described below.~~

~~Paragraph 2(b) is amended as follows:~~

~~(b) financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). HKAS 32 *Financial Instruments: Disclosure and Presentation* HKFRS 7 *Financial Instruments: Disclosures* requires disclosure about financial instruments, including financial instruments that contain such features.~~

~~Paragraph 35(d) is added as follows:~~

~~(d) although these contracts are financial instruments, an issuer applying paragraph 19(b) of HKFRS 7 to contracts with a discretionary participation feature shall disclose the total interest expense~~

~~recognised in profit or loss, but need not calculate such interest expense using the effective interest method.~~

~~After paragraph 37, the heading and paragraphs 38 and 39 are amended and paragraph 39A is added as follows:~~

~~Amount, timing and uncertainty of cash flows Nature and extent of risks arising from insurance contracts~~

~~38 An insurer shall disclose information that helps enables users of its financial statements to understand evaluate the amount, timing and uncertainty of future cash flows nature and extent of risks arising from insurance contracts.~~

~~39To comply with paragraph 38, an insurer shall disclose:~~

~~(a)its objectives, policies and processes for in managing risks arising from insurance contracts and the methods used to manage and its policies for mitigating those risks.~~

~~(b) those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows. [deleted]~~

~~(c) information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:~~

~~(i) the sensitivity to insurance risk (see paragraph 39A) of profit or loss and equity to changes in variables that have a material effect on them.~~

~~(ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area, or currency).~~

~~(iii) actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.~~

~~(d) the information about interest rate risk and credit risk, liquidity risk and market risk that HKAS 32 paragraphs 31-42 of HKFRS 7 would require if the insurance contracts were within the scope of HKAS 32 HKFRS 7. However:~~

~~(i) an insurer need not provide the maturity analysis required by paragraph 39(a) of HKFRS 7 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the balance sheet.~~

~~(ii) if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of HKFRS 7. Such an insurer shall also provide the disclosures required by paragraph 41 of HKFRS 7.~~

~~(e) information about exposures to interest rate risk or market risk under~~ arising from ~~embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.~~

~~39A To comply with paragraph 39(b)(i), an insurer shall disclose either (a) or (b) as follows:~~

~~(a)a sensitivity analysis that shows how profit or loss and equity would have been affected had changes in the relevant risk variable that were reasonably possible at the balance sheet date occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of HKFRS 7.~~

~~(b) qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.~~

Appendix E

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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

The heading above paragraph 20 is amended as follows:

~~Income statement and equity~~ Statement of comprehensive income

Paragraph 20 is amended as follows:

20 An entity shall disclose the following items of income, expense, gains or losses either ~~on the face of~~ in the ~~financial statements~~ statement of comprehensive income or in the notes:

(a) net gains or net losses on:

(i) ...

(ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised ~~directly in equity~~ in other comprehensive income during the period and the amount ~~removed~~ reclassified from equity ~~and recognised in~~ to profit or loss for the period;

(iii) ...

Paragraph 21 is amended as follows:

21 In accordance with paragraph ~~108~~ 117 of HKAS 1 *Presentation of Financial Statements* (as revised in 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.

Paragraph 23(c) and (d) is amended as follows:

23 For cash flow hedges, an entity shall disclose: …

(c) the amount that was recognised in ~~equity~~ other comprehensive income during the period;

(d) the amount that was ~~removed~~ reclassified from equity ~~and included in~~ to profit or loss for the period, showing the amount included in each line item in the ~~income~~ statement of comprehensive income; and …

In paragraph 27(c), ‘in equity’ is amended to ‘in other comprehensive income’.

Paragraph 44A is added as follows:

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.

Paragraph B5 is amended as follows:

B5 … Paragraph ~~113~~ 122 of HKAS 1 (as revised in 2007) also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, 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.

In paragraph B14 of Appendix B, 'balance sheet amount' is amended to 'amount in the statement of financial position'.

APPENDIX
Amendments to Basis for Conclusions on other IFRSs (included in the Basis for Conclusions on the corresponding HKFRSs)

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.

~~BCA1 The Basis for Conclusions on IAS 32 *Financial Instruments: Disclosure and Presentation* (as revised in December 2003) is amended as described below.~~

~~The reference to IAS 32 in paragraph BC1 is footnoted as follows:~~

> ~~In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7. The paragraphs relating to disclosures that were originally published in this Basis for Conclusions were relocated, if still relevant, to the Basis for Conclusions on IFRS 7.~~

~~The headings above paragraph BC34 and paragraphs BC34-BC48 are deleted.~~

~~In paragraph BC49, subparagraphs (i) and (j) are deleted and new subparagraph (k) is added as follows:~~

> ~~(k) In August 2005, the IASB issued IFRS 7 *Financial Instruments: Disclosures*. As a result, disclosures relating to financial instruments, if still relevant, were relocated to IFRS 7.~~

~~BCA2 In the Basis for Conclusions on IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in December 2003), the references to IAS 32 in paragraphs BC90 and BC222(s) are footnoted as follows:~~

> ~~In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.~~

~~BCA3 In the Basis for Conclusions on IAS 41 *Agriculture*, the reference to IAS 30 in paragraph B3 is footnoted as follows:~~

> ~~In August 2005, IFRS 7 *Financial Instruments: Disclosures* superseded IAS 30.~~

~~BCA4 The Basis for Conclusions on IFRS 4 *Insurance Contracts* is amended as described below.~~

~~Paragraph BC203 is amended and paragraphs BC203A-BC203C are added as follows:~~

> ~~BC203 The two principles and most of the supporting requirements are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements (particularly IAS 32 IFRS 7). The Board's project on financial risk and other amendments to financial instruments disclosures may lead to amendments to IAS 32 that could require consequential amendments to the disclosures for insurance contracts. Furthermore, that project will consider possible disclosures in various areas that IFRS 4 does not address (eg capital and solvency requirements, market risk, liquidity risk and operational risk).~~

~~BC203A IFRS 7 was issued in August 2005 and replaced the disclosure requirements in IAS 32, including those on which the disclosures originally in IFRS 4 were based. Accordingly, the Board amended the disclosure requirements in IFRS 4 to be consistent with IFRS 7, when possible. The Board noted that:~~

~~(a) insurers will have both insurance contracts and financial instruments. In particular, some of the investment products issued by insurers are financial instruments, not insurance contracts as defined in IFRS 4. It is more useful for users and easier for preparers if the risk disclosures for insurance contracts and financial instruments are the same.~~

~~(b) making the disclosure requirements of IFRS 4 consistent with IFRS 7 makes the disclosures easier to prepare. In particular, IFRS 7 removes the "terms and conditions" disclosure previously in paragraph 39(b) of IFRS 4. Some commentators on ED 5 (the Exposure Draft that preceded IFRS 4) objected to this disclosure requirement, believing it to be onerous and not to provide the most useful information.~~

~~(c) the disclosures in IFRS 7 are designed to be implemented as a package, and if implemented piecemeal would result in less useful information for users. For example, the risk disclosures replace the "terms and conditions" disclosure previously in paragraph 60(a) of IAS 32 and paragraph 39(b) of IFRS 4. Merely updating the reference in paragraph 39(d) from IAS 32 to IFRS 7 would have resulted in some, but not all, of the risk disclosures being applicable to insurance contracts and the "terms and conditions" disclosure being retained.~~

~~(d) as discussed in paragraph BC207, significant changes to the risk disclosures in paragraphs 38-39A are not expected as a result of phase II of the project on insurance contracts (although consequential changes may be needed to the accounting-related disclosures in paragraphs 36 and 37).~~

~~BC203B Some respondents, particularly preparers, did not agree that IFRS 4 should be amended as part of IFRS 7. In particular, some respondents argued that sensitivity analysis of market risk would be problematic for insurance contracts; they disagreed that such an analysis would be relatively easy to understand or calculate while issues relating to the measurement of fair value for insurance contracts remain unresolved. Those respondents suggested that disclosure requirements on sensitivity analysis should be considered during phase II of the project on insurance contracts, rather than in finalising IFRS 7. The Board noted that this requirement should not be unduly onerous for insurers, nor require them to provide quantitative information, because the sensitivity analysis applies only to changes in market risk variables that have an effect on profit or loss and equity in the period being reported. In addition, the Board noted that a sensitivity analysis is intended to replace the terms and conditions disclosures, which entities found onerous. The Board did not want to *require* insurers to comply with the older terms and conditions disclosures while allowing other entities to use the less onerous sensitivity analysis. However, the Board also noted that providing the sensitivity analysis would mean systems changes for some entities. Because the purpose of IFRS 4 was to minimise such changes pending the outcome of phase II, the Board did not want to require extensive systems changes for insurance contracts as a result of IFRS 7.~~

~~BC203C To address the concerns of those who do not want to make systems changes and those who want to substitute the new sensitivity analysis for the terms and conditions disclosures, the Board decided to permit a choice of sensitivity analysis disclosures for insurance risk only. Paragraph 39A of IFRS 4 has been added so that entities will be able to choose between providing:~~

~~(a) the terms and conditions disclosures, together with the qualitative sensitivity analysis currently permitted by IFRS 4; or~~

~~(b) the quantitative sensitivity analysis required by IFRS 7 (and permitted, but not required, by IFRS 4).~~

~~The Board permitted entities to choose to disclose a combination of qualitative and quantitative sensitivity analysis for insurance risk because it believes that entities should not be prevented from providing more useful information for some insurance risks, even if they do not have the ability to provide this information for all insurance risks. The Board noted that this option was a temporary solution to the problems cited in paragraph BC203B and would be eliminated in phase II.~~

Appendix
Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions 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 Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC47 is footnoted as follows:

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

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions on IFRS 7 is amended as follows:

> *This Basis for Conclusions accompanies, but is not part of, IFRS 7.*
>
> <u>*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)*</u>

Contents

APPENDIX
Amendments to guidance on other HKFRSs

This appendix contains amendments to guidance on HKFRSs other than HKFRS 4 that are necessary in order to ensure consistency with HKFRS 7. Amendments to the Guidance on Implementing HKFRS 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.

~~IGA1 The Guidance on Implementing HKAS 39 *Financial Instruments: Recognition and Measurement* is amended as described below.~~

~~Q&A E.4.8 is amended as follows:~~

> ~~**If an impaired financial asset is secured by collateral and foreclosure is probable that does not meet the recognition criteria for assets in other Standards, is the collateral recognised as an asset separate from the impaired financial asset?**~~
>
> ~~No. The measurement of the impaired financial asset reflects the fair value of the collateral. The collateral would generally not meet the recognition criteria until it is transferred to the lender. Accordingly, the collateral is not recognised as an asset separate from the impaired financial asset before foreclosure unless it meets the recognition criteria for an asset in another Standard.~~

~~In Q&A F.1.12 issue (b), both references to “HKAS 32.58” are replaced by “HKFRS 7.22”.~~

~~In Q&A G.1, the answer is amended as follows:~~

> ~~HKAS 32.94(h) HKFRS 7.20 requires material items of income, expense and gains and losses to be disclosed whether included in profit or loss or in equity. This disclosure requirement encompasses material items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of material fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in equity. Further breakdown is provided of changes that relate to:~~
>
> ~~(a) AFS assets, showing separately the amount of gain or loss recognised directly in equity during the period and the amount that was removed from equity and recognised in profit or loss for the period;~~
>
> ~~(b) financial assets and or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) classified as held for trading in accordance with HKAS 39; and~~
>
> ~~(c) hedging instruments.~~
>
> ~~HKAS 32 HKFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with HKAS 39 classifies it categorises as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.~~

~~In addition, HKAS 32.94(e) HKFRS 7.8 requires disclosure of the carrying amounts of financial assets and or financial liabilities at fair value through profit or loss, showing separately that: (i) those designated as such upon initial recognition are classified as held for trading and (ii) were, upon initial recognition, designated by the entity as financial assets and financial liabilities at fair value through profit or loss (ie those not financial instruments those classified as held for trading) in accordance with HKAS 39.~~

Appendix
Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance 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 Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007)– effective for annual periods beginning on or after 1 January 2009

In paragraph IG3, in the quotation from HKAS 1, 'of users taken' is amended to 'that users make'.

Paragraphs IG6 and IG13 are amended as follows:

IG6 Paragraph ~~15~~ 17(c) of HKAS 1 requires an entity …

IG13 The total interest income and total interest expense disclosed in accordance with paragraph 20(b) is a component of the finance costs, which paragraph ~~81~~ 82(b) of HKAS 1 requires to be presented separately ~~on the face of~~ in the ~~income~~ statement of comprehensive income. The line item …

In the example in paragraph IG36, 'other components of equity' is amended to 'other comprehensive income' (four times).

In the table after paragraph IG41, footnote (a) is deleted and footnote (b) is amended as follows:

'~~(b)~~(a) See paragraph 44 of HKFRS 7'

CONTENTS

Appendix B
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2009. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

~~B1 References to HKAS 14 *Segment Reporting* are amended to HKFRS 8 *Operating Segments* in the following paragraphs:~~

~~paragraph 20 of HKAS 27 *Consolidated and Separate Financial Statements*~~

~~paragraph 130(d)(i) of HKAS 36 *Impairment of Assets*.~~

~~B2 In HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 41 is amended as follows:~~

~~41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:~~

~~...~~

~~(d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*.~~

~~B3 In HKFRS 6 *Exploration for and Evaluation of Mineral Resources*, paragraph 21 is amended as follows:~~

~~**21 An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment. Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than a segment based on either the entity's primary or secondary reporting format an operating segment determined in accordance with HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*.**~~

~~B4 In HKAS 2 *Inventories*, paragraphs 26 and 29 are amended as follows:~~

~~26 For example, inventories used in one business operating segment may have a use to the entity different from the same type of inventories used in another business operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.~~

~~29 Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example,~~

~~finished goods, or all the inventories in a particular industry or geographical operating segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.~~

~~B5 In HKAS 7 *Cash Flow Statements*, paragraph 50 is amended as follows:~~

~~50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:~~

~~...~~

~~(d) the amount of the cash flows arising from the operating, investing and financing activities of each reported industry and geographical reportable segment (see HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*).~~

~~B6 In HKAS 19 *Employee Benefits*, the example illustrating paragraph 115 is amended as follows:~~

~~**Example illustrating paragraph 115**~~
~~An entity discontinues a business an operating segment and employees of the discontinued segment will earn no further benefits...~~

~~B7 In HKAS 33 *Earnings per Share*, paragraph 2 is replaced as follows:~~

~~**2 This Standard shall apply to:**~~

~~**(a) the separate or individual financial statements of an entity:**~~

~~**(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or**~~

~~**(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory information for the purpose of issuing ordinary shares in a public market; and**~~

~~**(b) the consolidated financial statements of a group with a parent:**~~

~~**(i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or**~~

~~**(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory information for the purpose of issuing ordinary shares in a public market.**~~

~~B8 In HKAS 34 *Interim Financial Reporting*, paragraph 16 is amended as follows:~~

~~**16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an**~~

~~**understanding of the current interim period:**~~

~~**...**~~

~~**(g) the following segment revenue and segment result for business segments or geographical segments, whichever is the entity's primary basis of segment reporting information (disclosure of segment data information is required in an entity's interim financial report only if HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments* requires that entity to disclose segment data information in its annual financial statements);:**~~

~~**(i) revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;**~~

~~**(ii) intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;**~~

~~**(iii) a measure of segment profit or loss;**~~

~~**(iv) total assets for which there has been a material change from the amount disclosed in the last annual financial statements;**~~

~~**(v) a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss;**~~

~~**(vi) a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation;**~~

~~...~~

~~B9 HKAS 36 *Impairment of Assets* is amended as described below.~~

~~In the Introduction, paragraph IN11 is amended as follows:~~

~~IN11 SSAP 31 required goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it related. It employed a "bottom-up/top-down" approach under which the goodwill was, in effect, tested for impairment by allocating its carrying amount to each cash-generating unit or smallest group of cash-generating units to which a portion of that carrying amount could be allocated on a reasonable and consistent basis. The Standard similarly requires goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it relates. However, the Standard clarifies that:~~

~~...~~

(b) each unit or group of units to which the goodwill is allocated should:

(i) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(ii) not be larger than an operating segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*.

Paragraph 80 is amended as follows:

80 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:

...

(b) not be larger than an operating segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*.

Paragraph 129 is amended as follows:

129 An entity that reports segment information in accordance with HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments* shall disclose the following for each reportable segment based on an entity's primary reporting format:

In paragraph 130, subparagraphs (c)(ii) and (d)(ii) are amended as follows:

130 (c) (ii) if the entity reports segment information in accordance with HKAS 14 HKFRS 8, the reportable segment to which the asset belongs, based on the entity's primary reporting format.

103 (d) (ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with HKAS 14 HKFRS 8, by reportable segment based on the entity's primary reporting format; and

Appendix C
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.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

Paragraphs 21 and 23(f) are amended as follows:

21 To give … Reconciliations of the amounts in the statement of financial position ~~balance sheet amounts~~ for reportable segments to the amounts in the entity's statement of financial position ~~balance sheet amounts~~ are required for each date at which a ~~balance sheet~~ statement of financial position is presented. Information for prior periods shall be restated as described in paragraphs 29 and 30.

23 An entity shall...

(f) material items of income and expense disclosed in accordance with paragraph ~~86~~ 97 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007);

Paragraph 36A is added as follows:

36A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 23(f). 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.

Appendix B

Amendments to Basis for Conclusions on other IFRSs (included in the Basis for Conclusions on the corresponding HKFRSs)

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to note the replacement of IAS 14 by IFRS 8.

* * *

The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the relevant Basis for Conclusions.

~~BCA1 In the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, paragraph BC4 is footnoted as follows:~~

> ~~In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.~~

~~BCA2 In the Basis for Conclusions on IFRS 6 *Exploration for and Evaluation of Mineral Resources*, paragraph BC46 is footnoted as follows:~~

> ~~In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*, which does not require the identification of primary and secondary segments. See paragraph BC150A of the Basis for Conclusions on IAS 36 *Impairment of Assets*.~~

~~BCA3 In the Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*, paragraph BC47 is footnoted as follows:~~

> ~~In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.~~

~~BCA4 In the Basis for Conclusions on IAS 27 *Consolidated and Separate Financial Statements*, paragraph BC21 is footnoted as follows:~~

> ~~In 2006 IAS 14 *Segment Reporting* was replaced by IFRS 8 *Operating Segments*.~~

~~BCA5 The Basis for Conclusions on IAS 36 *Impairment of Assets* is amended as described below.~~

~~Paragraph BC144 is footnoted as follows:~~

> ~~In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*. IFRS 8 does not require disclosure of primary and secondary segment information. See paragraph BC150A.~~

~~In the footnote to paragraph BC147, the following is added at the end:~~

> ~~IAS 14 was replaced by IFRS 8 in 2006. See paragraph BC150A.~~

~~Paragraph BC150A is added after paragraph BC150, as follows:~~

> ~~BC150A In 2006 IFRS 8 replaced IAS 14 and changed the basis for identifying segments. Under IAS 14, two sets of segments were identified–one based on related products and services, and the other on geographical areas. Under IFRS 8, operating segments are identified on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. The objective of the change was to improve the disclosure of segment information, not to change the requirements of IAS 36 relating to~~

~~the allocation of goodwill for impairment testing. The previous wording of the requirement in IAS 36 that each unit or group of units to which goodwill is allocated shall "not be larger than a segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with IAS 14" has been amended by IFRS 8 to "not be larger than an operating segment determined in accordance with IFRS 8". The arguments set out above in support of the original requirement based on segments determined in accordance with IAS 14 support the revised requirements based on segments determined in accordance with the requirements in IFRS 8.~~

~~The second sentence of paragraph BC166(b) is footnoted as follows:~~

~~In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*, which does not require disclosure of primary and secondary segment information. See paragraph BC150A.~~

Appendix
Amendments to other Implementation Guidance

This appendix contains amendments to guidance on other HKFRSs that are necessary in order to ensure consistency with HKFRS 8. 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.

~~IGA1 In the Guidance on Implementing HKFRS 4 *Insurance Contracts*, paragraph IG43 is amended as follows:~~

> ~~IG43 Under HKAS 14 *Segment Reporting* HKFRS 8 *Operating Segments*, the identification of reportable segments reflects differences in the risks and returns of an entity's products and services the way in which management allocates resources and assesses performance. HKAS 14 takes the position that the segments identified in an organisational and management structure and internal financial reporting system normally provide an appropriate segmentation for financial reporting. An insurer might adopt a similar approach to identify broad classes of insurance contracts for disclosure purposes, although it might be appropriate to disaggregate disclosures down to the next level. For example, if an insurer identifies life insurance as a reportable segment for HKAS 14 HKFRS 8, it might be appropriate to report separate information about, say, life insurance, annuities in the accumulation phase and annuities in the payout phase.~~

~~IGA2 In the Illustrative Examples accompanying HKAS 36 *Impairment of Assets*, paragraph IE80 is amended as follows:~~

> ~~IE80 Entity M is a multinational manufacturing firm that uses geographical segments as its primary format for reporting segment information. M's three reportable segments based on that format are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to three individual cash-generating units–two in Europe (units A and B) and one in North America (unit C)–and to one group of cash-generating units (comprising operation XYZ) in Asia. Units A, B and C and operation XYZ each represent the lowest level within M at which the goodwill is monitored for internal management purposes.~~