

Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard

The SME-FRF & SME-FRS (Revised) has been updated to reflect the amendments of the Companies (Amendment) (No. 2) Ordinance 2018. Please refer to paragraph 54 of the SME-FRF for the effective date of the amendments. Earlier application is not permitted.



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

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The *Small and Medium-sized Entity Financial Reporting Framework (SME-FRF)* and *Financial Reporting Standard (SME-FRS)* are standards of accounting practices issued by the Council of the Hong Kong Institute of Certified Public Accountants pursuant to section 18A of the Professional Accountants Ordinance and the *Company (Accounting Standards (Prescribed Body)) Regulation* issued under sections 357 and 380 of the new Hong Kong Companies Ordinance (Cap. 622) ("new CO"). The new CO came into effect on 3 March 2014. This version of the SME-FRF and SME-FRS takes into account all relevant subsequent amendments to the new CO, up to and including the Companies (Amendment) (No. 2) Ordinance 2018 which comes into effect on 1 February 2019 ("the 2018 Amendment Ordinance").

SME-FRF and SME-FRS should be read in the context of the *Preface to Hong Kong Financial Reporting Standards*. SME-FRS should also be read in the context of the SME-FRF.

Where the SME-FRF and SME-FRS make reference to requirements in the new CO, this is for information purposes only and should not be relied upon to be a complete account of all the requirements of the new CO which may be relevant to a particular entity's circumstances. Nothing in the SME-FRF or SME-FRS should be taken as interpreting or amending the requirements set out in the new CO and if there is a conflict between the SME-FRF or SME-FRS and the new CO, then the new CO will prevail.

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SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING FRAMEWORK

Scope

1. The new Hong Kong Companies Ordinance (Cap. 622) (“new CO”), which ~~becomes~~ came into effective on 3 March 2014, contains an optional reporting exemption for certain private companies and companies limited by guarantee which satisfy the conditions set out in section 359 of the new CO. On 7 December 2018, the Government of the Hong Kong Special Administrative Region published the Companies (Amendment) (No. 2) Ordinance 2018 (“the 2018 Amendment Ordinance”) to amend some of the provisions in the new CO so as to improve the clarity and operation of the new CO and further facilitate business in Hong Kong.¹ These amendments include amendments relating to the eligibility criteria set out in section 359 of the new CO. The Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard which are effective for annual periods beginning on or after ~~3-1 March 2014~~ February 2014²⁰¹⁹ (the “revised SME-FRF and FRS”) are the accounting standards issued by the HKICPA that are to be followed in accordance with section 380(4) by those Hong Kong incorporated companies which are entitled to, and decide to^{1a}, take advantage of this reporting exemption in the new CO, as amended by the 2018 Amendment Ordinance.
2. In accordance with paragraph 23 of the SME-FRF, an entity which is not a company incorporated under either the new CO or any former CO, subject to any specific requirements imposed by the law of the entity’s place of incorporation and subject to its constitution, qualifies for reporting under the SME-FRF when the entity meets the same requirements that a Hong Kong incorporated entity is required to meet under section 359 of the new CO.
3. The revised SME-FRF sets out the following:
 - (a) the conceptual basis for the preparation of financial statements in accordance with the SME-FRS (paragraphs 4-18)
 - (b) an overview of the reporting exemption introduced in the new CO (paragraphs 19 to 21)
 - (c) the qualifying criteria (paragraphs 22-43) for the reporting exemption;
 - (d) guidance on transitioning from a different GAAP to SME-FRF and FRS (paragraphs 44-45); and
 - (e) guidance on the extent to which profits or losses recognised under the SME-FRF and FRS may be regarded as realized profits or losses for the purposes of making a distribution in accordance with section 297 of the new CO (paragraphs 46 to 52).

1 Source: press release issued by the Government of the Hong Kong Special Administrative Region on 7 December 2018.

1a The reporting exemption is optional for those companies which are eligible. If a non-dormant private company or company limited by guarantee is not eligible, or decides not to take advantage of the reporting exemption, then it should prepare financial statements which comply with all the relevant requirements of the new CO, including subsections (1)-(6) of section 380. Subsections (1), (2), (5) and (6) of section 380 relate to the requirement for the financial statements to give a true and fair view of the financial position of the company (or the company and all its subsidiary undertakings, as the case may be) as at the end of the financial year and the financial performance of the company (or the company and all its subsidiary undertakings, as the case may be) for the financial year. Subsection (4) of section 380 requires compliance with the accounting standards applicable to the financial statements. In the case of a company not taking advantage of the reporting exemption, this would be Hong Kong Financial Reporting Standards (HKFRSs) or HKFRS for Private Entities as issued by the HKICPA.

Users

4. Users of financial statements generally include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and, in some cases, the public. For SMEs incorporated in Hong Kong, the most significant users are likely to be owners, government (in the form of the Inland Revenue Department) and creditors (such as banks), who may have the power to obtain information additional to that contained in the financial statements. Management is also interested in the information contained in the financial statements, even though it has access to additional management and financial information.

Objective

5. The objective of financial statements is to provide information about the financial position and performance of an entity that is useful to users of such information. Financial statements show the results of management's stewardship of and accountability for the resources entrusted to it.

Underlying Assumptions

6. Financial statements are prepared on the accrual basis of accounting. They are normally prepared on the assumption that an entity is a going concern and will continue to operate for at least the foreseeable future.

Qualitative Characteristics

7. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal characteristics are:
 - (a) **Understandability:** It is essential that information provided in financial statements is readily understandable by users.
 - (b) **Relevance:** To be useful, information must be relevant to the needs of users. The relevance of information is affected by its nature and materiality.
 - (c) **Reliability:** Information is reliable when it is free from material error and bias and can be depended on by users to represent faithfully that which it is said to represent. In assessing reliability, substance over form, prudence, neutrality and completeness are also considered.
 - (d) **Comparability:** Users must be able to compare the financial statements of an entity over time in order to identify trends in the entity's financial position and performance.
8. **Constraints:** The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Users of financial statements should be aware of this constraint.
9. In practice, trade-offs between qualitative characteristics are often necessary. Determining the relative importance of the characteristics in different cases is a matter of professional judgment.

Elements

10. An "asset" is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
11. A "liability" is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

12. “Equity” is the residual interest in the assets of the entity after all its liabilities have been deducted.
13. “Income” encompasses both revenue and gains. It includes increases in economic benefits during the accounting period in the form of inflows or enhancements of assets as well as decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
14. “Expenses” encompass losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses are decreases in economic benefits.

Recognition

15. An item that meets the definition of an element should be recognised if (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.
16. Recognition of an item as income or expense in accordance with the SME-FRS does not necessarily result in that item being “realized” within the meaning of section 291 of the new CO. Consequently, a profit which is recognised for accounting purposes under the SME-FRS may not necessarily be capable of distribution to shareholders by way of a dividend. The concept of “realized profits and losses” and their relationship to profits and losses as recognised under the SME-FRS is dealt with in paragraphs 46 to 52 of the SME-FRF.

Measurement

17. The measurement base most commonly adopted by entities in preparing their financial statements is historical cost. This may be combined with other measurement bases for certain specific items, as referred to in the SME-FRS (for example, Section 15 *The Effects of Changes in Foreign Exchange Rates*).
18. Under the historical cost convention:
 - (a) assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition; and
 - (b) liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Assets should not be revalued nor should future cash flows be discounted in the measurement of assets and liabilities except when required or permitted by the SME-FRS.

The new CO reporting exemption

19. The new CO permits private companies and companies limited by guarantee to take advantage of a “reporting exemption” if they meet certain qualifying criteria set out in section 359. The reporting exemption takes the form of exemption from certain of the requirements for the contents of the directors’ report and financial statements that would apply if the entities did not qualify for exemption.

20. Of these exemptions, the most significant one for the purposes of the SME-FRS is the exemption from the requirement for the financial statements to give a true and fair view as set out in section 380(7) of the new CO. Instead, financial statements prepared by entities taking advantage of the reporting exemption are required to be properly prepared in accordance with the applicable accounting standards issued or specified by the HKICPA under sections 357(1) and 380(4)(b) and 380(8), as the prescribed body under the Company (Accounting Standards (Prescribed Body)) Regulation ~~issued in January 2013 (Cap. 622C) as amended by the 2018 Amendment Ordinance effective from February 2019~~. For the purposes of section 380(4)(b), the SME-FRF and SME-FRS are the applicable accounting standards.
21. Unless specifically exempt from a particular requirement, the financial statements and directors' report prepared by a qualifying entity are required to follow the same requirements as apply to full financial statements and directors' reports. Further details of these non-exempt disclosure requirements which apply under the new CO are set out in Part D of Appendix 1 to the SME-FRS.

Qualifying Entities

22. A company incorporated under the new or a former CO qualifies for reporting under the SME-FRF² if it satisfies the criteria set out in section 359 of the new CO and the sections and Schedules to which that section refers. Specifically:
- (a) Section 359(1)(b) brings forward the qualifying criteria that were previously found in section 141D of the predecessor CO, relating to private companies which do not have subsidiaries and are not a subsidiary of another company. These companies (unless they fall within the types of companies listed in paragraph 27 below) are eligible for the reporting exemption provided that they obtain 100% agreement in writing from their shareholders for the financial year.
 - (b) The remainder of section 359 introduces ~~34 additional~~ categories of entities (or groups) that fall within the reporting exemption if they meet certain criteria relating to the type of entity (or group), the size of the entity (or group) and in certain cases the need for shareholder approval. Further details on these criteria are set out in paragraphs 24 to 43 below.
 - (c) Qualifying groups may consist of Hong Kong and non-Hong Kong incorporated body corporates.
23. An entity which is not a company incorporated under either the new CO or a former CO, subject to any specific requirements imposed by the law of the entity's place of incorporation and subject to its constitution, qualifies for reporting under the SME-FRF when the entity meets the same requirements that a Hong Kong incorporated entity is required to meet under section 359 of the new CO.

Types of companies

24. Only certain types of companies can qualify for the reporting exemption under the new CO. At a minimum, in accordance with section 359 of the new CO these companies ~~(or groups)~~ must be private companies ~~(or groups)~~ or companies ~~(or a group of companies)~~ limited by guarantee.
25. According to section 11 of the new CO, a company that is not limited by guarantee is a "private company" if its articles:
- (a) restrict a member's right to transfer shares; and
 - (b) limit the number of its members to 50; and

2 As stated in footnote 1a to the SME-FRF, taking advantage of the reporting exemption is optional even if the company qualifies. If a company which is eligible does not take advantage of the reporting exemption then its financial statements should comply with HKFRSs as issued by the HKICPA instead of the SME-FRF. Further details are stated in footnote 1a.

- (c) prohibit any invitation to the public to subscribe for any shares or debentures of the company.

The new CO clarifies that the term “*member*” above excludes employees of the company and former employees, who became members whilst they were employees of the company and who continue to be members. Also, if two or more people own shares in a company jointly they are regarded as one single member.

According to section 382 of the new CO, if at any time during the financial year a private company breaches any of the above criteria then it is required to prepare its financial statements as if it were a public company i.e. it will no longer qualify for the reporting exemption, unless the Court allows otherwise.

26. According to section 9 of the new CO, a company is “limited by guarantee” under the new CO if:

- (a) it does not have a share capital; and
- (b) its articles limit the liability of its members to the amount its members undertake, by those articles, to contribute to the assets of the company if it is wound up.

27. According to section 359(4) of the new CO, the following companies are not permitted to take the reporting exemption:

- (a) the entity carries on any banking business and holds a valid banking ~~license~~licence granted under the Banking Ordinance (Cap. 155);
- (b) the entity accepts, by way of trade or business (other than banking business) loans of money at interest or repayable at a premium, other than on terms involving the issue of debentures or other securities;
- (c) the entity is a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a business in any regulated activity within the meaning of that Ordinance; or
- (d) the entity carries on any insurance business, otherwise than solely as an agent.

- 27A. According to sections 359(3)(b), 359(3A) and 359(5) of the new CO, a holding company is not permitted to take the reporting exemption when the group of which it is the holding company includes a company specified in section 359(4) (i.e. includes one of the types of companies set out above in paragraph 27) or includes a non-Hong Kong body corporate that:

- (a) carries on any business that, had it been carried on in Hong Kong, would be required to be carried on under a valid banking licence granted under the Banking Ordinance (Cap. 155);
- (b) accepts, by way of trade or business (other than banking business) loans of money at interest or repayable at a premium, other than on terms involving the issue of debentures or other securities;
- (c) carries on any business that, had it been carried on in Hong Kong, would be required to be carried on under a licence under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a business in any regulated activity within the meaning of that Ordinance;
- (d) carries on any insurance business, otherwise than solely as an agent; or
- (e) would have fallen within the meaning of public company in section 12 of the new CO had it been incorporated under the new CO.

Size tests

28. There are ~~34~~ sets of size tests set out in Schedule 3 to the new CO which are used to define the following types of entity for the purposes of the reporting exemption:
- (a) small guarantee companies (or a group of small guarantee companies which may include non-Hong Kong body corporates);
 - (b) small private companies (or a group of small private companies which may include non-Hong Kong body corporates);
 - (c) larger “eligible” private companies (or a group of “eligible” companies which may include non-Hong Kong body corporates);
 - (d) mixed group (being a group comprising a mix of (i) one or more small and/or eligible private companies and (ii) one or more small guarantee companies) which may include non-Hong Kong body corporates.

As explained in paragraph 22 above, consistent with section 141D of the predecessor CO, private companies which do not have subsidiaries and are not a subsidiary of another company do not need to meet any size test in order to qualify under section 359(1)(b) of the new CO, provided that they obtain 100% agreement from their shareholders for the financial year.

29. If a parent is not exempt from preparing consolidated financial statements in accordance with section 379(3) of the new CO, then the parent, each company in the group and the group of which it is the parent as a whole must meet the relevant size tests in order for the parent to prepare consolidated financial statements in accordance with the SME-FRS.

Meeting the size tests in the first year that the new Companies Ordinance ~~applies~~applied

30. Sub-section (2) of each of sections 361 to 366 of the new CO (as applicable) sets out the transitional requirements which ~~applied~~ in the first financial year after the new CO ~~comes first~~ came into operation, i.e. in the first financial year ~~beginning~~ beginning which began on or after 3 March 2014. In accordance with sub-section (2) of each of sections 361 to 366 of the new CO (as applicable), the entity ~~will qualify~~ qualified for the reporting exemption for the first financial year beginning on or after 3 March 2014 if it ~~meets~~ met the relevant size tests:
- (a) in that first financial year; ~~and/or~~
 - (b) in the immediately preceding financial year.

If the entity ~~qualifies~~ qualified in the first financial year in accordance with the above, it will have continued to qualify until it is disqualified in accordance with sub-section (4) or (5) (as set out in paragraphs 32 and 33 below).

Meeting the size tests for mixed groups in the first year that section 366A applies

- 30A. The qualifying category of "mixed group", as described in paragraph 28(d) above, was introduced into the new CO by way of the 2018 Amendment Ordinance, specifically by way of new sections 359(3A) and 366A. Sub-section (1)(c) of section 366A of the new CO sets out the transitional requirements which apply in the first financial year after this section comes into operation, i.e. in the first financial year beginning on or after 1 February 2019. In accordance with sub-section (1)(c) of section 366A of the new CO, a mixed group will qualify for the reporting exemption for the first financial year beginning on or after 1 February 2019 if it meets the relevant size tests:
- (a) in that first financial year; or
 - (b) in the immediately preceding financial year.

If the mixed group qualifies in the first financial year in accordance with the above, it will continue to qualify until it is disqualified in accordance with sub-section (6) or (7) (as set out in paragraphs 32 and 33 below). Paragraph 39A below sets out further detail on how to identify which is relevant size test for a mixed group.

Meeting the size tests in all subsequent financial years

31. In accordance with sub-section (3) of each of sections 361 to 366, or sub-section (5) of section 366(A), of the new CO (as applicable), an entity/a group of companies which was previously disqualified on the grounds of its size will need to meet the size tests for **two** consecutive reporting periods, before it will qualify for the reporting exemption in the third reporting period, regardless of its size in that period.
32. In accordance with sub-section (4) of each of sections 361 to 363, or sub-section (5) of each of sections 364 to 366, or sub-section (7) of section 366(A), of the new CO (as applicable), where an entity has previously qualified for the reporting exemption in terms of its size, the entity will continue to qualify for the reporting exemption even when it no longer meets the relevant size tests, unless the entity has failed the size tests for **two** consecutive reporting periods. It will then fail to qualify for the reporting exemption in the third reporting period, regardless of its size in that period.
33. An exception to this two year grace period for losing entitlement is where a new company or a non-Hong Kong body corporate enters the group. In this case, in accordance with sub-section (4) of each of sections 364 to 366, or sub-section (6) of section 366(A), of the new CO (as applicable), the group will no longer be eligible for the reporting exemption in the year in which the new company or non-Hong Kong body corporate enters the group, if ~~that~~ that new subsidiary is of such a size that the group fails the size tests in that year.

Size tests for small guarantee companies (or a group of small guarantee companies which may include non-Hong Kong body corporates)

34. According to paragraph 1(5) of Schedule 3, a company limited by guarantee qualifies as a small guarantee company if its total annual revenue does not exceed HK\$25 million.
35. According to paragraphs 1(13) and 12A(b) of Schedule 3, in order to qualify for the reporting exemption as a group of small guarantee companies:
 - (a) each company in the group must qualify as a small guarantee company; and
 - (b) each non-Hong Kong body corporate in the group (if any) would have been qualified as a small guarantee company for the financial year had it been incorporated under the new CO; and
 - ~~(b)(c)~~ (c) the aggregate annual revenue of the group must not exceed HK\$25 million.

Size tests for small private companies (or a group of small private companies which may include non-Hong Kong body corporates)

36. According to paragraph 1(1) of Schedule 3, a private company qualifies as a small private company if does not exceed any two of the following:
 - (a) total annual revenue of HK\$100 million
 - (b) total assets of HK\$100 million at the end of the reporting period
 - (c) 100 employees

37. According to paragraphs 1(8) and 7(b) of Schedule 3, in order to qualify for the reporting exemption as a group of small private companies:
- (a) each company in the group must qualify as a small private company; ~~and~~
 - (b) each non-Hong Kong body corporate in the group (if any) would have been qualified as a small private company for the financial year had it been incorporated under the new CO; and
 - ~~(b)(c)~~ (c) the aggregate amounts for the group in total must not exceed 2 out of 3 of the small size tests.

Size tests for larger “eligible” private companies (or a group of “eligible” companies which may include non-Hong Kong body corporates)

38. According to paragraph 1(3) of Schedule 3, a private company may qualify as an “eligible” private company if does not exceed any two of the following:
- (a) total annual revenue of HK\$200 million
 - (b) total assets of HK\$200 million at the end of the reporting period
 - (c) 100 employees (not 200 employees)

In addition, in order to qualify, the company must meet the shareholder approval requirements as set out in paragraphs 41-42 below.

39. According to paragraphs 1(11), 7(b) and 10(b) of Schedule 3, in order to qualify for the reporting exemption as a group of “eligible” companies:
- (a) each company in the group must qualify ~~meet the size tests~~ as either a small private company or a larger “eligible” private company; ~~and~~
 - (b) each non-Hong Kong body corporate in the group (if any) would have been qualified as either a small private company or a larger “eligible” private company for the financial year had it been incorporated under the new CO on basis of its size; and
 - (c) the aggregate amounts for the group in total must not exceed 2 out of 3 of the larger “eligible” size tests.

In addition, the company which is the holding company in this group must meet the shareholder approval requirements as set out in paragraphs 41-42 below.

Size tests for mixed groups which may include non-Hong Kong body corporates

- 39A. The relevant size tests for a mixed group depend on the status of the holding company in that group. Specifically, the requirements in this regard are set out in sub-section (4) of section 366(A) of the new CO and are as follows:

- (a) If the holding company in that mixed group is a small private company, the aggregate amounts for the mixed group in total must not exceed 2 out of 3 of the size tests for a group of small private companies as set out in paragraph 36 above.
- (b) If the holding company in that mixed group is an eligible private company, the aggregate amounts for the mixed group in total must not exceed 2 out of 3 of the size tests for a group of larger “eligible” companies as set out in paragraph 38 above^{2a}.

^{2a} These size tests for larger “eligible” groups would also apply to mixed groups if the holding company of the mixed group is a private company and the mixed group in total exceeds the size tests for a group of small private companies as set out in paragraph 36 above.

- (c) If the holding company in that mixed group is a small guarantee company, the aggregate annual revenue of the mixed group must not exceed HK\$25 million.

Interpretative guidance in Schedule 3 of the new CO

40. For the purposes of the size tests for all ~~three~~four categories of qualifying entities, Schedule 3 to the CO states that:
- (a) the total revenue and total assets are those reflected in the annual financial statements for the financial year^{2a2b};
 - (b) in the case where the reporting period is shorter or longer than a year, the amount of total revenue for a financial year is to be calculated on a pro-rata basis as if the length of the financial year were 12 months;
 - (c) in the case where the entity is a group, the aggregate total annual revenue and aggregate total assets are calculated after eliminating intragroup transactions and balances; and
 - (d) the number of employees is the average number of persons employed by the entity during the reporting period (irrespective of whether in full-time or part-time employment) determined on a monthly basis as follows:
 - (i) Determine the number of employees as at the end of each calendar month.
 - (ii) Add together all the monthly numbers in (i).
 - (iii) Divide the number in (ii) by the number of months in the reporting period.

Shareholder approval

41. Subject to anything to the contrary in the Articles of a company, shareholder approval is not required to be obtained by a company wishing to take advantage of the reporting exemption under the CO if the company is a ~~for~~ small guarantee company~~ies~~ (or groups) ~~or~~ a small private company~~ies~~ (or groups) or a mixed group which does not exceed the small private company size limits or small guarantee size limits as applicable under section 366A(4) as set out in paragraph 39A above ~~wishing to take advantage of the reporting exemption.~~
42. In accordance with section 360 of the new CO, the shareholder approval requirements for ~~the~~ larger “eligible” ~~category of~~ private companies or groups are as follows:
- (a) to gain exemption as a larger “eligible” private company or group at least 75% of all the members of the company or the holding company of the group (as the case may be) must pass a resolution at a general meeting that the company or the holding company is to fall within the reporting exemption for the financial year, ~~with none objecting~~; and
 - (b) ~~to gain exemption for a group of larger “eligible” private companies all the companies in the group individually, as well as the parent of the group, must have obtained the necessary shareholder approval (except for those subsidiaries within the group that fall within the “small private company” category)~~ none of the members holding the remaining voting rights in that company or the holding company vote against the resolution.

^{2a2b}See paragraphs 2 and 3 of Schedule 3 to the CO for details on determination of total revenue and total assets for the purpose of the size tests for the reporting exemption.

The 75% vote is calculated as a percentage of the entire shareholding of ~~a the~~ company seeking to use the reporting exemption, not simply as a percentage of the shareholders of that company who attend the general meeting. The resolution is defeated if any member of that company objects either at the meeting or at any time by giving notice in writing to the company, provided that the written notice is given at least 6 months before the end of the financial year to which the objection relates.

42A. As a result of the 2018 Amendment Ordinance, for the purposes of preparing consolidated financial statements of a larger “eligible” group under the SME-FRS, it is sufficient for the holding company seeking to make use of the reporting exemption to obtain the above approval from its own shareholders. It is no longer necessary for the holding company to also obtain shareholder approval from the shareholders of any of its subsidiaries, even if those subsidiaries exceed the small size limits and are therefore also “eligible” private companies in their own right. Such approval from the subsidiary’s shareholders need only be obtained if those larger “eligible” subsidiaries wish to take advantage of the reporting exemption when preparing their own financial statements.

43. ~~In addition, as~~As stated in paragraph 22 above, private companies which do not have subsidiaries and are not a subsidiary of another company do not need to meet any size test in order to qualify under section 359(1)(b) of the new CO, provided that each year they obtain 100% approval from their shareholders. This approval must be in writing and can only be given for one year at a time.

Transitioning from a different GAAP to SME-FRF and SME-FRS

44. The transition from a different GAAP (for example the transition from reporting in accordance with Hong Kong Financial Reporting Standards) to the SME-FRF and SME-FRS is accounted for as follows:

- (a) All items recognised previously under a different GAAP (for example, deferred tax liability) which do not meet the recognition criteria under the SME-FRF and SME-FRS are to be derecognised and dealt with as a change of accounting policy under section 2 of the SME-FRS.
- (b) All items not recognised previously under a different GAAP which meet the recognition criteria under the SME-FRF and SME-FRS³ are to be recognised in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under section 2 of the SME-FRS.
- (c) All items recognised previously under a different GAAP, which meet the recognition criteria under the SME-FRF and SME-FRS, but which were previously measured on a basis inconsistent with the SME-FRF and SME-FRS (for example, unamortised goodwill) are to be re-measured in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under section 2 of the SME-FRS.

45. When an entity transitions from a different GAAP to the SME-FRF and SME-FRS it should disclose the following in the year of transition:

- (a) the fact that this is the first year that the entity has adopted the SME-FRF and SME-FRS;
- (b) the previous accounting framework adopted by the entity in its annual financial statements;
- (c) a reconciliation of net assets as reported in the previous annual financial statements and net assets reported as of the same date under the SME-FRF and SME-FRS, showing separately:

³ Such items are not expected to arise on a transition from full HKFRS to SME-FRF and SME-FRS but are included here for the sake of completeness.

- (i) any items derecognised because they do not meet the recognition criteria under the SME-FRF and SME-FRS;
- (ii) any items recognised for the first time because they meet the recognition criteria under the SME-FRF and SME-FRS but were not recognised under the previous accounting framework; and
- (iii) the amount by which any items have been re-measured as a result of adopting the measurement requirements of the SME-FRF and SME-FRS.

This reconciliation should be presented for the opening balances of the current period and any comparative period presented which have been restated as a result of transitioning to the SME-FRF and SME-FRS; and

- (d) if any opening balances have not been restated because it would require undue cost or effort to do so, this fact.

Realized profits and Realized Losses

- 46. Consistent with section 79A of the predecessor CO (Cap. 32), section 297 of the new CO states that a company may only make a distribution out of profits available for distribution and that, for the purposes of this section, a company's profits available for distribution are its accumulated, realized profits, so far as not previously utilized by distribution or capitalization, less its accumulated, realized losses, so far as not previously written off in a reduction or reorganisation of capital. Such distributable profits are to be computed at the company-level, irrespective of whether the company prepares consolidated financial statements.
- 47. Also consistent with section 79A of the predecessor CO, section 291 of the new CO states that a reference to realized profits or losses of a company is a reference to those profits or losses of the company that are regarded as realized for the purposes of any financial statements prepared by the directors in accordance with principles generally accepted, at the time when the financial statements were prepared, with respect to the determination for accounting purposes of realized profits or realized losses.
- 48. In accordance with Accounting Bulletin 4 "Guidance on the Determination of Realized Profits and Losses in the Context of Distributions under the Hong Kong Companies Ordinance" issued by the HKICPA, a profit shall be treated as realized only when realized in the form of:
 - (a) cash; or
 - (b) other assets, the ultimate cash realization of which can be assessed with reasonable certainty.
- 49. Most transactions recognised under the SME-FRS in company-level financial statements would satisfy this test. For example, a sale of inventory on normal credit terms will still give rise to a realized profit at the point of sale if the debtor is capable of settling the receivable within a reasonable period of time and there is a reasonable certainty that the debtor will be capable of settling when called upon to do so.
- 50. However, if the sale was in exchange for an illiquid asset, such as a property, the profit could not be regarded as realized until the property itself was sold in a cash or near-cash transaction, because the property would not be regarded as readily convertible to cash without a period of marketing. Similarly, unrealized profits might also arise if the sale was to, for example, a subsidiary, and the subsidiary had no independent means of settling the inter-company payable without assistance from the parent. As a result, care should be taken when computing profits available for distribution for the purposes of section 291 of the new CO, to exclude from the company-level retained earnings any amounts relating to profits which are still unrealized.

51. With respect to realized losses, in general, where amounts are charged against profit or loss (and hence recorded in company-level retained earnings), the charge should be regarded as being “realized” irrespective of whether it arose on re-measurement of the carrying value of an asset or liability, or the charge has crystallised, for example on settlement of a law suit. Adjustments should not therefore be made to add back any expenses or other charges when computing profits available for distribution for the purposes of section 291 of the new CO.
52. Further guidance on the concept of realized profits and realized losses can be found in Accounting Bulletin 4 and the accompanying Staff Summary issued by the HKICPA. However, it should be noted that this guidance is primarily intended to address a wide variety of differences between recognition requirements under full HKFRSs and the concept of realized profits or losses. Although the same principles for defining realized profits and losses will apply whether a company follows full HKFRSs or SME-FRS, in practice as the SME-FRS does not permit upwards revaluation of assets and does not contain specific requirements relating to more complex financial instruments, many of the differences identified in the Bulletin between recognised profits and losses and realized profits and losses will not be applicable to financial statements prepared in accordance with the SME-FRS. This guidance will therefore only be of relevance when the nature of consideration received in a transaction recognised under the SME-FRS gives rise to a potentially unrealized profit. For example, the guidance in section 9 on intra group transactions and in section 10 on asset swaps may be relevant in such situations.

Effective Date

53. Consistent with section 358 of the new CO, this revised SME-FRF becomes effective for a Qualifying Entity’s financial statements that cover a period beginning on or after 3 March 2014, the commencement date of the new CO. Earlier application of this revised SME-FRF is not permitted.
54. The 2018 Amendment Ordinance was enacted on 28 November 2018 and commences operation on 1 February 2019. As a consequence of the 2018 Amendment Ordinance, paragraphs 1, 20, 22, 28, 30 - 33, 35, 37 - 42 of the SME-FRF and section 19.1 of the SME-FRS have been amended, and paragraphs 27A, 30A, 39A and 42A of the SME-FRF and their relevant headings have been added. Consistent with sections 366A(1)(c) and 359(6) of the new CO, as amended by the 2018 Amendment Ordinance, the amendments in paragraphs 22, 27A, 28, 30A, 31-33, 35 and 37-40 which relate to the reporting exemption criteria for mixed groups and non-Hong Kong body corporates are effective for a Qualifying Entity’s financial statements which cover a financial year beginning on or after 1 February 2019. All other amendments to SME-FRF and SME-FRS come into effect immediately on 1 February 2019. Earlier application is not permitted.

SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING STANDARD

Definitions

The following terms are used in the SME-FRS with the meanings specified:

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

Acquisition date is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer.

An **active market** is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

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

An **asset** is a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the entity.

An **associate** is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

Borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds.

A **business** is an integrated set of activities and assets conducted and managed for the purpose of providing:

- (a) a return to investors; or
- (b) lower costs or other economic benefits directly and proportionately to policyholders or participants.

A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set should be presumed to be a business.

A **business combination** is the bringing together of separate entities or businesses into one reporting entity, whereby the reporting entity gains control over the other entity or businesses.

Carrying amount is the amount at which an asset or a liability is recognised in the statement of financial position after the deduction of (if applicable) any accumulated depreciation (amortisation) and accumulated impairment losses thereon, or any write-down to net realisable value.

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity. They may include:

- (a) the individual's spouse and children;
- (b) children of the individual's spouse; and
- (c) dependants of the individual or the individual's spouse.

The **closing rate** is the spot exchange rate at the end of the reporting period.

Company-level financial statements are financial statements of a company which are not consolidated financial statements.

A **component of an entity** comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

Consolidated financial statements are financial statements which are prepared by the parent of a group and present financial information about the group as a single economic entity.

A **construction contract** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use. Construction contracts include: contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

A **constructive obligation** is an obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A **contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A **contingent liability** is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.

Contingent rent is that portion of the lease payments which is not fixed in amount but is based on a factor other than the passage of time (e.g. percentage of sales, amount of usage, price indices, market rates of interest).

Control (of an asset) is the power to obtain the future economic benefits that flow from the asset.

Control (of an entity) is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset or a business at the time of its acquisition, production or construction.

A **cost-plus contract** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Depreciable amount is the cost of an asset less its residual value.

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

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Economic life is either:

- (a) the period over which an asset is expected to be economically usable by one or more users; or
- (b) the number of production or similar units expected to be obtained from the asset by one or more users.

Events after the end of the reporting period are events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

- (a) those providing evidence of conditions that existed at the end of the reporting period (adjusting events); and
- (b) those indicative of conditions that arose after the end of the reporting period (non-adjusting events).

Exchange difference is the difference resulting from translating a given number of units of one currency to another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

A **finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Former Companies Ordinance (former CO) means

- (a) the Companies Ordinance 1865 (1 of 1865);
- (b) the Companies Ordinance 1911 (58 of 1911); or
- (c) the predecessor CO (see definition).

A **fixed price contract** is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

Foreign currency is a currency other than the reporting currency of an entity.

Foreign operation is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than the country or reporting currency of the reporting entity.

Government refers to government, government agencies and similar bodies, whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed on them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Grants related to income are government grants other than those related to assets.

A **group** is a parent and all its subsidiaries.

Guaranteed residual value is:

- (a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and
- (b) in the case of the lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging the obligations under the guarantee.

Historical cost is:

- (a) in the case of assets, the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition; and
- (b) in the case of liabilities, the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Historical cost convention is the measurement basis whereby:

- (a) assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition;

- (b) liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business; and
- (c) assets should not be revalued nor should future cash flows be discounted in the measurement of assets and liabilities except when required or permitted by the SME-FRS.

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

The **inception of the lease** is the earlier of the date of the lease agreement or the date of commitment by the parties to the principal provisions of the lease.

The lessee's **incremental borrowing rate of interest** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

An **intangible asset** is an identifiable non-monetary asset without physical substance.

The **interest rate implicit in the lease** is the discount rate that, at the inception of the lease, causes the aggregate present value of:

- (a) the minimum lease payments; and
- (b) the unguaranteed residual value

to be equal to the fair value of the leased asset.

Inventories are assets:

- (a) held for sale in the ordinary course of business;
- (b) in the process of production for such sale; or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Investment (in a security) is a financial asset (such as a bond or share or other negotiable instrument evidencing debt or ownership) held by an entity for trading, the accretion of wealth through distribution (such as interest and dividends), for capital appreciation or for other benefits to the investing entity such as those obtained through trading relationships. Current investments are those that would satisfy the criteria for being classified as current in accordance with paragraph 1.16 of the SME-FRS.

A **joint arrangement** is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint arrangements include joint ventures and other joint arrangements.

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).

A **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity through an entity that is separate from the parties and subject to joint control.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

A **lease** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The **lease term** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

A **legal obligation** is an obligation that derives from:

- (a) a contract (through its explicit or implicit terms);
- (b) legislation; or
- (c) other operation of law.

A **liability** is a present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with, in the case of the lessee, any amounts guaranteed by the lessee or by a party related to the lessee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable, and if, at the inception of the lease, it is reasonably certain that the option will be exercised, then the minimum lease payments comprise the minimum payments payable over the lease term and the payment required to exercise this purchase option.

Non-controlling interest 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.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The **new Companies Ordinance (or new CO)** means the Companies Ordinance (Cap. 622) as in force from 3 March 2014.

A **non-cancellable lease** is a lease that is cancellable only:

- (a) upon the occurrence of some remote contingency;
- (b) with the permission of the lessor;
- (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor;
or
- (d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

An **obligating event** is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

An **onerous contract** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

A **parent** is an entity that has one or more subsidiaries.

An **operating lease** is a lease other than a finance lease.

The **predecessor Companies Ordinance** (or **predecessor CO**) means the Companies Ordinance (Cap. 32) as in force before 3 March 2014 which is the commencement date of the new Companies Ordinance (Cap. 622) (see section 2 of Cap. 622).

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

- (a) was available when financial statements for those periods were authorised for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

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

Property, plant and equipment are tangible assets that:

- (a) are held by an entity for use in the production or supply of goods or services, for rental to others, for investment potential, or for administrative purposes; and
- (b) are expected to be used during more than one period.

A **provision** is a liability of uncertain timing or amount.

A **qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Recoverable amount is the greater of an asset's net selling price and future net cash flow expected from the continued use of that asset.

A **related party** is a person or entity that is related to the entity that is preparing its financial statements (the 'reporting entity').

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - (i) has control or joint control over the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
- (iii) Both entities are joint ventures of the same third party.
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

A **related party transaction** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

An entity's **reporting currency** is the currency of the primary economic environment in which the entity operates.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Residual value 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.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Significant influence is the power to participate in the financial and operating policy decisions of an entity, but is not control or joint control over those policies.

A **subsidiary** is an entity that is controlled by another entity (known as the parent).

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, on which income taxes are payable (recoverable).

Useful life is:

- (a) the period of time 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.

A **venturer** is a party to a joint venture or other form of joint arrangement and has joint control over that arrangement.

Section 1

Presentation of Financial Statements

Components of financial statements

1.1 For an entity that qualifies under the Small and Medium-sized Entity Financial Reporting Framework (SME-FRF) to prepare and present its financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS), a complete set of financial statements for the entity includes the following components:

- (a) a statement of financial position;
- (b) an income statement; and
- (c) accounting policies and explanatory notes.

An entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS.

These financial statements should be consolidated financial statements unless the reporting entity is exempt from the preparation of consolidated financial statements in accordance with paragraph 19.1 or the reporting entity has no subsidiaries.

Overall considerations

1.2 Financial statements should properly present the financial position and financial performance of an entity. For an entity that qualifies for reporting under the SME-FRF, the appropriate application of the SME-FRS, with additional disclosure when necessary, would result in financial statements that achieve a proper presentation appropriate for SMEs. In the event that the SME-FRS does not cover an event or a transaction undertaken by an entity, management may consider the SME-FRF for guidance on developing an appropriate accounting policy, consistent with the historical cost convention, for that particular event or transaction.

1.3 An entity whose financial statements comply with the SME-FRS should disclose that fact⁴. Such financial statements should not be described as complying with Hong Kong Financial Reporting Standards (HKFRS).

1.4 Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.

1.5 In the extremely rare circumstances when management concludes that compliance with a requirement in the SME-FRS would be misleading, and that therefore departure from a requirement is necessary in order to achieve a proper presentation, in accordance with the SME-FRS, an entity should disclose:

- (a) that management has concluded that the financial statements properly present the entity's financial position and financial performance;

4 Note also that section 4 of Part 1 of Schedule 4 to the new CO requires the financial statements to state whether they have been prepared in accordance with the applicable accounting standards ~~within the meaning of section 380 as defined by section 357(4)~~ of the new CO and, if they have not been so prepared, to state the particulars of, and the reasons for, any material departure from those standards. As stated in paragraph 20 of the SME-FRF, the SME-FRF and FRS are the applicable accounting standards for the purposes of section 380 for those companies which are entitled to and do take advantage of the reporting exemption.

- (b) that it has complied in all material respects with applicable sections of the SME-FRS, except for departing from them in order to achieve a proper presentation; and
- (c) the nature and financial effect (when quantifiable) of the departure, including the treatment that the SME-FRS would require, the reason why that treatment would be misleading in the circumstances and the treatment adopted.

In the event of a departure, management should only adopt an accounting policy that is consistent with the historical cost convention.

- 1.6 When preparing financial statements, management should make an assessment of an entity's ability to continue as a going concern. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not considered to be a going concern.
- 1.7 An entity should prepare its financial statements under the accrual basis of accounting.
- 1.8 The presentation and classification of items in the financial statements should be retained from one period to the next unless:
- (a) a significant change in the nature of the operations of the entity or a review of its financial statement presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or
 - (b) a change in presentation is required by the SME-FRS.
- 1.9 Each material item should be presented separately in the financial statements. Immaterial amounts may be aggregated with amounts of a similar nature or function and need not be presented separately. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item judged in the particular circumstances where its presentation comes into question.
- 1.10 Assets and liabilities should not normally be offset in the financial statements. However, some offsetting is required or permitted in exceptional circumstances, as mandated by the SME-FRS. Offsetting may also take place where gains, losses and related expenses arising from the same or similar transactions are not material.
- 1.11 Unless the law requires otherwise or the SME-FRS permits or requires otherwise, comparative information with respect to the previous period should be disclosed for all numerical information in the financial statements. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Structure and content

- 1.12 Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed, and repeated when it is necessary for a proper understanding of the information presented:
- (a) the name of the reporting entity or other means of identification;
 - (b) the end of the reporting period or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements; and

(c) the reporting currency.

1.13 Financial statements should be presented at least annually. When, in exceptional circumstances⁵, an entity's accounting reference date changes and annual financial statements are presented for a period longer or shorter than one year, an entity should disclose, in addition to the period covered by the financial statements:

(a) the reason why a period other than one year is being used; and

(b) the fact that comparative amounts for the income statement and related notes are not comparable.

Statement of financial position

1.14 An entity should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the statement of financial position. Paragraphs 1.16 to 1.21 of this Section apply when this distinction is made.

1.15 When an entity chooses not to make the classification in paragraph 1.14, assets and liabilities should be presented broadly in order of their liquidity and the entity should disclose, for each asset and liability item that combines amounts expected to be recovered or settled both before and after 12 months from the end of the reporting period, the amount expected to be recovered or settled after more than 12 months.

1.16 An asset should 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 12 months after the end of the reporting period; or

(d) it is cash or a cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the end of the reporting period.

All other assets should be classified as non-current.

5 Section 371 of the new CO sets out the conditions that must be met before a company may change its "accounting reference date" i.e. the end of its reporting period.

- 1.17 A liability should 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;
 - (c) it is due to be settled within 12 months after the end of the reporting period; or
 - (d) the entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.⁶

All other liabilities should be classified as non-current.

- 1.18 An entity classifies its financial liabilities as current when they are due to be settled within 12 months after the end of the reporting period, even if:
- (a) the original term was for a period longer than 12 months; and
 - (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the end of the reporting period and before the financial statements are authorised for issue.
- 1.19 The face of the statement of financial position should include, where applicable, line items presenting the following amounts:
- (a) property, plant and equipment;
 - (b) intangible assets (including goodwill);
 - (c) financial assets (including investments but excluding amounts shown under (e) and (g));
 - (d) inventories;
 - (e) trade and other receivables;
 - (f) tax assets;
 - (g) cash and cash equivalents;
 - (h) trade and other payables;
 - (i) tax liabilities;
 - (j) provisions;

⁶ The classification of a term loan as a current or non-current liability in accordance with paragraph 1.17(d) should be determined by reference to the rights and obligations of the lender and the borrower, as contractually agreed between the two parties and in force as of the end of the reporting period. In this regard, the probability of the lender choosing to exercise its right within the next twelve months after the end of the reporting period is not relevant.

The classification of a term loan in accordance with the paragraph 1.17(d) should depend on whether or not the borrower has an unconditional right to defer payment for at least twelve months after the end of the reporting period. Consequently, amounts repayable under a loan agreement which includes a clause that gives the lender the unconditional right to call the loan at any time should be classified by the borrower as current in its statement of financial position. This is because the borrower under such an agreement does not have an unconditional right to defer settlement of the liability for at least twelve months after the end of the reporting period.

A more detailed discussion can be found in Hong Kong Interpretation 5 to the Hong Kong Financial Reporting Standards "Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause".

- (k) non-current liabilities;
 - (l) issued capital; and
 - (m) reserves.
- 1.20 Where the statement of financial position is a consolidated statement of financial position, the following additional items should be disclosed separately on the face of the statement of financial position:
- (a) investments accounted for using the equity method (if the equity method is the adopted accounting policy in accordance with paragraph 20.3 and/or 21.4);
 - (b) an allocation of reserves between:
 - (i) non-controlling interest (if any); and
 - (ii) reserves attributable to equity holders of the parent.
- 1.21 Additional line items, headings and subtotals should be presented on the face of the statement of financial position when such presentation is necessary to present properly the entity's financial position.
- 1.22 An entity should disclose the following, either on the face of the statement of financial position or in the notes:
- (a) for each class of share capital:
 - (i) the number of shares authorised (if applicable)⁷;
 - (ii) the number of shares issued and fully paid, and issued but not fully paid;
 - (iii) par value per share, or that the shares have no par value⁸;
 - (iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;
 - (v) the rights, preferences and restrictions attaching to that class, including restrictions on the distribution of dividends and the repayment of capital;
 - (vi) shares in the entity held by the entity itself; and
 - (vii) shares reserved for issuance under options and sales contracts, including the terms and amounts;
 - (b) where it is not otherwise self-evident, a description of the nature and purpose of each component within equity;
 - (c) the amount of dividends that were proposed or declared after the end of the reporting period but before the financial statements were authorised for issue; and
 - (d) the amount of any cumulative preference dividends not recognised.

⁷ The concept of "authorized share capital" no longer exists in the new CO.

⁸ As stated in section 135 of the new CO, under the new CO there is no longer the concept of "nominal value" (otherwise known as par value) for share capital. Instead the amount paid on the share is the sum of all amounts paid to the company at any time for the share and the amount remaining unpaid on the share is the difference between the issue price of the share and the amount paid on the share. According to Schedule 11 of the new CO, upon the commencement date of section 135 of the new CO, any amount standing to the credit of, as well as any amount would be required by a continuing provision to be transferred to, the company's share premium account and capital redemption reserve become part of the company's share capital.

An entity without share capital, such as a partnership, should disclose information equivalent to that required above, showing movements during the period in each category of equity interest and the rights, preferences and restrictions attaching to each category of equity interest.

- 1.23 In accordance with section 380(3)(a) and Part 1 of Schedule 4 to the new CO, if a parent company presents consolidated financial statements, it must also include in the notes to the consolidated financial statements:
- (a) a note which contains the parent company's company-level statement of financial position in the format in which that statement would have been prepared if the parent company had not been required to prepare consolidated financial statements; and
 - (b) a note which discloses the movement in the parent company's reserves.

Further notes to the parent company's company-level statement of financial position are not required.

Income statement

- 1.24 The face of the income statement should include, where applicable, line items that present the following amounts:
- (a) revenue;
 - (b) finance costs;
 - (c) tax expense; and
 - (d) profit or loss for the period.
- 1.25 Where the income statement is a consolidated income statement, the following additional items should also be disclosed separately on the face of the income statement:
- (a) share of profit or loss of associates and joint ventures accounted for using the equity method (if the equity method is the adopted accounting policy in accordance with paragraph 20.3 and/or 21.4); and
 - (b) an allocation of profit or loss for the period between:
 - (i) profit or loss attributable to non-controlling interest (if any); and
 - (ii) profit or loss attributable to equity holders of the parent.

Additional line items, headings and subtotals should be presented on the face of the income statement when such presentation is necessary to present properly the entity's financial performance.

- 1.26 All items of income and expense recognised in a period should be included in the determination of the profit or loss for the period unless the SME-FRS requires or permits otherwise.
- 1.27 When items of income and expense within profit or loss are of such size, nature or incidence that their disclosure is relevant to explain the performance of the entity for the period, the nature and amount of such items should be disclosed separately.

- 1.28 Circumstances that may give rise to the separate disclosure of items of income and expense in accordance with paragraph 1.27 include the following:
- (a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs;
 - (b) the write-down of intangible assets to recoverable amount, as well as the reversal of such write-downs;
 - (c) a restructuring of the activities of an entity and the reversal of any provisions for the costs of restructuring;
 - (d) disposals of items of property, plant and equipment;
 - (e) disposals of intangible assets;
 - (f) disposals of subsidiaries and other long-term investments;
 - (g) litigation settlements; and
 - (h) other reversals of provisions.
- 1.29 An entity should present, either on the face of the income statement or in the notes, an analysis of expenses using a classification based on either the nature of expenses (for example depreciation, purchases of materials, employee benefits) or their function within the entity (for example, costs of goods sold, distribution expenses, administration costs).
- 1.30 Entities classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and amortisation expense and staff costs.
- 1.31 An entity should disclose, either on the face of the income statement or in the notes, the amount of dividends per share, declared or proposed, for the period covered by the financial statements.

Changes in equity

- 1.32 An entity should present changes in equity either in the notes to the financial statements or as a separate component of the financial statements. Changes in equity should include the following:
- (a) the profit or loss for the period;
 - (b) each item of income and expense, gain or loss that, as required by the SME-FRS, is recognised directly in equity, and the total of these items;
 - (c) the total income and expense for the period (calculated as the sum of (a) and (b));
 - (d) the cumulative effect of changes in accounting policy and the correction of prior period errors;
 - (e) capital transactions with owners and distributions to owners; and
 - (f) a reconciliation between the carrying amount of each class of equity capital and each reserve at the beginning and end of the period, separately disclosing each movement. Comparative information is not required for this reconciliation.

Accounting policies and explanatory notes

- 1.33 The notes to the financial statements should:
- (a) present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and events;
 - (b) disclose the information required by the SME-FRS that is not presented elsewhere in the financial statements; and
 - (c) provide additional information that is necessary for a proper presentation.
- 1.34 Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of financial position and the income statement should be cross-referenced to any related information in the notes.
- 1.35 The accounting policies section of the notes to the financial statements should describe:
- (a) whether the financial statements have been prepared in accordance with the SME-FRS and the criteria on which the entity qualifies to apply the SME-FRS;
 - (b) the measurement basis (or bases) used in preparing the financial statements; and
 - (c) each specific accounting policy that is necessary for a proper understanding of the financial statements.
- 1.36 An entity should disclose the following, if the information is not disclosed elsewhere in information published with the financial statements:
- (a) the domicile and legal form of the entity, its place of incorporation and the address of the registered office (or principal place of business, if different from the registered office); and
 - (b) a description of the nature of the entity's operations and its principal activities.

Section 2

Accounting Policies, Changes in Accounting Estimates and Errors

- 2.1 Management should use its judgment in developing an accounting policy resulting in information that is relevant to the needs of users of the financial statements and is reliable in nature. Management should select and apply an entity's accounting policies so that the financial statements comply with all the requirements of the SME-FRS and are consistent with the historical cost convention.
- 2.2 An entity should select and apply its accounting policies for a period consistently for similar transactions, other events and circumstances, unless the SME-FRS specifically requires or permits categorisation of items for which different policies may be appropriate.

Changes in accounting policies

- 2.3 A change in accounting policy should be made only if it is required by the SME-FRS or if it results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position or financial performance.
- 2.4 The following are not changes in accounting policies:
- (a) the adoption of an accounting policy for transactions or other events that differ in substance from those previously occurring; or
 - (b) the adoption of a new accounting policy for transactions or other events that did not occur previously or were immaterial.
- 2.5 A change in an accounting policy that is made following an amendment to the SME-FRS should be accounted for in accordance with the transitional provisions, if any, issued with the amendment to the SME-FRS.
- 2.6 Where application of a change in the SME-FRS has a material effect on the current period or any prior period presented, an entity should disclose the following:
- (a) the fact that the change in accounting policy is made in accordance with the change in the SME-FRS, with a description of those provisions;
 - (b) the amount of the adjustment for the current period and for each prior period presented;
 - (c) the amount of the adjustment relating to periods prior to those included in the comparative information; and
 - (d) the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort or because this is in accordance with the transitional provisions issued with the amendment to the SME-FRS.
- 2.7 A change in an accounting policy other than the one mandated under paragraph 2.5 should be applied retrospectively unless it is impracticable to determine the cumulative effect of the change. Subject to paragraph 2.8, the opening balance of reserves for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented should be adjusted, where applicable, as if the new accounting policy had always been in use.

- 2.8 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When comparative information for a particular prior period is not restated, the new accounting policy should be applied to the balances of assets and liabilities as at the beginning of the next period, and a corresponding adjustment should be made to the opening balance of reserves for the next period unless impracticable.
- 2.9 When a change in an accounting policy has an effect on the current period or any prior period presented, or may have an effect in subsequent periods, an entity should disclose the following:
- (a) the reasons for the change;
 - (b) the amount of the adjustment for the current period and for each prior period presented;
 - (c) the amount of the adjustment relating to periods prior to those presented; and
 - (d) that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.

Changes in accounting estimates

- 2.10 The effect of a change in an accounting estimate should be recognised prospectively by including it in profit or loss in:
- (a) the period of the change, if the change affects that period only; or
 - (b) the period of the change and future periods, if the change affects both.
- 2.11 The nature and amount of a change in an accounting estimate that has an effect on the current period or is expected to have an effect in subsequent periods should be disclosed. If it would require undue cost or effort to quantify that amount, this fact should be disclosed.

Errors

- 2.12 Subject to paragraph 2.13, the amount of the correction of a material prior period error should be accounted for retrospectively unless it is impracticable to determine the cumulative effect of the correction. A prior period error should be corrected by:
- (a) either restating the comparative amounts for the prior periods in which the error occurred; or
 - (b) when the error occurred before the earliest prior period presented, restating the opening balance of reserves for that period, so that the financial statements are presented as if the error had never occurred.

All errors other than prior period errors should be corrected in the current period.

- 2.13 Comparative information presented for a particular prior period need not be restated if restating the information would require undue cost or effort. When no restatement of comparative figures takes place, the opening balance of reserves for the next period should be restated for the cumulative effect of the error before the beginning of that period.
- 2.14 An entity should disclose:
- (a) the nature of the prior period error; and
 - (b) the amount of the correction for each prior period presented.

Section 3

Property, Plant and Equipment

- 3.1 An item of property, plant and equipment (including property held for rental and/or for investment potential) should be recognised as an asset when:
- (a) it is probable that future economic benefits associated with the asset will flow to the entity; and
 - (b) the cost of the asset to the entity can be measured reliably.
- 3.2 An item of property, plant and equipment that qualifies for recognition as an asset should initially be measured at its cost.
- 3.3 The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs include the following:
- (a) the cost of site preparation;
 - (b) initial delivery and handling costs;
 - (c) installation costs;
 - (d) professional fees such as for architects, engineers and lawyers; and
 - (e) the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision under Section 10.
- 3.4 Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar pre-production costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset's achieving planned performance are recognised as an expense.
- 3.5 The cost of a self-constructed asset is determined using the same principles as for an acquired asset.
- 3.6 An item of property, plant and equipment may be acquired in exchange or part exchange for a dissimilar item of property, plant and equipment or other asset. The cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred.
- 3.7 Subsequent expenditure relating to an item of property, plant and equipment that has already been recognised should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the entity. All other subsequent expenditure should be recognised as an expense in the period in which it is incurred.
- 3.8 Expenditure on repairs or maintenance of property, plant and equipment is made to restore or maintain the future economic benefits that an entity can expect from the originally assessed standard of performance of the asset. As such, it is usually recognised as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.

- 3.9 Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph 3.1 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

Measurement subsequent to initial recognition

- 3.10 Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Depreciation and impairment

- 3.11 The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity. The depreciation charge for each period should be recognised as an expense unless it is included in the carrying amount of another asset.
- 3.12 The economic benefits embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful life of an asset:
- (a) the expected usage of the asset by the entity (usage is assessed by reference to the asset's expected capacity or physical output);
 - (b) the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used, the repair and maintenance programme of the entity, and the care and maintenance of the asset while idle;
 - (c) technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or the service output of the asset; and
 - (d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.
- 3.13 Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. Freehold land normally has an unlimited life and, therefore, is not depreciated. Leasehold interest in land from the Government of the Hong Kong Special Administrative Region or elsewhere with similar features are accounted for as property, plant and equipment in accordance with this Section. Leasehold land is to be depreciated over the lease term. Buildings have a limited 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 useful life of the building.
- 3.14 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. The method used for an asset is selected based on the expected pattern of economic benefits from that asset and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits from that asset.

- 3.15 The useful life of an item of property, plant and equipment should be reviewed annually and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods should be adjusted.
- 3.16 The depreciation method applied to property, plant and equipment should be reviewed annually and, if there has been a significant change in the expected pattern of economic benefits from those assets, the method should be changed to reflect the changed pattern. When such a change in depreciation method is necessary, the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.
- 3.17 To determine whether an item of property, plant and equipment is impaired, an entity applies Section 9 *Impairment of Assets*. That Section explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

Retirements and disposals

- 3.18 An item of property, plant and equipment should be eliminated from the statement of financial position on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.
- 3.19 Gains or losses arising from the retirement or disposal of an item of property, plant and equipment should be determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

Disclosure

- 3.20 An entity should disclose, for each class of property, plant and equipment:
- (a) the measurement bases used for determining the gross carrying amount;
 - (b) the depreciation methods used;
 - (c) the useful lives or the depreciation rates used;
 - (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
 - (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
 - (i) additions;
 - (ii) disposals;
 - (iii) impairment losses recognised in the income statement during the period (if any);
 - (iv) impairment losses reversed in the income statement during the period (if any);
 - (v) depreciation; and
 - (vi) other movements.

_____ Comparative information is not required.

- 3.21 An entity should also disclose the existence and amounts of restrictions on title, as well as property, plant and equipment pledged as security separately for:
- (a) the entity's liabilities; and
 - (b) another entity's liabilities.

Section 4

Intangible Assets (other than goodwill)

Control of an asset

- 4.1 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an entity may be able to control the future economic benefits in some other way.

Recognition and initial measurement

- 4.2 An intangible asset should be recognised if, and only if:
- (a) in the case of an intangible asset acquired in a business combination, its fair value is readily apparent or otherwise can be measured reliably without undue cost; and
 - (b) in all other cases, it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

- 4.3 An entity should assess the probability of future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

- 4.4 An intangible asset should be measured initially at cost.

- 4.5 Internally generated goodwill should not be recognised as an asset.

4.6 *Research phase*

No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

4.7 *Development phase*

An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an entity can demonstrate all of the following:

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- (b) the entity's intention to complete the intangible asset and use or sell it;
- (c) its ability to use or sell the intangible asset;
- (d) how the intangible asset will generate probable future economic benefits (among other things, the entity should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset);
- (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

- (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

4.8 Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

Recognition of an expense

4.9 Expenditure on an intangible item should be recognised as an expense when it is incurred, unless it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 4.2 to 4.8).

4.10 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 4.6). Examples of other expenditure that is recognised as an expense when it is incurred include:

- (a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment under Section 3. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);
- (b) expenditure on training activities;
- (c) expenditure on advertising and promotional activities; and
- (d) expenditure on relocating or re-organising part or all of an entity.

4.11 Expenditure on an intangible item that was initially recognised as an expense in previous financial statements should not be recognised as part of the cost of an intangible asset at a later date.

4.12 Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

- (a) it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and
- (b) this expenditure can be reliably measured and attributed to the asset.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

4.13 After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation

4.14 The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

- 4.15 If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:
- (a) the legal rights are renewable; and
 - (b) renewal is virtually certain.
- 4.16 The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another section of this SME-FRS permits or requires it to be included in the carrying amount of another asset.
- 4.17 The residual value of an intangible asset should be assumed to be zero unless:
- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
 - (b) there is an active market for the asset and:
 - (i) its residual value can be determined by reference to that market; and
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.
- 4.18 The amortisation period and the amortisation method should be reviewed at least at the end of each financial year. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates by adjusting the amortisation charge for the current and future periods.
- 4.19 To determine whether an intangible asset is impaired, an entity applies Section 9 *Impairment of Assets*. That Section explains when and how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.
- 4.20 An intangible asset should be derecognised (eliminated from the statement of financial position) on disposal or when no future economic benefits are expected from its use and subsequent disposal.
- 4.21 Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

Disclosure

- 4.22 An entity should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:
- (a) the useful lives or the amortisation rates used;
 - (b) the amortisation methods used;
 - (c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;

- (d) the line item(s) of the income statement in which the amortisation of intangible assets is included; and
- (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
 - (i) additions;
 - (ii) retirements and disposals;
 - (iii) impairment losses recognised in the income statement during the period (if any);
 - (iv) impairment losses reversed in the income statement during the period (if any);
 - (v) amortisation recognised during the period; and
 - (vi) other changes in the carrying amount during the period.

Comparative information is not required.

4.23 An entity should also disclose:

- (a) if an intangible asset is amortised over more than 10 years, the reasons why the presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use is rebutted;
- (b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the entity as a whole; and
- (c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security separately for:
 - (i) the entity's liabilities; and
 - (ii) another entity's liabilities.

Section 5

Leases

Classification of leases

- 5.1 The classification of leases is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibility of losses from idle capacity or technological obsolescence and of variations in return caused by changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value.
- 5.2 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Following are examples of situations that would normally lead to a lease being classified as a finance lease:
- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
 - (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;
 - (c) the lease term is for the major part of the economic life of the asset, even if title is not transferred;
 - (d) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
 - (e) the leased assets are of a specialised nature such that only the lessee can use them without major modifications.
- 5.3 Following are indicators of situations that, individually or in combination, could also lead to a lease being classified as a finance lease:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
 - (c) the lessee has the ability to continue the lease for a secondary period at a rent substantially lower than market rent.

Finance leases

- 5.4 Lessees should recognise finance leases as assets and liabilities in their statements of financial position at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments, the discount factor is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.
- 5.5 Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated on a systematic basis to periods during the lease term either by way of the straight-line method or a method that produces an

approximately constant periodic rate of interest on the remaining balance of the liability for each period.

- 5.6 A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for leased assets should be consistent with that for depreciable assets that are owned.
- 5.7 If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

Disclosure

- 5.8 Lessees should disclose for a finance lease at the end of the reporting period the carrying amount of the asset, and the outstanding liability falling due in each of the following periods:
- (a) not later than one year; and
 - (b) later than one year.

Operating leases

- 5.9 Lease payments under an operating lease should be recognised as an expense in the income statement on a straight-line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.
- 5.10 All incentives for the agreement of a new or renewed operating lease should be recognised as an integral part of the net consideration agreed for the use of the leased asset. Lessees should recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term.

Disclosure

- 5.11 Lessees should disclose the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
- (a) not later than one year; and
 - (b) later than one year.

Sale and leaseback

- 5.12 A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payment and the sale price are usually interdependent since they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease involved.
- 5.13 If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount should not be immediately recognised as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term.
- 5.14 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 should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should 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 should be deferred and amortised over the period for which the asset is expected to be used.

- 5.15 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 should be recognised immediately.

Section 6

Investments

6.1 This Section should be applied in accounting for investments in subsidiaries in company-level financial statements and in accounting for other investments in securities, whether in company-level financial statements or consolidated financial statements, including associates and joint ventures accounted for using the cost model.

This Section should not be applied in accounting for properties held for rental and/or for investment potential (as they are dealt with in Section 3 *Property, Plant and Equipment*), or investments in associates or joint ventures accounted for using the equity method (as they are dealt with in Section 20 *Investments in Associates* and Section 21 *Interests in Joint Ventures* respectively).

6.2 An investment should be recognised as an asset when:

- (a) it is probable that future economic benefits associated with the asset will flow to the entity; and
- (b) the cost of the asset can be measured reliably.

6.3 An investment that qualifies for recognition as an asset should initially be measured at its cost.

6.4 The cost of an investment includes acquisition charges such as brokerages, fees, duties and taxes.

6.5 If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued and not their nominal or par value. If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. In cases where the fair value of the securities issued or the asset given up is not reliably determinable, the acquisition cost should be the fair value of the investment acquired.

6.6 Interest and dividends receivable in connection with an investment are generally regarded as income, being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. For example, when unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost. When dividends on equity securities are declared from pre-acquisition profits a similar treatment applies. If it is difficult to make such an allocation except on an arbitrary basis, the cost of an investment is normally reduced by dividends receivable only if they clearly represent a recovery of part of cost.

Measurement subsequent to initial recognition

6.7 Except as provided in paragraph 6.8 for held-to-maturity securities, subsequent to initial recognition as an asset, an investment should be carried at:

- (a) the lower of cost and net realisable value for current investments; and
- (b) cost less accumulated impairment losses for long-term investments.

Changes in the carrying amount of an investment from the end of one reporting period to another should be recognised as income or expense in the income statement.

- 6.8 The difference between the acquisition cost and redemption value of an investment in held-to-maturity debt securities (the discount or premium on acquisition) should be amortised by the entity on a systematic basis over the period from acquisition to maturity either by way of the straight-line method, or a method whereby a constant yield is earned on the investment. The amortised discount or premium is credited or charged to income as though it were interest and added to or subtracted from the carrying amount of the security. The resulting carrying amount is then regarded as cost.

Disposals of investments

- 6.9 Gains or losses arising from the disposal of an investment should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.
- 6.10 When disposing of part of an entity's holding of a particular investment, a carrying amount must be allocated to the part sold. This carrying amount is usually determined from the average carrying amount of the total holding of the investment.

Disclosure

- 6.11 An entity should disclose:
- (a) the measurement bases used for determining the carrying amount of investments;
 - (b) the significant amounts included in income for:
 - (i) interest and dividends;
 - (ii) profits and losses on disposal of investments;
 - (iii) impairment losses; and
 - (iv) reversals of impairment losses;
 - (c) the market value of listed investments if they are not carried at market value;
 - (d) significant restrictions and other terms affecting the realisability of investments or the remittance of income and proceeds of disposal; and
 - (e) the accumulated write-down to net carrying amount (if any).
- 6.12 Investments in securities should be distinguished between equities and debt securities. They should be analysed between those that are listed and those that are unlisted. This analysis should be provided separately for current investments and long-term investments.
- 6.13 An entity should disclose the existence and amounts of restrictions on title, as well as investments pledged as security separately for:
- (a) the entity's liabilities; and
 - (b) another entity's liabilities.

Section 7

Inventories

- 7.1 Inventories should be measured at the lower of cost and net realisable value. Inventories are usually written down to net realisable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items.
- 7.2 The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- 7.3 The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs.
- 7.4 The cost of inventories, other than those dealt with in paragraph 7.3, should be assigned by using the first-in, first-out or weighted average cost formulas.

Recognition as an expense

- 7.5 When inventories are sold, the carrying amount of those inventories should be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories should be recognised as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories arising from an increase in net realisable value should be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Disclosure

- 7.6 An entity should disclose:
- (a) the accounting policies adopted in measuring inventories, including the cost formula used;
 - (b) the total carrying amount of inventories analysed in classifications appropriate to the entity;
 - (c) the carrying amount of inventories pledged as security for the entity's liabilities; and
 - (d) the carrying amount of inventories pledged as security for another entity's liabilities.

Section 8

Construction Contracts

- 8.1 This Section should be applied in accounting for construction contracts in the financial statements of contractors.
- 8.2 Contract revenue comprises:
- (a) the initial amount of revenue agreed in the contract; and
 - (b) variations in contract work, claims and incentive payments:
 - (i) to the extent that it is probable that they will result in revenue; and
 - (ii) they are capable of being reliably measured.
- 8.3 Contract costs comprise:
- (a) costs that relate directly to the specific contract;
 - (b) costs that are attributable to contract activity in general and can be allocated to the contract; and
 - (c) such other costs as are specifically chargeable to the customer under the terms of the contract.

Recognition

- 8.4 When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 8.10.
- 8.5 In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
- (a) total contract revenue can be measured reliably;
 - (b) it is probable that the economic benefits associated with the contract will flow to the entity;
 - (c) both the contract costs to complete the contract and the stage of contract completion at the end of the reporting period can be measured reliably; and
 - (d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.
- 8.6 In the case of a cost-plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
- (a) it is probable that the economic benefits associated with the contract will flow to the entity; and
 - (b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

- 8.7 The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
- (a) the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
 - (b) surveys of work performed; or
 - (c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect the work performed.

- 8.8 When the outcome of a construction contract cannot be estimated reliably:
- (a) revenue should be recognised only to the extent of contract costs incurred that it is probable they will be recoverable; and
 - (b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 8.10.

- 8.9 When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 8.4 rather than in accordance with paragraph 8.8.

Expected losses

- 8.10 When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.
- 8.11 The amount of such a loss is determined irrespective of:
- (a) whether work has commenced on the contract; or
 - (b) the stage of completion of contract activity.

Disclosure

- 8.12 An entity should disclose:
- (a) the amount of contract revenue recognised as revenue in the period;
 - (b) the methods used to determine the contract revenue recognised in the period; and
 - (c) the methods used to determine the stage of completion of contracts in progress.
- 8.13 An entity should disclose each of the following for contracts in progress at the end of the reporting period:
- (a) the aggregate amount of costs incurred and recognised profits (less recognised losses) to date;
 - (b) the amount of advances received; and
 - (c) the amount of retentions.

- 8.14 Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts received by the contractor before the related work is performed.
- 8.15 An entity should present:
- (a) the gross amount due from customers for contract work as an asset; and
 - (b) the gross amount due to customers for contract work as a liability.
- 8.16 The gross amount due from customers for contract work is the net amount of:
- (a) costs incurred plus recognised profits; less
 - (b) the sum of recognised losses and progress billings,
- for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings.
- 8.17 The gross amount due to customers for contract work is the net amount of:
- (a) costs incurred plus recognised profits; less
 - (b) the sum of recognised losses and progress billings,
- for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

Section 9

Impairment of Assets

9.1 At the end of each reporting period, an entity should consider whether there exist any indications of impairment and, if so, the entity should estimate the recoverable amount of all assets (including items of property, plant and equipment, intangible assets and investments in subsidiaries, associates, joint ventures and other securities) other than inventories, construction contracts and current investments. In the event that an asset's carrying amount exceeds its recoverable amount, the carrying amount should be restated to recoverable amount and an impairment loss should be recognised in the profit or loss for the period.

9.2 In assessing whether there is any indication that an asset may be impaired, an entity should consider, as a minimum, the following indications:

External sources of information

- (a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;
- (b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated;

Internal sources of information

- (c) evidence is available of obsolescence or physical damage of an asset;
- (d) 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 the manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date; and
- (e) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

9.3 The list in paragraph 9.2 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount.

9.4 Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

- (a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
- (b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;
- (c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or
- (d) operating losses or net cash outflows for the asset, when current period figures are aggregated with budgeted figures for the future.

- 9.5 An impairment loss should not be reversed unless its fair value is readily apparent or the asset's recoverable amount can otherwise be measured reliably without undue cost. For those assets (if any) which may satisfy this condition, at the end of each reporting period, an entity should assess whether there is any indication that an impairment loss recognised in prior periods for an asset may no longer exist or may have decreased and, if so, estimate the recoverable amount of that asset.
- 9.6 In case of a reversal of impairment loss, the increased carrying amount of an asset should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.
- 9.7 It is not always necessary to determine both an asset's net selling price and future net cash flow expected from the continued use of that asset. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
- 9.8 In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations for determining recoverable amount. Discounting is permitted but not required. If discounting is used, the discount rate(s) should be a pre-tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted. When discounting is used, an asset's future net cash flow expected from the continued use of that asset may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Additional requirements for impairment of goodwill

- 9.9 Goodwill, by itself, cannot be sold and it does not generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the recoverable amount of goodwill cannot be measured directly. Therefore, goodwill should be allocated to the component(s) of the entity that benefit from the goodwill (generally the lowest level within the entity at which the goodwill is monitored for internal management purposes) so that the recoverable amount of goodwill can be derived from measurement of the recoverable amount of the larger group of assets of which the goodwill is a part.
- 9.10 The principles in paragraphs 9.1 – 9.4 and paragraphs 9.7 and 9.8 for recognising and measuring impairment of assets apply to goodwill. Therefore, at the end of each period the entity should assess whether there is any indication that goodwill may be impaired. In addition to considering the indicators of impairment in paragraph 9.2, the entity should also consider whether:
- (a) since acquisition, the acquired entity to which the goodwill relates has performed significantly worse than expected;
 - (b) the acquired entity to which the goodwill relates is being restructured, held for sale or abandoned; or
 - (c) significant impairment losses have been recognised for other assets of the acquired entity to which the goodwill relates.
- 9.11 If there is an indication that goodwill has been impaired the entity should follow a two-step process to determine whether to recognise an impairment loss:

Step 1:

- (a) measure the recoverable amount of the component in its entirety, including the

goodwill;

- (b) compare the recoverable amount of the component with the carrying amount of the component (see paragraph 9.12 if there is a non-controlling interest in the component); and
- (c) if the recoverable amount of the component equals or exceeds its carrying amount, neither the component nor the goodwill is impaired; if the recoverable amount of the component is less than its carrying amount, the difference is an impairment loss that should be recognised in accordance with Step 2.

Step 2:

- (a) write down the component's goodwill by the amount of the loss determined in Step 1(c) and recognise an impairment loss in profit or loss; and
- (b) if the amount of the loss determined in Step 1(c) exceeds the carrying amount of the component's goodwill, the excess should be allocated to the identifiable non-cash assets of the component on the basis of their relative carrying amounts and recognised in profit or loss.

9.12 If there is a non-controlling interest in the component to which goodwill has been allocated, the carrying amount of that component comprises:

- (a) both the parent's interest and the non-controlling interest in the identifiable net assets of the component; and
- (b) the parent's interest in goodwill.

The carrying amount of such a component, as recognized on the consolidated statement of financial position, does not include any goodwill attributable to the non-controlling interest. Therefore, in order to ensure that the carrying amount of the component used in Step 1(b) is computed on a consistent basis compared to the recoverable amount of the component computed in Step 1(a), it is necessary to gross up the carrying amount of goodwill allocated to the component include the goodwill attributable to the non-controlling interest. For example, goodwill relating to a 60% owned subsidiary would be grossed up by a factor of 100/60.

Under Steps 1(b) and 1(c) this notionally adjusted carrying amount is then compared with the recoverable amount of the component to determine whether the larger group of assets (including the notionally grossed-up goodwill) is impaired.

If an impairment loss is identified, then in accordance with Step 2(a) this loss is first allocated to the notionally grossed-up goodwill, with any excess allocated to other assets under Step 2(b). Any impairment loss allocated to the notionally grossed-up goodwill under Step 2(a) is then apportioned between that attributable to the parent and that attributable to the non-controlling interest on a pro rata basis, with only the former being recognised in the financial statements as a goodwill impairment loss against the goodwill recognised in the consolidated statement of financial position. This computation is illustrated in Part C of Appendix 1.

9.13 An impairment loss recognised for goodwill should not be reversed in a subsequent period.

Section 10

Provisions, Contingent Liabilities and Contingent Assets

10.1 A provision should be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event, excluding those arising from executory contracts, except where these are onerous;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

Probable outflow of resources embodying economic benefits

10.2 For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Section, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur (i.e. the probability that the event will occur is greater than the probability that it will not). Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 10.19).

Reliable estimate of the obligation

10.3 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other statement of financial position items. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision. Discounting of the amount to arrive at the present value of the expenditures expected to be required to settle the obligation is permitted but not required. If discounting is used, the discount rate should be a pre-tax rate (or rates) that reflect(s) current assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

Contingent liabilities

10.4 An entity should not recognise a contingent liability.

10.5 A contingent liability is disclosed, as required by paragraph 10.19, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

10.6 An entity should not recognise a contingent asset.

10.7 Contingent assets are not recognised in financial statements, since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

10.8 A contingent asset is disclosed, as required by paragraph 10.20, where an inflow of economic benefits is probable.

Measurement

- 10.9 The amount recognised as a provision should be the best estimate of the amount required to settle the present obligation at the end of the reporting period.

Risks and uncertainties

- 10.10 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
- 10.11 The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.
- 10.12 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision. Gains from the expected disposal of assets should not be taken into account when measuring a provision.
- 10.13 In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.
- 10.14 Provisions should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
- 10.15 A provision should be used only for expenditures for which the provision was originally recognised.
- 10.16 Provisions should not be recognised for future operating losses.
- 10.17 For a contract that is onerous, a provision should be recognised and measured at the best estimate of the unavoidable cost of meeting the obligation under the contract less any economic benefits expected to be received under it. The unavoidable cost of meeting the obligation under the contract is the lower of:
- (a) the cost of exiting the contract (e.g. any penalties that would be payable on early cancellation); and
 - (b) the cost of fulfilling the contract.

Disclosure

- 10.18 For each class of provision, an entity should disclose:
- (a) the carrying amount at the beginning and end of the period; and
 - (b) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

When discounting is used to arrive at the best estimate of the provision, that fact should also be disclosed.

- 10.19 Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, measured under paragraphs 10.9 and 10.10.
- 10.20 Where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 10.9 and 10.10.
- 10.21 Where any of the information required by paragraphs 10.19 and 10.20 is not disclosed because it is not practicable to do so, that fact should be stated.
- 10.22 In extremely rare cases, disclosure of some or all of the information required by paragraphs 10.18 to 10.20 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information but should disclose the general nature of the dispute, together with the fact that, and the reason why, the information has not been disclosed.

Section 11

Revenue

Measurement

11.1 Revenue should be measured at the fair value of the consideration received or receivable.

Recognition: sale of goods

11.2 Revenue from the sale of goods should be recognised when all the following conditions have been satisfied:

- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
- (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- (c) the amount of revenue can be measured reliably;
- (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Recognition: rendering of services

11.3 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- (a) the amount of revenue can be measured reliably;
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity;
- (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and
- (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

11.4 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised only to the extent of the expenses recognised that are recoverable.

11.5 “Goods” include goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

11.6 The rendering of services typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to construction contracts – for example, those for the services of project managers and architects.

- 11.7 Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties, such as sales taxes, goods and services taxes and value-added taxes, are not economic benefits flowing to the entity and, hence, do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

Interest, royalties and dividends

- 11.8 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends should be recognised on the bases set out in paragraph 11.9 when:
- (a) it is probable that the economic benefits associated with the transaction will flow to the entity; and
 - (b) the amount of the revenue can be measured reliably.
- 11.9 Revenue should be recognised on the following bases:
- (a) interest should be recognised on a time proportion basis;
 - (b) royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement; and
 - (c) dividends should be recognised when the shareholder's right to receive payment is established.
- 11.10 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense rather than as an adjustment of the amount of revenue originally recognised.

Disclosure

- 11.11 An entity should disclose:
- (a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
 - (b) the amount of each significant category of revenue recognised during the period, including revenue arising from:
 - (i) the sale of goods;
 - (ii) the rendering of services;
 - (iii) interest;
 - (iv) royalties; and
 - (v) dividends; and
 - (c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Section 12

Government Grants and Other Government Assistance

Government grants

- 12.1 Government grants should not be recognised until there is reasonable assurance that:
- (a) the entity will comply with the conditions attaching to them; and
 - (b) the grants will be received.
- 12.2 Government grants should be recognised as income over the periods necessary to match them with the related costs they are intended to compensate, on a systematic basis. They should not be credited directly to equity.
- 12.3 In most cases, the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable, and thus grants in recognition of specific expenses are recognised as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognised as income over the periods and in the proportions in which depreciation on those assets is charged.
- 12.4 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, should be recognised as income of the period in which it becomes receivable.
- 12.5 Government grants related to assets should be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.
- 12.6 Grants related to income are sometimes presented as a credit in the income statement, either separately or under a general heading such as "Other income"; alternatively, they are deducted in reporting the related expense.
- 12.7 A government grant that becomes repayable should be accounted for as a revision to an accounting estimate. Repayment of a grant related to income should be applied first against any unamortised deferred credit set up in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment should be recognised immediately as an expense. Repayment of a grant related to an asset should be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised to date as an expense in the absence of the grant should be recognised immediately as an expense.

Government assistance

- 12.8 Excluded from the definition of government grants are certain forms of government assistance that cannot reasonably have a value placed on them and transactions that cannot be distinguished from the normal trading transactions of the entity.
- 12.9 Examples of assistance that cannot reasonably have a value placed on them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales. The existence of the benefit might be unquestioned, but any attempt to segregate the trading activities from government assistance could well be arbitrary.

- 12.10 The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements will not be misleading.
- 12.11 Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.
- 12.12 Government assistance to entities meets the definition of government grants even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited to equity.

Disclosure

- 12.13 An entity should disclose:
- (a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;
 - (b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and
 - (c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Section 13

Borrowing Costs

13.1 Borrowing costs may include:

- (a) interest on bank overdrafts and short-term and long-term borrowings;
- (b) amortisation of discounts or premiums relating to borrowings;
- (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) finance charges in respect of finance leases; and
- (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

13.2 A reporting entity should make an accounting policy choice between the benchmark treatment and the allowed alternative treatment and apply the policy consistently in accordance with paragraphs 2.2 – 2.3.

Borrowing costs: benchmark treatment

13.3 Borrowing costs should be recognised as an expense in the period in which they are incurred.

Borrowing costs: allowed alternative treatment

13.4 Borrowing costs should be recognised as an expense in the period in which they are incurred, except to the extent that they are capitalised in accordance with paragraph 13.5.

13.5 Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Section.

13.6 Examples of qualifying assets are inventories that require a substantial period of time to bring them to a saleable condition, manufacturing plants, power generation facilities and properties held for investment potential. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Borrowing costs eligible for capitalisation

13.7 To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

13.8 To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

- 13.9 The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when:
- (a) expenditures for the asset are being incurred;
 - (b) borrowing costs are being incurred; and
 - (c) activities that are necessary to prepare the asset for its intended use or sale are in progress.
- 13.10 Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.
- 13.11 Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- 13.12 When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

Disclosure

- 13.13 An entity should disclose:
- (a) the accounting policy adopted for borrowing costs;
 - (b) the total borrowing costs incurred during the period;
 - (c) the amount of borrowing costs capitalised during the period; and
 - (d) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Section 14

Income Taxes

Current tax

- 14.1 Current tax for current and prior periods should, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognised as an asset.
- 14.2 The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognised as an asset.
- 14.3 Current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.
- 14.4 Current tax should be recognised as income or an expense and included in the profit or loss for the period, except to the extent that the tax arises from a transaction or event that is recognised other than in the income statement.
- 14.5 Current tax should 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.

Deferred tax

- 14.6 Deferred tax liabilities (assets) (that is, the amounts of income taxes payable (recoverable) in future periods in respect of taxable temporary differences (deductible temporary differences and the carryforward of unused tax losses and tax credits)) should not be recognised.

Presentation

- 14.7 Current tax assets and current tax liabilities should be presented separately from other assets and liabilities in the statement of financial position.
- 14.8 An entity should offset current tax assets and current tax liabilities if, and only if, the entity:
- (a) 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.

Disclosure

- 14.9 An entity should disclose:
- (a) the accounting policy adopted for income taxes;
 - (b) major components of tax expense (income);
 - (c) the applicable tax rates and jurisdictions in which the tax expense arose; and
 - (d) the amount of unused tax losses available to be carried forward against future taxable profits and the expiry dates of those losses.

14.10 Components of tax expense (income) may include:

- (a) current tax expense (income);
- (b) any adjustments recognised in the period for current tax of prior periods; and
- (c) the amount of benefit arising from a previously unrecognised tax loss or tax credit of a prior period that is used to reduce current tax expense.

Section 15

The Effects of Changes in Foreign Exchange Rates

Reporting currency

- 15.1 Each entity should identify its reporting currency. An entity's reporting currency is the currency of the primary economic environment in which the entity operates.
- 15.2 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Therefore, the following are the most important factors an entity considers in determining its reporting currency:
- (a) the currency:
 - (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled), and
 - (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).
- 15.3 The following factors may also provide evidence of an entity's reporting currency:
- (a) the currency in which funds from financing activities (issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.
- 15.4 The following additional factors are considered in determining the reporting currency of a foreign operation, and whether its reporting currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):
- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.
 - (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
 - (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
 - (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Foreign currency transactions

- 15.5 A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.
- 15.6 At the end of each reporting period:
- (a) foreign currency monetary items should be reported using the closing rate; and
 - (b) non-monetary items (including investments in subsidiaries, associates and joint ventures) denominated in a foreign currency should be reported using the exchange rate at the date of the transaction or event (for example, the recognition and reversal of an impairment loss).
- 15.7 Exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or expenses in the period in which they arise.

Translation of a foreign operation

- 15.8 Where a foreign operation does not form an integral part of the entity and operates as a separate business with local finance, it is not uncommon that the foreign operation would report in a currency which is different from the reporting currency of the entity. Where this is the case, the results and financial position of the foreign operation should be translated into the reporting currency of the entity using the following procedures:
- (a) assets and liabilities for each statement of financial position presented (i.e. including comparatives) should be translated at the closing rate at the end of that reporting period;
 - (b) income and expenses for each income statement (i.e. including comparatives) should be translated at average rate for the period or closing rate at the end of that reporting period; and
 - (c) all resulting exchange differences should be recognised as a separate component of equity.
- 15.9 On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation should be recognised in profit or loss when the gain or loss on disposal is recognised.
- 15.10 Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation should be treated as assets and liabilities of the foreign operation. Thus they should be expressed in the reporting currency of the foreign operation and should be translated at the closing rate.

Forward contracts

- 15.11 Where a non-speculative forward contract is used as a hedge of a net monetary asset or liability the gain or loss on the contract should be taken to the income statement and the discount or premium may be either amortised over the period of the contract or taken to the income statement.

- 15.12 Where a non-speculative forward contract is used as a hedge of a firm commitment no gain or loss need normally be recognised during the commitment period. At the end of that period any gain or loss will be added to, or deducted from, the amount of the relevant transaction. The discount or premium should be either amortised over the period of the contract or deferred with the gain or loss.
- 15.13 Where a forward contract is speculative the gain or loss should be credited or charged to the income statement.

Disclosure

15.14 An entity should disclose:

- (a) the accounting policy adopted for foreign currency transactions, including the basis used in the translation of the foreign currency transactions, balances denominated in foreign currencies at the end of the reporting period and the basis used in the translation of financial statements of foreign operations and the treatment accorded to exchange differences;
- (b) the amount of exchange differences included in the profit or loss for the period; and
- (c) net exchange differences recognised as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

Section 16

Related Party Disclosures

- 16.1 This Section deals only with the identification and disclosure of related party relationships and transactions. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.
- 16.2 In the context of this Section the following are deemed not to be related parties:
- (a) two companies simply because they have a director or other member of key management personnel in common, (but it is necessary to consider the possibility, and to assess the likelihood, that the director would be able to affect the policies of both companies in their mutual dealings) or because a member of key management personnel of one entity has significant influence over the other entity;
 - (b) two venturers simply because they share joint control over a joint venture;
 - (c)
 - (i) providers of finance;
 - (ii) trade unions;
 - (iii) public utilities; and
 - (iv) government departments and agencies, in the course of their normal dealings with an entity by virtue only of those dealings (although they may circumscribe the freedom of action of an entity or participate in its decision-making process); and
 - (d) a single customer, supplier, franchisor, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

Disclosure

- 16.3 An entity should disclose the name of the entity's parent and, if different, the ultimate controlling company irrespective of whether there have been transactions between those related parties.
- 16.4 An entity should disclose the total remuneration of key management personnel.
- 16.5 If there have been transactions between related parties, an entity should disclose the nature of the related party relationships 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. These disclosure requirements are in addition to the requirements in paragraph 16.4 to disclose key management personnel compensation. At a minimum, disclosures should include:
- (a) the amount of the transactions;
 - (b) the amount of outstanding balances and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) details of any guarantees given or received;
 - (c) provisions for doubtful debts related to the amount of outstanding balances; and

- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.
- 16.6 The disclosures required by paragraph 16.5 should be made separately for each of the following categories:
- (a) the parent;
 - (b) entities with joint control or significant influence over the entity;
 - (c) subsidiaries;
 - (d) associates;
 - (e) joint ventures in which the entity is a venturer;
 - (f) key management personnel of the entity or its parent; and
 - (g) other related parties.
- 16.7 The following are examples of situations where related party transactions may lead to disclosures by an entity in the period they affect:
- (a) purchases or sales of goods (finished or unfinished);
 - (b) purchases or sales of property and other assets;
 - (c) rendering or receiving of services;
 - (d) leases;
 - (e) transfers of research and development;
 - (f) transfers under licence agreements;
 - (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);
 - (h) provision of guarantees or collateral; and
 - (i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.
- 16.8 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.
- 16.9 No disclosure of transactions is required:
- (a) in consolidated financial statements in respect of intra-group transactions; and
 - (b) in financial statements of a reporting entity in respect of transactions for which specific exemptions on disclosure are granted by statute. In such circumstances, reliance on the legal dispensation should be disclosed in the financial statements.

Section 17

Events After the End of the Reporting Period

- 17.1 An entity should adjust the amounts recognised in its financial statements to reflect adjusting events after the end of the reporting period.
- 17.2 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:
- (a) the resolution after the end of the reporting period of a court case that, because it confirms that an entity already had a present obligation at the balance sheet date, requires the entity to adjust a provision already recognised, or to recognise a provision instead of merely disclosing a contingent liability;
 - (b) the receipt of information after the end of the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
 - (i) when the bankruptcy of a customer occurs after the end of the reporting period, it usually confirms that a loss already existed at the end of the reporting period on a trade receivable account and that the entity needs to adjust the carrying amount of the trade receivable account; and
 - (ii) the sale of inventories after the end of the reporting period may give evidence about their net realisable value at the end of the reporting period;
 - (c) the determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period;
 - (d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events before that date; and
 - (e) the discovery of fraud or errors indicating that the financial statements were incorrect.
- 17.3 An entity should not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.
- 17.4 An example of a non-adjusting event after the end of the reporting period is a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The fall in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that arise in the following period. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure under paragraph 17.8.
- 17.5 If dividends to holders of equity instruments (for example, ordinary shares, certain preferred shares, warrants or options to purchase ordinary shares) are declared after the end of the reporting period, an entity should not recognise those dividends as a liability at the end of the reporting period.
- 17.6 An entity should not prepare its financial statements on a going concern basis if management determines, after the end of the reporting period, either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Disclosure

- 17.7 If an entity receives information after the end of the reporting period about conditions that existed at the end of the reporting period, the entity should, in the light of the new information, update disclosures that relate to these conditions.
- 17.8 Where non-adjusting events after the end of the reporting period are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an entity should disclose the following information for each significant category of non-adjusting event after the end of the reporting period:
- (a) the nature of the event; and
 - (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.
- 17.9 The following are examples of non-adjusting events after the end of the reporting period that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:
- (a) announcing a plan to discontinue an operation;
 - (b) major purchases and disposals of assets, or expropriation of major assets by government; and
 - (c) the destruction of a major production plant by a fire after the end of the reporting period.
- 17.10 An entity should disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issuance, the entity should disclose that fact.

Section 18

Business Combinations and Goodwill

Scope

- 18.1 This Section should be applied in accounting for business combinations in a reporting entity's consolidated financial statements. A business combination is the bringing together of separate entities or businesses into one reporting entity, whereby the reporting entity gains control over the other entity or businesses. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. This Section should also be applied in accounting for the acquisition of an unincorporated business in a reporting entity's company-level financial statements.
- 18.2 The accounting requirements in this Section are not required to be applied to business combinations involving entities or businesses under common control. 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. If a business combination under common control is not accounted for in accordance with the accounting requirements of this Section, it should be accounted for in accordance with one of the following methods:
- (a) merger accounting in accordance with Accounting Guideline 5 "Merger accounting for common control combinations"; or
 - (b) at book values as stated in the financial statements of the acquired entity or in the consolidated financial statements of the previous parent.

Purchase method of accounting

- 18.3 All business combinations should be accounted for by applying the purchase method.
- 18.4 Applying the purchase method involves the following steps:
- (a) identifying an acquirer;
 - (b) measuring the cost of the business combination; and
 - (c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities assumed.

Identifying the acquirer

- 18.5 An acquirer should be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.
- 18.6 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. Control of one entity by another is described in Section 19 *Consolidated and Company-level Financial Statements*.
- 18.7 Although sometimes it may be difficult to identify an acquirer, there are usually indications that one exists. For example:
- (a) if the fair value of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;
 - (b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely

to be the acquirer; and

- (c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

Cost of a business combination

- 18.8 The acquirer should measure the cost of a business combination as the aggregate of the fair values, at the acquisition date, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree.
- 18.9 Other costs attributable to effecting the business combination (such as finder's fees, advisory, legal, accounting or other professional fees or general administrative costs) do not form part of the cost of a business combination. These costs should instead be recognised as expenses in the income statement in the periods in which the costs are incurred and the services are received.

Adjustments to the cost of a business combination contingent on future events

- 18.10 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer should include the estimated amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable (ie more likely than not) and can be measured reliably.
- 18.11 After the acquisition date changes to the estimated amount of contingent consideration should only be treated as an adjustment to the cost of the combination when the changes arise as a result of new information about the facts and circumstances that existed at the date of acquisition which becomes known within twelve months after the acquisition date or to correct an error in accordance with paragraph 18.17. All other changes to the estimated amount of contingent consideration should be recognised in accordance with Section 10 *Provisions, Contingent Liabilities and Contingent Assets*.

Allocating the cost of a business combination to the assets acquired and liabilities assumed

- 18.12 The acquirer should, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities that satisfy the recognition criteria under the SME-FRF and SME-FRS at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets and liabilities so recognised should be accounted for in accordance with paragraphs 18.18 to 18.23.
- 18.13 The acquirer should recognise separately the acquiree's identifiable assets and, liabilities at the acquisition date only if they satisfy the following criteria at that date:
 - (a) in the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;
 - (b) in the case of a liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably; and
 - (c) in the case of an intangible asset, its fair value is readily apparent or otherwise can be measured reliably without undue cost or effort.

- 18.14 The acquirer's income statement should incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's income statement that relates to the acquiree's depreciable assets should be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.
- 18.15 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination should be considered in assessing when the acquirer has obtained control.
- 18.16 In accordance with paragraph 18.12, the acquirer recognises separately only the identifiable assets and liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 18.13. Therefore:
- (a) the acquirer should recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with Section 10 *Provisions, Contingent Liabilities and Contingent Assets*; and
 - (b) the acquirer, when allocating the cost of the combination, should not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.

Measurement period

- 18.17 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. If, within twelve months after the acquisition date, any new information is obtained about the facts and circumstances that existed at the date of acquisition which is relevant to those estimates, the acquirer should retrospectively adjust the provisional amounts recognized (i.e. as if the adjustments were made at the acquisition date). Beyond twelve months after the acquisition date, adjustments to the initial accounting for a business combination should be recognised only to correct an error in accordance with Section 2 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Goodwill

- 18.18 The acquirer should, at the acquisition date:
- (a) recognise goodwill acquired in a business combination as an asset; and
 - (b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets and liabilities recognised in accordance with paragraph 18.12.
- 18.19 After initial recognition, the acquirer should measure goodwill acquired in a business combination at cost less any accumulated amortisation and any accumulated impairment losses.
- 18.20 Goodwill should be amortised on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of goodwill will not exceed 5 years from initial recognition. The amortisation method used should reflect the pattern in which the future economic benefits arising from goodwill are expected to be consumed. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense.

- 18.21 The amortisation period and the amortisation method should be reviewed at least at the end of each financial year if the useful life of goodwill exceeds 5 years. If the expected useful life of goodwill is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the goodwill, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates by adjusting the amortisation charge for the current and future periods.
- 18.22 To determine whether goodwill is impaired, an entity applies Section 9 *Impairment of Assets*. That Section explains when and how an entity reviews the carrying amount of its assets and how it determines the recoverable amount of an asset.

Excess of acquirer's interest in the net fair value of acquiree's identifiable assets and liabilities over cost ("Gain on a bargain purchase")

- 18.23 If the acquirer's interest in the net fair value of the identifiable assets and liabilities recognised in accordance with paragraph 18.12 exceeds the cost of the business combination, the acquirer should:
- (a) reassess the identification and measurement of the acquiree's identifiable assets and liabilities and the measurement of the cost of the combination; and
 - (b) recognise immediately in profit or loss any excess remaining after that reassessment.

Disclosure

For business combination(s) effected during the period

- 18.24 For each business combination that was effected during the period (or group of individually immaterial business combinations), the acquirer should disclose the following:
- (a) the names and descriptions of the combining entities or businesses;
 - (b) the acquisition date;
 - (c) the percentage of voting equity instruments acquired;
 - (d) the nature of control if the acquirer does not own, directly or indirectly through subsidiaries, more than one half of the voting power of the acquiree;
 - (e) the cost of the combination and a description of the components of that cost (such as cash and equity instruments)

When there is a potential adjustment to the cost of the business that is contingent on future events and is not recognised at the acquisition date, this contingency should be disclosed in accordance with Section 10, *Provisions, Contingent Liabilities and Contingent Assets*;

- (f) the amount recognised at the acquisition date for each class of the acquiree's assets and liabilities, including goodwill; and
- (g) the amount of any excess recognised in profit or loss in accordance with paragraph 18.23, and the line item in the income statement in which the excess is recognised.

For business combination(s) effected after the end of the reporting period but before the financial statements are authorised for issue

- 18.25 For each business combination effected after the end of the reporting period but before the financial statements are authorised for issue, the acquirer should disclose it as a non-adjusting event in accordance with Section 17 *Events After the End of the reporting period* if

the business combination is of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

For goodwill

18.26 For goodwill, an acquirer should disclose the following, where applicable:

- (a) the amortisation period(s) adopted;
- (b) if goodwill is amortised over more than 5 years, the reasons why the presumption that the useful life of goodwill will not exceed 5 years from initial recognition is rebutted;
- (c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- (d) the line item(s) of the income statement in which the amortisation of goodwill is included; and
- (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
 - (i) additions arising from new business combinations;
 - (ii) changes arising from disposals of previously acquired businesses;
 - (iii) impairment losses recognised in the income statement during the period;
 - (iv) amortisation or write-off recognised during the period; and
 - (v) other changes in the carrying amount during the period.

Comparative information is not required.

Previous business combinations

18.27 An entity that has not previously issued consolidated financial statements should apply this Section either:

- (a) retrospectively to all past business combinations as a change in accounting policy in accordance with Section 2 *Accounting Policies, Change in Accounting Estimates and Errors*; or
- (b) as if all the past business combinations that occurred before the beginning of the comparative period had taken place at the beginning of the comparative period. The difference between the consideration transferred and the carrying amounts of assets and liabilities of the business acquired that meet the recognition criteria under the SME-FRF and SME-FRS at the beginning of the comparative period should be made against the opening balance of retained earnings. Any business combination for which the acquisition date falls between the beginning of the comparative period and the date of the first application of this Section should be accounted for in accordance with this Section. In the case where this option is used, this fact should be disclosed.

In each case, the assets and liabilities of the business acquired should be remeasured using SME-FRS for consolidation purposes.

Section 19

Consolidated and Company-Level Financial Statements

Requirement to prepare consolidated financial statements

- 19.1 An entity which is a parent at the end of the financial year is required to present consolidated financial statements in accordance with the SME-FRS except when:
- (a) it is a wholly-owned subsidiary of another entity at the end of the financial year; or
 - (b) it is a partially-owned subsidiary of another entity at the end of the financial year and it meets ~~all~~ either of the following conditions:-
 - ~~(i) it is a partially-owned subsidiary of another entity;~~
 - ~~(ii) —~~ at least 6 months before the end of the financial year, the directors notify the members in writing of the directors' intention not to prepare consolidated financial statements for the financial year, ~~and~~ the notification does not relate to any other financial year; and₁
 - ~~(iii) as at a date falling 3 months before the end of the financial year, no member has responded to the notification by giving the directors a written request for the preparation of consolidated financial statements for the financial year; or~~
 - (ii) all members agree in writing before the end of the financial year that consolidated financial statements will not be prepared for the financial year and the agreement does not relate to any other financial year⁹; or
 - (c) all of its subsidiaries qualify for exclusion from consolidation in accordance with paragraph 19.2.

If a parent is exempt from preparing consolidated financial statements and does not prepare such financial statements, it should prepare company-level financial statements. Company-level financial statements are those in which investments in subsidiaries, associates and joint ventures are accounted for using the cost model set out in Section 6.

- 19.2 If consolidated financial statements are presented they should include all subsidiaries of the parent, except that one or more subsidiaries may be excluded from consolidation when:
- (a) their exclusion measured on an aggregate basis is not material to the group as a whole; or
 - (b) their inclusion would involve expense and delay out of proportion to the value to members of the company.
- 19.3 A parent may only exclude a subsidiary from consolidation on the grounds of expense and delay out of proportion to the value to members of the company if the members of the company have been informed in writing about, and do not object to, this exclusion. In order to satisfy this condition:
- (a) the notification to the members of the company must:

⁹ These criteria align with the criteria set out in section 379(3) of the Companies Ordinance, as amended by the 2018 Amendment Ordinance, which exempt an entity which is a parent at the end of the reporting period from presenting consolidated financial statements if it satisfies them.

- (i) state which financial year that the notification relates to (and the notification must not relate to more than one financial year);
 - (ii) specify the subsidiary or subsidiaries proposed to be excluded; and
 - (iii) state the directors' reasons for believing that the inclusion of the subsidiary or subsidiaries in the consolidated financial statements may involve expense and delay out of proportion to the value to the shareholders;
- (b) in the case of an entity which needs to obtain shareholder approval in accordance with paragraphs 41 to 43~~2~~ of the SME-FRF in order to qualify for the reporting exemption, the notification to the members of the company proposing to exclude one or more subsidiaries from consolidation must be included as part of the notice to obtain the necessary shareholder approvals required to qualify for the reporting exemption and must be subject to the same approval and objection processes as apply to that approval;
- (c) in all other cases the notification must be sent to the members before the date of approval of the financial statements and must allow the members of the company a period of no less than one month to raise objections, unless all the members of the company confirm that such a period is not necessary; and
- (d) within the time frame allowed in accordance with (b) or (c) no member has indicated to the company that they disagree with the directors' assertion that the inclusion of the subsidiary or subsidiaries would involve expense and delay out of proportion to the value to members of the company.

Control

- 19.4 A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- 19.5 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. That presumption should be overcome if it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:
- (a) power over more than half of the voting rights by virtue of an agreement with other investors;
 - (b) power to govern the financial and operating policies of the entity under a statute or an agreement or by having options or convertible instruments that can be exercised or converted;
 - (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
 - (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

Consolidation procedures

- 19.6 The consolidated financial statements present financial information about the group as a single economic entity. In preparing consolidated financial statements, an entity should:
- (a) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;
 - (b) eliminate the carrying amount of the parent's investment in each subsidiary and the

parent's portion of equity of each subsidiary at acquisition date;

- (c) identify any non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period separately from the parent shareholders' interest; and
- (d) identify any non-controlling interests in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Non-controlling interests in the net assets consist of:
 - (i) the amount of those non-controlling interests at the date of the original combination; and
 - (ii) the non-controlling interest's share of changes in equity since the date of the combination.

The proportion of profit or loss and changes in equity allocated to the owners of the parent and to the non-controlling interests (if any) are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of options and convertible instruments.

Intragroup balances and transactions

- 19.7 Intragroup balances and transactions, including accounts payable and receivable, income, expenses and dividends, are eliminated in full. Profits resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full. Losses resulting from intra-group transactions are also eliminated in full unless they indicate an impairment that requires recognition in the consolidated financial statements.

Uniform reporting date

- 19.8 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements should be prepared as of the same reporting date unless it is impracticable to do so.
- 19.9 When, in accordance with paragraph 19.8, 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 should be made for the effects of significant transactions or events that occur between that date and the date of the parent's financial statements. The length of the reporting periods and any difference in the reporting dates should be the same from period to period.

Uniform accounting policies

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

Acquisition and disposal of subsidiaries

- 19.11 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date until the date on which the parent ceases to control the subsidiary. The difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal is recognised in the consolidated income statement as the gain or loss on the disposal of the subsidiary. This gain or loss includes the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity in accordance with Section 15 *The Effects of Changes in Foreign Exchange Rates*, except when undue cost or effort is needed to arrive at such cumulative amount of exchange difference

and disclosure is made in the financial statements for such exclusion on a transaction by transaction basis.

- 19.12 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold some equity shares, those shares should be accounted for as an investment in accordance with Section 6 *Investments* from the date the entity ceases to be a subsidiary, provided that it does not become an associate (in which case Section 20 *Investments in Associates* applies) or a joint venture (in which case Section 21 *Interests in Joint Ventures and Other Forms of Joint Arrangements* applies). The carrying amount of any investment retained in the former subsidiary at the date that the entity ceases to be a subsidiary should be regarded as the cost on initial measurement of an investment.

Non-controlling interests in subsidiaries

- 19.13 An entity should present non-controlling interests (if any) in the consolidated statement of financial position within equity, separately from the parent shareholders' equity.
- 19.14 An entity should disclose non-controlling interests (if any) in the profit or loss of the group separately in the income statement.
- 19.15 Profit or loss should be attributed to the owners of the parent and to the non-controlling interest (if any) even if this results in the non-controlling interest having a deficit balance.

Disclosure

- 19.16 An entity should disclose:
- (a) the fact that the exemption from consolidation has been used if an entity elects in accordance with paragraph 19.1 not to present consolidated financial statements;
 - (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
 - (c) the basis for concluding that control does not exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an investee, if applicable;
 - (d) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements;
 - (e) 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;
 - (f) a list of significant investments in subsidiaries (other than any subsidiaries excluded in accordance with paragraph 19.2(b)), including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held; and
 - (g) particulars of each subsidiary that has been excluded from consolidation in accordance with paragraph 19.2(b) including:
 - (i) the name of the subsidiary;
 - (ii) the principal place of operation and place of incorporation and an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held;
 - (iii) any amounts recognised in the entity's income statement in respect of:

- a. dividends received or receivable from the excluded subsidiary;
- b. impairment losses relating to the investment in the excluded subsidiary;
- c. other transactions with the excluded subsidiary;
- (iv) amounts recognised in the entity's statement of financial position in respect of:
 - a. investment in the excluded subsidiary;
 - b. any balances due to or from the excluded subsidiary;
- (v) whether the excluded subsidiary prepares audited financial statements;
- (vi) summarised financial information in respect of the excluded subsidiary, including the excluded subsidiary's:
 - a. revenue;
 - b. profit before tax;
 - c. income tax expense;
 - d. profit after tax;
 - e. total assets; and
 - f. total liabilities; and
- (vii) the basis of preparation of the summarised financial information disclosed in respect of the excluded subsidiary, including:
 - a. the period covered by the information;
 - b. the accounting framework adopted in its preparation; and
 - c. whether the information has been extracted from audited financial statements and if not, why not.

19.17 As stated in paragraph 1.23, in accordance with section 380(3)(a) and Part 1 of Schedule 4 to the new CO, if a parent company presents consolidated financial statements, it must also include in the notes to the consolidated financial statements:

- (a) a note which contains the parent company's company-level statement of financial position in the format in which that statement would have been prepared if the parent company had not been required to prepare consolidated financial statements; and
- (b) a note which discloses the movement in the parent company's reserves.

Further notes to the parent company's company-level statement of financial position are not required.

Section 20

Investments in Associates

20.1 This Section applies to accounting for investments in associates. An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

Significant influence

20.2 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not control or joint control over those policies.

- (a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
- (b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.
- (c) A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Initial recognition and subsequent measurement

20.3 A reporting entity should make an accounting policy choice between the benchmark treatment and the allowed alternative treatment and apply the policy consistently in accordance with paragraphs 2.2 – 2.3.

Investments in associates: benchmark treatment

20.4 An investor should account for its investments in all associates using the cost model in accordance with Section 6 *Investments*, irrespective of whether the investor is presenting company-level financial statements or consolidated financial statements under Section 19 *Consolidated and Company-level Financial Statements*.

Investments in associates: allowed alternative treatment

20.5 An investor which presents consolidated financial statements under Section 19 *Consolidated and Separate Financial Statements* should account for its investments in associates in the consolidated financial statements using the equity method set out in paragraphs 20.6 to 20.17. In all other cases, the investor should use the cost method in accordance with Section 6 *Investments*.

Equity method

20.6 Under the equity method, the investment is initially recorded at the transaction price (including transaction costs) and is subsequently adjusted to reflect the investor's share of the profits or losses of the associate after the date of acquisition. The investor's share of the profit or loss of the associate is recognised in the investor's profit or loss, after adjusting for those differences identified in paragraph 20.8. 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 investee's equity that have not been included in the income statement. Such changes include those arising from foreign exchange translation differences. An investor should measure its share or profit or loss of the associate and its share of changes in the associate's equity on the basis of the present ownership interests. Those measurements should not reflect the possible exercise or conversion of potential voting rights.

Application of the equity method

- 20.7 Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in Section 19 *Consolidated and Company-level Financial Statements*. Furthermore, the broad concepts underlying the procedures used in accounting for the acquisition of a subsidiary set out in Section 18 *Business Combinations and Goodwill* are also adopted in accounting for the acquisition of an investment in an associate to be accounted for under the equity method.
- 20.8 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 values of the associate's identifiable assets and liabilities is treated as goodwill or as a gain on a bargain purchase as appropriate. Goodwill and gains on bargain purchases should be accounted for in accordance with paragraphs 18.17 to 18.22. Goodwill relating to an associate is included in the carrying amount of the investment unless fully amortised or impaired. Appropriate adjustments to the investor's share of the profits or losses after acquisition reported by the associate are made to account for:
- (a) 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 property, plant and equipment; and
 - (b) amortisation of goodwill.
- Any excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment (i.e. negative goodwill) 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.
- 20.9 The financial statements of the associate used by the investor in applying the equity method should be prepared as of the same date as the investor unless it is impracticable to do so. 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.
- 20.10 When, in accordance with 20.9, 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 should be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. The length of the reporting periods and any difference in the reporting dates should be the same from period to period.
- 20.11 The investor's financial statements should be prepared using uniform accounting policies for like transactions and events in similar circumstances.
- 20.12 If an associate uses accounting policies different from those of the investor for like transactions and events in similar circumstances, adjustments should 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, unless it is impracticable to do so.
- 20.13 If an investor's share of losses of an associate equals or exceeds the carrying amount of 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 preference 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).

- 20.14 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.
- 20.15 An investor should cease using the equity method from the date that significant influence ceases and should account for the investment in accordance with Section 6 *Investments* from that date, provided the associate does not become a subsidiary or a joint venture.
- 20.16 The carrying amount of any investment retained in the former associate at the date that it ceases to be an associate should:
- (a) be regarded as its cost on initial measurement as an investment in accordance with Section 6 *Investments*, if the investor loses significant influence over the associate; or
 - (b) form part of the new cost of investment for the purposes of Section 19 *Business Combinations and Goodwill* (if the associate becomes a subsidiary) or Section 21 *Interests in Joint Ventures and Other Forms of Joint Arrangement* (if the associate becomes a joint venture).

Any difference between the sum of the proceeds received plus the deemed cost on initial measurement of the retained interest and the carrying amount of the associate at the date significant influence ceases should be recognised in profit or loss.

Transactions with associates

- 20.17 Where an associate is accounted for using the equity method, the investor should eliminate unrealized profits and losses resulting from upstream and downstream transactions to the extent of the investor's interest 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. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.

Disclosure

- 20.18 An investor in an associate should disclose:
- (a) the accounting policy for investments in associates;
 - (b) a list of significant investments in associates, including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held; and
 - (c) the nature and extent of any significant restrictions (e.g. 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.
- 20.19 For investments in associates accounted for by the equity method, an investor should disclose separately its share of the profit or loss of such associates and the carrying amount of those investments.

Section 21

Interests in Joint Ventures and Other Forms of Joint Arrangements

21.1 This Section should be applied in accounting for interests in joint ventures and other forms of joint arrangements and the reporting of joint arrangement assets, liabilities, income and expenses in the financial statements of venturers and investors.

Joint ventures and other forms of joint arrangements

21.2 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity through an entity that is separate from the parties and subject to joint control. 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).

21.3 Joint ventures do not include other forms of joint arrangements, such as an arrangement to use the assets and other resources of the venturers or the joint ownership by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint arrangement, as these do not involve the establishment of an entity that is separate from the venturers themselves. In respect of its interests in these other forms of joint arrangements, a venturer should recognise in its financial statements:

- (a) its assets and its share of any jointly controlled assets, classified according to the nature of the assets;
- (b) any liabilities that it has incurred and its share of any liabilities incurred jointly with the other venturers in relation to the joint arrangement;
- (c) any income from the sale or use of its share of the output of the joint arrangement, together with its share of any expenses incurred by the joint arrangement; and
- (d) any expenses that it has incurred in respect of its interest in the joint arrangement.

Initial recognition and subsequent measurement of joint ventures

21.4 A reporting entity should make an accounting policy choice between the benchmark treatment and the allowed alternative treatment and apply the policy consistently in accordance with paragraphs 2.2 – 2.3.

Investments in joint ventures: benchmark treatment

21.5 A venturer should account for its investments in all joint ventures using the cost model in accordance with Section 6 *Investments*, irrespective of whether the venturer is presenting company-level financial statements or consolidated financial statements under Section 19 *Consolidated and Company-level Financial Statements*.

Investments in joint ventures: allowed alternative treatment

21.6 A venturer which presents consolidated financial statements under Section 19 *Consolidated and Separate Financial Statements* should account for its investments in joint ventures in the consolidated financial statements using the use the procedures for the equity method set out in paragraphs 20.6 – 20.17 of Section 20 *Investments in Associates*. In all other cases, the venturer should use the cost method in accordance with Section 6 *Investments*.

If investor does not have joint control

21.7 An investor in a joint venture that does not have joint control should account for that investment in accordance with Section 6 *Investments* or, if it has significant influence in the joint venture, in accordance with Section 20 *Investments in Associates*.

Disclosure

21.8 A venturer should disclose:

- (a) the accounting policy for its interests in joint ventures;
- (b) a listing and description of interests in significant joint ventures including the name, the principal place of operation and place of incorporation, an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held;
- (c) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of joint ventures to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;
- (d) the aggregate amount of its contingent liabilities relating to the joint ventures, unless the probability of loss is remote, including its share in each of the contingent liabilities that have been incurred jointly with other venturers and of the joint ventures themselves for which it is contingently liable, as well as those contingent liabilities that arise because the venturer is contingently liable for the liabilities for the other venturers of a joint venture; and
- (e) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves.

21.9 For investments in joint ventures accounted for by the equity method, an investor should disclose separately its share of the profit or loss of such joint venture and the carrying amount of those investments.

Section 22

Cash Flow Statement (optional)

- 22.1 The cash flow statement provides information about the historical changes in cash and cash equivalents of an entity, showing separately changes during the period from operating, investing and financing activities. In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS.
- 22.2 Cash equivalents are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Presentation of a cash flow statement

- 22.3 An entity which chooses to present a cash flow statement should report in that statement cash flows for the reporting period and the comparative period¹⁰ classified by operating activities, investing activities and financing activities. Cash flows that are not investing or financing are classified as cash flows from operating activities.

Operating activities

- 22.4 Operating activities are the principal revenue-producing activities of the entity. Therefore, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of profit or loss. Examples of cash flows from operating activities are:
- (a) cash receipts from the sale of goods and the rendering of services;
 - (b) cash receipts from royalties, fees, commissions and other revenue;
 - (c) cash payments to suppliers for goods and services;
 - (d) cash payments to and on behalf of employees;
 - (e) cash payments or refunds of income taxes, unless they can be specifically identified with financing and investing activities; and
 - (f) cash receipts and payments from investments, loans, and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

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

¹⁰ In accordance with section 1.11 comparative information with respect to the previous period should be disclosed for all numerical information in the financial statements. This requirement is applicable to the cash flow statement if a cash flow statement is presented.

Investing activities

- 22.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:
- (a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets (including capitalised development costs), and other long-term assets;
 - (b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
 - (c) cash payments to acquire equity or debt instruments of other entities, including the net cash out flow on acquisition of a subsidiary in a consolidated set of financial statements (see paragraph 22.10) (other than payments for those instruments classified as cash equivalents or held for dealing or trading);
 - (d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);
 - (e) cash advances and loans made to other parties; and
 - (f) cash receipts from the repayment of advances and loans made to other parties.

Financing activities

- 22.6 Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of an entity. Examples of cash flows arising from financing activities are:
- (a) cash proceeds from issuing shares or other equity instruments;
 - (b) cash payments to owners to acquire or redeem the entity's shares;
 - (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
 - (d) cash repayments of amounts borrowed; and
 - (e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities in the cash flow statement

- 22.7 If a cash flow statement is presented, an entity should report cash flows from operating activities using either:
- (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
 - (b) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

- 22.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:
- (a) changes during the period in inventories and operating receivables and payables;
 - (b) non-cash items such as depreciation, provisions, unrealised foreign currency gains and losses, and undistributed profits of associates accounted for under the equity method; and
 - (c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables.

- 22.9 The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, net cash flow from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:
- (a) from the accounting records of the entity; or
 - (b) by adjusting sales, cost of sales and other items in the income statement for:
 - (i) changes during the period in inventories and operating receivables and payables;
 - (ii) other non-cash items; and
 - (iii) other items for which the cash effects are investing or financing cash flows.

Reporting cash flows from investing and financing activities in the cash flow statement

- 22.10 If a cash flow statement is presented, an entity should present separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities. The aggregate amount of the cash paid or received as consideration for the acquisition or disposal of subsidiaries and other business units is reported in the consolidated cash flow statement net of cash and cash equivalents acquired or disposed of as part of such events.
- 22.11 An entity shall disclose, in aggregate, in respect of both acquisitions and disposals of subsidiaries or other business units during the period each of the following:
- (a) the total purchase or disposal consideration;
 - (b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents; and
 - (c) the amount of cash and cash equivalents in the subsidiary or business unit acquired or disposed of.

Foreign currency cash flows in the cash flow statement

- 22.12 If a cash flow statement is presented, an entity should record cash flows arising from transactions in a foreign currency in the entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

- 22.13 The entity should translate cash flows of a foreign subsidiary/branch at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows.
- 22.14 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be reported in the cash flow statement. Therefore, the entity should remeasure cash and cash equivalents held during the period at period-end exchange rates. The entity should present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

Interest and dividends in the cash flow statement

- 22.15 If a cash flow statement is presented, an entity should disclose separately cash flows from interest and dividends received and paid. Dividends received include dividends received from associates and joint ventures accounted for under the equity method in accordance with Section 20 *Interest in Associates* and Section 21 *Interests in Joint Ventures and Other Forms of Joint Arrangement*. Interest paid includes amount capitalised under the accounting policy choice in Section 13 *Borrowing Costs*. The entity should classify these cash flows consistently from period to period as operating, investing or financing activities in accordance with the following guidance.
- 22.16 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.
- 22.17 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Taxes on income in the cash flow statement

- 22.18 If a cash flow statement is presented, an entity should disclose separately cash flows arising from taxes on income and should classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity should disclose the total amount of taxes paid.

Non-cash transactions

- 22.19 An entity should exclude from the cash flow statement investing and financing transactions that do not require the use of cash or cash equivalents. An entity should disclose such transactions elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.
- 22.20 Many investing and financing activities do not have a direct impact on current cash flows although they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement because these items do not involve cash flows in the current period. Examples of non-cash transactions are:
- (a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;
 - (b) the acquisition of an entity by means of an equity issue; and

- (c) the conversion of debt to equity.

Components of cash and cash equivalents

- 22.21 If a cash flow statement is presented, an entity should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts reported in the cash flow statement to the equivalent items reported in the statement of financial position.
- 22.22 In view of the variety of cash management practices and banking arrangements around the world and in order to comply with Section 1 *Presentation of Financial Statements*, an entity should disclose the policy which it adopts in determining the composition of cash and cash equivalents.

Other disclosures

- 22.23 An entity should disclose the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

Appendix 1

Examples of Application

This appendix is illustrative only and does not form part of the SME-FRS. The purpose of this appendix is to illustrate the application of the related Sections of the SME-FRS and to assist in clarifying their meaning.

A. RECOGNITION OF PROVISIONS

Example A1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event: The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement: Probable for the warranties as a whole.

Conclusion: A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period.

Example A2: Legal Requirement to Fit Smoke Filters

Under new legislation, an entity is required to install smoke filters in its factories by 30 June 20X2. The entity has not fitted the smoke filters. The entity has an accounting reference date of 31 December.

(a) At 31 December 20X1

Present obligation as a result of a past obligating event: There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion: No provision is recognised for the cost of fitting the smoke filters.

(b) At 31 December 20X2

Present obligation as a result of a past obligating event: There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement: The likelihood of incurring fines and penalties for non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion: No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example A3: A Court Case

After a wedding in 20X0, 10 people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are underway seeking damages from the entity, but it disputes its liability. Up to the date of approval of the financial statements for the year to 31 December 20X0 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 ending 31 December 20X1, its lawyers advise that, because of new developments in the case, it is probable that the entity will be found liable.

(a) At 31 December 20X0

Present obligation as a result of a past obligating event: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion: No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 December 20X1

Present obligation as a result of a past obligating event: On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognised for the best estimate of the amount required to settle the obligation.

Example A4: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. By the end of the reporting period, the lining has been in use for three years.

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognised.

The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions; even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes into account its consumption (i.e. it is depreciated over five years). The relining costs then incurred are capitalised, with the consumption of each new lining shown by depreciation over the subsequent five years.

Example A5: Long Service Payments

Under the Employment Ordinance, an entity is required to make long service payments to its employees upon the termination of their employment or retirement when the employee fulfils certain conditions and the termination meets the required circumstances. However, where an employee is simultaneously entitled to a long service payment and to a retirement scheme payment, the amount of the long service payment may be reduced by certain benefits arising from the retirement scheme (such as the amount accumulated in a Mandatory Provident Fund account for that employee relating to contributions made by the employer). Based on the entity's past experience and the directors' knowledge of the business and work force, it is probable that the entity will have to make long service payments to some employees on termination of their employment or retirement.

Present obligation as a result of a past obligating event: The obligating event is the employment of its work force which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement: Probable.

Conclusion: A provision is recognised for the best estimate of the long service payments that are required to be made to the employees of the entity in respect of their services to date less any amounts that would be expected to be met out of a retirement scheme.

Example A6: Building Management Ordinance

The Building Management Ordinance section 20(2) suggests the (Owners) Corporation to consider establishing a contingency fund to provide for any expenditure of an unexpected or urgent nature. In line with the above, a Maintenance and Repair Fund is normally established by a property management company in order to provide funds for the estimated cost of anticipated maintenance, redecoration and repair works that will be undertaken in the foreseeable future on the premises. Should a provision for such repairs and maintenance be recognised in the financial statements?

Present obligation as a result of a past obligating event: There is no present obligation.

Conclusion: No provision is recognised.

However, the SME-FRS neither encourages nor prohibits the segregation of funds within equity to meet future obligations as suggested by the Building Management Ordinance.

B. REVENUE RECOGNITION

The following examples illustrate the application of Section 11 of the SME-FRS in a number of commercial situations in order to clarifying its meaning. The examples focus on particular aspects of a transaction and do not constitute comprehensive discussions of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably; that it is probable that the economic benefits will flow to the entity; and that the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the SME-FRS.

Sale of Goods

Since laws vary from country to country, the recognition criteria in the SME-FRS will be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

B1. *“Bill and hold” sales, in which delivery is delayed at the buyer’s request but the buyer takes title and accepts billing*

Revenue is recognised when the buyer takes title, provided:

- (a) it is probable that delivery will be made;
- (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

B2. Goods shipped subject to conditions, including the following situations:

(a) *Installation and inspection*

Revenue is normally recognised when the buyer accepts delivery and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

- (i) the installation process is simple in nature (e.g. the installation of a factory-tested television receiver which only requires unpacking and connection of power and antenna); or
- (ii) the inspection is performed only for purposes of final determination of contract prices (e.g. for shipments of iron ore, sugar or soya beans).

(b) *On approval when the buyer has negotiated a limited right of return*

If there is uncertainty about the possibility of return, revenue is recognised when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

(c) *Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)*

Revenue is recognised by the shipper when the goods are sold by the recipient to a third party.

(d) *Cash on delivery sales*

Revenue is recognised when delivery is made and cash is received by the seller or its agent.

B3. Lay away sales, in which the goods are delivered only when the buyer makes the final payment in a series of instalments

Revenue from such sales is recognised when the goods are delivered. However, when experience indicates that most of such sales are consummated, revenue may be recognised when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

B4. Orders in which payment (or partial payment) is received in advance of delivery for goods not presently held in inventory (e.g. the goods are still to be manufactured or will be delivered directly to the customer from a third party)

Revenue is recognised when the goods are delivered to the buyer.

B5. 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

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.

B6. Sales to intermediate parties, such as distributors, dealers or others, for resale

Revenue from such sales is generally recognised when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

B7. Subscriptions to publications and similar items

When the items involved are of similar value in each time period, revenue is recognised on a straight-line basis over the period in which the items are despatched. When the items vary in value from period to period, revenue is recognised on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

B8. Instalment sales, under which the consideration is receivable in instalments

Revenue attributable to the sales 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, on a time proportion basis that takes into account the imputed rate of interest.

B9. Real estate sales

Revenue is normally recognised when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognise revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognised as the acts are performed. An example is a building or other facility on which construction has not been completed.

In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determine how the transaction is accounted for. It may be accounted for as a sale, or as a financing, a leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

A seller must also consider the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, revenue is recognised only to the extent that cash is received.

Rendering of Services

B10. Installation fees

Installation fees are recognised as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

B11. *Servicing fees included in the price of the product*

When the selling price of a product includes an identifiable amount for subsequent servicing (e.g. after sales support and product enhancement on the sale of software), that amount is deferred and recognised as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

B12. *Advertising commissions*

Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

B13. *Insurance agency commissions*

Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognised as revenue over the period during which the policy is in force.

B14. *Admission fees*

Revenue from artistic performances, banquets and other special events is recognised when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

B15. *Tuition fees*

Revenue is recognised over the period of instruction.

B16. *Initiation, entrance and membership fees*

Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to the purchase of goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

B17. *Franchise fees*

Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) *Supplies of equipment and other tangible assets*

The amount, based on the fair value of the assets sold, is recognised as revenue when the items are delivered or title passes.

(b) *Supplies of initial and subsequent services*

Fees for the provision of continuing services, whether part of the initial fee or a separate fee are recognised as revenue as the services are rendered. When the

separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period during which the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (e.g. assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectable over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

(c) *Continuing franchise fees*

Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

(d) *Agency transactions*

Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor's acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

B18. *Fees from the development of customised software*

Fees from the development of customised software are recognised as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

B19. *Licence fees and royalties*

Fees and royalties paid for the use of an entity's assets (e.g. trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognised in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely such that the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

B20. *Determining whether an entity is acting as a principal or as an agent*

Paragraph 11.7 states that ‘in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.’ Determining whether an entity is acting as a principal or as an agent requires judgement and consideration of all relevant facts and circumstances.

An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include:

- (a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- (b) the entity has inventory risk before or after the customer order, during shipping or on return;
- (c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- (d) the entity bears the customer’s credit risk for the amount receivable from the customer.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

C. IMPAIRMENT ALLOCATION

C1. *Measuring and recognising impairment allocation when there is a non-controlling interest*

Background

Parent acquires a 70 per cent controlling interest in Subsidiary for HK\$2,000,000 on 1 January 20X5, when the fair value of Subsidiary’s identifiable net assets is \$1,500,000. In accordance with paragraph 18.18(b), goodwill is measured as the excess of the cost of the business combination over the acquirer’s interest in the fair value of the identifiable net assets acquired:

	HK\$’000
Fair value of identifiable net assets acquired	1,500
Less: 30% attributable to non-controlling interest	(450)
Fair value of identifiable net assets acquired attributable to Parent	1,050
Cost of acquisition	2,000
Goodwill recognised by Parent in consolidated statement of financial position	950

By the end of 20X5, Subsidiary has not performed as well as expected and Parent decides it is necessary to carry out an impairment test to compare the recoverable amount of Subsidiary with its carrying amount. In Parent's consolidated financial statements the carrying amount of Subsidiary's net assets at that date is \$1,350,000 and goodwill is now \$760,000 (after one year of being amortised by Parent over 5 years).

Per paragraph 9.12, for the purposes of comparing carrying value to recoverable amount, the carrying amount of Subsidiary at 31.12.20X5 has to be grossed up to include goodwill attributable to the 30% non-controlling interests, as the goodwill recognised by Parent only relates to its 70% interest in Subsidiary. The necessary calculation is as follows:

	HK\$'000
Goodwill recognised by Parent in consolidated statement of financial position (70% interest)	760
Gross up for 30% attributable to non-controlling interest (760/70 x 30)	325
Notional goodwill attributable to 100% interest	1,085
Carrying amount of Subsidiary's identifiable net assets at 31.12.20X5	1,350
Notional carrying amount of 100% of Subsidiary at 31.12.20X5	2,435

Parent will therefore need to book an impairment loss if the recoverable amount of Subsidiary at 31.12.20X5 is less than \$2,435,000. Two scenarios below with different recoverable amounts are illustrated: these show how the loss to be recognised by Parent is computed, depending on whether the impairment loss is more or less than the notional amount of goodwill.

Scenario 1 Recoverable amount of Subsidiary is HK\$2,300,000: this results in an impairment loss of \$135,000 which is less than the notional amount of goodwill

As this impairment loss is less than the notional amount of goodwill (being \$1,085,000), all of the impairment loss is allocated to goodwill in accordance with paragraph 9.11. Parent is therefore required to recognise 70% of this loss (i.e. \$94,500) as an impairment of the goodwill it is carrying on its consolidated statement of financial position. This will reduce the goodwill recognised by Parent from \$760,000 to \$665,500.

The remainder of the impairment loss attributable to the 30% non-controlling interest (being \$40,500) is not recognised in Parent's consolidated financial statements as the non-controlling interest in Parent's consolidated statement of financial position only relates to its 30% share of the identifiable net assets, and not to the goodwill.

Scenario 2 Recoverable amount of Subsidiary is HK\$1,300,000: this results in an impairment loss of \$1,135,000 which is more than the notional amount of goodwill

If the recoverable amount of Subsidiary is only HK\$1,300,000, then the apparent impairment loss of \$1,135,000 is more than the notional amount of goodwill (being \$1,085,000). The impairment loss is allocated as follows:

	HK\$'000
Goodwill recognised by Parent in consolidated statement of financial position (70% interest)	760
Notional goodwill attributable to 30% non-controlling interest	325
Total amount of impairment loss allocated to goodwill	1,085
Total impairment loss identified	1,135
Remainder: allocated to other identifiable non-cash net assets on pro-rata basis under Section 9.11	50

As in Scenario 1, any impairment loss allocated to notional goodwill attributable to the non-controlling interest is not recognised in Parent's consolidated financial statements. Parent will therefore only recognise an impairment loss of \$810,000 in its consolidated profit or loss comprising:

	HK\$'000
Full write-down of goodwill recognised by Parent	760
Write-down of other identifiable non-cash net assets on pro-rata basis	50
Total amount of impairment loss recognised by Parent	810

D. NEW CO NON-EXEMPT DISCLOSURE REQUIREMENTS

As explained in paragraph 21 of the SME-FRF, unless specifically exempt from a particular requirement, the financial statements and directors' report prepared by a qualifying entity are required to follow the same requirements in the new CO as apply to full financial statements and directors' reports. These non-exempt disclosure requirements which apply under the new CO are set out below:

CO reference	Disclosure requirements
S. 383	<p>The financial statements must contain the information prescribed by the Regulation about the following matters:</p> <ul style="list-style-type: none"> (a) directors' emoluments (b) directors' retirement benefits (c) termination benefits paid to directors (d) loans, quasi-loans and other dealings in favour of directors of the company or its holding company (e) material interests of directors in transactions, arrangements or contracts entered into by the company or another company in the same group* (f) consideration provided to or receivable by a third party for making available the services of a director <p>In this regard, reference should be made to the Companies (Disclosure of Information about Benefits of Directors) Regulation ("the Regulation") made under sections 451 and 452(2) for the purposes of section 383.</p> <p><i>* Disclosure requirements in respect of item (e) are set out in Part 4 of the Regulation. However, Section 23 of the Regulation sets out a specific exemption in this regard for a company that falls within the reporting exemption for the financial year concerned. Therefore, in practice a company which falls within the reporting exemption is only required by section 383 and the Regulation to disclose information relating to items (a) to (d) and (f) above, and not (e).</i></p>
Sch 4 Part 1.1	The financial statements must disclose the aggregate amount of outstanding loans made under the authority of sections 280 and 281.

SMALL AND MEDIUM-SIZED ENTITY FINANCIAL REPORTING
FRAMEWORK AND FINANCIAL REPORTING STANDARD

Sch 4 Part 1.2	<p>If a company presents consolidated financial statements it must also include in the notes to the consolidated financial statements:</p> <p>(a) a note which contains the parent company's company-level statement of financial position in the format in which that statement would have been prepared if the parent company had not been required to prepare consolidated financial statements; and</p> <p>(b) a note which discloses the movement in the parent company's reserves.</p> <p>Further notes to the parent company's company-level statement of financial position are not required.</p>
Sch 4 Part 1.3	<p>If at the end of the year the company is a subsidiary of another undertaking, it must disclose particulars relating to that parent undertaking as set out in Sch. 4.</p>
Sch 4 Part 1.4	<p>The financial statements must state whether they have been prepared in accordance with the applicable accounting standards within the meaning of section 380 as defined by section 357(4) of the new CO and, if they have not been so prepared, must state the particulars of, and the reasons for, any material departure from those standards.</p> <p><i>(NB As stated in paragraph 20 of the SME-FRF, the SME-FRF and FRS are the applicable accounting standards for the purposes of sections <u>357(1) and 380</u> for those companies which are entitled to and do take advantage of the reporting exemption)</i></p>
S. 387	<p>The statement of financial position must be approved by the directors and must be signed by 2 directors on the directors' behalf (unless the company only has one director, in which case the sole director must sign the statement of financial position). The names of the director(s) who signed the statement of financial position must be stated on any statement of financial position laid before the company in general meeting, sent to a member under section 430 or otherwise, circulated, published or issued by the company.</p>

Appendix 2

Illustrative Company-level Financial Statements Prepared in Accordance with the SME-FRS

This appendix is illustrative only and does not form part of the SME-FRS. The purpose of this appendix is to illustrate the application of the SME-FRS and to assist in clarifying its meaning. It is prepared in compliance with the SME-FRF.

It should be noted that:

- (a) *Under SME-FRS 1.26, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity should be presented either on the face of the income statement or in the notes to the income statement. In this illustration the group has presented an analysis by function on the face of the income statements with further details on the nature of expenses in the notes.*
- (b) *Under SME-FRS 1.28 dividends can be presented either on the face of the income statement or in the notes. In this illustration the company has presented the information in the notes.*
- (c) *Under SME-FRS 1.29, changes in equity can be presented either in the notes to the financial statements or as a separate component of the financial statements. In this illustration the company has presented the information in the notes.*
- (d) *Under SME-FRS 13.1A an entity can choose an accounting policy of expensing all borrowing costs or capitalising those that meet certain criteria. In this illustration the group has chosen to expense all borrowing costs.*
- (e) *In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. In this illustration the entity has chosen to include a cash flow statement and has made the following additional choices in this regard:*
 - i. *Under SME-FRS 22.7 an entity can chose to present cash flows from operating activities using either the direct or the indirect method. In this illustration the entity has chosen the indirect method.*
 - ii. *Under SME-FRS 22.16 in the cash flow statement an entity can chose where to present interest paid and interest and dividends received. In this illustration the company has chosen to present interest paid as financing cash flows and interest and dividends received as investing cash flows.*
- (f) *For example auditor's reports on financial statements prepared in accordance with the SME-FRS, please refer to Appendices 1 – 3 of Practice Note (PN) 900 (Revised) Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard.*

SME LIMITED
INCOME STATEMENT

for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Revenue	2	29,054,180	24,834,610
Cost of sales		<u>(19,114,120)</u>	<u>(16,490,300)</u>
		9,940,060	8,344,310
Other income		23,680	23,060
Distribution costs		(702,200)	(627,200)
Administrative expenses		(7,240,955)	(5,901,420)
Other operating expenses		(423,050)	(400,120)
Finance costs	3	<u>(53,530)</u>	<u>(63,130)</u>
Profit before tax	4	1,544,005	1,375,500
Income tax expense	6	<u>(225,050)</u>	<u>(225,430)</u>
Profit for the year		<u>1,318,955</u>	<u>1,150,070</u>

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME LIMITED

STATEMENT OF FINANCIAL POSITION

as at 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Non-current assets			
Property, plant and equipment	7	5,270,300	4,104,010
Intangible assets	8	2,100,000	2,400,000
Long-term investments	9	430,000	400,000
		<u>7,800,300</u>	<u>6,904,010</u>
Current assets			
Inventories	10	1,938,680	1,964,590
Prepayments		147,040	261,910
Trade and other receivables		1,115,150	1,113,535
Current investment	11	200,000	-
Cash and bank balances	12	1,106,800	1,083,500
		<u>4,507,670</u>	<u>4,423,535</u>
Less: Current liabilities			
Income tax payable		(225,050)	(225,430)
Bank overdraft – secured	13	(318,840)	(533,520)
Bank loan due within 12 months – secured	13	(300,000)	(300,000)
Obligations under finance leases	14	(117,630)	(62,805)
Trade payables		(1,892,530)	(1,702,250)
Due to related parties	18	(360,300)	(343,900)
		<u>(3,214,350)</u>	<u>(3,167,905)</u>
Net Current Assets		<u>1,293,320</u>	<u>1,255,630</u>
Non-current liabilities			
Bank loan – secured	13	(100,000)	(400,000)
Obligations under finance leases	14	(89,770)	(64,745)
		<u>(189,770)</u>	<u>(464,745)</u>
NET ASSETS		<u>8,903,850</u>	<u>7,694,895</u>
Equity			
Share capital			
Issued & fully paid: 100,000 ordinary shares	15	100,000	100,000
Retained earnings	15	8,803,850	7,594,895
		<u>8,903,850</u>	<u>7,694,895</u>

Approved on behalf of the Board by:

Name, Director

Name, Director

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME LIMITED
STATEMENT OF CASH FLOWS¹¹
for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Profit before taxation		1,544,005	1,375,500
Adjustments for non-operating and non-cash items:			
Interest expense		53,530	63,130
Interest income		(6,200)	(5,600)
Depreciation and amortisation		865,770	622,820
Gain on disposal of fixed assets		(23,680)	(23,060)
Changes in working capital:			
Decrease / (Increase) in inventories		25,910	(40,078)
(Increase) / decrease in trade and other receivables		(1,615)	24,118
Decrease/ (increase) in deposits and prepayment		114,870	(156,910)
Increase/ (decrease) in due to related parties		16,400	(216,900)
Increase/ (decrease) in trade and other payables		190,280	(347,880)
Cash generated from operations		<u>2,779,270</u>	<u>1,295,140</u>
Hong Kong profits tax paid		<u>(225,430)</u>	<u>(221,500)</u>
Net cash generated from operating activities		<u>2,553,840</u>	<u>1,073,640</u>
Investing activities			
Payment for purchase of property, plant and equipment		(2,381,530)	(1,217,670)
Proceeds from disposals of property, plant and equipment		673,150	623,060
Payment for purchase of investments		(230,000)	-
Interest received		6,200	5,600
Net cash used in investing activities		<u>(1,932,180)</u>	<u>(589,010)</u>

...continued

11 In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS.

SME LIMITED
STATEMENT OF CASH FLOWS
for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Financing activities			
Dividend paid		(110,000)	-
Repayment of bank loans		(300,000)	(600,000)
Increase/ (decrease) in finance lease payable		79,850	(61,300)
Interest paid		<u>(53,530)</u>	<u>(63,130)</u>
Net cash used in financing activities		<u>(383,680)</u>	<u>(724,430)</u>
Net increase/ (decrease) in cash and cash equivalents		237,980	(239,800)
Cash and cash equivalents at 1 January		<u>549,980</u>	<u>789,780</u>
Cash and cash equivalents at 31 December	12	<u><u>787,960</u></u>	<u><u>549,980</u></u>

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME LIMITED

ACCOUNTING POLICIES AND EXPLANATORY NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 20X5

Reporting entity

SME Limited is a company incorporated in Hong Kong with limited liability. The company's registered office is located at 9/F, 28 Nowhere Street, Kowloon, Hong Kong. The principal activity of the company is trading of toys. The company has adopted a trade name "Fun Times" for its business.

1. Basis of preparation and accounting policies

The company qualifies for the reporting exemption as a small private company under section 359(1)(a) of the Hong Kong Companies Ordinance (Cap. 622) and is therefore entitled to prepare and present its financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants.

These financial statements comply with the SME-FRS and have been prepared under the accrual basis of accounting and on the basis that the company is a going concern.

The measurement base adopted is the historical cost convention.

The following are the specific accounting policies that are necessary for a proper understanding of the financial statements:

(a) Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the company and when the revenue can be measured reliably, on the following bases:

- (i) sale of goods is recognised when the goods are delivered and the risks and rewards of ownership have passed to the customer;
- (ii) rental income is recognised on a time proportion basis over the lease terms;
- (iii) interest income is recognised on a time proportion basis taking into account the principal outstanding and the interest applicable; and
- (iv) dividend income is recognised when the shareholder's right to receive payment is established.

(b) Borrowing costs

Borrowing costs are recognised as an expense in the period in which they are incurred.

(c) Foreign exchange

The reporting currency of the company is Hong Kong Dollars, which is the currency of the primary economic environment in which the company operates.

Foreign currency transactions are converted at the exchange rate applicable at the transaction date. Foreign currency monetary items are translated into Hong Kong Dollars using exchange rates applicable at the end of the reporting period. Gains and losses on foreign exchange are recognised in the income statement.

(d) Taxation

Income tax expense represents current tax expense. The income tax payable represents the amounts expected to be paid to the taxation authority, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is not provided.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

The depreciable amount of an item of property, plant and equipment is allocated on a systematic basis over its estimated useful life using the straight-line method. The principal annual rates used for depreciation are as follows:

Leasehold land	Over the lease terms
Buildings	2%
Furniture, fixtures and equipment	10%-20%

(f) Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses and are amortised on a systematic basis over their estimated useful lives using the straight-line method.

(g) Investments in securities

Current investments are stated at the lower of cost and net realisable value. Long-term investments are stated at cost less accumulated impairment losses.

(h) Impairment of assets

An assessment is made at the end of each reporting period to determine whether there is any indication of impairment or reversal of previous impairment, including items of property, plant and equipment, intangible assets and long-term investments. In the event that an asset's carrying amount exceeds its recoverable amount, the carrying amount is reduced to recoverable amount and an impairment loss is recognised in the income statement. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount that would have been determined (net of amortisation or depreciation), had no impairment losses been recognised for the asset in prior years.

(i) Leases

Leases that transfer substantially all the rewards and risks of ownership of assets to the company are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where substantially all the risks and rewards of ownership of assets are not transferred to the lessee are accounted for as operating leases. Annual rents applicable to such operating leases are charged to the income statement on a straight-line basis over the lease term.

(j) Inventories

Inventories are stated at the lower of cost (using a first-in-first-out basis) and net realisable value. In arriving at net realisable value an allowance has been made for deterioration and obsolescence.

(k) Trade and other receivables

Trade and other receivables are stated at estimated realisable value after each debt has been considered individually. Where the payment of a debt becomes doubtful a provision is made and charged to the income statement.

(l) Cash and cash equivalents¹²

Cash and cash equivalents comprise cash at bank and on hand and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts that are repayable on demand and form an integral part of the company's cash management are also included as a component of cash and cash equivalents for the purpose of the cash flow statement.

2. Revenue

An analysis of the company's revenue is as follows:

	20X5 HK\$	20X4 HK\$
Sale of goods	28,957,860	24,753,540
Rental income	78,000	68,000
Interest income	6,200	5,600
Dividend income	12,120	7,470
	<u>29,054,180</u>	<u>24,834,610</u>

¹² In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. Consequently, this policy note is only appropriate if an entity chooses to present a cash flow statement.

3. Finance costs

	20X5 HK\$	20X4 HK\$
Interest on bank loan and overdraft	41,030	55,100
Interest on finance leases	12,500	8,030
	<u>53,530</u>	<u>63,130</u>

4. Profit before tax

Profit before tax is arrived at:

	Note	20X5 HK\$	20X4 HK\$
After crediting the following item:			
Gain on disposal of property, plant and equipment		23,680	23,060
And after charging the following items:			
Depreciation	7	(565,770)	(322,820)
Amortisation*	8	(300,000)	(300,000)
Key management personnel's remuneration		(762,850)	(470,000)
Other staff costs		(1,522,570)	(1,968,920)
Exchange losses, net		(16,250)	(19,920)
Provision for inventories		(106,000)	(86,700)
Provision for bad and doubtful debts		(98,800)	(65,600)

* The amortisation of acquired brand name for the year is included in "Other operating expenses" on the face of the income statement.

5. Directors' remuneration

Directors' remuneration disclosed pursuant to section 383(1) of the Companies Ordinance is as follows:

	20X5 HK\$	20X4 HK\$
Fees	350,000	350,000
Other emoluments	120,000	120,000
	<u>470,000</u>	<u>470,000</u>

6. Income tax expense

Hong Kong profits tax has been provided at the rate of 16.5% (20X4: 16.5%) on the estimated assessable profits arising in Hong Kong during the year.

	20X5 HK\$	20X4 HK\$
Tax charge for the year	235,250	225,430
Overprovision in prior years	<u>(10,200)</u>	<u>-</u>
	<u>225,050</u>	<u>225,430</u>

7. Property, plant and equipment

	Leasehold land and buildings HK\$	Furniture, fixtures and equipment HK\$	Total HK\$
Cost:			
At 1 January 20X5	5,040,000	2,428,180	7,468,180
Additions	-	2,381,530	2,381,530
Disposals	-	(1,527,470)	(1,527,470)
At 31 December 20X5	<u>5,040,000</u>	<u>3,282,240</u>	<u>8,322,240</u>
Accumulated depreciation and impairment losses:			
At 1 January 20X5	2,160,000	1,204,170	3,364,170
Depreciation for the year	80,000	485,770	565,770
Written back on disposal	-	(878,000)	(878,000)
At 31 December 20X5	<u>2,240,000</u>	<u>811,940</u>	<u>3,051,940</u>
Net carrying amount:			
At 31 December 20X5	<u>2,800,000</u>	<u>2,470,300</u>	<u>5,270,300</u>
At 31 December 20X4	<u>2,880,000</u>	<u>1,224,010</u>	<u>4,104,010</u>

The carrying amount of equipment held under finance leases at 31 December 20X5 was HK\$205,500 (20X4: HK\$108,000).

8. Intangible assets

	HK\$
<u>Acquired brand name</u>	
Cost:	
At 1 January and 31 December 20X5	3,000,000
Accumulated amortisation:	
At 1 January 20X5	600,000
Amortisation for the year	300,000
At 31 December 20X5	900,000
Net carrying amount:	
At 31 December 20X5	2,100,000
At 31 December 20X4	2,400,000

The acquired brand name is being amortised over 10 years.

9. Long-term investments

	20X5 HK\$	20X4 HK\$
Listed equity securities, at cost	430,000	400,000

The market value of listed equity securities as at 31 December 20X5 was HK\$525,190 (20X4: HK\$552,740).

10. Inventories

Inventories comprise entirely of stock in trade.

11. Current Investment

Current investment represents an investment in an equity linked note with a term of six months and its return is dependent on the performance of a single security.

12. Cash and cash equivalents

	20X5 HK\$	20X4 HK\$
Cash at bank and in hand	1,106,800	1,083,500
Bank overdrafts (see Note 13)	(318,840)	(533,520)
Cash and cash equivalents in the cash flow statement ¹³	787,960	549,980

13 In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. Consequently, this reconciliation is only required to be disclosed if an entity chooses to present a cash flow statement.

13. Secured bank loan and overdraft

	20X5	20X4
<u>Bank loan</u>		
HK\$900,000 3 year loan – fully repayable in September 20X7	400,000	700,000
Less: Current Portion	<u>(300,000)</u>	<u>(300,000)</u>
Non-current Portion	<u><u>100,000</u></u>	<u><u>400,000</u></u>

The company's bank loan and overdraft are secured by a floating charge over the company's leasehold land and building with aggregate carrying value as at 31 December 20X5 of HK\$2,800,000 (20X4: HK\$2,880,000).

14. Obligations under finance leases

The present value of lease payments under finance leases are as follows:

	20X5 HK\$	20X4 HK\$
Not later than one year	117,630	62,805
Later than one year	<u>89,770</u>	<u>64,745</u>
	<u><u>207,400</u></u>	<u><u>127,550</u></u>

15. Changes in equity

	Share capital HK\$	Retained earnings HK\$	Total HK\$
Balance as at 31 December 20X4	100,000	7,594,895	7,694,895
Profit for the year	–	1,318,955	1,318,955
Dividend paid (Interim dividend of HK\$1.1 per share)	–	(110,000)	(110,000)
Balance as at 31 December 20X5	<u>100,000</u>	<u>8,803,850</u>	<u>8,903,850</u>

16. Commitments under operating leases

The company had the following total future minimum lease payments payable under non-cancellable operating leases:

	20X5 HK\$	20X4 HK\$
Not later than one year	573,060	573,060
Later than one year	<u>573,060</u>	<u>1,146,120</u>
	<u><u>1,146,120</u></u>	<u><u>1,719,180</u></u>

17. Contingent liabilities

The company had the following contingent liabilities not provided for in the financial statements:

	20X5 HK\$	20X4 HK\$
Guarantees given to banks in connection with facilities granted to related companies	<u>197,120</u>	<u>–</u>

Mr. X, a shareholder of the company, controls both the company and the related companies.

18. Other related party transactions

In addition to the transactions and balances detailed elsewhere in these financial statements, the Company had the following transactions with related parties:

	20X5 HK\$	20X4 HK\$
Goods sold to related companies	393,500	372,840
Goods purchased from related companies	1,519,400	2,505,920

Mr. X, a shareholder of the company, controls both the company and the related companies.

The amounts due to related parties are unsecured, interest-free and have no fixed terms of repayment.

19. Approval of financial statements

These financial statements were authorised for issue by the company's Board of Directors on 15 March 20X6.

Appendix 3

Illustrative Consolidated Financial Statements Prepared in Accordance with the SME-FRS

This appendix is illustrative only and does not form part of the SME-FRS. The purpose of this appendix is to illustrate the application of the SME-FRS and to assist in clarifying its meaning. It is prepared in compliance with the SME-FRF.

It should be noted that:

- (a) Under SME-FRS 1.26, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity should be presented either on the face of the income statement or in the notes to the income statement. In this illustration the group has presented an analysis by function on the face of the income statements with further details on the nature of expenses in the notes.*
- (b) Under SME-FRS 1.28 dividends can be presented either on the face of the income statement or in the notes. In this illustration the company has presented the information in the notes.*
- (c) Under SME-FRS 1.29, changes in equity can be presented either in the notes to the financial statements or as a separate component of the financial statements. In this illustration the group has presented the information in the notes.*
- (d) Under SME-FRS 13.1A an entity can choose an accounting policy of expensing all borrowing costs or capitalising those that meet certain criteria. In this illustration the group has chosen to expense all borrowing costs.*
- (e) Under SME-FRS 20.3 and 21.4, for the purposes of the consolidated financial statements the entity can make an accounting policy choice to carry investments in associates and joint ventures using either the cost method or the equity method. In this illustration the group has chosen the equity method.*
- (f) In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. In this illustration the entity has chosen to include a cash flow statement and has made the following additional choices in this regard:
 - (i) Under SME-FRS 22.7 an entity can chose to present cash flows from operating activities using either the direct or the indirect method. In this illustration the group has chosen the indirect method.*
 - (ii) Under SME-FRS 22.16 in the cash flow statement an entity can chose where to present interest paid and interest and dividends received. In this illustration the group has chosen to present interest paid as financing cash flows and interest and dividends received as investing cash flows.**
- (g) For example auditor's reports on financial statements prepared in accordance with the SME-FRS, please refer to Appendices 1 – 3 of Practice Note (PN) 900 (Revised) Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard.*

SME GROUP
CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Revenue	2	29,054,180	24,834,610
Cost of sales		(19,114,120)	(16,490,300)
		<u>9,940,060</u>	<u>8,344,310</u>
Other income		23,680	23,060
Distribution costs		(702,200)	(627,200)
Administrative expenses		(7,240,955)	(5,901,420)
Other operating expenses		(423,050)	(400,120)
Share of profit of associate		30,000	50,000
Share of profit of joint venture		60,000	80,000
Finance costs	3	(53,530)	(63,130)
Profit before tax	4	1,634,005	1,505,500
Income tax expense	6	(225,050)	(225,430)
Profit for the year		<u>1,408,955</u>	<u>1,280,070</u>
Profit attributable to the equity shareholders		1,305,220	1,173,770
Profit attributable to non-controlling interest		103,735	106,300
		<u>1,408,955</u>	<u>1,280,070</u>

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Non-current assets			
Property, plant and equipment	7	5,270,300	4,104,010
Intangible assets (including goodwill)	8	2,310,000	2,500,000
Investment in associate	9	420,000	400,000
Investment in joint venture	10	540,000	500,000
Other long-term investments	11	310,000	-
		<u>8,850,300</u>	<u>7,504,010</u>
Current assets			
Inventories	12	1,796,025	1,964,590
Deposits and prepayments		147,040	261,910
Trade and other receivables		1,005,150	1,113,535
Cash and bank balances	13	1,096,800	1,083,500
		<u>4,045,015</u>	<u>4,423,535</u>
Current liabilities			
Income tax payable		(225,050)	(225,430)
Bank overdraft – secured	14	(388,840)	(533,520)
Bank loan – secured	14	(900,000)	(900,000)
Obligations under finance leases	15	(64,745)	(62,805)
Trade payables		(2,222,830)	(2,046,150)
		<u>(3,801,465)</u>	<u>(3,767,905)</u>
Net Current Assets		<u>243,550</u>	<u>655,630</u>
Non-current liabilities			
Bank loan – secured	14	(100,000)	(400,000)
Obligations under finance leases	15	-	(64,745)
		<u>(100,000)</u>	<u>(464,745)</u>
Net Assets		<u>8,993,850</u>	<u>7,694,895</u>
Equity			
Share capital: issued & fully paid			
100,000 ordinary shares	16	100,000	100,000
Retained earnings	16	8,422,115	7,226,895
Total equity attributable to the shareholders of the company		<u>8,522,115</u>	<u>7,326,895</u>
Non-controlling interest		<u>471,735</u>	<u>368,000</u>
Total equity		<u>8,993,850</u>	<u>7,694,895</u>

Approved on behalf of the Board by: _____

Name, Director

Name, Director

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME GROUP
CONSOLIDATED STATEMENT OF CASH FLOWS¹⁴

for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Profit before taxation		1,634,005	1,505,500
Adjustments for non-operating or non-cash items:			
Interest expense		53,530	63,130
Interest income		(6,200)	(5,600)
Dividend income from long term investment		(12,120)	(7,470)
Depreciation and amortisation		905,770	647,820
Gain on disposal of fixed assets		(23,680)	(23,060)
Share of profit of associate		(30,000)	(50,000)
Share of profit of joint venture		(60,000)	(80,000)
Exchange losses on cash balances		5,505	3,920
Changes in working capital:			
Decrease/ (increase) in inventories		168,565	(40,078)
Decrease in trade and other receivables		108,385	24,118
Decrease/ (increase) in deposits and prepayment		114,870	(156,910)
Increase in trade and other payables		176,680	11,820
Cash generated from operations		<u>3,035,310</u>	<u>1,893,190</u>
Hong Kong profits tax paid		<u>(225,430)</u>	<u>(237,300)</u>
Net cash generated from operating activities		<u>2,809,880</u>	<u>1,655,890</u>
Investing activities			
Payment for purchase of property, plant and equipment		(2,031,530)	(1,217,670)
Proceeds from disposals of property, plant and equipment		673,150	623,060
Payment for purchase of investments		(310,000)	-
Dividend received from the associate		10,000	20,000
Dividend received from the joint venture		20,000	30,000
Dividend received from long term investment		12,120	7,470
Interest received		6,200	5,600
Net cash outflow for acquisition of a subsidiary	17	<u>(500,000)</u>	<u>-</u>
Net cash used in investing activities		<u>(2,120,060)</u>	<u>(531,540)</u>

continued...

14 In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS.

...continued

SME GROUP
CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 20X5

	Note	20X5 HK\$	20X4 HK\$
Financing activities			
Dividend paid		(110,000)	-
Proceeds from new bank loans		600,000	-
Repayment of bank loans		(900,000)	(1,300,000)
Repayment of finance lease payable		(62,805)	(61,300)
Interest paid		<u>(53,530)</u>	<u>(63,130)</u>
Net cash used in financing activities		<u>(526,335)</u>	<u>(1,424,430)</u>
Net increase/ (decrease) in cash and cash equivalents		163,485	(300,080)
Exchange losses on cash balances		(5,505)	(3,920)
Cash and cash equivalents at 1 January		<u>549,980</u>	<u>853,980</u>
Cash and cash equivalents at 31 December	13	<u><u>707,960</u></u>	<u><u>549,980</u></u>

The accompanying Accounting Policies and Explanatory Notes form an integral part of, and should be read in conjunction with, these financial statements.

SME GROUP

ACCOUNTING POLICIES AND EXPLANATORY NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 20X5

Reporting entity

SME Holdings Limited (the company) is a company incorporated in Hong Kong with limited liability. The company's registered office is located at 9/F, 28 Nowhere Street, Kowloon, Hong Kong. SME group consists of the Company, its 90% owned subsidiary, SME (Manufacturing) Limited, which adopted the brand name "Fun Times" for its business and its wholly owned subsidiary SME (Trading) Limited, which the group acquired in the current year. The Group's principal activities are the manufacture and sale of toys.

1. Basis of preparation and accounting policies

The company and each of its subsidiaries qualify for the reporting exemption as small private companies under section 359(1)(a) of the Hong Kong Companies Ordinance (Cap. 622), and the group as a whole qualifies for the reporting exemption as a small private group under section 359(2). The group is therefore entitled to prepare and present its financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants.

These consolidated financial statements comply with the SME-FRS and have been prepared under the accrual basis of accounting and on the basis that the group is a going concern.

The measurement base adopted is the historical cost convention.

The following are the specific accounting policies that are necessary for a proper understanding of the financial statements:

(a) Subsidiaries and non-controlling interests

Subsidiaries are entities controlled by the group. Control exists when the group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests represent 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 company.

Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from equity attributable to the equity shareholders of the company. Non-controlling interests in the results of the group are presented separately on the face of the consolidated income statement.

(b) Associates and joint ventures

An associate is an entity in which the group or company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A joint venture is a contractual arrangement whereby the group or company and other parties undertake an economic activity through an entity that is separate from the parties and subject to joint control.

An investment in an associate or a joint venture is accounted for in the consolidated financial statements under the equity method. Under the equity method, the investment is initially recorded at the transaction price (including transaction costs) and is subsequently adjusted to reflect the group's share of profit or loss after the date of acquisition. The group's share of the profit or loss of the associate and joint venture is recognised in the consolidated income statement. Distributions received from an associate or a joint venture reduce the carrying amount of the investments.

When the group's share of losses exceeds its interest in the associate or the joint venture, the group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the group has incurred legal or constructive obligations or made payments on behalf of the investee.

Unrealised profits and losses resulting from upstream and downstream transactions are eliminated to the extent of the group's interest in the associate and joint venture. 'Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the group. 'Downstream' transactions are, for example, sales of assets from the group to an associate or a joint venture. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.

In the company's statement of financial position, investments in associates and joint ventures are stated at cost less impairment losses (see note 1(j)).

(c) Business combinations and goodwill

Acquisitions of businesses are accounted for using the purchase method. The cost of a business combination is the aggregate of the fair values, at the acquisition date, of assets given, liabilities incurred or assumed by the group and the equity instruments issued by the group in exchange for the control of the acquiree. Any costs directly attributable to the business combination are recognised in the income statement in the periods in which the costs are incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair values.

Goodwill represents the excess of

- (i) the cost of the business combination; over
- (ii) the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill acquired in a business combination is stated at cost less any accumulated amortisation and any accumulated impairment losses (see note 1(k)). Goodwill is amortised over its estimated useful life not exceeding 5 years using the straight-line method.

(d) Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the company and when the revenue can be measured reliably, on the following bases:

- (i) sale of goods is recognised when the goods are delivered and the risks and rewards of ownership have passed to the customer;
- (ii) rental income is recognised on a time proportion basis over the lease terms;
- (iii) interest income is recognised on a time proportion basis taking into account the principal outstanding and the interest applicable; and
- (iv) dividend income is recognised when the shareholder's right to receive payment is established.

(e) Borrowing costs

Borrowing costs are recognised as an expense in the period in which they are incurred.

(f) Foreign exchange

The reporting currency of the company and its subsidiaries is Hong Kong Dollars, which is the currency of the primary economic environment in which each of these entities operates.

Foreign currency transactions are converted at the exchange rate applicable at the transaction date. Foreign currency monetary items are translated into Hong Kong Dollars using exchange rates applicable at the end of the reporting period. Gains and losses on foreign exchange are recognised in the income statement.

(g) Taxation

Income tax expense represents current tax expense. The income tax payable represents the amounts expected to be paid to the taxation authority, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is not provided.

(h) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

The depreciable amount of an item of property, plant and equipment is allocated on a systematic basis over its estimated useful life using the straight-line method. The principal annual rates used for depreciation are as follows:

Leasehold land	Over the lease terms
Buildings	2%
Furniture, fixtures and equipment	10%-20%

(i) Intangible assets (other than goodwill)

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses and are amortised on a systematic basis over their estimated useful lives using the straight-line method.

(j) Investments

Current investments are stated at the lower of cost and net realisable value. Long-term investments are stated at cost less accumulated impairment losses.

(k) Impairment of assets

An assessment is made at the end of each reporting period to determine whether there is any indication of impairment or reversal of previous impairment, including items of property, plant and equipment, intangible assets, long term investments, goodwill, interest in subsidiaries and interests in associates and joint ventures. In the event that an asset's carrying amount exceeds its recoverable amount, the carrying amount is reduced to recoverable amount and an impairment loss is recognised in the income statement.

An impairment loss in respect for goodwill is not reversed. In respect of assets other than goodwill, a previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount that would have been determined (net of amortisation or depreciation), had no impairment losses been recognised for the asset in prior years.

(l) Leases

Leases that transfer substantially all the rewards and risks of ownership of assets to the company are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where substantially all the risks and rewards of ownership of assets are not transferred to the lessee are accounted for as operating leases. Annual rents applicable to such operating leases are charged to the income statement on a straight-line basis over the lease term.

(m) Inventories

Inventories are stated at the lower of cost (using a first-in-first-out basis) and net realisable value. In arriving at net realisable value an allowance has been made for deterioration and obsolescence.

(n) Trade and other receivables

Trade and other receivables are stated at estimated realisable value after each debt has been considered individually. Where the payment of a debt becomes doubtful a provision is made and charged to the income statement.

(o) Cash and cash equivalents¹⁵

Cash and cash equivalents comprise cash at bank and on hand and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts that are repayable on demand and form an integral part of the group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

2. Revenue

An analysis of the group's revenue is as follows:

	20X5 HK\$	20X4 HK\$
Sale of goods	28,957,860	24,753,540
Rental income	78,000	68,000
Interest income	6,200	5,600
Dividend income from long term investment	12,120	7,470
	<u>29,054,180</u>	<u>24,834,610</u>

3. Finance costs

	20X5 HK\$	20X4 HK\$
Interest on bank loan and overdraft	41,030	55,100
Interest on finance leases	12,500	8,030
	<u>53,530</u>	<u>63,130</u>

¹⁵ In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. Consequently, this policy note is only appropriate if an entity chooses to present a cash flow statement.

4. Profit before tax

Profit before tax is arrived at:

	Note	20X5 HK\$	20X4 HK\$
After crediting the following item:			
Gain on disposal of property, plant and equipment		23,680	23,060
And after charging the following items:			
Depreciation	7	(565,770)	322,820
Amortisation*	8	(340,000)	(325,000)
Key management personnel's remuneration		(762,850)	(470,000)
Other staff costs		(1,522,570)	(1,968,920)
Exchange losses, net		(16,250)	(19,920)
Provision for inventories		(106,000)	(86,700)
Provision for bad and doubtful debts		(98,800)	(65,600)

* The amortisation of acquired brand name and goodwill for the year is included in "Other operating expenses" on the face of the income statement.

5. Directors' remuneration

Directors' remuneration disclosed pursuant to section 383(1) of the Companies Ordinance is as follows:

	20X5 HK\$	20X4 HK\$
Fees	350,000	350,000
Retirement benefits	12,000	12,000
Other emoluments	108,000	108,000
	<u>470,000</u>	<u>470,000</u>

6. Income tax expense

Hong Kong profits tax has been provided at the rate of 16.5% (20X4: 16.5%) on the estimated assessable profits arising in Hong Kong during the year.

	20X5 HK\$	20X4 HK\$
Tax charge for the year	235,250	225,430
Overprovision in prior years	(10,200)	-
	<u>225,050</u>	<u>225,430</u>

7. Property, plant and equipment

	Leasehold land and buildings HK\$	Furniture, fixtures and equipment HK\$	Total HK\$
Cost:			
At 1 January 20X5	5,040,000	2,428,180	7,468,180
Additions	-	2,031,530	2,031,530
Addition through acquisition of a subsidiary (see note 17)	-	350,000	350,000
Disposals	-	(1,527,470)	(1,527,470)
At 31 December 20X5	<u>5,040,000</u>	<u>3,282,240</u>	<u>8,322,240</u>
Accumulated depreciation and impairment losses:			
At 1 January 20X5	2,160,000	1,204,170	3,364,170
Depreciation for the year	80,000	485,770	565,770
Written back on disposal	-	(878,000)	(878,000)
At 31 December 20X5	<u>2,240,000</u>	<u>811,940</u>	<u>3,051,940</u>
Net carrying amount:			
At 31 December 20X5	<u>2,800,000</u>	<u>2,470,300</u>	<u>5,270,300</u>
At 31 December 20X4	<u>2,880,000</u>	<u>1,224,010</u>	<u>4,104,010</u>

The carrying amount of equipment held under finance leases at 31 December 20X5 was HK\$81,000 (20X4: HK\$108,000).

8. Intangible assets

	Acquired brand name HK\$	Goodwill HK\$	Total HK\$
Cost:			
At 1 January 20X5	3,000,000	125,000	3,125,000
Addition through acquisition of a subsidiary (see note 17)	-	150,000	150,000
At 31 December 20X5	<u>3,000,000</u>	<u>275,000</u>	<u>3,275,000</u>
Accumulated amortisation:			
At 1 January 20X5	600,000	25,000	625,000
Amortisation for the year	300,000	40,000	340,000
At 31 December 20X5	<u>900,000</u>	<u>65,000</u>	<u>965,000</u>
Net carrying amount:			
At 31 December 20X5	<u>2,100,000</u>	<u>210,000</u>	<u>2,310,000</u>
At 31 December 20X4	<u>2,400,000</u>	<u>100,000</u>	<u>2,500,000</u>

The acquired brand name is being amortised over 10 years and the goodwill is being amortised over 5 years.

9. Interest in associate

	20X5 HK\$	20X4 HK\$
Interest in an associate	<u>420,000</u>	<u>400,000</u>

The following list contains the particulars of the associate which is an unlisted corporate entity and principally affected the results or assets of the Group:

Name of the associate	Place of incorporation and principal place of operation	% of ownership and voting power	Nature of business
SME Associate Limited	Hong Kong	25%	Provision of logistic management services

SME Associate Limited entered into a bank loan agreement for HK\$2,000,000 with ABC Bank on 30 September 20X3. The agreement restricts SME Associate Limited from paying any cash dividends prior to the full repayment of the bank loan, which is scheduled on 30 September 20X6.

10. Interest in joint venture

	20X5 HK\$	20X4 HK\$
Interest in a joint venture	<u>540,000</u>	<u>500,000</u>

The following list contains the particulars of the joint venture which is an unlisted corporate entity and principally affected the results or assets of the Group:

Name of the jointly controlled entity	Place of incorporation and principal place of operation	% of ownership and voting power	Nature of business
SME JV Limited	Hong Kong	50%	Operation of retail stores

11. Other long term investments

	20X5 HK\$	20X4 HK\$
Listed equity securities, at cost	<u>310,000</u>	<u>-</u>

The market value of listed equity securities as at 31 December 20X5 was HK\$325,190.

12. Inventories

Inventories comprise entirely of stock in trade.

13. Cash and cash equivalents

	20X5 HK\$	20X4 HK\$
Cash at bank and in hand	1,096,800	1,083,500
Bank overdrafts	<u>(388,840)</u>	<u>(533,520)</u>
Cash and cash equivalents in the consolidated cash flow statement ¹⁶	<u><u>707,960</u></u>	<u><u>549,980</u></u>

14. Secured bank loan and overdrafts

At 31 December 20X5, the bank loan and bank overdraft were repayable as follows:

	20X5 HK\$	20X4 HK\$
Within 1 year or on demand	1,288,840	1,433,520
After 1 year	<u>100,000</u>	<u>400,000</u>
	<u><u>1,388,840</u></u>	<u><u>1,833,520</u></u>

The group's bank loan and overdraft are secured by a floating charge over the group's leasehold land and building with aggregate carrying value as at 31 December 20X5 of HK\$2,800,000 (20X4: HK\$2,880,000).

15. Obligations under finance leases

The carrying value of lease payments under finance leases are as follows:

	20X5 HK\$	20X4 HK\$
Not later than one year	64,745	62,805
Later than one year	<u>-</u>	<u>64,745</u>
	<u><u>64,745</u></u>	<u><u>127,550</u></u>

¹⁶ In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. Consequently, this reconciliation is only required to be disclosed if an entity chooses to present a cash flow statement.

16. Capital and reserves of the company and the group

(a) Movement in components of equity of the group

	Share capital	Retained earnings	Total shareholders' equity	Non- controlling interest	Total equity
	HK\$	HK\$	HK\$	HK\$	HK\$
Balance as at 1 January 20X5	100,000	7,226,895	7,326,895	368,000	7,694,895
Profit for the year	-	1,305,220	1,305,220	103,735	1,408,955
Dividend paid (Interim dividend of HK\$1.1 per share)	-	(110,000)	(110,000)	-	(110,000)
	<u>100,000</u>	<u>8,422,115</u>	<u>8,522,115</u>	<u>471,735</u>	<u>8,993,850</u>
Balance as at 31 December 20X5	<u>100,000</u>	<u>8,422,115</u>	<u>8,522,115</u>	<u>471,735</u>	<u>8,993,850</u>

(b) Movement in components of equity of the company

	Share capital	Retained earnings	Total equity
	HK\$	HK\$	HK\$
Balance as at 1 January 20X5	100,000	2,391,650	2,491,650
Profit for the year	-	342,330	342,330
Dividend paid (Interim dividend of HK\$1.1 per share)	-	(110,000)	(110,000)
	<u>100,000</u>	<u>2,623,980</u>	<u>2,723,980</u>
Balance as at 31 December 20X5	<u>100,000</u>	<u>2,623,980</u>	<u>2,723,980</u>

17. Business combination

On 30 June 20X5, the group acquired the entire equity interests in SME (Trading) Limited for business expansion. SME (Trading) Limited is incorporated in Hong Kong and engages in retail sales of toys.

The acquisition had the following effect on the group's assets and liabilities on the date of acquisition:

	Note	HK\$
Property, plant and equipment	7	350,000
Inventory		52,500
Trade and other receivables		102,300
Deposits and prepayments		46,710
Cash at bank		50,000
Trade and other payables		<u>(201,510)</u>
Fair value of identifiable net assets		<u>400,000</u>
Total consideration, satisfied in cash		<u>550,000</u>
Goodwill	8	<u>150,000</u>
Total consideration, satisfied in cash		550,000
Less: cash at bank acquired		<u>(50,000)</u>
Net outflow of cash and cash equivalents in respect of the acquisition of subsidiaries ¹⁷		<u>500,000</u>

¹⁷ In accordance with section 1.1 of the SME-FRS, an entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, if an entity voluntarily includes a cash flow statement in those financial statements, then this cash flow statement should be prepared in accordance with the requirements of section 22 of the SME-FRS. Consequently, this reconciliation is only required to be disclosed if an entity chooses to present a cash flow statement.

19. Commitments under operating leases

The group had the following total future minimum lease payments payable under non-cancellable operating leases:

	20X5 HK\$	20X4 HK\$
Within one year	573,060	573,060
After one year	573,060	1,146,120
	<u>1,146,120</u>	<u>1,719,180</u>

20. Contingent liabilities

The group had the following contingent liabilities not provided for in the financial statements:

	20X5 HK\$	20X4 HK\$
Guarantee given to the bank in connection with the facility granted to the joint venture	<u>500,000</u>	<u>-</u>

At 31 December 20X5, a subsidiary of the group had undertaken to guarantee a revolving banking facility granted to the joint venture to the extent of HK\$1,000,000. The maximum liability of the group at 31 December 20X5 under the guarantee issued was the outstanding amount of the facility advanced by the bank to the joint venture of HK\$500,000.

21. Other related party transactions

In addition to the transactions and balances detailed elsewhere in these financial statements, the group had the following transactions with related parties:

	20X5 HK\$	20X4 HK\$
Goods sold to the joint venture	2,567,890	2,356,790
Trade receivables from the joint venture	238,000	205,120
Logistic services received from the associate	589,000	528,000
Trade payables to the associate	58,000	52,000

The amounts due from/ to the related parties are unsecured, interest-free and have no fixed terms of repayment/ settlement.

22. Approval of financial statements

These financial statements were authorised for issue by the company's Board of Directors on 15 March 20X6.

Appendix 4

Amendments to the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (Amendments to the SME-FRF & SME-FRS)

Amendments to Small and Medium-sized Entity Financial Reporting Framework

Paragraph 44 of the SME-FRF and paragraph 15.8 of the SME-FRS are amended. Paragraph 55 of the SME-FRF, paragraphs 5.11A – I, 15.15 and 19.16A – B of the SME-FRS and related definition are added. New text is underlined and deleted text is struck through. Paragraph 19.16 of the SME-FRS has not been amended but is included for ease of reference.

Transitioning from a different GAAP to SME-FRF and SME-FRS

44. The transition from ~~a different~~ the entity's previous GAAP (for example the transition from reporting in accordance with Hong Kong Financial Reporting Standards) to the SME-FRF and SME-FRS is accounted for as follows:

...

- (c) All items recognised ~~previously~~ under a different the entity's previous GAAP, which meet the recognition criteria under the SME-FRF and SME-FRS, but which were previously measured on a basis inconsistent with the SME-FRF and SME-FRS (for example, unamortised goodwill) are to be re-measured in accordance with the relevant section of the SME-FRS and dealt with as a change of accounting policy under section 2 of the SME-FRS. An entity may also use the following exemptions for each class of property, plant and equipment* or intangible assets in preparing its first financial statements that conform to the SME-FRF and SME-FRS:
- (i) Previous GAAP carrying amount as deemed cost: An entity may elect to measure all items in each class of assets at their previous GAAP carrying amount on transition; or
 - (ii) Fair value as deemed cost: An entity may elect to measure all items in each class of assets at their fair value on transition.

Effective Date

55. Amendments to the SME-FRF & SME-FRS, issued in March 2020, amended paragraph 44 of the SME-FRF and paragraph 15.8 of the SME-FRS, and added paragraphs 5.11A – I, 15.15 and 19.16A – B and related definition to the SME-FRS. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2021. Amendments to the SME-FRF & SME-FRS shall be applied retrospectively in accordance with paragraph 2.7 of SME-FRS. Earlier application of Amendments to the SME-FRF & SME-FRS is permitted. If an entity applies Amendments to the SME-FRF & SME-FRS for an earlier period it shall disclose that fact.

* The definition of property, plant and equipment in the SME-FRS includes property classified as investment property applying HKFRS or the HKFRS for Private Entities.

Amendments to the Definitions

The definition of presentation currency and previous GAAP are added after the definition of predecessor Companies Ordinance.

Presentation currency is the currency in which the financial statements are presented.

Previous GAAP is the basis of accounting that an entity used immediately before adopting SME-FRF and SME-FRS.

Amendments to the Small and Medium-sized Entity Financial Reporting Standard

Section 5 Leases

A heading is added after paragraph 5.3.

Leases in the financial statements of lessees

...

Leases in the financial statements of lessors

Finance leases

5.11A Lessors should recognise assets held under a finance lease in their statement of financial position, and present them as a receivable at an amount equal to the net investment in the lease. The net investment in a lease is the lessor's gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the aggregate of:

- (a) the minimum lease payments receivable by the lessor under a finance lease, and
- (b) any unguaranteed residual value accruing to the lessor.

Unguaranteed residual value is that portion of the residual value of the leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

5.11B The recognition of finance income should be based on a pattern reflecting a constant periodic rate on the lessor's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income. If there is an indication that the estimated unguaranteed residual value used in computing the lessor's gross investment in the lease has changed significantly, the income allocation over the lease term is revised, and any reduction in respect of amounts accrued is recognised immediately in profit or loss.

Disclosure

5.11C Lessors should disclose for a finance lease at the end of the reporting period the present value of minimum lease payments receivable, for each of the following periods:

- (a) not later than one year; and
- (b) later than one year.

Operating leases

- 5.11D Lessors should present assets subject to operating leases in their statement of financial position according to the nature of the asset.
- 5.11E The lessor should recognise lease income from operating leases (excluding amounts for services such as insurance and maintenance) in profit or loss on a straight-line basis over the lease term, unless another systematic basis is more representative of the pattern in which benefit from the leased asset is diminished.
- 5.11F The lessor should recognise costs, including depreciation, incurred in earning the lease income as an expense. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.
- 5.11G The lessor should add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.
- 5.11H To determine whether a leased asset has become impaired and to account for any impairment loss identified, a lessor shall apply Section 9 *Impairment of Assets*.

Disclosure

- 5.11I Lessors should disclose the total of future minimum lease payments receivable under non-cancellable operating leases for each of the following periods:
- (a) not later than one year; and
 - (b) later than one year.

Section 15 The Effects of Changes in Foreign Exchange Rates

Translation of a foreign operation**Use of a presentation currency other than the reporting currency**

- 15.8 Where a foreign operation does not form an integral part of the entity and operates as a separate business with local finance, it is not uncommon that the foreign operation would report in a currency which is different from the reporting currency of the entity. Where this is the case, the results and financial position of the foreign operation should be translated into the reporting currency of the entity using the following procedures: An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's reporting currency, the entity should translate its items of income and expense and financial position into the presentation currency. For example, when a group contains individual entities with different reporting currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented. An entity should translate its results and financial position into a different presentation currency using the following procedures:
- (a) assets and liabilities for each statement of financial position presented (i.e. including comparatives) should be translated at the closing rate at the end of that reporting period;
 - (b) income and expenses for each income statement (i.e. including comparatives) should be translated at average rate for the period or closing rate at the end of that reporting period; and
 - (c) all resulting exchange differences should be recognised as a separate component of equity.

Disclosure

15.15 An entity should disclose the currency in which the financial statements are presented. When the presentation currency is different from the reporting currency, an entity should state that fact and should disclose the reporting currency and the reason for using a different presentation currency.

Section 19 Consolidated and Company-Level Financial Statements

Disclosure

19.16 An entity should disclose:

...

- (b) the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
- (c) the basis for concluding that control does not exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an investee, if applicable;
- (d) any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements;

...

- (g) particulars of each subsidiary that has been excluded from consolidation in accordance with paragraph 19.2(b) including:
 - (i) the name of the subsidiary;
 - (ii) the principal place of operation and place of incorporation and an indication of the nature of business, the proportion of ownership interest and, if different, proportion of voting power held;
 - (iii) any amounts recognised in the entity's income statement in respect of:
 - a. dividends received or receivable from the excluded subsidiary;
 - b. impairment losses relating to the investment in the excluded subsidiary;
 - c. other transactions with the excluded subsidiary;
 - (iv) amounts recognised in the entity's statement of financial position in respect of:
 - a. investment in the excluded subsidiary;
 - b. any balances due to or from the excluded subsidiary;
 - (v) whether the excluded subsidiary prepares audited financial statements;
 - (vi) summarised financial information in respect of the excluded subsidiary, including the excluded subsidiary's:
 - a. revenue;
 - b. profit before tax;
 - c. income tax expense;
 - d. profit after tax;
 - e. total assets; and
 - f. total liabilities; and

- (vii) the basis of preparation of the summarised financial information disclosed in respect of the excluded subsidiary, including:
 - a. the period covered by the information;
 - b. the accounting framework adopted in its preparation; and
 - c. whether the information has been extracted from audited financial statements and if not, why not.

19.16A The disclosure requirements in paragraphs 19.16(b), (c), (d) and (g) apply to consolidated financial statements only. However, if a parent does not prepare consolidated financial statements because one or more of its subsidiaries are excluded from consolidation in accordance with paragraph 19.2(b), the disclosure requirements in paragraph 19.16(g) would apply to the parent's company-level financial statements.

19.16B The summarised financial information in paragraphs 19.16(g)(vi) can be aggregated if there is more than one excluded subsidiary. The inter-company transactions between those excluded subsidiaries should be eliminated for aggregated summarised financial information.